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THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980: WHAT HAS CONGRESS WROUGHT?

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The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) appears to be the single most important and far reaching federal legislation affecting the U.S. financial system since the Banking Act (Glass-Steagall) of 1933. Like the Banking Act, DIDMCA is highly complex and the long-term implications of its provisions will not be fully understood for some time to come.

Parts of the Act were passed after many years of careful study and consideration; other parts after only brief analysis. In either case, as with the Banking Act, the country will have to live with the implications for a long time. Indeed, some of the less desirable implications of the Banking Act are still with us almost 50 years later. Paradoxically, one of these--the ceilings on time deposit rates--is scheduled to be terminated by DIDMCA. Because of the unique importance of the two acts, the first part of this paper will highlight their similarities and interrelationsips. The second part will discuss some of the

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implications for the Federal Reserve and the nature of some of the "reforms" introduced.

There are at least four important similarities between the Banking Act of 1933 and DIDMCA of 1980:

1. Both were enacted in periods of financial crisis--1933, and Spring, 1980, respectively. It is uncertain whether either act would have passed in more or less the same form in more serene settings.
2. Both acts are long and complex. In my copies, DIDMCA has 62 pages and 9 titles and the Banking Act has 40, but larger, pages.
3. Both acts increased the power and centralization of the Federal Reserve System and the power of the Federal Government:

   Banking Act

   a. Reorganized and strengthened the Board of Governors, then called the Federal Reserve Board.
   b. Formally established the Federal Open Market Committee that took over the function of open market operations from individual Reserve Banks.
   c. Established the FDIC and required insured banks to be members of the Federal Reserve System.
   d. Prohibited cash interest payments on demand deposits and required the Federal Reserve to limit cash interest payments on time and savings deposits.

DIDMCA

a. Placed reserve requirements on transactions balances at all depository institutions under the Federal Reserve.

b. Implicitly increased the incentive to be a nationally chartered bank and, thus, a member of the Federal Reserve.

c. Overrode state usury laws by extending an earlier temporary measure enacted at yearend 1979.

4. Both acts combined substantially different bills in the House and Senate. The Senate part of the Banking Act of 1933 was the Glass Bill and emphasized primarily separation of commercial and investment banking and reorganization of the Federal Reserve System, the original structure of which Glass had helped to design as a member of the House twenty years earlier.[1/] The House part of the act was the Steagall Act, which emphasized federal deposit insurance. The Senate part of DIDMCA focused on the phaseout of Regulation Q and additional powers for thrift institutions, while the House part focused on solving the Federal Reserve "membership problem." The final provisions of DIDMCA were worked out at a House-Senate Conference. The differences in the two bills going into conference are

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[1/] H. Parker Willis and John M. Chapman, The Banking Situation (New York: Columbia University Press, 1934).

obvious from the following verbage reported in the preamble to the conference explanation of the joint bill:

> The Senate amendment struck out all of the House bill after the enacting clause and inserted a substitute text.
>
> The House amendment to the Senate amendment struck out all of the Senate amendment and inserted a substitute text.
>
> The Senate recedes from its disagreement to the amendment of the House with an amendment which is a substitute for the House amendment and the Senate amendment.

Thus, the conferees were confronted by two completely different bills carrying the same number, HR4986.

There are also at least three important aspects in which the Banking Act of 1933 and DIDMCA of 1980 are interrelated:

1. As already noted, DIDMCA is scheduled to phase out the Regulation Q deposit ceilings established by the Banking Act. (But it does not end the prohibition of interest payments on demand deposits, which consequently may be expected to shrink rapidly as a proportion of overall transactions balances.)

2. DIDMCA reestablishes the effective universal reserve requirements for commercial banks indirectly established by the Banking Act through requiring the cost of Fed membership for the benefits of FDIC insurance. Paradoxically, although the Fed lobbied intensely for this solution to its membership problem in recent years, it had lobbied equally intensely

against this solution in the 1930s because it did not wish to be forced to accept financially questionable banks as members. In 1938, the Fed was successful in getting Congress to rescind the required Fed membership provision.

3. DIDMCA raised the ceilings for deposit insurance, first established by the Banking Act, to $100,000.

II

What does DIDMCA do? Briefly, there are eight major thrusts:

1. All depository institutions offering transactions accounts are subject to Federal Reserve reserve requirements and are provided access to the discount window. Reserve requirements for member banks are reduced dramatically. Requirements are removed altogether on savings and personal time deposits, and may be removed on other time deposits.

2. Requires the Federal Reserve to price most of the services it previously provided free to member banks. These include:

   a. Currency and coin
   b. Wire transfer
   c. Check clearing and collection
   d. Automatic clearing houses
   e. Settlement services
   f. Safekeeping

g. Fed float

h. New services

3. Phases out deposit rate ceilings on time and savings deposits, including transactions-type accounts, over a six-year period. Transfers power to adjust ceilings until 1986 to a new Depository Institutions Deregulation Committee (DIDC) comprised of the chairs of the Fed, FDIC, FHLBB, and NCUA as voting members, and the COC as a nonvoting member.

