Chapter Four: The S&L Industry Deregulated: Out With the Old, In With the New

Ronald Reagan, according to one 1990 *New York Times* op-ed, "set [sic] table for savings and loan orgy." The author blamed Reagan's deregulatory policies for the savings and loan industry's collapse; he argued,

> It was Ronald Reagan's deregulation program that freed the savings and loans from the restrictions of their historical role. The Reagan administration made good on its promise to get Government off the back of business, with a special bonus for the savings and loans: they were given the changes to make large, high-risk loans without risk to themselves….Lifting the restrictions on loans while leaving Government insurance in place was a prescription for disaster, even without the fraud and corruption that developed.[1]

This interpretation understandably linked deregulation to Reagan since he made deregulation a centerpiece of his initial economic program, but it neglected three important aspects of the political evolution of deregulation as a viable policy alternative to thrift instability. One, the Carter administration's extensive regulatory reform initiatives. Two, the rhetorical claims for the benefits of deregulation that became part of President Jimmy Carter's legacy. Three, the inescapable structural challenges that the S&Ls faced long before Reagan entered the White House in 1981.

The legislative and regulatory processes that propelled S&Ls beyond their historic role as depository institutions that transferred working- and middle-class savings into home mortgages actually began shortly after the 1966 credit crunch. It then quickly accelerated during the Carter presidency. It was Carter, not Reagan, who signed the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) into law.

---

[1] Edgar Villchur, *NY Times*, "Reagan Set Table for Savings and Loan Orgy," August 23, 1990.

Justifications offered for DIDMCA simultaneously participated in the deregulatory discourses coming into vogue in the late 1970s and represented, in many respects, a significant deviation from previous congressional policies that had for decades maintained a protected niche for the thrifts. Just as important, the Carter administration designed and pursued, and in several industries achieved, extensive deregulatory changes. In fact, Carter's regulatory reform rhetoric closely mirrored that of Gerald Ford and, often times, clearly anticipated the languages later adopted by Ronald Reagan. If regulatory reform rhetoric offered during the Carter and Reagan presidencies is analyzed for its ideological assumptions, one must conclude that both presidential administrations heavily relied upon ideologically grounded frameworks to interpret, explain, and rectify the increasingly unstable S&L industry. Carter and Reagan administration criticisms of regulation focused upon its inflationary, expensive, expansive, and undemocratic effects. Their proposed solutions demonstrated their faith in the inherent efficiency and effectiveness of markets.

Despite the increased political and economic saliency of deregulation by the late 1970s and early 1980s, Carter and Reagan administration policies, according to William Black, a lawyer who served in various capacities at the Federal Home Loan Bank Board (FHLBB) and Federal Savings and Loan Insurance Corporation (FSLIC) during the 1980s, significantly worsened eventual S&L losses. Black claimed their policies fostered a "criminogenic" environment that created both a corporate and a regulatory moral hazard that stemmed from the asymmetrical nature of risks and rewards for the former and a desire to disallow failure on "his watch" for the latter.[2] This chapter examines the ideological leanings

[2] William Black, *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry*, passim. Black was a litigation director for the FHLBB between 1984-1986, the Deputy Director of the FSLIC in 1987, the General Counsel to the FHLBB, San Francisco from 187-1989, and the Senior Deputy Chief Counsel at the Office of Thrift Supervision, which replaced the Federal Home Loan Bank

that were operative in each administration as they pursued financial sector regulation. It also evaluates their distinctive assessments of the requirements of the evolving regulatory and political contexts, which they could not entirely control.

Nominating a FHLBB Chairman in the Carter Years: Competing Democratic Constituencies

As national defense experts, economists, and businessmen traveled to Plains, Georgia to advise the president-elect in the two months before his inauguration, one of Carter's "respected Georgia friends," J. Robin Harris, sent him a letter.[3] In it he emphasized two critical points concerning Carter's two upcoming Federal Home Loan Bank Board (FHLBB) nominees. Both will "materially affect the lives of millions," he counseled, and they "are extremely critical to the future success of the Board." Carter apparently understood the magnitude of those appointments. As he forwarded Harris' letter to Chief of Staff Hamilton Jordan, he wrote into the margin, "Good—top positions for us to fill."[4]

Carter administration officials fully realized that the Bank Board's next chairman faced a daunting task of overseeing and regulating an S&L industry that one Carter staffer suggested was "at a point of potentially substantial change." The Senate Subcommittee on Financial Institutions, according to congressional staff members who spoke to Carter administration officials, intended to introduce legislation that would allow S&Ls to broaden their consumer services. Doing so would make S&Ls more competitive with commercial

---

Board as the regulatory agency of federal savings and loan institutions after the passage of FIRREA. Black identified "control fraud" as the true cause of the thrift crisis. Control fraud (which he used to refer to both the idea and those perpetrating them) was essentially accounting fraud orchestrated by thrift executives. These CEO's and managers possessed the power to limit or eliminate internal and external controls; they used lawyers and auditors to deceive market participants by generating false income and hiding losses. The "criminogenic" environment of the early 1980s pushed—or damn near demanded—that thrift owners make risky investments because corporate limited liability dictated they were only responsible for the loss of stock prices, not corporate debts.

[3] March 15, 1977 Memo, Butler to Jordan, "Federal Home Loan Bank Board Chairman"

[4] Harris letter, Jan 3, 1977, Harris to JC letter_Recommendations for FHLBB Chairman

banks since additional asset powers would expand the range of services and products individuals could consume at their neighborhood thrift.[5] Administration officials also identified several "major issues facing [the] Board": urban reinvestment, alternative mortgage instruments, consumer protection, additional asset powers, Regulation Q, sexual and racial discrimination in U.S. housing and credit markets, branch banking powers, and mutual/stock convertibility. They also observed that the two previous FHLBB chairmen, Preston Martin (1969-1974) and Thomas Bomar (1974-1975), had both been "Californians"; consequently, they suspected Martin's and Bomar's policies and industry perceptions had quite possibly unintentionally favored the "large, state chartered stock institutions under holding company control" of California, as opposed to the "generally smaller in size" institutions "in other parts of the country" that tended to be mutual associations.[6]

As Carter administration officials began to vet potential candidates in this tumultuous and fluid context, they concluded that their nominee should "appeal to three groups: 1) consumer groups, 2) savings and loan associations (progressive and conventional), and 3) commercial banks."[7] Additionally, the nominee should ideally support and represent Carter's views on housing, possess a "sound knowledge of the structure" of the S&L industry, remain personally autonomous even as he maintained the industry's respect, reflect a consumer-oriented approach, exhibit "sound political judgment and an ability to mobilize support for programs and legislation," effectively articulate FHLBB policies and programs, and demonstrate "solid administrative abilities."[8] Months quickly passed after Carter's inauguration, and the FHLBB chairmanship remained vacant. Political observers at the time

---

[5] Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB"
[6] Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB"
[7] Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB"
[8] Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB"

speculated that the Carter administration "paid little attention to appointments to the little-known, but powerful agencies which oversee the giant U.S. financial industry." Given the administration's "slow pace of appointments" at the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and FHLBB, such speculation clearly was not just journalistic whistling.[9]

More than potential administrative ineptitude, however, was to blame for the slow moving Carter regulatory appointment apparatus. Identifying suitable nominees in the complex and often incongruous world of interest group politics took time, a political complication that partially helped explain the six-month time lag between Carter's inauguration and Robert McKinney's nomination to head the FHLBB on June 23, 1977. Carter stated time and again on the campaign trail that "regulators shouldn't come from the industry they regulated."[10] Ralph Nader's Consumer Federation of America and other consumer interest groups expected Carter to keep that promise.[11] Additionally, administration officials needed to balance the interests of the U.S. League of Savings Institutions, whose opinion they actively sought, with those of commercial bankers, housing lobbyists, civil rights advocates, Carter's "Georgia S&L friends," and key legislators such as Senator John Sparkman (D, MS) and Senator Thomas McIntyre (D, NH).[12]

Despite administration officials identifying ten potential candidates as early as March 1977, none of them worked out. One appeared "experienced, but undistinguished." Another

---

[9] James Rowe Jr., "Problems Arise from Slow Pace of Appointments," *The Washington Post*, July 5, 1977
[10] Memo, Geno Baroni to Jay Janis, April 26, 1977; "McKinney Nominated by Carter to Head Home Loan Baord," *Wall Street Journal*, June 24, 1977.
[11] Memo, Lisbeth Godley to Landon Butler, February 22, 1977.
[12] Memo, Landon Butler to Hamilton Jordan, March 15, 1977. See also, Memo, Lisbeth Godley to Landon Butler, February 22, 1977; Memo, "Federal Home Loan Bank Board re: John Heiman," March 4, 1977; Memo, Ron Royal to Landon Butler, March 2, 1977. TALK ABOUT SPARKMAN'S RELATIONSHIP TO GRADY PERRY, SPARKMAN'S CHAIRMANSHIP AND MCINTYRE, as Chairman of Subcommittee on Financial Institutions intentions to submit legislation to reform S&Ls.

"superficial" and "strongly opposed by Ralph Nader." Another failed because it would have been "hard to rationalize placing a former industry lobbyist in charge of the agency that regulates the S&L industry." Highlighting the downside of racial politicking and also providing a poignant example of the institutional roadblocks minorities faced as they continued to fight for economic equality, administration officials passed on Pazel Jackson, the "candidate…most acceptable to all interested parties," because "we already have a black person as Secretary of DHUD, and another black might simply be too much, especially to an industry that is as conservative the S&L industry."[13] Even though the mayor of Indianapolis described the eventual nominee Robert McKinney as not "overly sensitive to inner city needs" or "active on issues affecting the minority community," Pazel Jackson's chances slimmed even further after a New York-based public interest group told an administration official that Jackson had "not fought redlining—or at least not successfully."[14] As Jordan subsequently advised the president, "I think we can do better."[15]

Back in January, Robin Harris had encouraged Carter, regardless of Nader's condemnation of the "revolving door syndrome," to nominate a "person knowledgeable about and with first-hand experience in the management" of an S&L. The FHLBB needed a chairman, Harris claimed, who was "capable of translating proposed actions into practical effects." Mindful that Carter had two upcoming nominations to the FHLBB, he advised Carter to nominate a lawyer as well. A lawyer, Harris insisted, would "understand the legal consequences of the [Bank Board's] actions…without having to rely solely upon staff

---

[13] Memo, Landon Butler to Hamilton Jordan, March 15, 1977. Landon Butler described Jackson as "probably the most knowledgeable black man in the country on housing, mortgage financing, and savings institutions."
[14] Memo, Jay Janis, April 15, 1977; Memo, Hamilton Jordan to Jimmy Carter, April 18, 1977; Memo, Laurie Lucey to Landon Butler, March 18, 1977.
[15] Memo, Hamilton Jordan to Jimmy Carter, April 18, 1977

counsel."[16] Finally in June, apparently taking Harris' recommendations to heart, Carter nominated Robert McKinney, a successful lawyer and businessman from Indianapolis. His comparatively discrete tenure as the Chairman of First Federal Savings and Loan Association of Indianapolis, Hamilton Jordan claimed, "would therefore bring to the job of FHLBB Chairman a working knowledge of the S&L industry, but he would not be perceived as an industry representative." And despite the aforementioned reservations regarding McKinney's previous interest, or lack thereof, in reducing redlining in Indianapolis, both Senator Birch Bayh (D, IN) and Indianapolis mayor Richard Hatcher, whose confidence was later relayed to President Carter, strongly believed that McKinney "would be a loyal member of the Administration who would carry out consumer and neighborhood programs with enthusiasm and ability."[17]

Within days of McKinney's "possible appointment" going public in April 1977, several community organizations based in Indianapolis contacted the Consumer Affairs and Regulatory Functions Office at the Department of Housing and Urban Development. They raised concerns that a McKinney nomination "seems contrary to the President's campaign promises to appoint persons to regulatory positions who are not products of the industries they will be regulating." They also described McKinney as "uncooperative" when their coalition of neighborhood organizations had attempted, a few years prior, to "negotiate reinvestment programs"—an accusation that evidence later bore out.[18] Other civil rights, labor, consumer, and congressional leaders, including the Congressional Black Caucus and

---

[16] Letter, J. Robin Harris to Jimmy Carter, January 3, 1977.
[17] Memo, Hamilton Jordan to Jimmy Carter, April 18, 1977.
[18] Memo, Geno Baroni to Jay Janis, April 26, 1977. See also letters, January 20, 1975; Febraruy 3 & 11, 1975; report, July 16, 1974.

