Public and Private Financial Institutions: A Review of Reports from Two Presidential Committees

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(Continued on inside back cover)
THEORIES of monetary and financial markets are generally concerned with the behavior of broad aggregates. As yet, economists have not successfully blended the rich variety of institutional details that make up the financial markets with the theory of relative prices. Perhaps as a result of our procedures and the state of knowledge, our policy recommendations are often suggestions for pervasive changes in institutional arrangements. Many of our perennial policy debates are concerned with issues such as whether or not the Federal Reserve should be replaced by an immutable rule or whether banks should be prevented from independently creating money.

The discussions of "practical" men most often emphasize those institutional details that economists ignore. Practitioners (and many economists as well) generally fail to recognize that appraisals of existing or new institutional arrangements have relevance only within the context of validated hypotheses. Their concern is with the details of financial arrangements, and their proposals treat of such details, dismissing our theories as cavalierly as we dismiss many existing details.

The men charged with administration of federal credit programs or involved in governmental operations affecting financial markets and institutions have now presented their recommendations. The reports and proposals of the two committees considered here appear to be the work of "practical" men. Few of the proposals emerge from a detailed analysis of the monetary system or from the validated hypotheses that we currently possess in monetary theory.

Those who were "disappointed" by the nature of the recommendations and the absence of suggestions for sweeping changes in the report of the Commission on Money and Credit will be similarly discouraged by these reports. There are few indications that major institutional rearrangements would be desirable. Indeed Financial Institutions goes in the opposite direction. It, "... offers reassurance that our financial system, for the most part, functions soundly and efficiently to promote the growth and stability of our economy." While there is a warning that, "... it would be unfortunate to confuse lack of urgency with lack of importance," one of the reports cautiously suggests that the recommendations made, "... are not so compelling as to command the highest priority in the President’s legislative program." This suggestion was duly noted by the late President who took steps to implement the recommendations in Federal Credit but allowed time for most of the suggestions in Financial Institutions to mature further.

The two reports differ in more than their implementation. Federal Credit is primarily a series of guidelines for the executive departments and agencies that administer loan and guarantee programs or engage in secondary market operations. There are occasional glances at Congress, but most of the recommendations in the reports of the Committee on Federal Credit to the President of the United States and The Report of the Committee on Financial Institutions to the President of the United States (Washington: Government Printing Office, Feb., and April, 1963), 67 and 66 respectively. The former report is referred to as Federal Credit, the latter as Financial Institutions.

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* Commission on Money and Credit, Money and Credit: Their Influence on Jobs, Prices, and Growth (New Jersey: Prentice-Hall, 1961) hereafter the CMC.

* Financial Institutions, v.
Recommendations deal with the arrangements that should be adopted if new programs are approved, the criteria for choosing between loans and guarantees, the relation of credit programs to the economic policy of the government, criteria for the participation of private lenders, methods of coordinating administrative operations, and similar matters that do not require new legislation. *Financial Institutions* is concerned with a number of matters that either cannot or will not be solved without legislative direction. Among the more interesting issues discussed are the magnitude and form of reserve requirements for commercial banks, the application of reserve requirements to financial institutions other than banks, the payment of interest rates on demand deposits, and the currently heated question of supervision, regulation, and branching of commercial banks. Some of these issues are considered in more detail below.

The composition of the two committees differed also. For reasons that are not immediately obvious, a four-man team consisting of the Secretary of the Treasury, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers, and the Chairman of the Board of Governors was charged with responsibility for recommendations affecting the federal credit programs. Agencies operating in the lending field, particularly housing and farm credit agencies, were appointed to the Committee on Financial Institutions but not to the Committee on Federal Credit. However, representatives of the agencies were permitted to discuss and comment upon a preliminary report by the Federal Credit Committee, and the final report, to some unknown extent, represents a consensus of available viewpoints.

