The Deregulation and Monetary Control Act of 1980

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The Deregulation and Monetary Control Act of 1980
by Jeffrey Rogers Hummel

On 31 March President Carter signed into law the Depository Institutions Deregulation and Monetary Control Act of 1980, one of the most significant and sweeping pieces of legislation enacted during his administration. Rep. Henry S. Reuss (D-Wis.), chairman of the House Committee on Banking, Finance, and Urban Affairs and one of the chief sponsors of the bill, described the act as the most significant package of financial legislation since the 1930s, and Sen. William Proxmire (D-Wis.), chairman of the Senate Committee on Banking, Housing, and Urban Affairs and another of the bill’s sponsors, declared the act the most important banking legislation since passage of the Federal Reserve Act.

Despite the act’s momentous importance, however, it sailed quickly and quietly through Congress with almost no resistance just prior to the Easter recess. Solitary voices of opposition were raised in the House by Ron Paul (R) of Texas and in the Senate by William Armstrong (R) of Colorado. News coverage of the act has been almost nonexistent. Few publications have even bothered to mention the act’s passage, and those that have done so have given the legislation little more than cursory treatment.

Background
To appreciate the substantial impact that the act will have, one must know a little about the existing structure for government control over money, banking, and credit. Commercial banks in the United States do business under three distinct tiers of government regulation. The first and oldest of these, the National Bank Act, is a legacy of the Civil War. It established a system of national banks chartered by the federal government and regulated by the Comptroller of the Currency. Second, in 1913 the Federal Reserve Act created a system of 12 regional Federal Reserve Banks coordinated by a seven-member Board of Governors appointed by the President. The Federal Reserve System (Fed) became the nation’s central bank, with the power to control the size of the money stock. All national banks were required to become members of the Fed, and state chartered banks were given the option of doing so. The third tier emerged during the Great Depression with the creation of the Federal Deposit Insurance Corporation (FDIC), which insures the deposits of those commercial banks that comply with its regulations. All members of the Fed were compelled to get insurance from the FDIC, and nonmember banks could do so if they wished.

The result of these successive waves of legislation has been to divide U.S. commercial banks into four categories: (1) national banks, which are regulated by all three agencies—the Comptroller of the Currency, the Fed, and the FDIC; (2) state banks that are members of the Fed and are therefore also regulated by the FDIC; (3) state banks that are not members of the Fed but are members of the FDIC; and (4) those state banks that belong neither to the Fed nor the FDIC. In addition, state banks must conform to their own state banking regulations, which adds to the regulatory confusion.

The Fed, in its conduct of monetary policy, has control over the first two categories of banks, but none over the second two. In recent years more and more banks have decided that life is a good deal less onerous outside the Fed, and as a result the Fed has been plagued with a large number of defections. Approximately 5,600 commercial banks are members of the Fed, but over 8,900 are not. Three hundred banks have withdrawn from the Fed in the last six years; over 150 left in the last two. Although the total assets of member banks—$860 billion—still exceed those of nonmembers—$300 billion—these defections nevertheless represent a steady erosion in the Fed’s authority.

The growth of what economists call financial intermediaries (e.g., savings and loan associations) is another cause of the declining power of the Fed. Financial intermediaries, like banks, make investments with funds they acquire by issuing financial liabilities. Unlike commercial banks, however, the liabilities of financial intermediaries do not include demand deposits (checking accounts) and are therefore not traditionally considered part of the money stock. Thus while banks can

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Simplistic Solutions Reconsidered

That mass delusions can afflict entire civilizations is a well documented historical fact. In our own time there is no belief more widely held than the theory that the government can solve economic problems. Liberals and conservatives alike place the blame for economic ills squarely on Washington and loudly proclaim that economic well-being must, in some sense, either come from government or be coordinated by government. It is our contention that this view of government as problem solver is a mass delusion and nothing more.