Senator Proxmire, strongly opposed McKinney's nomination. They accused his savings and loan of redlining, identified potential conflicts of interests, and alleged political nepotism.[19]

Carter's nomination of McKinney highlighted his willingness, at least within the world of financial regulation, to reject political pressures from both old and new Democratic constituencies. Even in the face of significant lobbying pressure from consumer, labor, housing, and civil rights advocates to end redlining, limit "special interests," and prevent regulatory capture, the Carter administration risked appearing beholden to S&L interests in order to pursue regulatory reform efforts that aimed at making government regulatory structure more efficient.

The contentiousness of the nomination process was not lost on McKinney however. Only two months after his confirmation, he explained to an audience of S&L executives in Houston, "The confirmation process showed how important the Bank Board is to a number of people, including, of course, the Congress….It is time to broaden our perspective." McKinney clearly understood the moment as one in which the political and intellectual justifications for regulation continued to change. Even as popular and political forces bemoaned anti-competitive and cost-increasing economic regulations, those same advocates increasingly argued for social regulations that guaranteed workers' safety and protected the environment as well. But McKinney also realized that many policymakers and voters still viewed financial institutions as unique; they expected financial executives to promote and

---

[19] Memo, Hamilton Jordan to Jimmy Carter, April 18, 1977; Memo, Geno Baroni to Jay Janis, April 26, 1977; letter, XXXX to Jimmy Carter (joint letter?!), May 11, 1977; letter, Parren Mitchell to Jimmy Carter, May 11, 1977; letter, William Taylor to Landon Butler, May 12, 1977; letter, William Proxmire to Robert McKinney, June 28, 1977; and letter, Parren Mitchell to Jimmy Carter, May 26, 1977. Alleged conflicts of interests resulted from McKinney's business involvements in his S&L, his law firm, several mortgage companies, a title insurance company, a commercial bank, a real estate company, and several life insurance companies. McKinney was also a classmate of Carter's at the Naval Academy. He served as the Carter Campaign's Indiana Chairman in both the 1976 primary and general elections and was also the Caucus Chairman at the 1976 Democratic Convention.

pursue investment strategies that also responded to community's needs and problems—not just to the bottom line. In this vein, McKinney reminded his audience,

> We would be making a very great mistake if we somehow think that society will pass the financial community by….Society, through its elected officials, is beginning to call the financial community to account. This process is going to continue….It could even lead to credit allocation schemes…if the financial community is perceived by society at large as unresponsive to its needs, its problems.

Clearly a scare tactic to convince S&L executives to earnestly address urban blight, this veiled threat also undoubtedly deeply resonated with many thrift managers in the audience, as well as with those who were not, given the overwhelming bipartisan support for the only days-old Community Reinvestment Act (1977).[20]

Despite his alleged "uncooperative" track record in Indianapolis, McKinney now unequivocally explained to his Texas audience, "I believe, without any qualification or reservation whatsoever, that you have a legal and moral obligation to lend in your local communities….The savings and loan industry should serve the housing needs of our urban areas." Years before Reagan promoted his "new federalism" agenda, then, and at the same moment that second layer lenders helped further nationalize American primary and secondary mortgage markets, McKinney argued that urban renewal and community reinvestment strategies "must be done and only can be successfully accomplished at the local level. It must be a people program, not a federal money program." A life-long Democrat, chairing a small but mightily significant federal regulatory agency, appeared distasteful of government efforts to oversee efforts to stop racial discrimination within American housing

[20] Speech, Robert McKinney, October 21, 1977. NOTE ON CIVIL RIGHTS AND EFFECTS ON VIEWS OF CREDIT AND BANKING.

and credit markets. As Bob Dylan had recently proclaimed, "The times they are a-changin'."[21]

Just as important, McKinney expected, after some initial regulatory encouragement from the FHLBB, that the need for "the Board's incentives will fade away."[22] Financial executives, he hoped, "will find profitable opportunities in urban areas and you will need no prodding from government to seize them."[23] If only S&L executives could realize the vast potential of community reinvestment, he insisted, the moral would merge with the profitable. In fact, in many cities across the country, however, urban renewal efforts transformed urban blight into gentrified neighborhoods that attracted middle and upper class families—processes that only further disenfranchised many of America's most poverty stricken citizens, including many minority populations.

Carter's "Reorganization Project": Carter Administration Pursues Regulatory Reform

As the president-elect prepared his inaugural address, advisors Simon (Si) Lazarus and Harrison Wellford suggested to Carter that "government reform and reorganization…may be worth particular emphasis in the inaugural, since the tight economic and financial situation reduces the prospect for new initiatives in social policy as major achievements."[24] They cautioned, however, that pursuing regulatory reform "will likely produce long, drawn-out struggles" over "complex and often dull issues," and only produce "small, undramatic victories and possible even "some visible losses." Nevertheless, they still

---

[21] Bob Dylan, "The Times They Are A-Changin'." 1964
[22] Give example of incentive McKinney discussing here.
[23] McKinney also established a FHLBB task force to study urban lending problems. They concluded: XXXX
[24] Harrison Wellford, PhD in Government from Harvard and JD from Georgetown University, headed the Government Reform Task Force for Carter's transition team. He also served as the Executive Associate Director of OMB in the Carter administration. Simon Lazarus, JD from XXXX, served as the Associate Director, Domestic Policy Staff.

believed the issue carried enough political saliency to gamble Carter's electoral mandate on regulatory reform. Carter, they believed, could "inject drama" into his inaugural, which "should signal to the public that much of the excitement and achievement they should expect to emanate from Jimmy Carter's Washington will relate to government reform and reorganization."[25]

Even though Carter focused on other themes in his inaugural address, Carter and several of his staffers "made a strong and visible commitment to regulatory reform," both throughout the 1976 presidential campaign, as discussed in the previous chapter, and from the "outset" of the Carter administration.[26] As of January 20, 1977, administration officials had already penned "several planning memos" that outlined legislative priorities, crafted "workplans," and identified "new tools" to pursue its own regulatory reform agenda.[27] Before the end of January, Carter authorized a cabinet sub-group, the Regulatory Working Group, to "review the proliferation of regulations, guidelines, bulletins, and other paperwork issued by the federal government, including, but not limited to, regulations under OSHA, HEW, EPA, and ERISA." Carter instructed its chairman, "I don't want to fiddle around the edges of the problem. Get to the heart of it with drastic reductions."[28]

Carter personally wanted regulations "written in plain English," regulatory officials held accountable, agency heads "more involved in the regulatory process," and competition to replace regulations "wherever such action would better serve the public interest."[29] Offering, probably unknowingly, a Hayekian interpretation of the relationship between

---

[25] Memo, Harrison Wellford and Si Lazarus to Jimmy Carter and Jody Powell, January 6, 1977.
[26] Memo, Bert Lance to Jimmy Carter, August 3, 1977. He did stress in his inaugural, however, the importance of a "competent and compassionate" government.
[27] Memo, Bill Drayton to Harrison Wellford, January 17, 1977.
[28] Memo, Jack Watson to Jimmy Carter, January 30, 1977.
[29] Memo, Bert Lance to Jimmy Carter, August 3, 1977. In another memo, CEA member Lyle Gramley replaced "competition" with "incentive mechanisms." See Memo, Lyle Gramley to Charles Schultze, March 25, 1977.

governments and markets, other administration officials acknowledged how businessmen, academics, consumers, and interest groups decried the uncertainty and unpredictability that regulations produced, which they claimed resulted in fewer capital investment opportunities and needless government interference in the market.[30]

Si Lazarus, spokesman for the Regulatory Working Group, offered several proposals to Carter that aimed to "remake the role of government" itself.[31] Regulation, "once considered [sic] highest expression of rational government and democratic control over private power," Lazarus claimed, now symbolized an "object of contempt—burden on people—drag on economy—source of division." For those reasons, Lazarus justified additional regulatory reform efforts when he adeptly acknowledged the public's growing hostility toward the "symptoms" of regulation—paperwork, overlap, and duplication—as well as the "many regulatory programs and approaches [that] are fundamentally obsolete, inefficient or ineffective."[32]

In August 1977, the Regulatory Working Group presented Carter the "President's Reorganization Project," their plan to restructure the American regulatory governance mechanism and reorient the expectations of policymakers and businessmen alike. Their proposals, if implemented properly, would "streamline the federal regulatory process," replace regulations with competition "wherever such action would better serve the public interest," "make it [regulation] more responsive to public," effectively train regulation writers, institute "common sense management strategies," initiate sunset review programs, and improve new regulation development processes.[33] They also proposed to "provide

---

[30] FIND FOOTNOTE FOR THIS.
[31] WORKS THAT SUGGESTED CARTER'S DEREG = ANTI-INFLATION.
[32] Memo, Si Lazarus to Larry Gilson, June 22, 1977
[33] Memo, Bert Lance to Jimmy Carter, August 3, 1977.

government-wide coordination…to reform the process of issuing new regulations, to review existing regulations and to reduce paperwork."[34] Carter incorporated most of these objectives into Executive Order 12044 (E.O. 12044), which he signed in March 1978 to "improve existing and future regulations."[35]

Of particular importance to policymakers who had in the recent past questioned the theoretical justifications for command-and-control regulation, Carter mandated regulatory agencies to conduct a "regulatory analysis," or an economic impact statement, on "regulations identified as significant." Since, as Carter argued, regulations "may have major economic consequences for the general economy, for individual industries, geographical regions or levels of government," the regulatory analysis provided policymakers with an opportunity to collect and evaluate large amounts of information so that they, Carter believed, more effectively identify and evaluate regulatory costs and benefits. In certain respects, Carter's "regulatory analysis" built upon President Ford's Inflation Impact Statement program that he initiated in November 1974. In executive orders issued by both presidents, Ford and Carter showed a keen interest in how regulation purported to limit competition and increase costs for consumers, businesses, and local/state/federal governments.[36]

But even as the Ford administration combated inflation, an effort that clearly involved the utilization of political and ideological assumptions regarding the "proper" functioning of

---

[34] Memo, Bert Lance to Jimmy Carter, August 3, 1977.
[35] Executive Order 12044, http://www.presidency.ucsb.edu/ws/index.php?pid=30539&st=&st1. Executive Order 12044 stated regulations needed to be simple, clear, effective, and efficient; they should also not "impose unnecessary burdens." E.O. 12044 required regulatory agencies that fell under the purview of the Executive Branch to publish semiannual agendas and regulatory analyses. Interestingly, independent regulatory agencies, which included the Federal Home Loan Bank Board, were exempted from these new requirements.
[36] Executive Order 11821, http://www.presidency.ucsb.edu/ws/?pid=23905; Executive Order 12044, http://www.presidency.ucsb.edu/ws/index.php?pid=30539&st=&st1;

the economy, its inflation impact statements maintained a relatively narrow focus that encouraged policymakers to study inflation's impact on wages, productivity, and competition. Carter's "regulatory analysis," on the other hand, significantly expanded the scope of inquiry by asking regulatory agencies to consider "the need for and purposes of" both existing and new regulations, which involved analyzing the structural, regional, and industrial costs and benefits of old and new regulations alike. As previously discussed, Carter also aimed to minimize compliance costs and paperwork burdens. Whereas Ford administration officials hoped that inflation impact statements forced regulators to carefully consider the inflationary impact of their proposals, Carter's E.O. 12044 pushed that policymakers to reconsider the necessity of existing regulations. It also complicated the process of issuing new regulations by requiring executive agencies to identify and consider lower-cost alternatives and create opportunities for "early participation and comment" by various public constituencies and other governmental agencies—ironically opening the door for further interest group influence.[37]

The economic impact statement requirement in E.O. 12044 no doubt pleased the thousands of corporations represented by the Business Roundtable, who specifically lobbied Si Lazarus to incorporate them into the administration's regulatory reform package. The Business Roundtable also pushed Lazarus to either install or train "analytic groups" within each executive agency that would complete the economic impact statements; the Business Roundtable feared "relying on present staff which is untrained in economic studies of this

---

[37] Executive Order 12044, http://www.presidency.ucsb.edu/ws/index.php?pid=30539&st=&st1; Gerston, Fraleigh, and Schwab, *Deregulated Society*, 46-47.

nature."[38] The fact the country's largest corporate lobbying firm advocated for economist-created economic impact statements was not surprising.