4. Permits commercial banks to offer NOW and AT accounts, savings and loan associations and mutual savings banks to offer NOW accounts, credit unions to offer share drafts, and savings and loan associations to offer remote service units. (This section was in response to an earlier Federal court ruling that the regulatory agencies had overstepped their authority in permitting these "nonlegislated" services.)

5. Powers of savings and loan associations are extended into shorter-term assets, such as consumer loans, credit cards, and commercial paper, and federally chartered mutual savings banks into business loans and business demand deposits.

6. Permits the Federal Home Loan Bank Board and the National Credit Union Administration to enter the payments system by providing clearing and settlement services for transfers from transactions accounts of

member institutions. The FHLBB and NCUA must charge for these services consistent with Fed charges. The FHLBB and NCUA may also hold member institution required reserves on a pass-through basis to the Federal Reserve.

7. Overrides state usury ceilings on mortgage and business loans, unless the states override preemption within three years.
8. Increases the ceiling on deposit amounts covered by the FDIC to $100,000.

The above represent major changes in our financial structure and system. As noted earlier, the full implications of many of these changes are not known even now, one year after the Act was passed. Implementation of many of the provisions are technically difficult and will require time, in some instances more time than the Act permits. The Federal Reserve was forced to delay the phasing in of the new reserve requirements, although there was a provision for retroactive adjustment, and reporting requirements were eased for small institutions. Because the legislative aspects of DIDMCA have already been discussed at length in many places, I will not repeat this exercise here. Rather, I will touch briefly on two issues:

1. The new role of the Federal Reserve in monetary control and as a regulator, and

2. How successful DIDMCA is in achieving the finanical "reforms" advocated by experts since the 1960s.

III

The Federal Reserve is a chief beneficiary of DIDMCA. It emerges stronger than ever in terms of both monetary control and financial regulation. The Act almost overnight reversed a well developed trend of declining Fed influence and power, particularly in Congress.[1/] In response to the Fed's long-standing post-World War II requests for legislation to stem the so-called "membership problem," Congress extended the major cost of membership--a tax in the form of reserve requirements--to all commmercial banks as well as to all depository institutions offering transactions accounts.[2/] (The reserve requirement percentages imposed were sufficiently low so as not to increase the burden substantially for nonmember banks but to lower it substantially for member banks.) Whether this change will improve monetary control in the narrow sense of money supply control is questionable. Most economists did not believe that, given sufficiently accurate reporting, the nonmembers

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1/ The political decline of the Federal Reserve System up to the enactment of DIDMCA is documented in Edward J. Kane, "External Pressure and the Operations of the Fed," in Raymond Lombra, ed. Conference on Political Economy of Domestic and International Monetary Relations (Pennsylvania State University), forthcoming.

2/ The Act brings an additional 8,900 nonmember commercial banks, 4,800 savings and loan associations, 320 mutual savings banks, and 22,000 credit unions under potential Fed control. This sums to 36,000 additional institutions, or some six times the number of member commercial banks.

represented a serious control leakage nor that reserve requirements were a major and necessary weapon in the Fed's arsenal. On the other hand, the phasing out of Regulation Q when complete should reduce both the shift of funds across deposit categories, and thereby also across reserve requirement classifications, and the incentive for institutions and depositors to innovate new types of accounts with differing reserve effects. These effects would be reduced even more, of course, if the prohibition on interest payments on demand deposits is ever ended. Changes in required reserves resulting from shifts among types of deposits should also be reduced by the smaller number of new reserve classifications.[1/] These effects should reduce volatility in the money multiplier and may increase its predictability, thereby improving monetary control.[2/] In addition, by eliminating the membership problem, the Act removed the Fed's tendency to take actions that were intended to deal with this problem but whose unintended side-effects seriously hampered monetary control, e.g., lagged reserve accounting and multi-tiered progressive reserve requirements.

[1/] George G. Kaufman, "Federal Reserve Inability to Control the Money Supply: A Self-Fulfilling Prophecy." Financial Analysts Journal (September-October 1972) and William Poole, "Current Issues in Monetary Control," Economic Review (Federal Reserve of Richmond) (July/August 1980).

[2/] Michael A. Klein, "The Monetary Control Implications of the 1980 Depository Institutions Deregulation and Monetary Control Act: An Appraisal." Economic Review, (Federal Reserve Bank of San Francisco), forthcoming.

But, at least equally important, the Fed's ability to aim reserve requirements selectively at different sectors of the economy, as they did in the credit control program in early 1980, is enhanced greatly. This is particularly true with the extension of the requirements to mortgage lending thrift institutions. Although reserve requirements must be equal for all institutions for the same type of deposits, the number of targets at which the Fed can aim is increased. In addition, DIDMCA permits the Fed, upon a vote of at least five Governors, to impose supplementary reserve requirements on transactions balances above the ceilings established by Congress. The Fed can also now routinely require, at a minimum, deposit reports from all depository institutions holding transactions accounts and potentially additional reports. Lastly, the pricing of services, of course, gives the Fed considerable leverage over both users of the services and competitive correspondent banks.