The late President offered both committees the opportunity to use the recommendations of the CMC as a starting point. Neither group went much beyond the specific questions raised by the President's memoranda establishing the committees, nor beyond the issues discussed by the CMC. It is particularly noteworthy that *Federal Credit*, like the CMC, does not suggest any new lending programs, although it comments on the desirable administrative arrangements and financing methods when such programs are established, and notes that the "potential for credit programs as an effective tool of public policy will be substantial." The Committee did not choose to get into the subject of the desirability of particular programs, new or old, and the reader must decide for himself whether or not the CMC and *Federal Credit* represent a consensus of leading businessmen and government officials that such programs should be expanded slowly, if at all.

In this review, only a few of the approximately 50 recommendations in the two reports can be discussed. Since the underlying issues raised by the recommendations are sufficiently different, I will treat the two reports separately and will direct principal attention to some of the recommendations in *Financial Institutions*. Where the recommendations overlap topics discussed in an earlier report of the CMC or a committee established by the Comptroller of the Currency, I will comment on some of the latter suggestions as well. Although the conclusions regarding the desirability and/or type of change are different in the CMC, Advisory Committee, and *Financial Institutions* reports, some of the discussion applies to all three.

**Recommendations Directly Affecting Federal Reserve Monetary Policy Operations**

*Financial Institutions* makes a number of suggestions that would alter prevailing arrangements shaping the transmission mechanism for monetary policy. It was determined:

1. that reserve requirements on demand deposits should be based on volume of deposits rather than location of banks,
2. that requirement ratios for demand and time deposits should be made applicable to all commercial banks whether or not they are members of the

*Federal Credit*, 9.

Federal Reserve, (3) that all commercial banks should have access to the discount window, and (4) however, membership in the Federal Reserve System should continue to be voluntary for state chartered banks. Additional recommendations concerning the regulation of interest rates on demand and time deposits and the supervision of commercial banks were also made, but these can be more fruitfully discussed below in another context.

There is disagreement about the particular recommendations among the three groups. The Advisory Committee and the CMC urged uniform reserve requirements for all banks, although they differed about the desirable range within which the authorities might vary the requirements. Both the CMC and the Advisory Committee concluded that reserve requirements against time deposits should be eliminated, but they differed about compulsory membership in the Federal Reserve System. Only the CMC supported compulsory membership for all commercial banks. Only Financial Institutions desired to retain reserve requirements for time deposits.

Much of the discussion ostensibly supporting the recommendations for change consists of plausible assertions, augmented by some factual references and some factually incorrect statements. But the effect of the proposed changes in institutional arrangements cannot be fully appreciated without reference to an explicit frame of validated theory. Unfortunately, we possess no carefully developed, highly validated theory, integrating economic analysis and those monetary arrangements in which changes are proposed, that has been tested against alternative theories. But some work has been done in recent years to develop and test hypotheses connecting policy arrangements with the behavior of the money supply. These hypotheses are adequate for a preliminary appraisal of the proposed changes and permit a more detailed evaluation than is provided in Financial Institutions.

Moreover, the hypotheses permit us to examine the content of such remarks as, "open market operations and discount policy would have their effect even in the absence of required reserves" but, "most members of the Committee believe that monetary policy is strengthened by uniform reserve requirements for all commercial banks." 10

Some of the policy issues can be analyzed using the theory referred to in footnote 9. Equation (1) expresses the money supply as the product of a policy variable, the adjusted monetary base \((B^p)\), and the behavior of the banks and the public summarized in \(m\). A number of the proposed changes would alter prevailing reserve requirements, incorporated as \(r\) in equation (2). To more fully bring out the specific effects of the proposed changes in reserve requirements on the money supply, equation (3) presents \(r\) as a weighted average. 12

For example, we read on page 8 of Financial Institutions that the Federal Reserve was inhibited from using reserve requirements as an anti-inflationary weapon because of the "possibility that banks would withdraw from membership." But if we consider the use that was made of power to alter reserve requirements in the early postwar period, we find that changes in reserve requirements were almost always compensated or overcompensated by open market operations in the opposite direction. The net effect of such actions was expansionary with respect to the money supply in periods deemed to be inflationary (1948) and contractionary in periods of recession (1949). For a more complete discussion, see Brunner and Meltzer, An Analysis of Federal Reserve Monetary Policymaking, prepared for the House Committee on Banking and Currency (1964).
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\[ M = mB^* \]  
\[ m = \frac{1 + k}{(r + e - b)(1 + t) + k} \]  
\[ r = \frac{r^d 3D + r^* T + v}{D + T} \]