The Business Roundtable and their constituents—undoubtedly—understood that economic impact statements would reveal the higher costs of existing and proposed regulations, which were easy to identify and calculate, as opposed to the social and political benefits enabled by regulation that, in general, were harder to quantify and, therefore, justify.[39] Just as important, economic impact statements, given their almost singular focus on monetizing regulatory costs and benefits, would more than likely further validate recent work from public choice advocates, such as George Stigler and Richard Posner, who claimed that the cozy relationships between industry and legislators weakened the public's faith in the government's ability to identify and protect the public interest while simultaneously unnecessarily increasing costs for consumers and taxpayers.[40] Thus, the economic impact statements, the Business Roundtable argued, "should be part of the management process rather than used to justify decision."[41] Their incorporation into E.O. 12044 revealed the increased influence of Chicago School critics upon President Carter, specifically, and the

---

[38] Memo, Si Lazarus to Nina Cornell, Larry Gilson, Stan Morris, Rich Neustadt, Peter Petkas, Mary Schuman, Steve Simmons, Harrison Wellford, May 26, 1977, Memoranda: General to Regulatory Reform [2], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.

[39] The Business Roundtable advocated for "creative ways" to apply the "sunset" concept, which included a maximum regulatory shelf life of ten years. They also lobbied for uniform government procurement codes and procedures, reduced reporting requirements, a regulatory procedure guide for small businessmen, a regulatory coordinating commission to eliminate conflicting and overlapping jurisdictions, offer training for compliance personnel, and an "incentive reporting system" that rewarded "several years of sustained progress and successful government audit history" by exempting those businesses from location audits and all corresponding paper requirements for a one year period. Many of these recommendations represented reasonable solutions to legitimate regulatory concerns. Nevertheless, given the priority they attached to economic impact statements, which they listed first on their list of recommendations, the Business Roundtable sought to simultaneously narrow the theoretical and political space for government responses to market failures. Their opposition to OSHA "specification standards," as opposed to "performance standards," further demonstrates this point.

[40] STIGLER AND POSNER CITATION.

[41] Memo, Si Lazarus to Nina Cornell, Larry Gilson, Stan Morris, Rich Neustadt, Peter Petkas, Mary Schuman, Steve Simmons, Harrison Wellford, May 26, 1977, Memoranda: General to Regulatory Reform [2], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.

debate on and trajectory of regulatory reform more generally as the Carter administration pursued deregulatory objectives that disembedded economic factors from their larger social and political contexts. As such, Carter's policies further strengthened and perpetuated the public choice narrative that pitted markets against government regulation, which was not surprising since Carter used similar rhetoric during his presidential campaign.

An executive order alone, however, could not guarantee the regulatory reform many viewed as necessary. Policymakers in the Carter administration, including Carter himself, understood that a successful regulatory reform agenda required a vigilant and pro-active executive branch. To help create uniformity across executive and independent regulatory agencies, Carter administration officials considered distributing "regulatory transition books" to its regulatory appointees. The books, they suggested, "would help tie together and integrate the ideas advanced and the agency-specific issues raised" and "begin to communicate a broader sense of Presidential priorities."[42] Carter and several of his advisors feared that some appointees lacked the political courage and/or the personal conviction to pursue his regulatory reform agenda over the long haul.[43] Reagan administration officials subsequently shared similar concerns. In response to this growing concern, Carter administration officials proposed using the regulatory transition books in combination with "active involvement in monitoring and evaluating agency achievement of Presidential and agency objectives." Additionally, the Regulatory Working Group, demonstrating how

---

[42] Memo, Stan Morris to Larry Gilson, Mike Cardoza, Bob Crandall, Fred Emery, and Bill Drayton, February 11, 1977. The regulatory transition books discussed several potential areas for regulatory reform: economic and social regulations, information disclosure, and consumer protections. They also detailed the "Administration's program (e.g., revision of outmoded legislative statutes, new techniques to achieve statutory objectives in a more efficient manner, consolidation of overlapping and conflicting programs, simplifying regulation, and brings regulatory processes and proceedings closer to the American people).

[43] Memo, Bert Lance to Jimmy Carter, August 3, 1977; Memo, Jimmy Carter to Agency and Department Heads, June 22, 1977; Memo, Si Lazarus to Larry Gilson, June 22, 1977; and Memo, Bert Lance, Stu Eizenstat, and Charles Schultze to Jimmy Carter, June 23, 1977.

policymakers created and fostered public opinion, in addition to responding to it, developed several strategies to further stoke the flames of public discontent so that regulatory reform efforts would continue unabated.[44]

Just as important, the Carter administration tried to identify and/or create an institution to serve as the epicenter of regulatory reform, an agency that effectively and efficiently controlled and oversaw the production of new regulations and reviewed existing regulations. They hoped the Regulatory Analysis Review Group, and later the Regulatory Council, would serve this function, but unfortunately for the Carter administration, it was not until the Reagan administration established the Office of Management and Budget (OMB) as its regulatory relief hub would such an arrangement come to fruition.[45]

Only two months into Carter's presidency, administration officials had already identified a number of initial "areas of special emphasis" for their own "reorganization" agenda, which included airline, financial sector, communications (telephone), trucking, and shipping deregulation.[46] By August 1977, that regulatory reform agenda expanded even further. The administration established multiple interagency task forces to identify regulatory shortcomings and propose appropriate market-based solutions. Officials also pursued efforts to deregulate broadcasting and reform food inspection and labeling requirements.[47]

---

[44] Memo, Stan Morris to Larry Gilson, Mike Cardoza, Bob Crandall, Fred Emery, and Bill Drayton, February 11, 1977; and Memo, Bert Lance to Jimmy Carter, August 3, 1977. They drafted speeches, op-ed pieces, interview materials, etc that could be used in their propaganda campaign. They also proposed to require semi-annual publications that summarized upcoming regulatory actions; development regulation work plans; create opportunities for public participation; and implement training programs. They hoped to hold five or six public hearings at the local level, where "the cumulative confusion of regulations is apparent."

[45] They tried several, RARG, Regulatory Council, OTHERS? MEMO EVIDENCE FOR THIS? Gerston, Fraleigh, and Schwab, *Deregulated Society*, 46-53. The Office of Information and Regulatory Affairs also assisted the OMB in its regulatory relief efforts.

[46] Memo, Si Lazarus to Regulatory Working Group, March 8, 1977.

[47] Those task forces studied surface transportation regulation, equal employment opportunity regulations, health and safety regulations, and toxic substances and research activities controls.

Additional industries were targeted for deregulation between 1978 and 1980.[48]

Even though Carter appointed regulators who "were sympathetic to the goals of social regulation," in addition to publicly supporting social regulations that minimized harmful environmental externalities and protected workers' health and safety, his administration still privately targeted social regulations as part of their larger "reorganization" plans.[49] Of the eighteen different agencies and departments authorized to issue and enforce regulations, administration officials criticized the "few attempts…to compare the means used by these different programs."[50] The Regulatory Working Group questioned the efficiency and effectiveness of such an arrangement.

> These programs have also followed a common pattern of regulation that relies most heavily on a system of mandatory uniform national standards and federal enforcement machinery. It is a pattern often followed without careful scrutiny as to its appropriateness or effectiveness in achieving specific regulatory goals. Evidence is mounting that these patterns of traditional regulation are rapidly taxing the ability of the regulatory system to function efficiently and equitably. To remedy this situation, many believe we must improve the traditional patterns of regulation, as well as explore regulatory approaches that effectively utilize economic and social mechanisms outside the Federal Government. Critical to this reform…will be the formation of a group with the ability, experience and perspective to formulate more effective means of achieving environmental, health and safety goals.[51]

In this vein, the Regulatory Working Group, for example, tasked a Council of Economic Advisors and Environmental Protection Agency interagency task force with developing regulatory strategies that utilized "economic incentives" to realign the expectations and behaviors of both market participants and policymakers. Such

---

[48] LIST INDUSTRIES TARGETED/IDENTIFIED AS VIABLE BETWEEN 1978 and 1980.
[49] Gerston, Fraleigh, and Schwab, *Deregulated Society*, 45. LIST TWO OR THREE APPOINTMENTS THAT APPEARED "PROREGULATION" → BIVEN
[50] Memo, Stan Morris to Regulatory Reform Working Group, February 11, 1977. Officials also acknowledged that the eighteen agencies and departments did not include the "multitude of individual regulatory programs a single organization might administer, nor does it include other federal organizations which are involved in the formulation of policy and the provision of essential services that support these regulatory programs."
[51] Memo, Stan Morris to Regulatory Reform Working Group, February 11, 1977.

collaborations, they hoped, would eventually "less[en] reliance on regulation."[52] The Carter administration, then, long before inflationary pressures reignited in 1978, aggressively pursued regulatory reform—thereby demonstrating regulatory reform's increased ideological and political appeal years before Ronald Reagan entered the White House.

Financial Sector Deregulation: Deregulating What Exactly?

Despite the flurry of deregulatory rhetoric over the early years of the 1970s and during the earliest days of the Carter administration, financial commentators had not agreed upon an appropriate definition of financial sector (de)regulation. At a 1978 conference on the deregulation of the banking and securities industries, Lawrence Goldberg and Lawrence White, both associate Professors of Economics at the Graduate School of Business Administration at New York University, identified price, entry, and safety regulations as historically "pervasive" in American financial markets. Goldberg and White suggested that even though deregulatory measures had recently been actively pursued in the area of price regulation, trends in promotion of entry and safety deregulation were either more "more mixed" or, given the prominence of the consumer protection movement, "clearly toward more regulation."[53]

Others at the same conference, however, challenged the economic and political saliency of deregulation altogether. Roy Schotland, a professor of law at Georgetown University, explained the importance of distinguishing between deregulation and regulatory reform. Using the natural gas and trucking industries as examples, he defined deregulation as

---

[52] Memo, Bert Lance to Jimmy Carter, August 3, 1977.
[53] USE NOTE TO EXPLAIN WHAT ASPECTS OF THE CONSUMER PROTECTION MOVEMENT PRODUCED MORE FINANCIAL REGULATIONS

the "virtually complete dismantling of regulation," whereas regulatory reform represented the "possible elimination of some restrictions," as in proposals that allowed S&Ls to branch or offer NOW accounts. He also cautioned against "overaggregating," as in attacking one regulation but doing so by critiquing all bank regulations.[54] Instead of adopting Goldberg and White's definition of regulation, which focused on *what* was regulated, Schotland defined regulation as the *manner* of regulation and *who* did the work, as in the "continuous administration by some specialized body of people who, in another era, would have been called experts." He identified three types of regulation: generally applicable regulation as in corporate law or anti-trust, specific regulation as in drug and auto safety laws, and specific economic regulation, which had a range of methods and goals.[55] Despite the distinct lenses of analysis, both the Goldberg/White and Schotland definitions evaluated regulatory reform successes solely by whether the number of regulations increased or decreased.

Attempting to establish a definition that situated regulation within a larger policymaking context, Michael Redisch responded to Schotland's presentation by suggesting that banking regulations were actually interventions into economic markets with some end in mind. His observation, he claimed, allowed for the identification of "policy targets" or regulatory goals, which subsequently produced a standard that enabled outside observers to more objectively evaluate regulatory successes and failures.[56] P. Michael Laub, the director of the Economic and Finance Research Division for the American Bankers Association, even claimed that both the Ford and Carter administrations "deemphasized" banking deregulation because, "for better or for worse," banking "is usually looked at differently, even though the

[54] Roy Schotland, "An Overview: New Myths and Old Realities," in *The Deregulation of the Banking and Securities Industries*, 10.
[55] Roy Schotland, "An Overview: New Myths and Old Realities," 12.
[56] Michael Redisch, "Comment," in *The Deregulation of the Banking and Securities Industries*, 101. Redisch was an economist in the Program Analysis Division at the General Accounting Office.

same kinds of bad resource allocations occur because of unwarranted regulation." Despite the inaccurate interpretation of Carter administration deregulatory policy, Laub actually acknowledged the uniqueness of the financial sector, thereby adding an additional layer of scrutiny beyond what had previously been afforded by the other conference attendees.[57] Identifying the financial sector as fundamentally distinct from other industries in the U.S. necessitated establishing a unique set of criteria to justify and evaluate financial sector regulation because American financial institutions served as the economic intermediaries that collected and distributed credit throughout the economy. When attempting to identify areas for regulatory reform, Laub paradoxically claimed that expanding thrifts' asset and liability powers fell under a deregulatory rubric when in fact it still amounted to a case of policymakers dictating how S&Ls operated. Thus, as was and is typically the case, so-called deregulation is in effect still regulation.