By altering the cost-benefit ratio of Fed membership, DIDMCA alters the regulatory role of the Fed relative to its sibling financial regulatory agencies. With the burden of membership, or perhaps more accurately the benefit of non-membership, reduced dramatically, what will determine whether a bank will or will not be a member? (Of course, one can also ask what membership now means?) The decision will depend on three factors:

1. By which and how many agencies the bank prefers to be examined,
2. Which agency's regulatory posture is most favorable to the bank, and
3. The future of interstate branch banking.

Examination

National banks are now examined by only the Comptroller; state banks are examined by two agencies, either the Fed or the FDIC and the home state. (In about one-half of the states, the Fed or FDIC and the state now combine their examinations.) Banks incur two costs of examination. One, any fees that the examining agency may charge and, two, administrative and nuisance compliance costs. The first is out-of-pocket and the more visible, but likely to be the less important. Moreover, neither the Fed nor the FDIC imposes any charges. Thus, both national and state banks pay for only one examination, although the charges vary. It is unlikely that there are major economies to banks in undergoing a second examination. Thus, those state chartered banks that are examined by more than one agency are subject to a higher cost. This may encourage them to change to national charters. Because national banks are required to be members of the Fed, this will increase Fed membership.

Regulation

The regulatory atmosphere for national and state banks differs both because of differences in legislative and regulatory language and, perhaps more importantly, because of differences in regulatory interpretation and intent. The import of these differences varies with the size of the bank and the nature of its current and expected business. It appears that larger banks tend to find the Comptroller's environment more favorable to them, ceteris paribus, and some large state banks may consider switching to a national charter.[1/] Again, this is likely to increase the number of Fed members.

Interstate Branching

Permitting interstate branch banking, currently prohibited by the McFadden Act of 1927, is being given serious consideration by Congress and the Administration. Trade area interstate branch banking was included in the Glass Senate Bill in 1932, but did not make it into the final Glass-Steagall Act. A bill permitting bank holding companies to acquire and operate failing banks in other states, regardless of state legislation pertaining to bank

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1/ Evidence that national banks face both more liberal branching standards is provided by John T. Rose, "Branch Banking and the State/National Charter Decision," Journal of Bank Research (forthcoming) and more liberal merger standards in Robert Eisenbies, "Differences in Federal Regulatory Agencies' Bank Merger Policies," Journal of Money, Credit and Banking (February 1975), pp. 93-104 and Roberta G. Carey, "Evaluation Under the Bank Merger Act of 1960 of the Competitive Factors Involved in Bank Mergers," Journal of Monetary Economics (July 1975), 275-308.

acquisitions by out-of-state holding companies, was introduced in Congress earlier this year and solicited favorable testimony from the Board of Governors.[2/] Indeed, this or a similar bill permitting out-of-state acquisitions of failing banks to be operated as branches may have passed if the atmosphere of financial crisis and the threat of large numbers of failing depository institutions had not lessened suddenly.

As it is, banks can now engage in a number of interstate activities other than full service branching. They can have interstate loan production offices (although Florida recently attempted unsuccessfully to restrict this), trust offices (although DIDMCA limits new out-of-state offices until October 1981, and Florida also tried to limit this activity), finance companies (both Citibank via Person-to-Person and the Bank of America operate national networks), and Edge Act Corporations. The BankAmerica International recently ran a large advertisement in The Wall Street Journal showing its current branch offices in seven states and planned branch offices in two more. Bank holding companies may acquire additional banks in other states in which out-of-state acquisitions are specifically permitted

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[1/] Currently, the Douglas Amendment to the Bank Holding Company Act of 1956 restricts bank holding companies' acquisitions of banks in other states only if that state specifically permits out-of-state acquisitions of domestic banks.

by state statute. In a recent analysis in the Federal Reserve Bulletin, Stephen Rhoades concluded that:

> The indirect effects on banking structure of bank holding company expansion, foreign bank operations in the United States, and loan production offices are probably more significant than their direct effects because all have contributed, in one way or another, to a set of conditions that make political ratification of interstate banking more likely in the near future.[1/]

When and if permitted, full service interstate offices of state charatered banks may be expected to be examined by state examiners in every state in which they are located and to be subject to the laws, regulation, and supervision of these states. This may be expected to result in considerably more confusion, duplication, and expense to the bank than if all offices were under a single agency as the Comptroller of the Currency. Thus, banks contemplating interstate branches, when and if permitted, may be expected to opt for national charters and become Fed members if they were not then.

On the other hand, the new environment in which Fed membership is no longer a paramount economic or psychological issue may intensify the attempts to unify the

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1/ Stephen A. Rhoades, "The Competitive Effects of Interstate Banking," Federal Reserve Bulletin, (January 1980), p. 4. According to Rhoades, Citicorp has 229 consumer finance and mortgage offices in 55 cities and a total of about 400 offices in 38 states and the District of Columbia if loan production offices and Edge Act corporations are included, the Bank of America has 350 offices in 41 states, and the Manufacturers Hanover Trust has 190 offices in 18 states.

supervisory and regulatory functions of the different banking and depository institution agencies into a single federal banking commission. In the past, the different agencies have successfully managed to forestall such unification generally with the support of the financial institutions. But the opposition of the institutions may be expected to be weaker under DIDMCA if there no longer is much difference to an institution in being a member of one agency over another.