It can be seen that the changes proposed by the various committees would alter \( r^d \) or \( r^r \) and would remove \( \delta \) and \( r \) from equation (3). The initial effects of these rearrangements occur through the changes induced in the money multiplier, \( m \). The elasticities of \( m \) with respect to \( r^d \) and \( r^r \) are approximately \(-2.2\) \( r^d \) and \(-1.15\) \( r^r \). These values permit us to obtain the approximate changes in the money multiplier resulting from changes in \( r^d \) and \( r^r \) if values are assigned to \( m \) and the two policy variables.

Repeated applications of data to the money supply hypothesis suggest that \( m \) has remained in the neighborhood of 2.5 in the postwar period. If \( r^r \) is reduced from its current value, .04, to zero, as proposed by the CMC, the direct effect on the money supply would be to raise the elasticity of \( m \) with respect to \( r^r \) from its current value, \(-.046\), to zero. Similarly, a reduction in the weighted average of required reserves against demand deposits to a uniform value of \(.10\) would raise the elasticity of \( m \) with respect to \( r^d \) by approximately \(.10\) to \(-.22\).

Neither change would have a substantial effect on the relation between policy operations and the money supply or on the size of the money multiplier, \( m \), in equation (2). The hypothesis implies that the two requirement ratios are related to the rate of change in the money supply in an approximately linear way. Specifically, logarithmic differentiation of equations (1) and (2) shows that we obtain the policy variables and other elements multiplied by an appropriate elasticity, \( e^r \).

\[ \frac{dM}{M} = \frac{dB^*}{B^*} + e^d \frac{dr^d}{r^d} + e^r \frac{dr^r}{r^r} + e^k \frac{dk}{k} \]

A reduction in \( r^d \), or the elimination of \( r^r \), would not eliminate any of the parameters expressing the behavior of the banks and the public that are components of the elasticities, \( e^r \), in equation (4). However, each \( e^r \) changes when there are adjustments in the requirement ratios, since the weighted average \( r \) is a component of the \( e^r \). Thus the proposal to set \( r^r = 0 \) would remove one minor source of variation in the relation connecting the policy variables and the allocation ratios, \( k, t, e, \) and \( b \) with the money supply. But this would be true for any constant value of \( r^r \), including the present value. Lowering \( r^r \) (or \( r^r \)) would raise the growth rate of the money supply, but this could be accomplished, of course, by open market operations, i.e., by changing \( B^* \).

By a very similar procedure, the money supply hypothesis can be used to evaluate some effects of other proposed changes in monetary arrangements. Doing so, we would find that the application of equivalent reserve requirements to member and non-member banks would have a small effect on the size of the money multiplier also. The weighted average of reserve requirements, equation (3), would be raised by this action, offsetting in whole or part, the reduction of reserve requirements to a lower level (the \( 10\% \) proposed by the Advisory Committee) or the introduction of marginal

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13 See Karl Brunner and Allan Meltzer, op. cit., table 2.
14 It should be stressed that \( m \) is not a constant, but depends on the behavior of the banks and the public as well as on the policy choices made by the monetary authorities.
15 The relation is only approximately linear because we assume that the \( e^r \) are constants. Detailed analysis suggests that major changes in these elasticities have occurred primarily when there are changes in reserve requirements.

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reserve requirements graduated by deposit size in place of the present system. Whatever net effect these changes in policy arrangements might have would appear through the $e^*$ in equation (4). The lasting significance for the rate of change of the money supply of adopting the proposed regulations depends on the extent to which changes in reserve requirements are used in the future as a policy instrument. If the requirement ratios are maintained at the lower (higher) level, the growth rate is permanently higher (lower). Financial Institutions is silent about future discretionary changes; the Advisory Committee seems to favor limitation of the power of the Federal Reserve to introduce large fiat changes in the requirement ratios.