Financial Sector Deregulation: In the Interim before DIDMCA and Garn-St. Germain

It was in this context of socio-economic and political confusion and intellectual transformation that Carter administration officials, congressmen, academics, and many financial executives found themselves reevaluating the savings and loan industry. As outlined in the previous chapters, S&Ls faced serious structural, institutional, and economic challenges in the years before the Carter presidency. Blue-collar workers' wages stagnated beginning in 1973 and national savings rates declined thereafter, competition within America's mortgage and savings markets emerged, and housing costs and the inflation and unemployment rates all increased. These changes, which could have become visible to

---

[57] P. Michael Laub, "The Deregulation of Banking," in *The Deregulation of the Banking and Securities Industries*, 201.

policymakers as S&L executives modified their asset and liability portfolios and initiated a heretofore unprecedented thrift merger movement in the late 1960s and early 1970s, only hastened the transition from the "growth and saver" governance mechanism that channeled working- and middle-class workers' savings to finance American homeownership toward the "second layer lender" system that increasingly relied upon domestic and international capital markets as sources of liquidity.

Despite continued debates within the Carter administration and Congress over Regulation Q, NOW accounts, money market certificates, financial disintermediation, variable rate mortgages (VRMs), interstate banking and branching, and the dual banking system, *inter alia*, Congress passed no significant financial sector regulatory reform measures until March 1980, just nine months before Jimmy Carter left the Oval Office. After a decade in which several academic and governmental studies identified multiple structural, economic, and institutional shortcomings within the thrift industry, specifically, and the American financial sector more generally; the Senate passed the Financial Institutions Act (1975); Representative Fernand St. Germain introduced the Financial Reform Act (1976); and Carter administration officials, as of February 1977, expected the Senate Banking Committee's Subcommittee on Financial Institutions "to broaden the consumer services of the savings and loan associations to make them more competitive with commercial banks"; this newfound legislative inertia was perplexing.[58]

David Mason blamed a lack of consensus among competing policymakers—particularly federal regulators and thrift executives, S&L asset growth and continued profitability over the course of the 1970s, and the U.S. League's insistence upon maintaining

---

[58]Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB"
See the Friend Commission, Hunt Commission, FINE Study, Regualtion Q Task Force, McFadden Task Force.

Regulation Q for the legislative delays. The confluence of these factors, Mason argued, created a “lost opportunity” for policymakers who stared down into the regulatory abyss over the course of the 1970s. Mason’s narrative identified the U.S. League and its lobbying strength as a primary culprit for stalling S&L regulatory reform—an apparent textbook example of regulatory capture.[59] And evidence existed to validate such an assertion. A subsequent FHLBB chairman later claimed, “When it came to thrift matters in the U.S. Congress, the U.S. League and many of its affiliates were the *de facto* government. What the league wanted, it got. What it did not want from Congress, it got killed.”[60] Not incorrect, Mason’s explanation nevertheless downplayed and/or ignored several factors that, upon reconsideration, called into question his “lost opportunity” narrative.

Contrary to the troubling depictions of the S&L and housing industries in the Hunt Commission, the FINE Study, and Mason’s description, policymakers had several reasons to feel optimistic about the existing trajectories of these two important sectors of the American economy—in the short term at least. As Mason acknowledged, thrifts’ profits and asset portfolios grew significantly for most of the Carter presidency.[61] But S&Ls also expanded their “savings flows” an average of 23.5% per year between 1975 and 1979.[62] They even

---

[59] Mason, 209-212.
[60] Edwin Gray, quoted in Brooks Jackson and Paulette Thomas, “As S&L Crisis Grows, U.S. Savings League Loses Lobbying Clout,” *Wall Street Journal*, March 7, 1989.
[61] Mason, *From Buildings and Loans*, 210. Thrifts’ percentage of total assets of financial intermediaries, which included commercial banks, life insurance companies, savings and loans, mutual savings banks, finance and investment companies, credit unions, pension funds, and money market accounts, grew from 15.8% in 1975 to 17.3% in 1979, expanding S&Ls asset portfolio by $241 billion in those four years. The industry’s return on average assets increased from .47% in 1975 to .82% in 1978 before falling slightly in 1979 to .67% and precipitously thereafter, even going negative in 1981 and 1982. See also *S&L Factbook*, “Total Assets of Financial Intermediaries at Year-End” and “Selected Significant Ratios of Federally Insured Savings Institutions (by percent).”
[62] *S&L Factbook*, “Savings Association Savings Flows.” Thrifts’ gross receipts totaled $154 billion in 1975; they rose to $360 billion by 1979.

slightly increased their market share of over-the-counter savings between 1975 and 1979.[63] Just as important, as the economy began to recover from the deepest economic downturn since World War II, housing starts exploded from 1.2 million in 1975 to 2 million by 1978, before dipping slightly to 1.75 million in 1979 and plunging thereafter to 1.1 million starts by 1981.[64] Funding for government subsidized housing also doubled between 1975 and 1979.[65] And as mortgage foreclosures dropped by almost half between 1974 and 1979, the U.S. housing market appeared rather strong—an observation only strengthened by the fact that S&Ls channeled even more credit toward funding home purchases and away from construction loans and other investment opportunities.[66] So instead of merely providing another example of regulatory capture, U.S. League lobbyists quite possibly offered regulators, Carter administration officials, and legislators more than enough anecdotal and economic data to justify focusing legislators' attention elsewhere.

Far from a "lost opportunity," moreover, policymakers in both Congress and at the Federal Home Loan Bank Board actively pursued other regulatory reforms in the years just before and during the Carter presidency—changes that focused on minimizing financial executive malfeasance, combating discrimination within America's mortgage and savings

[63] *S&L Factbook*, "Over the Counter Savings (billions of dollars)." S&Ls over the counter savings market share jumped from 34.2% to 36.8% in 1979 before dropping to 36% in 1980 and 33.7% in 1981. This statistic is slightly misleading, however, since it only tabulated the market shares of thrifts, commercial banks, mutual savings banks, and credit unions; it clearly excludes monies lost to non-bank banks and money market mutual funds. Nevertheless, thrifts maintained their own as they continued to compete with "traditional" financial intermediaries.
[64] *S&L Factbook*, "Private Housing Starts, by Number of Family Units." One family home sales followed a similar trajectory. 3 million one-family homes were sold in 1975, that number jumped to 4.8 million in 1978 before falling slightly to 4.5 million in 1979 and plummeting thereafter to 3.5 million in 1980 and 2.4 million in 1982. See *S&L Factbook*, "New and Existing One-Family Homes Sold."
[65] *S&L Factbook*. 7.3% of housing starts in 1975 were subsidized; that number reached 14.6% by 1979 before hitting 5.5% in 1981 and less than 1% by 1984.
[66] *S&L Factbook*, "Mortgage Foreclosures By All Lenders." Mortgage lenders foreclosed upon 0.5% of all mortgages in 1974 and only 0.29% in 1979. Unfortunately for S&Ls and other mortgage providers, that number more than tripled over the course of the 1980s. See also *S&L Factbook*, "Mortgage Loans Made by FSLIC-Insured Institutions, By Purpose." In 1975, thrifts only used 55.8% of their credit to fund home purchases. Only four years later, however, they channeled 70.5% of inflows toward mortgage origination.

markets, and fostering more customer choice and convenience within American S&Ls.[67] The 95th and 96th Congresses also considered several important regulatory reform initiatives in other sectors of the economy, including surface transportation, air transportation, mining, and energy production, in addition to addressing other matters of national and international importance, which included, *inter alia*, several Carter administration initiatives, the Humphrey-Hawkins Full Employment Bill, SALT II negotiations, the Soviet invasion of Afghanistan, and, of course, inflation.[68] Policymakers prioritized what were often times competing objectives and acted accordingly; these Congresses addressed the issues they interpreted as the most economically and politically salient, which did not include a booming S&L industry.[69]

Many economic and political commentators understood that financial regulatory reform often times only resulted from "crisis –bred" environments because the "system has great inertial elements in it."[70] An economist from the University of Wisconsin explained the lackluster legislative response to the FINE Study this way.

---

[67] Redlining: Community Reinvestment Act (1979) and FHLBB $10 billion investment fund. Individual and Institutional malfeasance: Fair Credit Billing Act (1974); Consumer Leasing Act (1976); Truth in Lending Simplification and Reform Act (1980); Financial Reform Act (1976); Institute Regulatory Bill, a.k.a. "Safe Banking Bill," (1978, St. Germain, among other things, concern with interlocking directorates, put directorship clause of Clayton Act on banks and other financial institutions); and the Financial Institutions Regulatory and Interest Rate Control Act (1978). Customer convenience and choice: the FHLBB authorized Money Market Certificates (MMCs) in 1976; ARMs/VRMs, XXX. Proxmire's push for regulatory consolidation.

[68] Regulatory Reform legislation included: Surface Mining Control and Reclamation Act (1977), Clean Air Act amendments (1978), Motor Carrier Reform (1980), Staggers Rail Act (1980), Household Goods Transportation Act (1980), Airline Deregulation Act (1978), International Air Transportation Competition Act (1979), and the Natural Gas Policy Act. As aforementioned, the Carter administration also considered regulatory reform efforts in several sectors of the American economy. Give 3-4 Carter initiatives, energy, cap gains, tax bill, etc.

[69] Footnote about issue capacity and congressional attention.

[70] Almarin Phillips, "Regulatory Reform for the Deposit Financial Institutions—Retrospect and Prospects," *The Journal of Financial and Quantitative Analysis* 9 (Nov. 1974): 800. Phillips, who served as Co-Director for the Hunt Commission and worked as a professor of Economics at the University of Pennsylvania, compared and contrasted the regulatory changes that resulted from the Civil War, the Crisis of 1907, and the Great Depression with those "changes probable in the near future." Phillips, acknowledging the existing lack of crisis, thus concluded, "Currently the major pressure for change lies in new organizational forms and new technologies, the

> Proposals for financial reform in the past fifteen years have arisen in large part from organization innovations…With the possible exception of 1966 legislation pertaining to Regulation Q, reform proposals have not been introduced in response to dramatic crises. In these circumstances external pressure towards legislative action have been weak and vacillating. Not surprisingly, few major legislated reforms have been enacted."[71]

Senator William Proxmire confirmed this general sentiment when, debating a Regulation Q extension in early 1977, he reminded his colleagues on the Committee on Banking, Housing and Urban Affairs to "not kid ourselves, we can postpone this for two years and there is so much for Senators to do, we wont get around to this matter until just a month or two before the extension expires….We will just put it on the back burner….Unfortunately that is the way we operate here, and the way we have always operated."[72]

Beyond lacking the requisite crisis, many policymakers failed to arouse the necessary support because their regulatory reform rhetoric contradicted the socio-economic and political realities of the late 1970s. Supporters of the Consumer Financial Services Act (1977), for example, which authorized S&Ls to offer NOW accounts, argued the bill benefited consumers, helped improve S&Ls earnings, and protected the dual banking system.[73] Republican opposition, on the other hand, claimed the legislation reduced the earnings and net worth of depository institutions by increasing borrowing costs, harmed "small savers," undermined the dual banking system, and failed to resolve several other S&L problems.[74] Despite their divergent interpretations, both sides clearly evaluated the

---

influence of which may spread over enough years to give some hope that a sequence of marginal changes will be adequate to avert a crisis situation."

[71] Donald Hester, "Special Interests: The FINE Situation," *Journal of Money, Credit, and Banking 4* (Nov. 1977): 653.

[72] Proxmire, Meeting on Extension of Regulation Q, March 1, 1977, 15.

[73] Report, Consumer Financial Services Act of 1977, in Depository Institutions Deregulation Act of 1979, June 21, 1979, 36-73.