A number of other interesting aspects arise regarding the relationship of the Fed to the other regulatory agencies. For example, all depository institutions subject to Federal Reserve reserve requirements have access to the Fed's discount window. For savings and loan associations, the Fed is now in competition with Home Loan Banks. The two agencies charge differently for their loans. The Fed prices the discount window for policy purposes. Home Loan Banks, however, have to raise the funds they lend on the private capital market and price them to make a profit. At yearend 1980, the Fed discount rate was 13 percent, while the FHLB average new advance rate was 17.4 percent. Thus, it would have paid for SLAs to borrow at the Fed if possible, which it was apparently not. But at other times, the discount rate would be above the advance rate, and the incentives would be reversed.

In an attempt to head off the obvious competitive gameplaying that could result, the Fed issued regulations that

> Short-term adjustment credit...generally is available only after reasonable alternative sources of funds, including credit from special industry lenders, such as Federal Home Loan Banks, the National Credit Union Administration's Central Liquidity Facility, and corporate central credit unions have been fully used.[1/]

Similar restrictions apply to seasonal and other extended credit. But how are "reasonable" and "fully used" to be interpreted? Reasonable and fully used at a particular price or at any price? Whether this will be sufficient to prevent gameplaying on the part of the SLAs or powerplaying on the part of the Fed and Home Loan Banks remains to be seen. It is not overly far-fetched to imagine some interaction in the pricing process.

IV

In terms of legislating "reforms" in the financial system, DIDMCA has succeeded where many previous attempts failed. (Note that reforms are changes that one agrees with.) Major reforms have been proposed by reputable parties since the Commission on Money and Credit in 1961, some 20 years ago. An interesting history of the attempts at reform appears in Sidney Jones' recent book The Development of Economic Policy: Financial Institutions Reform.[2/]

[1/] Board of Governors of the Federal Reserve System, "Press Release," (August 11, 1980), p. 6.

[2/] Sidney Jones, The Development of Economic Policy: Financial Institutions Reform, (Ann Arbor, Mich.: University of Michigan, 1979). See also Thomas Saving et al, "Monetary Commissions: Their Role and Work," Journal of Money, Credit, and Banking, (November 1972), pp. 897-1009.

The CMC's report was followed by the reports of the Advisory Committee to the Comptroller of the Currency (1962), the President's Committee on Financial Institutions (Heller Committee) (1963), the President's Commission on Financial Structure and Regulation (Hunt Commission) (1971), and the House Banking Committee's Financial Institution and Nation's Economy (FINE) Study (1976). Comprehensive bills incorporating many of the reforms recommended in these reports and others were introduced in Congress in 1973 (Financial Institutions Act), which failed in both the House and Senate, in 1975 (Financial Institutions Act), which passed the Senate but not the House, and in 1976 (Financial Reform Act), which failed in the House. Some less comprehensive bills, primarily extending or modifying Regulation Q ceilings were enacted. The most important of these was the Financial Institutions Regulatory and Interest Rate Control Act of 1978, which extended Q ceilings, authorized federal charters for mutual savings banks, and established the National Credit Union Administration Central Liquidity Facility.

In his 1979 book, Jones, who was involved in attempts to achieve financial reform in various positions as a member of the Nixon and Ford administrations, was pessimistic about the passage of comprehensive financial reform. He spread the blame on almost everyone--Congress, the administration, the public, and, in particular, the special interest groups

affected who favored the reforms that benefited their industry but opposed all others. The influence of the special interest groups is particularly important because the issues were complex and not of general interest. Thus, there was no public mandate pressuring Congress for reform. Jones concluded that

> The pace and type of adjustments...are likely to resemble the "salami approach" to policy decisions--repeated small slices of reform, just enough to avoid major disruptions that could once again cause insoluble controversy ...Most reforms will continue to be defensive reactions to changing competitive relationships.[1/]

As a result of

> the failure to accept comprehensive reform...financial institutions (were compelled) to resort to what some have called superfluous innovation aimed at keeping one step ahead of legislative and regulatory rules.[2/]

This is similar to Edward Kane's "regulatory dialectic" and the battle between "the invisible hand of the market and the visible hand of regulation."[3/]

Why was Jones so wrong that one year later comprehensive reform was enacted? In my mind, neither he

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[1/] Jones, pp. 225 and 341.

[2/] Jones, p. 341.