Some additional effects of imposing member bank reserve requirements on non-member banks must be considered in a careful analysis. The report suggests that uniform, compulsory requirements for banks of equal deposit size would achieve most of the aims of compulsory Federal Reserve membership. It does not clearly indicate what these aims are. However, we can infer that membership in the FDIC or par collection of all checks are not an important part of the aim, since the report does not require either. Nor does the report give much consideration to the effect on the income of non-member banks, and the consequent reduction in their number. While the aggregate effect on the money supply of the elimination of such banks is perhaps minuscule, the effect on the local communities that these banks serve should be compared to the gain, if any, in monetary control.

Furthermore, it should be noted that the so-called slippage in monetary policy resulting from non-uniform requirements occurs primarily in the very short run. Evidence supporting the money supply theory outlined above suggests that the influence of policy changes on the money supply can be predicted closely within the framework described. There is little evidence that shifts of deposits from member to non-member banks (or from country to reserve city banks) seriously impaired the degree of control in the postwar period. To the extent that such problems arise, they are of extremely short-term — daily or weekly — significance. The proposal for marginal reserve requirements that increase with deposit size would produce similar disturbances when deposits are redistributed from banks with low marginal reserve requirements to banks with high marginal requirement ratios. But why should the Federal Reserve or the Committee be concerned about these changes in the reserve position of individual banks? It is difficult to demonstrate that the Federal Reserve has used its power to alter reserve requirements wisely or well. I have already referred to the overcompensation of changes in requirements that was a feature of early post-war policy. Compensation for reserve requirement changes by offsetting open market operations also has been a feature of several of the post-Accord changes in the requirement ratios. Even if we disregard the misuse in 1936–1937 of the power to alter reserve requirements, we are left with the question of the desirability of retaining the power to vary these requirements and the rationale for such changes. Moreover, the present size of the government security portfolios of the reserve banks and the financial institutions vitiates the hoary argument that the market or the reserve banks will not have a sufficient volume of securities with which to engage in open market operations. The failure of the Federal Reserve to analyze the position of the requirement ratios in the monetary mechanism, the availability of alternative policy instruments, and the increased stability of the $e^*$ that would result suggest that the two ratios might usefully be frozen. The precise levels for these ratios can then be decided after a detailed analysis of the competitive aspects of the banking industry and the probability of increased or curtailed service to the public in small or single bank communities associated with particular arrangements.19

17 Both the CMC and Advisory Committee suggested steps to stamp out non-par collection.

18 There is considerable evidence in the published statements of ranking officials and staff members and in the Record of Policy Actions that they are concerned. For a discussion of this question, see Brunner and Meltzer, An Analysis of Federal Reserve Monetary Policymaking.

19 In Brunner and Meltzer, op. cit., we find that the effectiveness of changes in rediscount rates or in reserve requirements depends directly on the interest elasticity of the supply of assets to banks by the public (including financial intermediaries). If this elasticity is zero, neither
The report makes few suggestions designed to improve the adequacy of existing arrangements for transmitting monetary policy. If there is a lag, as is widely believed, between the effect of open market operations on bond rates and the effect on mortgage markets, institutional rearrangements might usefully contribute to the reduction in the length of the lag. Restricted use of open market operations in mortgages—e.g., FHA 20- or 25-year mortgages—by the Federal Home Loan Banks could be used to speed the transmission of monetary policy to the housing market. In addition to whatever desirable effect this might have on the transmission mechanism of monetary policy, such operations would doubtless aid in the development of a secondary mortgage market. Furthermore, by reducing illiquidity premia or transactions costs on certain classes of mortgages, the development of a secondary market might contribute to the adoption of a more uniform mortgage contract and the reduction of the legal barriers to a uniform contract imposed by several states. Faced with the choice of their present law or higher interest payments for their citizens, many states may become more willing to review their existing mortgage laws than they have been in the past. 