The records established by governments all over the world as they have attempted to run their economies is unarguably dismal. Where the market becomes less free, regulations proliferate, "just prices" are decreed, and national economic plans are laid. The result is chaos, malinvestment, hyperinflations, and depressions. Where generally desired results do take place, it is often not because of the government's policies that produce them but simple market mechanisms. Take, for example, energy conservation: As the price of energy rises, consumers will, other things being equal, buy less energy. This may not be the optimal outcome from a purely technical sense—turning out lights and turning down thermostats—to longer term solutions such as investing in more fuel-efficient automobiles. These responses, however, are not free market solutions from the point of view of efficiently using resources. The responses are responses to a price rise in energy that can be predicted with confidence by economists of all political persuasions. Yet when such a price rise actually occurred and the predicted cutbacks followed immediately, who took the credit? Not the free market, since that is merely a useful abstraction denoting the voluntary choices of millions of individuals and companies; the government took credit for energy conservation because it ran a national advertising campaign implying people to use less energy. The campaign was, of course, complete superfluous and useless because the decline in energy consumption would have happened anyway. And the response to a higher price is to form the energy "crisis" expected by economists is product substitution. Such substitution occurs when two similar goods can be interchanged profitably after price changes. Hence, we would expect the market to begin exploiting synthetic fuels, solar energy, wood stoves, and gasohol as the prices of oil and natural gas rise and product substitution takes effect. What is happening? The government has once again and with much fanfare, has passed legislation to subsidize the development of all the fuels and technologies that would have been developed anyway, hence, the government, and not the market, will take credit for the decline in oil use.

That few question this basic "government as Mr. Fixit" paradigm can be seen equally clearly in the debates over transportation safety. One side argues that the federal rule imposed 55 miles-per-hour speed limit is saving lives, in conjunction with all the government-mandated extra equipment on recently produced autos. The other side argues that higher oil prices are causing people to drive less and that newer roads and cars are safer. But few point out that, in fact, highway deaths per passenger mile have continuously declined throughout the century and that, all the government programs notwithstanding, they would have continued to decline anyway. The state, once again, takes credit where none is due.

During the recent presidential campaign, whenever anyone policy analyst or candidate referred to the market as a better problem solver than the government; political opponents and media pundits immediately denigrated such notions with epithets such as "voodoo economics" or "simplistic solutions." So enameled have we become of government programs, task forces, committee studies, regulatory agencies, congressional mandates, and presidential directives that we have turned reality on its head. It is government programs that are based on voodoo, i.e., on a foundation of mass delusion.

When the state "regulates, controls, constrains, or directs" the free market, it necessarily diminishes the freedoms of real people because itotte actions such as the market do not act and do not have freedom. Both major political parties accuse each other of having poor economic policies, but in fact they are equally guilty because both offer American society the kinds of actions that are termed from simple conservation by taking away "freedoms of real people because abstractions such as regulation are necessarily means to end other means to achieve the same effects of the same regulatory structures. The structures themselves are never questioned, only the results, and each party fights desperately to gain control of the overall apparatus. When the economy "does well" it is in spite of government policies, not because of them.

It is now time to "put away childish things." It is time to recognize, once and for all, that the government has no clothes.
The Fed is granted the power to regulate the reserves of all depository institutions...
**GOVERNMENT SPENDING MONITOR**

A quarterly feature of Policy Report, the “Government Spending Monitor” summarizes the latest expenditures by the federal government.

<table>
<thead>
<tr>
<th>EXPENDITURES (annual rate in billions of $)</th>
<th>1980 Third Quarter</th>
<th>1980 Second Quarter</th>
<th>1980 First Quarter</th>
<th>Average for Last Four Quarters</th>
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<tr>
<td>Federal Government</td>
<td>567.2</td>
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<td>Defense</td>
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<td>Labor Department</td>
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<td>Education</td>
<td>13.8</td>
<td>13.2</td>
<td>13.5</td>
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<td>Department of Health and Human Services</td>
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<td>210.8</td>
<td>201.1</td>
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<td>Housing and Urban Development</td>
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<td>13.6</td>
<td>9.9</td>
<td>11.9</td>
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<td>Transportation Department</td>
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<td>Federal Aid to State and Local Governments</td>
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<td>86.9</td>
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<td>Federal Interest Paid</td>
<td>64</td>
<td>89.2</td>
<td>67.2</td>
<td>75</td>
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<td>Federal Transfer Payments</td>
<td>230</td>
<td>235.7</td>
<td>264.3</td>
<td>238</td>
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<td>Federal Surplus or Deficit</td>
<td>22.9</td>
<td>-49.2</td>
<td>-60</td>
<td>-44</td>
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<td>Reported Federal Debt</td>
<td>855.3</td>
<td>875.5</td>
<td>894.3</td>
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<td>Total Government</td>
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<td>16.2</td>
<td>16.3</td>
<td>16.2</td>
</tr>
<tr>
<td>Employment, All Levels (millions)</td>
<td>16.2</td>
<td>16.2</td>
<td>16.3</td>
<td>16.2</td>
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</table>

*Prior to May 1980, the Department of Education and Health were one department with an annual outlay rate of 201.6 for the 1st quarter of 1980.*

Sources: All data is derived from Treasury Bulletin, the Monthly Treasury Statement of Receipts and Outlays of the United States Government, and the National Bureau of Economic Research.