[3/] Edward J. Kane, "Accelerating Inflation, Technological Innovation, and the Decreasing Effectiveness of Banking Regulation," Journal of Finance (forthcoming), and "Good Intentions and Unintended Evil: The Case Against Selective Credit Allocation," Journal of Money, Credit and Banking (February 1977), 53-69.

nor anyone else could foresee the magnitude of the actual or perceived financial crisis in the Spring of 1980. The rate of inflation had jumped to near 20 percent, causing both the bank prime loan rate and the Fed funds rate to skyrocket to 20 percent and the 3 month Treasury bill rate to 16 percent. Disintermediation in substantial magnitude threatened. The bond market was pronounced dead by both Business Week (April 21, 1980) and Fortune Magazine (March 24, 1980). Reports and rumors circulated that many banks and, particularly, SLAs were in serious financial difficulties and on the verge of failure. The Fed argued that nonmembership leakage was hindering its ability to pursue an effective restrictive policy. Congress knows that in time of crisis the public demands action, any action almost (do not just stand still, do something), and various pieces of financial reform legislation were floating around.

In addition, a public mandate, albeit a weak but a mandate nevertheless, was developing for liberalizing Q ceilings. This movement was spearheaded by the senior citizens of the Gray Panthers, who were primarily savers not mortgage borrowers. In contrast, the pressures for Q originated from groups who were net mortgage borrowers or engaged in mortgage lending or construction, such as labor unions, thrift institutions, and home builders. For the first time, the latter group was outlobbied. (Senior citizens, like students, can take the time necessary for

amateur lobbying. It also beats sitting around and doing nothing.) Panthers flooded the halls of Congress, attended hearings on any subject, and buttonholed representatives and staff at every opportunity. In this, they were also supported by the credit unions, who both believed that they could be profitable without Q and desperately wanted a bill enacted that would preserve their right to offer share drafts. Credit unions are viewed by many politicians as groups more similar to labor unions than to financial institutions, and thus carry a more public interest than private interest image.

Equally important in speeding enactment was the galloping pace of technological advancements in communications, fund transfers, and information systems. Most importantly, these changes dramatically reduced the segmentation in financial markets, making it easy and cheap for investors and institutions alike to circumvent quickly artificial regulatory or legislative barriers. No longer did a stroke of the legislative or regulatory pen prevent third party payment account at nonbanks or cash interest payments on transactions accounts. Congress was forced to recognize reality or look particularly silly.

Pressure to bring forth some legislation also arose from the 1979 Federal Court ruling that the regulators had exceeded their legislated authority in approving automatic transfer services at commercial banks, NOW accounts and

remote service units at savings and loans and share drafts at credit unions. The Court gave Congress until year end 1979 to validate these actions. Not unexpectedly, Congress delayed acting and extended the status quo through March 31, 1980. But some congressmen preferred to enact more substantial financial reform and insisted upon this in return for legitimizing the threatened deposit services. As noted, continuation of these services was particularly favored by the credit unions, who initiated a major lobbying effort in support of almost any bill that would preserve share draft accounts.

Lastly, the bill succeeded in providing enough to most special interest and industry groups to overcome their opposition to the other parts. This was particularly true for the larger member and nonmember commercial banks with respect to universal reserve requirements on transactions balances. They gave high priority to achieving a "level playing field" relative to nonbank depository institutions. Nevertheless, many thrift institutions appear to feel that they received very little in terms of extended powers and higher deposit insurance in return for the liberalization of Q and greatly reduced influence on the Depository Institutions Deregulation Committee in setting the Q ceiling. They already have introduced legislation to repeal this provision and have filed legal challenges to its implementation. In a recent statement, Raymond D. Edwards,

Chairman of the large Glendale (California) Federal Savings and Loan Association and President of the California Savings and Loan League, argued "...sure we'll get more authority, but it's not what we want."[1/] Indeed, many SLA executives appear to see DIDMCA as providing a six-year extension of Q rather than a phasing out.

The full reasons behind the enactment of DIDMCA are not known even now. It involved considerable maneuvering and juggling by leading members of the House and Senate Banking Committees and their staffs. Unlike most pieces of legislation, whose paths from introduction to committee to conference to enactment are clearly traceable, DIDMCA effectively disappeared from sight between committee and conference, and when it resurfaced it bore only passing resemblance to its earlier versions that had passed either or neither the House or Senate. An accounting of the strange and mysterious path of DIDMCA through the jungles of Congressional committeeland by an involved party would make exciting reading and be a valuable contribution.

Regardless of why DIDMCA was enacted, how can it be graded with respect to the inclusion of reforms? One way to proceed is to compare the included reforms with those recommended in the Hunt Report. This was recently done by

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[1/] "S & L Official Fears U.S. Housing Shortage May Trigger Social Revolution," Portland Oregonian, September 14, 1980, p. E2.

Paul Horvitz.[1/] He concluded that "nearly all of the significant recommendations of the Hunt Commission have been enacted" in DIDMCA or earlier legislation.

Horvitz argues that almost all of the Hunt Commission's recommendations with respect to phasing out deposit rate ceilings, broadening the asset and liability powers of savings and loan associations (including third party payments), variable rate mortgages, authorizing national charters for mutual savings banks, phasing in equal reserve requirements on transactions balances at all depository institutions, and overriding state usury ceilings have been adopted. In addition, DIDMCA goes a long way in achieving the Commission's recommendation of no reserve requirements on savings and time deposits by eliminating reserve requirements on all savings and personal time deposits, and permitting no reserve requirements on nonpersonal time deposits. Major Hunt Commission recommendations not yet achieved include interstate branching; additional securities powers for commercial banks (such as trading and underwriting municipal revenue bonds and managing and selling mutual funds and commingled trust accounts); reorganization and centralization of financial institution regulation, supervision, and insurance; and special tax subsidies for housing.