Regulatory Equality For Non-Bank Financial Institutions 

Perhaps the most controversial recommendation in Financial Institutions calls for the "... introduction of a similar reserve requirement [to banks] for shares at saving and loan associations and deposits at mutual savings banks." (p. 18.) The Committee reached the conclusion opposite to the CMC, although it made use of much of the same information. After rejecting the arguments based on the destabilizing effects of the existence of close substitutes for money, Financial Institutions chose to favor reserve requirements for reasons of "... liquidity, equity and supervision." For much the same reasons, the Committee decided that interest rate regulation on time deposits should be on a stand-by basis for commercial and mutual banks and savings and loan associations. 

The arguments for required reserves for some intermediaries do not reflect serious consideration of the issues involved and offer little indication of how the proposed regulations would operate. If the Federal Home Loan Bank (FHLB) raised cash requirements, would the savings and loans (S & L) be expected to sell mortgages? Would time be allowed for the acquisition of reserves through mortgage repayments? Or would the S & Ls borrow from the FHLB? Under present arrangements, associations may borrow for as much as ten years and loans of less than one year generally do not need to be amortized. Furthermore, we read that, "... individual institutions should manage their portfolios so that, in ordinary circumstances, they can meet their own liquidity needs." (p. 16.) And on the following page, we are told that the cash reserves should be used for advances to the members only in case of substantial and widespread withdrawals of funds. How then would the requirements help to meet the variable day-to-day demand for cash assets by savings institutions? What purpose would the requirements serve? The report answers by suggesting that the power to impose reserve requirements would strengthen the hand of the FHLB when requesting higher liquidity ratios from the member associations. The members "... would become more acutely conscious of the role of the Federal Home Loan Bank System as a governmental institution operating in the public interest." (p. 17.)

The report suggests that "awareness," by
which they apparently mean an increase in administrative power, would encourage the savings associations to consider more carefully the requests of the FHLB that they acquire non-interest earning assets or maintain a greater proportion of their portfolios in government bonds. While analogies are often rightly suspect, it should be noted that few would argue that Federal Reserve "moral suasion" has had much impact on bankers or that Federal Reserve exhortations have been responsible for increases in the capital/deposit ratios of commercial banks.

The liquidity and "awareness" arguments do not seem to be fully developed. The "equity" argument is even weaker. The report suggests that there is an inequity because commercial banks maintain reserves against time and savings deposits while savings associations do not. Since the Committee does not wish to follow the CMC and eliminate reserve requirements for commercial bank time and savings deposits, "equity" is achieved by imposing the requirement on savings institutions. By such arguments administrative powers can continually grow. It is generally accepted in our society that the growth of power by administrative agencies should, at a minimum, be supported by reference to some desirable, public purpose and by some evidence that the proposed administrative arrangement is somehow related to the public interest.

If some insured savings institutions or commercial banks take risks that might lead to failure, is it the business of government to protect the institutions? The report correctly notes that simultaneous failure of a large number of financial institutions is a problem that can only be handled by an increase in the monetary base. The low rate of failures of commercial banks and savings institutions, and the high profit rates of many savings institutions in the recent past, suggest that there may be large elements of monopoly resulting from the chartering and supervisory practices of the regulating authorities. If this is the case, more competition rather than more supervision is the recommendation that would seem to follow from economic analysis.

The report suffers from the viewpoint of agencies like the FDIC that equate protection of the public with protection of the financial institutions. If the insurance system is presently unable to cope with the problem of varying attitudes toward risk among the member associations and incomplete coverage of the public's deposits or share accounts, that problem should be met directly by full insurance coverage and premiums that increase with portfolio risk. It is surprising that none of the reports suggested that insurance of deposits or shares should be graduated according to management's decision about the extent of desirable risk taking.

Transition to a system of insurance with premiums graduated by the risk of the asset portfolio would not be difficult in principle. All insured financial institutions are subject to periodic audits and scrutiny of their assets. Formulas have been developed to assign assets to classes roughly corresponding to risk. Management would be faced with explicit marginal costs that rise with the acceptance of greater risk. With 100% insurance of deposits or shares and premiums graduated according to risk, institutions need not be protected from the consequences of decisions by the management.