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**Policy Report**

**Deregulation Act** (Cont. from p. 5)

Reserve Board, on approval of at least five members, to impose a supplemental reserve requirement of 4% on the transaction accounts of every depository institution. These supplemental reserves, unlike regular reserves, will earn interest paid to the depository institutions by the Fed. Finally, an emergency provision that I describe more fully below allows the Fed to set reserve requirements on any depository liability at any level it desires, including zero, for a renewable period of 300 days.

In general, these new limits give the Fed greater discretion, although in some cases, as in the requirement that transaction accounts be uniform, the discretionary leeway of the Fed is reduced. In some cases the new limits will lower reserve requirements; in others, raise them. For instance, demand deposits now require fewer reserves. In general, however, these new limits and the general diversification of the Fed's balance sheet, have lower reserve requirements raised by the new rules. Furthermore, many institutions that were not previously subject to Fed reserve requirements will discover that they now need more reserves.

The new requirements went into effect on 1 September 1980. In addition, the act provides for a transition period of eight years for nonmember depository institutions and a transition period of four years for member banks. Depository institutions can hold required reserves in the form of vault cash or deposits at the Fed, and nonmembers will keep the required reserve deposit at corresponding institutions as long as the corresponding institution keeps an equal balance on deposit at the Fed. These reserve requirements apply uniformly to foreign branches of U.S. depository institutions, but deposits payable outside the United States are exempt. Depository institutions that are organized solely to do business with other depository institutions and are not expected to do business with other institutions, such as the Federal Home Loan Banks, are also exempt from reserve requirements.

The Fed’s discount window is open to all depository institutions. In other words, all depository institutions, and not just member banks, can borrow money created by the Fed. This is another step in eliminating the distinction between members and nonmembers of the Fed.

One of the minor provisions of the act that should be noted at this point is the elimination of the penalty discount rate. Previously the Fed was required to charge at least one-half percent more on loans to member banks that were secured by what was termed ineligible assets. The distinction between ineligible and eligible assets is a throwback to the days of the real bills doctrine, which tied the ability of banks to create money only to cover short-term, self-liquidating loans.

4) The Fed can now charge for such services as check clearing and can now offer these services to all depository institutions. Previously, the Fed provided such services as check clearing, settlement, and float to members for a zero price. Now the Fed must offer these services at a uniform fee to both members and nonmembers.

At first glance, this may appear to be a new source of profit for the Fed. The member banks, which legally own the Federal Reserve Banks, are restricted to no more than 6% dividends on their stock in the Federal Reserve Banks. If the new service fees do increase the revenue of the Fed—-which is not at all certain—the new service fees will be the U.S. Treasury, which gets all Fed income that does not cover operating expenses and dividends.

The net effect of these provisions is to effectively eliminate the difference between members of the Fed and nonmembers. All depository institutions will have access to the same reserve requirements, and all depository institutions will have access to the same benefits: the discount window, the check clearing, and other services. The only remaining difference between members and nonmembers will be that members will hold stock in the Federal Reserve Banks and nonmembers will not.

Advocates of the Depository Institutions Deregulation and Monetary Control Act argue that expansion of power for the Fed as necessary in order to give the Fed more effective control over the money stock in its fight against inflation. Opponents of the act argue that these increased powers will not tighten control over the money stock but in fact ease the way for even greater monetary expansion and worse inflation. Both positions are wrong.

In order to explain why, let me briefly review the three major ways that the Fed can alter the money stock. The Fed can expand the money stock, the Fed buys financial assets, such as government securities, with money that has been created just for that purpose. The Fed can also contract and reduce the money stock, the Fed can buy more assets and create more high-powered money. The expansionary potential of open market operations is nearly unlimited. If the Fed were to purchase enough financial assets to expand from its current total money stock, the Fed can sell assets and destroy money. Such a contraction is theoretically limited only by how many assets the Fed owns, but since the depository institutions can expand only on top of the high-powered money base created by the Fed, this limitation is of no practical importance.