[74] Report, Consumer Financial Services Act of 1977, in Depository Institutions Deregulation Act of 1979, June 21, 1979, 77-115. Senators John Tower (R, TX), Richard Lugar (R, IN), and Jake Garn (R, UT) submitted the

legislation's utility on how it affected consumers/small savers, the dual banking system, and S&L earnings. Policymakers' focus on these three issues, in particular, created serious operational and regulatory conundrums since helping savers hurt S&L earnings, and vice versa. Several economic observers also began to question the efficiency of the dual banking system, especially after it appeared the Hunt Commission acquiesced to political pressures to maintain this bulwark institution of the American financial sector.[75] Collectively resolving these issues made it all that much more difficult to get legislation passed.[76]

Just as important, several critics of interest rate ceilings framed the problem of Regulation Q as a consumer issue. They argued that Regulation Q ripped off many Americans—but particularly small savers.[77] When President Carter, for example, submitted his comprehensive financial reform legislation to Congress in May 1979, he turned to the small saver to prod Congress into action. He proclaimed his reforms would fix a system that was "increasingly unfair to the small saver," a criticism similar to that of Senate Republicans who opposed the Consumer Financial Services Act (1977). The "present rate ceilings," Carter explained, "are costing the American people billions of dollars in lost interest annually.[78] Framed another way, however, interest rate ceilings also saved depository institutions billions of dollars annually. Even though Regulation Q created higher levels of financial sector instability since disintermediation caused increasingly larger fluctuations in

minority views report. The S&L problems left unresolved by the bill included: asset issues, Regulation Q, and disintermediation.

[75] As discussed above, the Hunt Commission's focus on efficiency would seem to have demanded a fundamental restructuring of the American financial sector as it related to the dual banking system. For discussions of its political acquiescence, see…

[76] Paying higher interest rates to attract deposits clearly increased the operational costs for depository institutions, which in turn most often times led to lower earnings since those cost increases were not offset by decreases elsewhere. This was especially true when S&L operational costs rose in general. See → evidence for increased operational costs.

[77] Find article or articles that reference the $20 billion lost in savings

[78] Address to Congress, JC, May 22, 1979.

the availability of mortgage credit over the course of the 1970s, it was understandable that financial executives at commercial banks and S&Ls seriously questioned its removal. They realized the economic ramifications of returning to market interest rates for deposits—a billions of dollars increase in their operating costs.

Other political considerations, particularly lobbying efforts by various policymakers, also influenced how financial regulatory reform efforts were interpreted, contextualized, and pursued. Legislators in Congress, Carter administration officials, and federal regulators at the FHLBB and Federal Reserve all struggled to balance the "cacophony…of dissimilar financial market special interest groups" that they encountered as they considered restructuring the American financial sector. This plethora of competing interests, one economic observer claimed, almost guaranteed that any successful financial sector regulatory reform efforts in 1977, or thereafter, would "likely to be the outcome of smoky cloakrooms and take the form of inadequately illuminated riders."[79] This interpretation, similar to Mason's, implicitly portrayed federal policymakers as arbiters in a pluralistic framework willing to support those whose lobbying efforts they found most appealing; but the socio-economic and political realities were not that simple.

A March 1977 Senate Subcommittee on Financial Institutions' mark-up session on a Regulation Q extension provided a window into the complicated considerations and processes that actually produced legislative reforms. Senator John Towers (R, TX), at one point in the session, explained why he agreed with Senator Thomas McIntyre's (D, NH) comprehensive approach to financial regulatory reform.

> I thought the Financial Institutions Act we passed [in 1975] was responsible, it took into consideration the particular needs and requirements and desires of

[79] Hester, "Special Interests," 655.

> the various elements of the financial community. The House, in its usual splendid fashion, botched it up, turned it into something called the Financial Reform Act, to the point where the bankers, of course, opposed it very strongly. I agree with Senator McIntyre that the commercial bankers ought to be convinced that probably their own best interests are served in comprehensive legislation, and they are going to get piecemealed by legislation which is going to perhaps give some of the other financial institutions advantage over them.[80]

This telling exchange complicated the pluralistic and regulatory capture assumptions that many relied upon during the late 1970s, and since, to interpret congressional-lobbyist relationships in two important ways. One, Towers insinuated that the Senate, understanding the political dynamics of crafting legislation, managed to successfully balance the interests of competing financial institutions, only to see those efforts subsequently "botched" up by the House as Fernand St. Germain (D, NH) and others appeared to insert anti-commercial bank language into the legislation.[81] This friction over financial regulatory reform remedies, despite the fact that Democrats chaired the key banking committees in both the Senate and House of Representatives, proved too cumbersome to overcome without some external political and economic pressures—i.e. a crisis.[82]

Two, Tower's commentary highlighted how both financial executives and legislators identified and pursued their own institutional interests. On the one hand, bankers aggressively lobbied to kill the Financial Reform Act, according to Tower, because they interpreted the bill as anti-commercial banks. On the other hand, Tower exposed how policymakers at multiple levels of government were also capable of capturing constituencies.

---

[80] Tower, Meeting on Extension of Regulation Q, March 1, 1977, 6-7. McIntyre chaired the Subcommittee on Financial Institutions.

[81] Citation or two on St. Germain's pro-S&L positions/interpretations. Germain chaired the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance; he subsequently became chair of the House Committee on Banking, Finance and Urban Affairs in 1981.

[82] Senator Proxmire focused his attentions on regulatory agency consolidation. He also argued, on several occasions, that hyper consumption increased inflation. St. Germain, on the other hand, concentrated on eliminating financial malfeasance by trying to ban interlocking directorships AND… And inflation thoughts?

Legislators, in this particular case, aimed to reorient the perspectives and priorities of commercial bankers who, Tower claimed, were willing to sacrifice long-term institutional objectives and systemic stability for perceived short-term political gains.[83] If both legislators and industries could be captured, then the Chicago School's assumptions that many policymakers incorporated into their theoretical models to justify regulatory reform were too simplistic. Those assumptions also disregarded two key factors in public policy formation—state autonomy and industry capture.

The Bottom Falls Out: the Death of the Growth and Saver Governance Mechanism

Even though the housing and S&L industries appeared strong to many economic and political observers during the late 1970s, both had already undergone, and continued to undergo, significant changes—changes that helped reveal the systemic shortcomings of the "growth and saver" governance mechanism and eventually replace it.[84] S&Ls struggled to maintain control over their historic home lending niche during the Carter presidency. Of all of the mortgages originated in 1975, S&Ls financed 68% of them; by 1980, however, they only funded 28% of new mortgages. Put another way, another financial institution besides a savings and loan provided mortgage credit for 72% of mortgages originated in 1980.[85] The availability of mortgage credit became such a concern by 1979 that the Ad Hoc Task Force

[83] The notion that government bureaucrats pursued their own institutional interests is not new, but few have discussed how regulators actually lobby financial executives. CITE skorownek, Carpenter, Skocpol, others.
[84] For discussion of changes within the housing industry, see Michael Stone, "Housing and the Dynamics of U.S. Capitalism," in *Critical Perspectives on Housing*, eds. Rachel Bratt, Chester Hartman, Ann Meyerson (Philadelphia: Temple University Press, 1986).
[85] *S&L Factbook*, "Total Residential Mortgage Loans Outstanding and Savings Associations' Share."

on Mortgage Credit, a committee established by the National Association of Realtors, focused their attention on "attracting new types of mortgages investors."[86]

Global capital markets, which were one such place to find new investors, stepped into the fray to help sustain the expanding housing market in the late 1970s—and in the process, reorienting the American mortgage origination market and the S&L industry in several important ways.[87] One, the secondary mortgage market grew significantly during the 1970s and exponentially thereafter. At the beginning of the decade just over $34 billion worth of American mortgages were purchased and sold by investors. In 1980, that number exceeded $155 billion; by 1985, it was almost half a trillion dollars.[88] This explosion of activity within the secondary mortgage market provided much needed institutional liquidity for S&Ls as it simultaneously offered thrifts a place to sell their mortgage loans and buyers to purchase them.[89] During the earliest years of the 1970s, federal credit agencies such as FNMA and FHLMC purchased the largest share of mortgages on the secondary market; but in the years after 1975, "mortgage pools" consistently bought the most mortgages.[90] Investors' desire to purchase securitized mortgages, regardless if they were sold by second layer lenders or private financial institutions, clearly increased the importance of the secondary mortgage

---

[86] "Recommendations of the Ad Hoc Task Force on Mortgage Credit," in Depository Institutions Deregulation At of 1979 Hearing, June 27, 1979.

[87] Institutional investors were larger entities that invested vast sums of money in depository institutions—often times because they could afford to invest in certificates of deposit or other investment funds that required higher minimums but provided no interest rate ceilings. They included: pension funds, corporations, insurance companies, among others.

[88] *S&L Factbook*, "Purchases and Sales of Mortgage Loans, By Lender."

[89] The liquidity came as thrifts sold loans and participations to the secondary mortgage market. Thrifts' sales as a percentage of their total inflows (loan repayments + loans and participations sold) grew steadily over the 1970s. They represented just under 8% of inflows in 1970, but in 1975, they accounted for 15.5%, and by 1980 and 1982, 27% and 59%, respectively. In fact, between 1976 and 1980, S&Ls made roughly 20% of all sales to the secondary market. See *S&L Factbook*, "Inflows From Mortgage Portfolios At Insured Associations" and *S&L Factbook*, "Purchases and Sales of Mortgage Loans, By Lender."

[90] A "mortgage pool" is a group of mortgages held in trust as collateral for MBS. They can be overseen by both federal credit agencies and private financial institutions.

market. The federal credit agencies and mortgage pools collectively purchased on average 55.5% and 59% of all mortgages sold on the secondary market in the 1970s and 1980s, respectively.[91] But whosever giveth also taketh away, and the price thrifts paid for enhanced institutional liquidity was additional competition in the mortgage origination market—particularly from mortgage companies and government-sponsored enterprises.[92]

Two, the Federal Home Loan Bank Board essentially turned private depository institutions into publicly funded mortgage financiers and, in many instances after 1980, the personal piggy banks of financial gamblers. The FHLBB advance program in the years before 1976, as Table 4.1 demonstrates, provided cyclical assistance during economic downturns since

Table 4.1 *FHLBB Advance Program, 1966-1982*

	FHLBB Advances (millions of dollars)	Annual Percentage Change of Advances	Advances as Percentage of Loans Closed	Total Percentage of S&Ls That Borrowed
1966	$3,804	-24%	23%	42%
1967	$1,527	-60%	8%	32%
1968	$2,734	79%	13%	37%
1969	$5,531	102%	26%	48%
1970	$3,255	-41%	16%	42%
1971	$2,417	-17%	7%	37%
1972	$4,792	77%	10%	40%
1973	$10,013	109%	21%	49%
1974	$12,763	27%	34%	52%
1975	$5468	-57%	10%	52%
1976	$8,114	48%	9%	59%
1977	$13756	70%	11%	66%

[91] *S&L Factbook*, "Purchases and Sales of Mortgage Loans, By Lender."
[92] Government-sponsored entities (GSEs) only accounted for 3% of mortgage loans outstanding in 1965, but 1980, their market share stood at 18%, and was almost 30% by 1982. Mortgage companies incorporated the secondary markets into their business model as they represented on average, 55% and 41% of all mortgage sales in the 1970s and 1980-87, respectively. To give an idea of the amount of money involved, $454 billion worth of mortgages were sold throughout the 1970s, and $1.6 trillion were between 1980 and 1987. Banks also increased their market share, although, it was only by three to four percentage points. See *S&L Factbook*, "Mortgage Loans Outstanding on One- to Four-Family Nonfarm Homes, By Types of Lender."

1978	$25,297	84%	20%	64%
1979	$29,166	15%	25%	N/A
1980	$36,585	25%	43%	N/A
1981	$53,941	47%	87%	N/A
1982	$53,744	0%	89%	N/A

Source: *S&L Factbook, "FHLB Lending Operations."*

mortgage funds dried up due to disintermediation. After 1976, though, but long before interest rates spiked and disintermediation ensued after the Volcker shock, the FHLBB distributed advances with no apparent consideration to the business cycle. Advances increased 242% between 1976 and 1980 even though the recession did not begin until January 1980. Two-thirds of the industry by 1979 borrowed from the FHLBB. Without advances, then, as Table 4.1 illustrates, S&Ls would have failed to close an increasing percentage of their loans between 1976 and 1982.[93]

Three, mutual-to-stock charter conversions also reoriented the S&L industry. The FHLBB had instituted a ten-year ban on federal S&L mutual-to-stock conversions in 1963, but as thrift executives struggled to maintain their institutional net worth and secure deposits in the face of increased competition and higher operational costs in the early 1970s, the U.S. League lobbied the FHLBB to lift the bin. FHLBB Chairman Preston Martin eased the conversion rules in 1973 before finally fully repealing the ban in 1975.[94] The impact was immediate. In just one year, stock S&Ls grew their asset portfolios by 23%, jumping from $71 billion worth of assets in 1975 to $87 billion in 1976. And as interest rates continued to rise higher and higher in the late 1970s and early 1980s, so did the number of stock conversions and their control of industry assets, as Table 4.2 highlights. Stock S&Ls, after

[93] To further demonstrate the massive increase in advances to S&Ls, the FHLBB provided $17 billion in advances between 1966 and 1970. The next five years, almost $36 billion. And the five years before 1981, $113 billion. Between 1981 and 1985, the FHLBB supplied $377 billion in advances. See *S&L Factbook*, "FHLB Lending Operations."
[94] Mason, *From Building and Loans*, 204-5.