The Committee's proposal to remove interest rate ceilings and substitute stand-by controls is a desirable step in the direction of greater competition among financial institutions. But the Committee does not follow this proposal with a suggestion for substantially greater freedom for financial institutions to invest in assets of their choice. Only a few hesitant steps are made in this direction. The Committee does not take a position on freedom of investment policy as a means of increasing competition. Nor does the Committee seem aware that the cost of administering and offering a wide range of services and of obtaining information about the characteristics of particular instruments would impose a limit on the extent of diversification.

It is most unlikely that unrestricted rights to acquire assets would destroy the specialized financial institutions that the Committee deems to be desirable. Information is costly and search is expensive. Specialized knowledge acquired for use in the mortgage market, e.g., techniques of property valuation, knowledge
of future development of local areas, of legal and institutional restrictions on building, etc., are not easily applicable to the problems of consumer credit, municipal bonds, or business loans. Testimony to this effect is clearly given by the rich variety of specialized financial institutions marketing or distributing various securities and the variations in the amount and kinds of services offered by particular commercial banks. The expected life of institutions that ignored such costs and plunged headlong into portfolio diversification would not be long.

Unrestricted portfolio choice for financial institutions coupled with deposit or share insurance that is graduated according to asset risk would induce more competition among financial institutions and eliminate some of the haphazard institutional restrictions that presently exist. It is unfortunate, in my view, that the Committee on Financial Institutions retreated from the start made in this direction by the CMC and seemed more concerned about increasing administrative power than in providing a more rational set of institutional arrangements.

The Committee shows no clear awareness that restrictions previously imposed on the financial system have played a dominant role in determining the relative growth rates of the various intermediaries. It is inclined to treat such problems in terms of equity rather than economics. Given the larger wealth elasticity of the public’s demand for time and savings deposits than for demand deposits, increasing wealth implies a fall in the ratio of money to money plus time and savings deposits. Restrictions of the growth rate of the monetary base help to produce periods of relatively high interest rates. During such periods, the prohibition or limitation of payment of interest on demand and time deposits, or the limitation on portfolio acquisitions encourage the relative growth of unrestricted or less restricted intermediaries. Should we not expect that new or continued regulations that reduce the competitive position of mutuals, savings and loans or commercial banks relative to insurance companies, credit unions or some new type of intermediary will ultimately lead to the relative decline of existing institutions and the relative growth of alternative financial arrangements? Present arrangements that impose different costs or reduce revenues for particular intermediaries suggest a positive answer to the question posed. Since little or no validated analysis justifying the restrictions has been presented, it would appear that the CMC reached the more appropriate conclusion: Remove the source of the “inequity”; do not compound it by further administrative restrictions.

In the present controversial areas of branching and bank supervision, the Committee did not take a strong stand. It called for more study and closer coordination but did not accept the recommendations of either the Advisory Committee or the CMC. The latter groups proposed some liberalization of branching in the interests of increased competition and the consolidation of supervision within one or two agencies to reduce interagency disagreements. Doubtless, the presence of representatives of the FDIC, the Comptroller, and the Federal Reserve and our inadequate knowledge contributed to the difficulty of obtaining agreement.

Studies now under way or recently completed by the House Banking and Currency Committee and the State of New York should assist in the development of a more appropriate policy in this area. Information not available to the Committee — the early evidence from New York — seems to suggest that more liberal branching policies would contribute to competition among banks and improved service for the public.\(^{22}\)

**Federal Credit Agencies**

While both private financial institutions and federal credit agencies are shaped in varying degrees by government action, the two types of intermediaries are essentially different. One group emerges to satisfy demands in response to profitable market opportunities. The other most often is chartered because of the supposed failure of the private market to satisfy particular types of borrowers by offering a “sufficient” volume of loans at rates deemed by

\(^{22}\) New York State Banking Dept., Branch Banking, Bank Mergers, and the Public Interest — A Summary Report (Jan., 1964).
CONGRESS to be sufficiently low. There is, of course, a feedback from one type of institution to the other. The development of new federal credit agencies, or the provision of guarantees for particular types of loans, alters the risks and returns faced by private lenders. Similarly, the development of specialized private financial institutions, or changes in the lending practices of existing institutions, reduce the area in which federal credit agencies operate.