[1/] Paul M. Horvitz, "The Hunt Commission Revisited," American Banker, May 12, 1980, pp. 4-6.

Similar to Jones, Horvitz attributed the delayed adoption of most of the reforms and the failure of some to "each institution seeking adoption of those parts...with which it agreed, and opposing those which were not in its immediate interests."[1/] Overall, it appears that DIDMCA and its older but less important siblings accepted those reforms made most pressing by either technological advancement or the perceived financial crisis and delayed on those that these events made less immediately necessary.

In sum, this paper has presented only a bird's eye view of the content, history and implications of DIDMCA. The full implications of the Banking Act of 1933 only became evident in the 1960s. It is not unreasonable to speculate that it may take as long for DIDMCA, particularly with respect to the degree of deregulation actually achieved. After a slow and dubious start, deregulation appears to be occurring, at least temporarily putting to rest the fears of some cynics that the Act would become known as the Depository Institutions Reregulation rather than Deregulation Act. However, legal and legislative challenges from the thrift institutions have already been introduced and may be expected to intensify if the financial problems of these institutions worsen. With respect to the Fed's monetary control, DIDMCA provides more form than substance. The new powers enhance the Fed per se more than its ability

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[1/] Horvitz, p. 4.

to control the money supply. The latter always has been more a matter of will than of means. On the other hand, by removing the excuse of the lack of means, DIDMCA may have forced the Fed's hand to try to control money supply more carefully. On the other hand, if the Fed continues to lack the will, DIDMCA may inadvertently have provided the Fed with another excuse to the effect that "see, even with these additional powers it is not possible to control the money supply accurately." Nevertheless, DIDMCA represents milestone legislation and, on first blush, must be given a high grade, significantly higher than that given the Banking Act, at least in retrospect.

THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980: WHAT HAS CONGRESS WROUGHT?

DISCUSSION COMMMENTS

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I have found this paper to be a most useful contribution, and, as the title suggests, a forerunner of many to follow in years of institutional change as these implications of the legislation become apparent. I wish to indulge briefly in a few conjectures -- mainly political -- regarding some of these implications. More questions will be raised than answers supplied.

Professor Kaufman argues cogently that Federal Reserve membership will increase. One might, I feel, make even a stronger statement, such as: with this legislation, Congress has taken a giant step toward converting the Federal Reserve System into a central bank. There are several bits of evidence. Universal reserve requirements are, of course, the most far-reaching change. The Federal Reserve Board Chairman is chairman of the Depository Institutions Deregulations Committee (DIDC), and the Federal Reserve staff performs DIDC staff work. Related developments include the following: the Federal Reserve has general

rule-making authority for the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Electronic Funds Transfer Act, and the Truth-in-Lending Act. The Federal Home Loan Bank Board is limited in responsibility to the administration of the Federal pre-emption of state usury ceilings on mortgage loans. Within the System, the Federal Reserve Bank of New York has, in the eyes of some, been experiencing a relative decline in importance relative to the Board. There is even an active group on Capitol Hill that seeks the elimination of the Federal Open Market Committee (FOMC).

According to Professor Kaufman, a more rapid rationalization of the depository industries is indicated. This seems to be a reasonable inference. Franklin and First Pennsylvania notwithstanding, size counts. When deregulation makes markets more competitive, size (translate "economic power") counts even more. Before deregulation, the power of the advertising budget measures the capacity of an institution, in effect, to circumvent the ceilings. Open price competition is even more direct. A case in point is today's competition in finders' fees between New York commercial banks and thrift institutions. A survey of advertisements in the New York Times since Labor Day confirms the expectation that the giant money market banks have uniformly offered higher rewards. Consequently, they have been able to bid millions of dollars away from the thrift institutions. (It is curious that the DIDC, after

declaring "bring-a-friend" campaigns to be illegal, went on to postpone their termination to the first of next year and, even then, to provide for a lengthy phaseout period!)

My major concern is that too many, including the architects of the new law, assume that a balance exists between the loosening of constraints on the two sides of the balance sheet. Quite the contrary. There is a serious lag on the asset side, with obvious negative implications for the competitive position of the thrift industry and housing finance.