Table 4.2 *Stock Chartered Savings and Loans, 1975-1988*

	Number of Stock S&Ls	Percentage of All S&L Charters	Stock Assets (millions of dollars)	Percentage of All S&L Assets
1975	717	15%	$70,648	21%
1976	732	15%	$86,679	23%
1977	749	16%	$107,185	24%
1978	771	16%	$127,006	25%
1979	808	17%	$146,995	26%
1980	871	19%	$174,686	28%
1981	870	20%	$194,346	30%
1982	830	22%	$219,702	31%
1983	836	24%	$326,971	40%
1984	940	28%	$492,824	50%
1985	912	29%	$518,578	49%
1986	1,196	39%	$720,626	62%
1987	1,269	43%	$871,310	69%
1988	1,285	44%	$993,698	74%

Source: *S&L Factbook, "Number of Savings Associations, By Type of Charter."*

maintaining roughly 21% of industry assets for the ten years before 1975, controlled almost half of all thrift assets by 1985. This increase in stock associations, in combination with other regulatory and economic changes enabled by policymakers in Congress and the FHLBB in the early 1980s, helped push the industry down the road to perdition by the end of the decade.

Policymakers utilized the "Volcker shock" as a pretext to publicly force an already evolving thrift industry to rapidly deregulate. In August 1979, Federal Reserve Board Chairman Paul Volcker—nominated by Jimmy Carter to curb rising inflation—announced that monetary policy would no longer aim to keep interest rates low. The benchmark federal funds rate, over the next eight months, rose from 10.47 percent to 17.61 percent, and by January 1981, it soared to 19.08 percent. Thrifts lost billions of depository funds as individuals moved their money from low-interest rate passbook accounts to money-market mutual funds and other investment opportunities that paid market-rates—just as they had during earlier episodes of higher than normal interest rates. Between 1978 and 1982, the unregulated investments of money-market mutual funds, for example, exploded from $9.5 billion to $236 billion. Additionally, the interest from low-rate mortgages no longer produced sufficient funds to attract new investment. With Regulation Q still in effect, this turn of events effectively created a situation such that thrift liabilities outnumbered their assets, which quickly turned slim profits into growing losses for most thrifts. Industry profits fell from $3.6 billion in 1979 to only $781 million in 1980, and more important, almost half of all savings and loan institutions were legally insolvent because their net worth had fallen below the required regulatory minimum of 5 percent of insured deposits.[95] By the end of 1980, 141 associations (with assets of $9.8 billion) merged out of existence.[96]

In response to these dire conditions, in addition to an April 1979 U.S. Circuit Court ruling that forced depository institutions to address the discrimination small savers faced, an overwhelming Democratic Congress passed, and President Carter signed, the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) on March 31, 1980. DIDMCA, Carter claimed, simultaneously strengthened financial institutions and the free enterprise system.[97] It also represented President Carter's cautious attempt to deregulate thrifts, but it eventually proved ineffectual because Carter feared a potential political backlash from consumer groups and business executives.[98] DIDMCA created the Depository Insurance Deregulation Committee (DIDC) to carry out a six-year phase out of deposit rate

---

[95] Mason, *Bail-Outs*, 214.
[96] Roy Green, written statement, House Committee on Banking, Finance, and Urban Affairs, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, The *Depository Institutions Amendments of 1982*: *Hearings on S. 2879, H.R. 4603, H.R. 6267*, 97th Congress, 2nd sess., 21 and 22 September 1982, 441.
[97] JC to HBG letter, April 2, 1980.
[98] MASON evidence. Other evidence for timidity of DIDMCA?!

ceilings.[99] The legislation also authorized NOW accounts for individuals and nonprofit corporations; empowered federally chartered savings and loan institutions to make commercial real estate loans, consumer loans, and investments in commercial paper and corporate debt securities (up to 20 percent of assets); increased FSLIC coverage from $40,000 to $100,000; and authorized credit card lending and trust activities for federal savings and loans.[100] DIDMCA did not allow thrifts, however, to make variable-rate mortgages, and it only expanded thrifts' asset and liability powers on a limited basis.

Policymakers used the elimination of Regulation Q—legislatively mandated by DIDMCA—to force thrifts to openly compete with commercial banks and other financial institutions—even though S&Ls had already been competing with these institutions for years. Jay Janis, former Chairman of the FHLBB during the Carter administration, understood the operational and structural ramifications of DIDMCA when he speculated in 1981 that over the next few years "the number of savings and loan will decline, perhaps by as much as a third."[101] The expansive powers of DIDMCA, according to Janis, provided thrifts with the "freedom to provide a full range of services in housing and family finance…at least for those that survive." California Federal's chief executive officer described the uncertainly of this new deregulatory environment best: "You either have to be gutsy or stupid to do what I'm doing…but we want to be the first to turn it around."[102]

Even though policymakers failed to acknowledge several of the challenges to the growth and saver governance mechanism before 1980, the elimination of Regulation Q

---

[99] The DIDC had five members, the Federal Reserve Board Chairman, Treasury Secretary, Chairmen of the FHLBB and FDIC, and the National Credit Union Administrator.

[100] Say something and cite sources about deposit insurance change, why it occurred (CA S&Ls) and moral hazard.

[101] Janis, by 1981, had become the President of California Federal Savings and Loan Association, one of the nation's largest thrifts.

[102] Thomas Lueck, "The Competitive Era in Savings," *NY Times,* 18 January 1981.

unequivocally signaled their acceptance that S&Ls could no longer maintain their historical home origination niche. The Wall Street Journal, in early 1981, explained how State Savings and Loan Association, a subsidiary of Financial Corp. of America, represented the new ideal thrift—a deregulated S&L.[103] State Savings, they proclaimed, “aggressively” went “after the kinds of loan business that return a solid profit”—practices that former savings and loan examiners viewed as “dangerous and unsustainable.” During a year that most savings and loan institutions lost money, State Savings reported a 2 percent profit in 1980. This profit, no doubt, was enabled by their 24 percent interest rates that “socked borrowers.” Charles Knapp, Financial Corp.’s chairman, interpreted most other savings and loan managers—and their attempts to maintain Regulation Q—as “living in yesteryear.” So certain the industry was headed in new directions, Knapp prohibited his staff from attending industry conventions for fear of their being “infected with S&L mentality.” Ultimately, State Savings, just like so many other S&Ls during the 1980s, abandoned “S&Ls’ traditional customers” and the “traditional branch-office organization” of thrifts because, according to Knapp, “the small saver is gone forever.”[104]

President Carter claimed DIDMCA “will strengthen…our thrift institutions and commercial banks, and in addition to that it will help small savers,” but in the months after Carter signed the bill into law, S&L executives watched helplessly as previously unfathomable interest rates clobbered two of the most rate-sensitive sectors of the economy—finance and housing.[105] American homebuyers paid more than 15% for a new

---

[103] NOTE ON HOW FINANCIAL CORP OF AMERICA FAILED SPECTACULARLY.

[104] Thrift executives at State Savings, for example, projected to lend $1.3 billion in 1982, which 70 percent was expected to fund real estate development projects. G. Christian Hill, “Solo Flight,” *Wall Street Journal*, 6 April 1981.

[105] Carter, Depository Institutions Deregulation and Monetary Control Act of 1980 Remarks on Signing H.R. 4986 into Law, http://www.presidency.ucsb.edu.

mortgage by December 1981 and, consequently, fewer and fewer individuals dared to purchase a home in such an environment. Americans had purchased 4.5 million new and existing one-family homes in 1979, but by 1982, that number fell to 2.4 million.[106] Even though many S&L executives had advocated for expanded asset powers throughout much of the 1970s, a regulatory reform that they believed would have diversified their institutional portfolios, this sudden drop in housing starts and home purchases only further hindered an already struggling thrift industry. As S&Ls paid more to attract deposits and earned less from their asset portfolios comprised mostly of lower-yielding mortgages, their profit margins, return on equity, return on average assets, and net worth, as Table 4.3 illustrates, all continued to worsen into 1981, almost bankrupting the industry in the process.[107]

Table 4.3 – Significant Operational Ratios

	Profit margin	Return on equity	Return on average assets	Net worth
1979	7.35%	12.09%	0.67%	5.6%
1980	1.37%	2.44%	0.14%	5.2%
1981	-6.96%	-15.39%	-0.73%	4.2%
1982	-5.49%	-15.58%	-0.65%	3.7%

Source: S&L Factbook, "Selected Significant Ratios of Federally Insured Savings Institutions" and "Total Liabilities of S&L Associations."

Unfortunately for Jimmy Carter, the S&L industry's increasing instability, in addition to struggling automotive and housing sectors, occurred at the worst possible moment for the sitting president—right in the middle of his reelection campaign.

Continued S&L Decline: Reagan Administration Deregulates Further

[106] S&L Factbook, "New and Existing One-Family Homes Sold." Total housing starts dropped from 1.75 million in 1979 to 1.1 million by 1982, see S&L Factbook, "Public and Private Housing Starts."
[107] 1983 S&L Factbook, 26. ADD SOMETHING ABOUT HOW MANY INSTITUTIONS INSOLVENT IN 1980 AND 1981. HOW ONLY FORBEARANCE SAVED INDUSTRY FROM TOTAL COLLAPSE.

Both the 1980 Republican and Democratic presidential nominees, just as they had in 1976, supported financial sector regulatory reform. Even though political and economic commentators at the time, and since, interpreted Carter's regulatory "reform" as distinct from Reagan's regulatory "relief," Carter and Reagan's views on ideological deregulation aligned more than either candidate probably cared to admit.[108] The perceived distinction between Carter and Reagan resulted, in part, from Reagan's campaign rhetoric, which often times revealed a fervency and ideological vigor that Carter appeared to lack, despite the candidates' rhetorical and substantive similarities. One campaign pamphlet claimed, for example, "Mr. Carter doesn't want to talk about this problem of over-regulation…because he has no answers for it."[109] Reagan had bemoaned the size and role of government for years, but his attacks on Carter's "job-destroying regulation" rang truer in 1980 as Americans encountered higher inflation, struggling S&Ls, and declining industrial productivity.[110] As the Reagan campaign transitioned to enter the White House, his future director of OMB publicly declared the need for a "well-planned and orchestrated series of unilateral administrative actions to defer, revise, or rescind existing and pending regulations where clear legal authority exits."[111]

Reagan wasted no time in demonstrating his administration's commitment to regulatory reform. Just two days into his term, Reagan created the Task Force on Regulatory Relief (TFRR).[112] And on February 17, 1981, Reagan issued Executive Order 12291.[113]

---

[108] RELIEF/REFORM distincutions, EADS and FIX; Gerston, *Deregulated Society*, XX. OTHERS?! Gerston et. al. claimed JC focused exclusively on economic regulation. RR actually publicly acknowledged a place for social regulations.
[109] 80 Campaign Press Release, Martin Anderson files.
[110] Martin Anderson Files, 1980 Reagan-Bush campaign press release.
[111] Quoted in *Deregulated Society*, 50.
[112] Headed by Vice President George H.W. Bush, the TFRR had three duties: to review major proposals issued by executive regulatory agencies; to assess existing rules; and to oversee legislative proposals to codify the president's views regarding deregulation. See Gerston, *Deregulated Society*, 51.
[113] EO 12291 aimed to "reduce the burdens of existing and future regulations, increase agency accountability for regulatory actions, provide for presidential oversight of the regulatory process, minimize duplication and

Building upon Carter administration efforts to centralize regulatory oversight, Reagan's EO 12291 designated the Office of Management and Budget (OMB) as the epicenter of regulatory control. Under this new arrangement, OMB was given "unprecedented enforcement powers" to approve almost all new federal regulations.[114]

Key Reagan administration officials utilized highly ideological rhetoric to interpret and address the perceived shortcomings of S&Ls, specifically, and the American financial sector more broadly. Treasury Secretary Donald Regan, in a September 1981 speech that in many way mirrored criticisms voiced by Ford and Carter administration officials, suggested that credit controls have "never" worked because they were an "inefficient substitute for the marketplace." The degree of federal government involvement in regulating the economy, he declared, directly "determines whether our economy will respond to the new climate of incentive or whether it will miss this rare opportunity and continue to stagnate."[115] Just as important, the current financial system, he claimed, was "almost capable of flying itself," a metaphor that demonstrated that many within the Reagan administration believed in the self-regulating nature of markets as well as their attempt to reinforce that notion within American culture.