Consequently, giving the Fed greater power over reserve requirements is neither inflationary nor deflationary. Such power gives the Fed no more control over the total money stock than it already possesses. All that can be argued is that the act gives the Fed the ability to hit monetary targets with greater precision and speed, and even this alleged advantage owes more to the reporting requirements than to the reserve requirements.

The real significance of subordinating all depository institutions to the Fed lies not with the issue of inflation versus deflation but with the issue of liberty versus power. The exodus of banks from the Fed and the growth of financial intermediaries signify a shift in the banking and credit industry away from areas of government control and into areas of relative freedom. This shift demonstrates the market's capacity to survive and flourish in the interstices between regulations. The Depository Institutions Deregulation and Monetary Control Act is a reactionary countermove by the Fed to reassess its dominance and bring the entire banking and credit industry within its control. In order to achieve this goal, however, the Fed was forced to make some concessions to the market, and those are contained in the next two sets of provisions.

**Freeing Interest Rates**

1) The prohibition of interest for demand deposits and the limits on in-
Perhaps the most encouraging referendum approved by voters in November was Massachusetts' property tax initiative, which limits property taxes to 24% of a given piece of property's assessed value. Massachusetts citizens, among the most severely taxed in the nation, approved the measure by a 60% majority. Other states passing tax relief measures include Arkansas, Missouri, and Montana.

The minimum wage, which now stands at $3.10 an hour, is scheduled to go to $3.35 an hour on 1 January 1981. This will be the last scheduled increase in the minimum wage as voted by Congress in 1977. New proposals call for minimum wages of $3.70, $4.00, and even $5.00 over the next year or two.

New Census Bureau figures show that the average American paid $959 last year in state and local taxes. The figure is $46 higher than the 1978 average and represents 12% of personal income. Alaska, New York, and Washington, D.C., had the highest state and local taxes, averaging $2,546, $1,370, and $1,336 respectively. Arkansas, Alabama, and Mississippi have the lowest taxes.

A free telephone hot line set up by the federal government to encourage reports of fraud and abuse has already received 5,000 tips in the last two years. Over 1,000 of these calls have pointed a finger of guilt at the Department of Health and Human Services.

The Federal Food and Drug Administration has proposed new regulations to encourage the production of caffeine-free cola beverages. One of the regulations makes the use of caffeine as an additive dependent on the food industry's funding of studies addressing how caffeine affects children and human fetuses. The other regulation removes caffeine from the agency's list of safe substances but allows its use to continue, pending further studies.

The Carter administration has reported that the 1980 budget deficit was 12% of the second largest deficit in American history. This figure is twice the size of the projected $29 billion deficit that Carter originally reported in January. One Treasury official admitted that the release of this figure was delayed for several days until after the Carter-Reagan debate.

The Senate has voted $12 million toward a research program for the automobile industry in order to spur America's "reindustrialization." The grant, an addition to an $11.8 billion appropriation for the Transportation Dept., is intended to finance long-term studies of new technologies that would enable American auto makers to compete more effectively with foreign cars.

In 1980 the government spent approximately $51 billion on maintaining its day-to-day operations. This includes $33 billion for supplies and materials ranging from cleaning items to computers; $3.1 billion for travel; $4.9 billion for freight charges; $6.3 billion for rent and utilities; $1.7 billion for printing and duplicating material.

A recent study by the Congressional Budget Office has estimated that in 1979 the tax-free loans made available by the federal government cost American taxpayers $1 billion.

The governing Treasury Department has proposed new regulations that would increase a lawyer's liabilities for writing illegal statements about taxable properties. The Internal Revenue Service has labeled 25,000 tax shelters abusive in the last few years, and the Treasury Department is grappling with the new regulations to combat the growing tax evasion problem. Lawyers would be allowed to discuss only shelters that were legal, even if they wished to advise against illegal shelters. Penalties would include disbarment. Judges who disobeyed the regulation.

If a new IRS ruling is upheld, hundreds of attorneys will be denied the opportunity to see their books published and millions of books may have to be destroyed. The IRS contends that publishing houses have been improperly writing off their inventories by claiming sharply depreciated values for unsold books. Several Congressmen are planning to introduce bills to overturn the IRS ruling.

President Carter has named the members of his Synthetic Fuels Corp., the group that Carter claims will "literally change the way we live." Deputy Energy Secretary John Sawhill, head of the corporation, announced the members: Frank Cary, chairman of IBM; John Kirkland, the president of the AFL-CIO; Cecil Andrus, Secretary of the Interior; Frank Savage of Equitable Life Insurance; Catherine Cleary of the First Wisconsin Corp.; and John DeButt, former chairman of AT&T.