There is the ancillary, but important, regulatory question regarding discount window accommodation of thrifts as compared with commercial banks. During the past few weeks I have been conducting an inquiry into this question in an attempt to evoke a meaningful statement of policy. The results have been disconcerting. Spokesmen for one Federal Reserve bank assured me that accommodation aimed at the disintermediation cycle would be provided before an institution was forced to sell assets and incur losses which would impair its capital position. But another System institution's aides protested that they had fought passage of the legislation and that they would, in its implementation, endeavor to limit the use of the discount window to the commercial bank model. Apprehension was also expressed concerning the possibility that losses might be incurred on loans to thrifts. (This is an incredible statement since the Fed can, of course, refuse to lend

unless it has assured itself that adequate collateral has been provided). Still another Federal Reserve bank also responded negatively, after a rather tortured bit of sophistry, to wit: It will take five years of high interest rates to break the back of inflation. Disintermediation will thus occur for five years. The Fed does not make 5-year loans. The thrifts are, therefore, out of luck! Have these central bankers read the new law? It states:

> "Any depository institution in which transaction accounts or nonpersonal time deposits are held shall be entitled to the same discount and borrowing privileges as member banks. In the administration of discount and borrowing privileges, the Board and the Federal Reserve banks shall take into consideration the special needs of savings and other depository institutions for access to discount and borrowing facilities consistent with their long-term asset portfolios and sensitivity of such institutions to trends in the national money markets."

What, one may ask, would be the social impact of these possible outcomes? Is the consumer's welfare necessarily enhanced by:

(1) a monolithic supervisory structure,
(2) higher concentration ratios, and
(3) a dampening of housing finance?

These would seem to be rhetorical questions implying a negative response. A friend of mine, who obviously disagrees regarding housing finance, sums it up as follows:

> "The American ideal of home ownership is being recognized for what it is, an impossible dream. The vast majority of home owners got into that condition by being subsidized. But that subsidy became too costly to both savers and the government. With supply-side constraints on housing production, it became self-defeating.
>
> Let's face the fact that home buyers are a political minority. The realities of politics dictate that

> government policy will serve the interest of that great coalition of senior citizens, the affluent middle class and the poor. They either own homes, or do not want to own homes, or their poverty has dimmed even the aspiration to home ownership long ago. Those youngsters wanting a first home are going to get little more than lip service.
>
> And that is really not so bad. If we examine the motives of these youngsters wanting first homes we may find a few for whom home ownership satisfies a vague need to do the right and wholesome thing, like wanting to marry a virgin. But for most of those who have seen what has happened to housing prices in the last ten years, that desire translates into crass materialism -- a cheap way into a damn good investment, a way to get rich quick. And that desire or need will not command much political support." (P. Barnett)

But I still wonder about the eventual impact of the legislation. Remember, with regard to interstate branching, that the two Senators from New Jersey, or Connecticut, have the same number of votes as the two Senators from New York. Moreover, I have found that Congressmen have a way of reacting vigorously, and with dispatch, when their attention is gotten and directed to "what they have wrought."

Is all this what Professor Kaufman meant when he observed that the legislation "might become known as the Depository Institutions Re-regulation Act?"

THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980: WHAT HAS CONGRESS WROUGHT?

DISCUSSION COMMENTS

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In many ways, George had a very difficult task to try to foresee the unforseeable -- what is going to result from the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). As he points out, only recently have we appreciated the implications of legislation passed fifty years ago. However, I want to say that he has done an admirable job in summarizing the Act and delineating some important areas for discussion.

I am reminded, in considering the full question of what the implications of DIDMCA are, of an article that came out right after the Hunt Commission's recommendations. In that article an econometric model was used to simulate the potential implications of the Hunt Commission recommendations for the mortgage market. The article noted

that the financial system, if the Hunt Commission recommendations were adopted, would be completely different than that which underlay the model that was being used to simulate the results of the recommendations. Therefore, there was a question about how accurate and how useful the simulations that were reported would be. The authors of the study fully admitted this shortcoming but proceeded with their analysis. I think in some ways that we're in a similar situation in considering DIDMCA. That is, we're operating with a "model" that may not be applicable once all the implications of DIDMCA come to be felt in the economy.

Nevertheless, of course, I'll press ahead as George did and make some comments on some of the things that George said as well as some of the aspects of DIDMCA that I think have some fairly important implications. I can divide my comments into three areas: (1) financial innovation and regulation, particularly over the last few decades, follow a fairly predictable course. First, there was regulation, perhaps in response to innovation, then additional innovation, then further regulation, either to foreclose the innovation or attempt to foreclose it, or to ratify the innovation because the regulators felt helpless in the face of it, then additional innovation, and so on. Sometimes the innovation and the regulation have followed one another with substantial lags because there is another element that always seems to be necessary, particularly in generating some response either to the innovation or the regulation,

and that is some change in the economic environment that serves as a catalyst. For example, NOW accounts are a particular example of a response to a regulation that had been passed forty years before prohibiting the payment of interest on demand deposits. Somebody in New England thought that this would be a good opportunity to try to attract funds to a mutual savings bank by offering interest payments on something that he wouldn't call demand deposits, but were, in fact, demand deposits. Once he did this and had some success, of course, it spread. Interest paying checking accounts started springing up in various guises all across the country with Congress and various regulatory agencies permitting this spread in response to institutional and other pressure. Similar examples of financial innovation in the face of regulation and a changed environment abound--Eurodollars, repurchase agreements and so on. Particularly interesting, in light of my later discussion, is the widespread attempt to avoid the prohibition on interstate banking through, for example, loan production offices and bank finance companies' subsidiaries. George alludes to a number of these channels. It seems to me that many of the changes that DIDMCA makes with respect to financial institutions can be regarded in this context. In many ways, I regard DIDMCA as simply a belated recognition of changes that were already in process. For example, the phasing out of Regulation Q ceilings. Growth in commercial bank time deposit accounts has taken

place in areas where Regulation Q ceilings were suspended or modified in some fashion--large certificates of deposit, money market certificates. In addition, people typically were voting with their funds to move funds to areas where there was no prohibition on interest payments, no Regulation Q ceilings--I have in mind particularly money market mutual funds. So Regulation Q, I think, was on the wane in practice. This does not fully diminish the importance of its official demise but it certainly was being eliminated anyway. Regulation Q ceilings are but one example. There are others.