Secretary Regan identified four fundamental problems that resulted from changes in travel, technology, and communications since the 1930s, which had consequently altered the United States' financial system. First, interest rate restrictions—Regulation Q—forced banks and thrifts to borrow short and lend long, a practice now being called into "serious question."

---

conflict of regulations, and insure well-reasoned regulations," see Executive Order 12291, www.presidency.ucsb.edu.

[114] Remember, Carter administration officials hoped the Regulatory Analysis Review Group and Regulatory Council would help centralize administrative oversight of regulatory creation and enforcement. Gerston, *Deregulated Society*, 52.

[115] Donald Regan, speech, House Banking Committee, *Depository Institutions Amendments of 1982*, 418.

Second, specialization—thrifts' focus on mortgage lending—made it difficult for them to diversify their portfolios, which would spread risk and potentially limit losses during times of high inflation and interest rates. Third, the legislative ban on interstate banking and restrictions on branching ultimately "Balkanized our financial system." The current system ran "counter to the nature of a modern financial service industry, Regan argued, because of these "artificial geographic restraints," which limited competition and impaired efficiency. Fourth, the growth of regulatory agencies created an "inflexible" system with multiple regulatory agencies disseminating confusing and contradictory regulations.[116] As such, Regan concluded, "The time has arrived to look carefully at all the current regulations" because a "national debate on this issue is overdue."[117]

Another influential administrative official, William Poole, Cabinet Council on Economic Affairs member and Brown University economist, demonstrated the political perils of pursuing ideological deregulation. He reminded administration officials in mid-1982 that they "may not in the end be skillful enough, and the electorate patient enough, to reverse in a permanent and decisive way the destructive policy trends of the last 50 years. It is, and will remain for some time, a close call."[118] Poole encouraged the Cabinet Council for Economic Affairs to remember,

> For policy purposes all that is necessary is to accept the argument that markets work pretty well, especially as compared to the alternative of having Uncle Sam do it…It is essential to understand that in the context of expectational markets, market 'rationality' or 'efficiency' does not mean that the markets are especially successful in foreseeing the future. All that is meant is that the markets do not make easily avoidable mistakes.[119]

[116] Ibid, 420-29.
[117] Ibid, 431.
[118] Memo, William Poole to Cabinet Council on Economic Affairs, 8 October 1982, folder "Cabinet Council for Economic Policy_8/82-6/30/83 (6/8)," box 10699, William Poole Files, Ronald Reagan Library.
[119] Ibid.

Moreover, Poole, clearly with "rational expectations" in mind, argued that "constancy of purpose and consistency of action" was necessary to change the "market's vote" regarding any possible administrative long-term sustainability.[120] Impatience, Poole cautioned, "runs the clear risk of destabilizing rather than stabilizing market expectations." "When events go our way," he predicted, "economic recovery will cement a developing market view that this Administration has the correct policies and the guts to see them through."[121] The Reagan administration chose to follow its ideological commitment to deregulation, as Poole and Regan's rhetoric implied, even though extant circumstances suggested that such a course might well be imprudent, especially since historically high interest and unemployment rates continued to ravage several sectors of the American economy, including savings and loan institutions.

To achieve the success Poole and Regan envisioned, the Cabinet Council on Economic Affairs (CCEA) identified four "broad areas of financial institutions reform" that would enable economic growth and reinvestment: product powers, liability powers, restrictions on geographic activities, and regulatory structure. These CCEA reforms—if enacted—would have fundamentally changed the government's role in regulating the financial sector. By November 1981, the administration had successfully incorporated many of its thrift deregulation proposals into S. 1720, the Financial Institutions Restructuring and Services Act (1981). Once S. 1720 went to mark up, the administration would "have a better idea…of the work left to be done on thrift institution powers and Glass-Steagall

---

[120] Poole's rhetoric on "market votes" suggests a belief in a self-regulating market that is a rational, thinking actor that possesses all the requisite information to make the best decision possible. However, such a position fails to acknowledge how informational asymmetries (unknowable information to buyer), spillover/social costs (pollution, oil spills) public goods (education, infrastructure) and "rational irrationalities" (herding behavior) drastically affect the free-flow of the market. See John Cassidy, *How Markets Fail: The Logic of Economic Calamities* (New York: Farrar, Straus, and Giroux, 2009), 139-191.
[121] Ibid.

deregulation."[122] Even though S. 1720 did not become law in 1981; its language was incorporated into Garn-St. Germain, which was introduced in September 1982. The CCEA began to debate—"without the limiting consideration of whether a particular idea was 'saleable' politically"—the "optimal degree of concentration in the banking industry, federalism and the issues of state prerogatives, the appropriate pace of deregulation, the concept of the dual banking system and the safety of bank holding companies and their subsidiaries."[123] They eventually decided upon three proposals: to allow bank holding companies to acquire institutions on a national scale; to permit interstate branching within "natural market areas;" and to disallow electronic funds transfer terminals from being defined as "traditional brick-and-mortar branches."[124] All three proposals sought to undo existing regulatory practices that had been in place since the 1920s and 1930s.

Richard Pratt, stanch deregulator and Reagan's first FHLBB Chairman, contended that the cure for ailing thrifts "must come from the industry and not through government assistance."[125] Pratt's insistence on thrift self-help, in addition to the eventual lifting of Regulation Q, marked a dramatic shift in the relationship between the federal government and savings and loan institutions. Thrifts could no longer afford to focus primarily on the mortgage market—a market niche created and perpetuated by the federal government. Not all thrifts agreed with these changes, as many feared they would "bankrupt scores of institutions

[122] Memo, Roger Mehle to Cabinet Council on Economic Affairs, 3 November 1981, folder "Financial Institutions Reform Working Group (CM #149)," box OA 9946, Edwin Meese Files, Ronald Reagan Library.
[123] Ibid.
[124] Ibid.
[125] Michael Quint, "Talking Business: with Pratt of the Home Loan Bank Board," *NY Times*, 28 April 1981.

already on the brink of insolvency."[126] Ailing thrifts, therefore, "sandbagged" new deregulatory changes throughout 1981 to protect themselves from failure.[127]

Pratt argued that "defective structuring" was the "primary cause of the present economic vulnerability," since particular "constraints," such as the Emergency Banking Act (1933, aka Glass-Steagall), the McFadden Act (1927), and Douglas Amendment to the Bank Holding Company Act (1956), had forced thrifts to "act in a manner inconsistent with the logic of the marketplace."[128] Congress, according to Pratt, needed to recognize "the reality" that the "old secure days of comprehensive rate control and rigid specialization will not recur, regardless of the future movement of interest rates."[129] DIDMCA, Pratt argued, was also to blame for this defective structuring, because it only partially deregulated thrifts' liability and asset powers, a situation that proved "asymmetric and inherently unworkable."[130] Given these factors, Pratt believed Congress needed to expand thrift powers to meet these "new era demands." Congressional deliberations over the appropriate response to this escalating savings and loan crisis centered, primarily, around the issues that made State Savings ostensibly successful: expansive holding companies, interstate banking, direct real estate investment, portfolio diversification, and risk management. Political and economic commentators, coincidentally enough, subsequently identified those same factors as significant contributors to the industry's downfall.

---

[126] Deborah Rankin, Personal Finance, "Failed Promises in Banking Deregulation," *NY Times*, 29 November 1981.
[127] Ibid.
[128] Richard Pratt, written statement, House Banking Committee, *Depository Institutions Amendments of 1982*, 594-98. McFadden disallowed interstate banking of commercial banks. Glass-Steagall separated commercial and investment banking. Douglas barred interstate bank acquisitions.
[129] Ibid, 598.
[130] Ibid, 595.

In opposition to Reagan administration regulatory reform efforts, Paul Volcker believed that thrifts needed to maintain their housing specialization. Thrifts, Volcker argued, should be given more time to take advantage of the expanded powers provided by DIDMCA, since only a little more than a year had passed since its passage. If thrifts eventually needed additional opportunities to expand, Volcker suggested that Congress consider keeping them "community, family-oriented institutions."[131] Volcker additionally stressed the importance of federal pre-emption regarding state oversight since it would be the FSLIC, FDIC, and Federal Reserve that would "deal with any adverse consequences for the liquidity and viability of banks or thrifts of expanded powers."[132] Volcker envisioned four basic building blocks needed to maintain the integrity of the American financial system: the separation of banking and commerce; regulation of particular activities, not organizations; diversity among various financial institutions; and a public policy that protects the safety and soundness of depository institutions.[133] Those building blocks, Volcker argued, were the embodiment of a tradition in the U.S. that

> rests on concepts that concentration of economic power can be dangerous, that the potential for conflicts of interest in a service so vital as the extension of capital and credit should be minimized, and that there is a special public interest in the safety and soundness of our depository institutions—an interest that does not, and should not, extend in the same way to other businesses.[134]

Volcker clearly rejected the notion forwarded by Poole, Regan, and Pratt, and many others on the left and right of the political spectrum, that posited depository institutions were

---

[131] Paul Volcker, written statement, House Banking Committee, *Depository Institutions Amendments of 1982*, 637.
[132] Paul Volcker to David Elliott, 12 April 1983, folder "Financial Institution Reform (1/3)," box OA 11843, Edwin Meese Files, Ronald Reagan Library.
[133] Paul Volcker, written statement, House Banking Committee, *Depository Institutions Amendments of 1982*, 616-20.
[134] Ibid, 617.

no more unique than any other business. Volcker understood the positive and negative ramifications of the administration's deregulatory policies. He feared, with a possible expansion of bank holding companies, that it would become difficult to insulate banks and thrifts from the "fortunes of other holding company affiliates."[135] For a number of reasons, Volcker recommended that Congress disallow banks and thrifts to sponsor and sell money market mutual funds.[136] He maintained that it was "generally accepted that the new powers are of little relevance in relieving the existing (emphasis Volcker's) earnings pressure on thrift institutions—indeed…the new powers could precipitate greater difficulties."[137] Volcker, ultimately, did not "perceive an absence of competition, or large new competitive opportunities, in the national, regional, or foreign markets for commercial lending; indeed, there could be danger in looking toward those markets as a 'quick fix' for depressed earnings.[138] Additionally, he and others actually worried that the Reagan administration officials were using the thrift crisis and "budget emergency" as a "Trojan horse" to both sneak its deregulatory agenda through Congress and to justify inaction by the

[135] Ibid, 628.
[136] Ibid, 630-32. Investment in money market mutual funds by banks, Volcker suggested, could change the availability of credit, potentially create conflicts of interest, impair the Federal Reserve's ability to monitor the money supply, and ultimately, "weaken both our institutional structure and money control."
[137] Ibid, 635.
[138] Ibid, 637-38.

administration.[139] Given memoranda that were circulated by the Cabinet Council on Economic Affairs, their concerns were justified.[140]

Many feared, by September 1982, that if Congress did not act soon, the thrift industry would collapse. The thrift industry recorded a $4.6 billion loss in 1981 and a $3.9 billion loss through the first seven months of 1982. Chairman Pratt indicated that at the end of 1981, 801 thrifts ($167 billion in assets) were at or below the legislatively mandated 3 percent net worth. During the first six months of 1982, the average cost of funds for savings and loan associations was 11.5 percent, while the average yield on their mortgage portfolios was approximately 10.3 percent. The FHLBB projected that if interest rates averaged 9.5 percent for 1982 and 1983—the first eight months of 1982 maintained an average of 12.3 percent—1,334 institutions ($324 billion in assets) would fall below the 3 percent net worth minimum.[141]

As Ronald Reagan signed the new deregulatory law on 15 October 1982, he declared that Garn-St. Germain "is the most important legislation for financial institutions in the last

---

[139] Henry Gonzalez and Michael Edwards from the Conference of State Bank Supervisors also proffered the "Trojan horse" theory. See Henry Gonzalez, prepared statement, House Committee on Banking, Finance and Urban Affairs, Subcommittee on Housing and Community Development, *Effects of Budget Cuts and Deregulation on Low and Moderate-Income Groups in Cities*, 97th Congress, 2nd sess., 13 Sept 1982, 3. See also Donald Regan, written statement, House Banking Committee, *Depository Institutions Amendments of 1982*, 644, Regan claimed that a "budget authorization this large and problematical at a time of budget stringency would be totally inappropriate. Also see Michael Edwards, written statement, House Banking Committee, *Depository Institutions Amendments of 1982*, 329. Edwards argued that it was not "right to pursue a public interest concern of an emergency type nature to use as a driver for legislation."
[140] See Memo, Thomas Healey and Peter Wallison to Cabinet Council on Economic Affairs, "Depository Institution Holding Company Deregulation Act of 1983, folder Cabinet Council for Economic Policy_8/82 – 6/30/83 (1/8), box 10699, William Poole Files, Ronald Reagan Library; Memo, Roger Porter to Edwin Meese and Edwin Harper, 3 July 1983, "Depository Institution Holding Company Deregulation Act of 1983," folder Financial Institution Reform (3/3), box OA 11843, Edwin Meese Files, Ronald Reagan Library; and Memo, The Working Group on Federal Credit Policy to Cabinet Council on Economic Affairs, 30 June 1983, "Trusts for Investment in Mortgages (TIMs), folder Cabinet Council for Economic Policy_8/82 – 6/30/83 (2/8), box 10699, William Poole Files, Ronald Reagan Library. These three memoranda provide specific examples of administration officials presenting legislative proposals in terms of their political and/or ideological effects of their deregulatory efforts.
[141] Ibid, 593-94.