Credit programs have been a popular device (possibly second only to tax adjustments) by which Congress has aided particular groups or programs in accordance with its judgments about desirable public purposes. At their best, these programs reduce information costs about the risks inherent in particular types of loans, undertake experiments designed to improve market arrangements, reduce transaction costs, and permit external economies to become internalized. The pioneering work of the FHA in the mortgage market is perhaps the best known case of reduction in private cost at close to zero social cost.  

The CMC suggested a number of guidelines for existing programs and criteria applicable to new programs. Federal Credit augments the earlier report and attempts to make some of the suggested guidelines operational by indicating some standards and procedures for existing programs. As noted above, President Kennedy accepted the principal conclusions and took steps to see that they were applied.

Space does not permit any detailed treatment of the recommendations. In general, the report favors solutions to credit problems by the private economy or the participation of private lenders in government programs, flexible interest rates on programs under government guarantee, the elimination of disguised subsidies masked as loans, no new programs that guarantee tax-exempt securities, the elimination of provisions that permit private lenders to shift insured securities to the government when they decline in market value, and similar suggestions designed to eliminate hidden subsidies.

The report makes frequent references to the "imperfections of the private credit system." Hopefully, we will at some time in the future have an operationally useful definition of this commonly used term. It is perhaps too much to ask that a report of this kind would attempt such a definition, but it does seem to have important bearing for the choice between direct subsidies, government loans or guarantees, and private credit.

Conclusion

Judging from many of the reviews, economists tended to dismiss the recommendations of the CMC as inconsequential or lacking in imagination because they failed to suggest any major institutional changes. But the report was not without impact. It stimulated a great deal of attention to present financial arrangements within the government, gave rise to a number of other reports, to congressional interest and proposals for new legislation, and was partly responsible for the renewed attention to the details of existing arrangements and studies of the structure of the banking system.

The two reports discussed here are a direct outgrowth of the CMC recommendations. The suggestions of the Committee on Federal Credit Programs parallel many of the CMC guidelines, provide the details necessary for their application, but leave the decision about new programs to Congress. Steps have now been taken to carry out the recommendations and to assure their continued application. It seems reasonable to conclude that the CMC was largely successful in achieving its aims with respect to federal credit programs.

Many of the modest changes proposed by the CMC in the area of financial institutions were not acceptable to the agencies represented on the Committee on Financial Institutions. In general, the Committee retreats from the CMC suggestions with the notable exception of a poorly supported recommendation for reserve requirements for non-bank savings institutions.

Most of the suggestions in the Committee report have not been implemented. It would seem desirable that before such changes are made, economists might usefully attempt to
provide a more fully validated framework blending present arrangements into monetary theory so that we may more fully appreciate their significance. Since it is unlikely that anyone would deliberately design a financial system like that of the United States, future changes might improve the present financial arrangements in a number of ways, e.g., by increasing competition, eliminating arbitrary and poorly used administrative power and improving the transmission mechanism connecting monetary policy with the pace of economic activity.

Toward those ends this reviewer offers a few suggestions falling within the area encompassed by the Committee reports. These include: (1) elimination of Federal Reserve authority to change member bank reserve requirements; (2) deposit insurance premiums graduated with asset risk and accompanied by (3) removal of restrictions on asset portfolios of lenders; and (4) open market operations in mortgages by the Federal Home Loan Bank Board. Hopefully, these suggestions (and others) will one day be appraised within a validated theory connecting monetary and financial institutions with economic theory so that we will be in a better position to carry out the task that the President assigned to his committees and to review the conclusions.


(Continued on back cover)
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