A recent study of 74 federal agencies has tabulated 302,000 new publications in the last 18 months. The federal government's own estimate is 66,000 for the same period. One official remarked, "The government is putting out printed material faster than we can keep track of it."

The Commerce Department has started a new program that will help select businesses increase their exports to foreign nations. The program, dubbed "Strike One," will start with seminars on foreign trade for business executives, followed by trade shows and trade fairs. Herta Seidman, the assistant secretary of Commerce, has stated that most of the participating firms will be in the $300-$400 million yearly gross range.

Many of these provisions have already been enacted in past stopgap legislation. Because of doubts about the constitutionality of overriding state usury laws, the authors of the Deregulation Act added a severability clause that allows one provision relating to state usury laws to be declared invalid without affecting the other provisions.

The ceiling on interest rates charged by federal credit unions is raised from 12% to 15%. The National Credit Union Administration has already raised its ceiling this evening higher for periods up to 18 months after consultation with the Department of the Treasury, appropriate committees of Congress, and the other financial regulatory agencies.

All of these provisions are moving in the right direction, but none of them go far enough. Depositors and savers are forced to wait for six years for the elimination of restrictions on interest on deposits. The nullification of state usury laws is so hedged with qualifications as to be almost useless. Fortunately, the legalizing of NOW accounts, which will be discussed below, in effect eliminates the restriction on interest for demand deposits held by individuals. Particular notice should be taken of those provisions that tie the usury law override to the Fed discount rate. In periods of high inflation and high interest rates, when almost all state usury ceilings will be exceeded by the market, this converts the discount rate from an instrument for monetary control into an instrument for interest rate control.

If Congress were really interested in regulatory simplification, it would not have passed this act but abolished the regulatory agencies instead.
The net effect of all these provisions is to effectively eliminate the difference between members of the Fed and nonmembers.

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"To be governed..."

CPSC: just another agency under fire

Somebody out there doesn't seem to care much for the Consumer Product Safety Commission.

At least that's what it seems like to the employees at the agency's Bethesda headquarters.

Four times in the last month arsonists have set small fires in the high-rise office building that houses the agency. And then this week on election day an anonymous caller made a bomb threat that forced all 500 employees to evacuate.

John Bell, a spokesman for the agency, said the commission has asked the FBI to investigate the incidents.

The FBI, Bell said, told the commission that such incidents were "very common among federal agencies" and if they investigated the problems at the CPSC they would have to do the same for everyone else.

—Washington Post, Nov. 7, 1980

Tweedledum and Tweedledee

Political image makers squirmed over polls indicating that, despite 30 million dollars spent for television advertising, voters wound up with pretty much the same impressions of Carter and Reagan that they held at the start of the campaign.


The paper chase—part II

Officials of a major rubber company complain that complying with a single new order of the Occupational Safety and Health Administration required the firm to process in one week more than 345,000 sheets of paper weighing 3,200 pounds and taking more than 2,000 man-hours.


Nothing but the best for DOE

Hiring consultants can be a costly way of conducting the government's business. An internal Department of Energy report notes that last year some of the agency's top consultants drew annual salaries of $75,000 and $92,700. The head of the agency drew "only" $66,000 and his top aides were paid $47,500.

—Washington Post, Sept. 17, 1980

Two studies are better than one

Four Federal repositories can be used to locate a substantial portion of the studies performed by Government employees and consulting services. GAO has found that agencies are not searching these repositories before initiating new studies, and many completed studies are not submitted to the repositories.

—They're Your Taxes, Northern New Jersey Chamber of Commerce and Industry, July 1980

Be prepared

The nation's missile warning system is so delicate it produced 147 false indications of a Soviet missile attack on the United States during the last 18 months, a Senate report said yesterday.


But why am I still unemployed?

The recession ended in late summer, making it the shortest one on record. If it had been any shorter, the game warden would have made us throw it back. Autumn had scarcely begun when we knew the upturn had commenced. We have the giant computer to thank for this promptness in knowledge.

—Paul Samuelson, Newsweek, Nov. 3, 1980

A job well done

Forty-nine of the government's top career people got a $20,000 pat on the back the other day from the President. He did it by giving them the title "distinguished executive" which, along with the honor of the thing carries the larger first-time awards. Another 206 executives got $10,000 awards.

—Washington Post, Sept. 20, 1980