50 years… [It] represents the first step in our administration's comprehensive program of financial deregulation…[It] will make the thrift industry a stronger, more effective force in financing housing for millions of Americans in the years to come."[142] Jimmy Carter, interestingly enough, made similar comments concerning the importance of DIDMCA.[143] Garn-St. Germain passed both Houses of Congress by overwhelming margins. Policymakers hoped it would counter the burgeoning instability in savings and loan institutions. The new law, asserted one administration official, provided the "elbow room" necessary for savings and loan institutions to weather the high inflation and high interest rate storms of 1981 and 1982, which by August 1982 had cost thrifts some $8.5 billion.[144]

Garn-St. Germain provided capital (via net worth certificates) for ailing thrifts, eased restrictions for merging thrifts and ownership requirements, and increased thrift investment opportunities by allowing them to invest up to 40 percent of assets in commercial mortgages, 11 percent of assets in secured or unsecured commercial loans, and 3 percent of assets as direct equity investments in business.[145] Senator Jake Garn (R-Utah) and Congressman Fernand St. Germain (D-Rhode Island), in cooperation with Reagan administration officials and the U.S. League of Savings Associations, crafted a bill that Reagan believed "hit the jackpot."[146] Given the extent to which scholars have blamed the "casino economy"—enabled

[142] Ronald Reagan, Signing Ceremony for Garn-St. Germain Depository Institutions Act, 15 October 1982.
[143] Quote JC at DIDMCA signing.
[144] Edwin Gray, testimony, Senate Committee on Banking, Housing, and Urban Affairs, *Nomination of Edwin Gray*, 98th Congress, 1st sess., 23 February 1983, 4.
[145] Mason, *Bail-Outs*, 219. The "direct equity investments" also allowed for investment in junk bonds, which were high-risk financial instruments that proved scandalous as well.
[146] Ronald Reagan, Signing Ceremony for Garn-St. Germain Depository Institutions Act, 15 October 1982.

by Garn-St. Germain—for the eventual collapse of the savings and loan industry, Reagan's gambling metaphor proved more accurate than he originally intended.[147]

Despite the additional asset powers Garn-St. Germain authorized, the U.S. League assured legislators that "in good times or bad, our institutions will remain the backbone of the residential credit markets." For whatever reason, however, no policymakers realized or acknowledged that thrifts had already been supplanted as the backbone of American mortgage origination. Economic and political commentators in the post-Garn-St. Germain era would not only witness a continued decline in mortgage lending from savings and loan institutions, they would also experience the catastrophic collapse of the entire savings and loan industry.[148]

Not All Knowledge Was Created Equal: Lessons Ignored on the Road Toward Financial Regulatory Reform

Legislators passed financial regulatory reform legislation, beginning in 1980, that theoretically allowed S&L executive more flexibility to respond to the unprecedented high interest rates that resulted from Volcker's monetarist turn. As they drafted DIDMCA and Garn-St. Germain, policymakers could have drawn upon several previous regulatory, economic, and political experiences that would have allowed them to avoid many of the problems that S&Ls encountered in the later years of the 1980s. They, however, did not; instead, they fervently justified their regulatory reform proposals with ideologically motivated arguments that favored market mechanisms over government regulation.

---

[147] Kitty Calavita, Henry Pontell, and Robert Tillman, *Big Money Crimes: Fraud and Politics in the Savings and Loan Crisis* (Berkeley: University of California Press, 1997), 2. See also Martin Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (New York: Charles Scribner's Sons, 1990); and Stephen Pizzo, Mary Fricker, and Paul Muolo, *Inside Job: The Looting of America's Savings and Loan* (New York: McGraw-Hill Publishing Co., 1990).
[148] Ibid, 451.

One potential lesson learned related to S&L executives' previous lending practices and loan officer expertise. As Robert McKinney entered his chairmanship of the FHLBB, the Bank Board was under considerable pressure to confront racial discrimination within U.S. housing and financial markets. McKinney understood that funding "urban restoration" projects required, among other things, establishing "urban lending techniques" that maintained "sound underwriting criteria." He explained to an audience of S&L executives in October 1977, "as with any line of business, you must develop your base of experience….I can assure you that we will be working with our examining and supervisory staff to verify that they, too, develop an understanding of urban lending techniques….The Board's staff will be learning with you as you explore new approaches to urban lending."[149] McKinney clearly appreciated the operational and economic complexities of allowing, or in this case strongly encouraging, institutional lending into new fields, something his succecessors at the FHLBB either downplayed or outright ignored as they simultaneously expanded thrifts' asset and liability powers and reduced their regulatory and supervisory oversight. Many policymakers in the early 1980s failed to consider whether and how institutional expertise mattered as they authorized—and expected—S&Ls to quickly expand their asset portfolios to include: commercial mortgages, ADC loans, consumer loans, direct equity investments, and corporate debt securities, *inter alia*.

Several instances of individual abuse and rampant institutional speculation were other events that were later forgotten or ignored, especially by Reagan appointee Richard Pratt who single-handedly deregulated numerous aspects of the thrift industry.[150] Many policymakers, after the S&L industry collapsed, acted surprised that such a "conservative" industry could

---

[149] McKinney speech, October 21, 1977, "Savings and Loan Associations and the Cities."
[150] Pratt's FHLBB regulations as well as assistance in crafting Garn-St. Germain.

have run itself into the ground, but the signs were always there. In 1973, FDIC Chairman Frank Wille warned the House Committee on Banking and Currency, which included several legislators who subsequently voted for DIDMCA and Garn-St. Germain, "I think that any time you go into a period of tight monetary restraint where institutions have to act in somewhat unusual, abnormal ways in order to stay competitive, or to stay viable…the potentials of problems which have to be very carefully watched by all of the supervisory agencies….So I would have to say that historically we accelerate our oversight."[151]

Fernand St. Germain, one of the key legislative architects of Garn-St. Germain, only two years before Congress passed DIDMCA, spent much of his time as Chairman of the House Subcommittee on Financial Institutions combating institutional abuse and lender misconduct. He unsuccessfully fought to end intersecting directorates at financial institutions, but he actually secured legislation that limited loans to insiders and affiliates. It also established criteria that disallowed lenders from offering unlimited loans to any one borrower. Those rules were subsequently overturned by the Pratt-led FHLBB and/or eliminated by Garn-St. Germain.[152] Moreover, several senators and Carter administration officials debated whether the government-sponsored enterprises, FNMA in particular, met its fiduciary and social mandates, which called into question whether private and/or semi-private financial institutions could simultaneously maintain profits and provide public goods.[153]

Just as important, policymakers during the 1960s and 1970s witnessed increased

---

[151] 1973 Credit Crunch Hearing, Frank Wille, 427. Verify these legislators voted for DIDMCA and Garn-St. Germain: Henry Reuss (D, WI), Fernand St. Germain (D, RI), Thomas Ashley (D, OH), William Moorhead (D, PA), Henry Gonzalez (D, TX), Chalmers Wylie (R, OH), John Rousselot (R, CA), and Stewart McKinney (R, RI), among others.
[152] Fighting malfeasance examples, 1978 legislation. Proxmire and Germain comments, others?
[153] Memo, Eizenstat to Carter, Feb 7, 1978; Memo, Eizenstat to Carter, Feb 15, 1978; "Secondary Market Operations of FNMA and FHLMC," December 1976, Senate. Carter administration officials, including President Carter, internally debated how to best replace Oakley Hunter and Lester Condon as directors of FNMA.

amounts of speculative behavior from S&Ls in the largest housing and financial market in the country, California—the state with the highest number of institutional failures once the industry finally collapsed in 1989.[154] Real estate speculation, according to a Federal Home Loan Bank of San Francisco staffer in 1977, should be discouraged because "speculative buyers overstate demand and eventually contribute to overbuilding…they drive prices upward, which is not in the interest of the consumer, especially new entrants to the home-ownership market."[155] These problematic practices from S&L executives, long before the supposed emergence of "high-flyers" in the early 1980s, created rifts within the thrift industry that time and again resurfaced as legislators and other policymakers debated regulatory reform efforts during the late 1960s, 1970s, and 1980s.[156] The continued existence of these intra-industry disagreements should have forced policymakers to seriously analyze which S&Ls were capable of taking advantage of regulatory reform as well as consider the adverse effects of loosening the regulatory reins when operational abuses and speculative behavior had rather consistently required previous regulatory attention.

CONCLUSION

Even though Reagan and other contemporary economic and political observers identified fundamental differences between his approach toward regulatory relief and Carter's regulatory reform, both administrations interpreted the rapidly changing contexts of

---

[154] Eichler, *The Thrift Debacle*, 16-32; Strunk and Case, *Where Deregulation Went Wrong*, 10. See also Memo, D.L. Parry to M.A. Jesseee, "Speculation in California Housing Markets," April 5, 1977.
[155] Memo, D.L. Parry to M.A. Jesseee, "Speculation in California Housing Markets," April 5, 1977.
[156] Mason, 159-240. The U.S. League, for example, was increasingly accused of representing the interest of the largest S&Ls in the country, which for most of the postwar period were located in California. The Carter administration acknowledged as much when they debated the long-term effects of the two previous "Californian" FHLBB chairmen. See Lisbeth Godley to Landon Butler memo, February 22, 1977, "Presidential Appointment at the FHLBB."

the late 1970s and early 1980s through similar ideological lenses. Both pursued ideological deregulation from the earliest days of their administrations. Both aimed to reduce the number of regulations, increase economic efficiency, and promote market-based solutions. Both pushed policies that made no distinction between economic and social regulations. Both portrayed the existing regulatory structures as outdated, inefficient, expensive, and captured. Both propounded politically expedient interpretations of and solutions to S&L instability, which included protecting small savers, not acknowledging structural changes within the American financial sector, and appeasing the investor class, that not only minimized the potential for political fallout, but they also ignored and/or misidentified thrifts' actual problems—all actions that further hastened the industry's demise.

Granted, Carter's nuanced ideological deregulation clearly differed from Reagan's all out rhetorical and political assault on the vestiges of the New Deal regulatory framework. Some of Carter's regulatory appointees publicly defended and pursued social regulatory goals in the name of the public good. Reagan's, on the other hand, initially favored and unequivocally pursued ideological deregulation within the executive agencies they oversaw—so fervently, in fact, they eventually sparked a public backlash.[157] Their differences, however, were of degree and not substance. Jimmy Carter's extensive regulatory reform achievements cleared the beachhead made Reagan's efforts possible. Just as important, both administrations' financial regulatory reform efforts dismantled the final remnants of the growth and saver governance mechanism while simultaneously striving to replace it with the XXXX governance mechanism.

Dustin Walker 8/13/15 9:13 PM
Comment: Need to devise name for replacement, still unsure of what to call it

[157] Eads and Fix.