In general, it would be encouraging if Congress did not merely react to changes after they occurred but anticipated them. For example, George mentions the Hunt Commission Report. That report was issued in 1971 and he points out that DIDMCA incorporated many of the Hunt Commission's recommendations. The FINE study and the related activities around the FINE report took place over the time 1974, let's say, to 1976. Again, recommendations were there, many of which finally did go into DIDMCA in 1980. It seems, again, that if Congress is going to devote internal resources and employ study commissions to come up with proposals to anticipate potential trends, they should pay more effective attention to the results of these efforts. Although recommendations were included in prior legislation, until 1980 this legislation failed.

There are also a number of things, it seems to me, that were left undone by the Act, most of which George refers to. Let me just take a few minutes on these omissions. The most grievous errors, I would say, were the failure to remove prohibitions on the payment of interest on demand deposit accounts and the failure to allow interstate branching. Dr. Scott alluded to the failure of the latter in terms of the composition of the Senate and I suspect that's correct. Nevertheless, both of these trends are in force now anyway. George points out that there's going to be a rapid redistribution of funds from demand deposit interest-earning accounts after January 1. I think that's true although the prohibition on corporate accounts limits this redistribution. Nevertheless, with overnight repurchase agreements and Eurodollars and with new innovations such as money market mutual funds designed particularly for corporations with massive check-writing privileges, over time we are going to effectively have an empty set--or close to an empty set--in terms of what we traditionally call demand deposits.

Similarly, interstate banking activities that I mentioned before and George discussed as well are effectively obliterating regulatory restrictions. I'm exaggerating somewhat but almost every day you see some attempt by banks to expand interstate. The recent flap in Maryland about Citicorp and their reverse credit card is but one example. There is innovation going on around what are

clearly regulations that, in my opinion, have outlived their usefulness. And I think Congress and regulatory agencies would be doing a service in recognizing these changes as inevitable.

I want to go to the Federal Reserve System for a minute. George talks about the fact that DIDMCA has enhanced the stature and the power of the Federal Reserve System, and I think that is probably so. The Fed clearly perceived the problem of banks leaving the System as a threat. The threat that they saw was to monetary control. That's certainly one possibility, though the merits of their argument can be debated. Somebody, I can't remember who, previously mentioned something about the response of the bureaucracy when it is threatened and it could be interpreted that the fear of member bank attrition stemmed from a feeling that they were, in fact, losing power. Any kind of bureaucratic organization that felt its power threatened would, I think, respond in terms of trying to preserve it.

So you either have a situation of actual fear of loss of monetary control because of banks leaving the System or just the bureaucratic response in terms of preservation of power. Supporting the latter possibility, Ed Kane, as George mentions, points out that the Fed was perceived to have lost power before this Act went into effect. Whatever the Fed's motivations, the Act certainly, in my judgment, has restored considerable power to the Fed. Whether it

helps monetary control or not, I'm not quite sure. Technically, using the money multiplier framework for analytical purposes and assuming a reserve aggregate strategy, the reduction in the number of reserve categories and elimination of the significance of funds movements between member and nonmember banks may aid multiplier forecasting. However it is not at all clear that overall the net result of DIDMCA will be to make monetary control more precise.

In any event, there is one point that I don't really have a firm judgment on at all but I throw out for discussion. We may also be able to get some inside information as well. One thing that does trouble me is there seems to be a larger escape valve from the discipline of monetary policy in the expanded ability of all depository institutions to access the discount window. There continues to be no penalty discount rate and the rate remains untied to open market rates. However, I understand that the Fed is currently reviewing putting into effect a tied discount rate. I think this is a useful step. Nevertheless, without any changes, the fact that large numbers of institutions potentially have an ability to access the discount window under DIDMCA despite the strict rules imposed by the Fed may create additional monetary policy problems that we haven't come to grips with as yet.

In summary, let me just say that I agree with George that the Act is important--I think George really did a

nice job in summarizing for us and delineating important areas for discussion. It is very difficult at this point in time to provide a lot of answers. I would, though, disagree with one thing that George said: he said it might take as long as it took for the Banking Act to realize the implications of DIDMCA. I don't think so. I think the financial system is changing too rapidly. I think we will, either fortunately or unfortunately, realize the implications of this Act far sooner. I thank George for his paper. In many ways some of the points that I have raised were implicit in his paper. However, since they were implicit, if he doesn't agree with me, he can deny that they were implied.