UC Santa Barbara
UC Santa Barbara Electronic Theses and Dissertations

Title
Unleashing the Financial Sector: Home Loan Deregulation and the Savings and Loan Crisis, 1966-1989

Permalink
https://escholarship.org/uc/item/1922d07b

Author
Walker, Dustin Ryan

Publication Date
2017

Peer reviewed|Thesis/dissertation

eScholarship.org Powered by the California Digital Library
University of California

UNIVERSITY OF CALIFORNIA

Santa Barbara

Unleashing the Financial Sector: Home Loan Deregulation and the Savings and Loan Crisis, 1966-1989

A dissertation submitted in partial satisfaction of the

requirements for the degree Doctor of Philosophy

in History

by

Dustin Ryan Walker

Committee in charge:

Professor Mary Furner, Chair

Professor Alice O'Connor

Professor Nelson Lichtenstein

Professor Stephen Weatherford

June 2018

The dissertation of Dustin Ryan Walker is approved.

Stephen Weatherford

Nelson Lichtenstein

Alice O'Connor

Mary Furner, Committee Chair

September 2017

Unleashing the Financial Sector: Home Loan Deregulation and the Savings and Loan Crisis, 1966-1989

Copyright © 2018

by

Dustin Ryan Walker

To JP: Sorry you missed this

ACKNOWLEDGEMENTS

This project, quite simply, could not have been completed without the mentorship and guidance of Mary O. Furner. Words cannot accurately convey the appreciation, the admiration, and the respect I have for you as a scholar and a human being. A simple thank you seems woefully inadequate as I gratefully acknowledge the overwhelming support and encouragement and insightful suggestions that you provided me as I analyzed and explained this vitally important, but previously misunderstood, episode in U.S. economic and political history. Nevertheless, I will still try, thank you Mary—for everything.

Several grants and fellowships made this project financially feasible. Those funds provided me the opportunity to travel to five different states and the District of Columbia and collect tens of thousands of pages of archival materials. They included: the UC Santa Barbara Graduate Dean's Dissertation Fellowship, Tobin Project Democracy and Market Fellowship, UC Santa Barbara Gradate Dean's Advancement Fellowship, UC Regent's Dissertation Fellowship, UC Santa Barbara Humanities and Social Science Research Grant, UC Santa Barbara Department of History Dissertation Fellowship, All-UC Group in Economic History Research Grant, UC Santa Barbara History Associates Fellowship, UC Santa Barbara History Associates Robert L. Kelley Fellowship, and the UCLA IRLE Collaborative Graduate Student Research Grant. Additionally, I am grateful to Nicole Pacino, Tara Tubb, Colleen Ho, and Rachel Winslow, who regularly provided constructive feedback on my grant and fellowship proposals. I'm grateful for your time and appreciative of the thoughtful historical observations and grammatical corrections. And to Colleen Ho, Shawn Mack, Lindsay and Josh Harris, and Helen-Jane and Russell Abrecht, thank you for opening your homes to me as I archived up and down the East Coast. I appreciate the kindness and generosity.

I am also eternally grateful to the many archivists who eagerly and openly shared their institutional expertise and historical knowledge with me. Without Bill Davis and Rod Ross (Center for Legislative Archives at the National Archives), Keith Shuler (Jimmy Carter Presidential Library), Kelly Barton (Ronald Reagan Presidential Library), Robert Beasecker and Nancy Richard (Special Collections and University Archives at Grand Valley State University), Roy Hinojosa (Dolph Briscoe Center for American History at UT Austin), and Nicholas Siekierski (Hoover Institution), this project stalled before it started. Additionally, thank you for the conversation and congeniality, it provided a welcome respite from the monotony of a seven-month archival bender. And to Bill Davis, in particular, a special thank you for the exhilarating trip into the stacks at the National Archives, I honestly felt like a kid on Christmas morning again.

As I struggled, throughout every stage in this process, to conceptualize the project, identify the various factors that contributed to the savings and loan industry's demise, and craft a nuanced narrative that accurately explained this complex moment in U.S. financial and political history, I relied upon so many individuals to offer me writing and research advice, identify previously unknown (to me) historical actors and historical context, suggest additional readings, provide economics tutorials, and pose potential narrative arcs and historiographical re-interpretations. So for all the time you spent reading and commenting on chapter drafts and/or brainstorming with me, I thank Mary Furner, Alice O'Connor, Steve Weatherford, Nelson Lichtenstein, Louis Hyman, Ken Hough, Kit Smemo, Samir Sonti,

Kashia Arnold, Serge Ferrari, Jesse Halvorsen, Cody Stephens, Caitlin Rathe, Tim Paulson, Anita Morgan, Scott Walker, Greg Storen, and Ryan Abman. And I would also like to extend a heartfelt thank you to Senate Historian Betty Coed, former Senate Historian Donald Ritchie, House of Representatives Historian Matthew Wasniewski and Associate Historian Kenneth Kato, and Center for Legislative Archives Historian Richard McCulley, who graciously spent countless hours with me sharing your unique perspectives and experiences as congressional insiders. The insights I gleaned from you proved invaluable to the completion of this work.

Additionally, I presented aspects of my research at several conferences and workshops, including the Tobin Project's Democracy and Market Workshop, the National Archives Brown Bag Lunch Series, the All-UC Group in Economic History student workshop and conference, the Center for the Study of Work, Labor, and Democracy at UC Santa Barbara, the UC Washington Center, the Histories of American Capitalism Conference at Cornell University, and the Third Biennial Conference of the ECPR Standing Group on Regulatory Governance at University College Dublin. These sessions with archivists, historians, political scientists, and economists, among others, forced me to not only re-evaluate the tone and accessibility of my narrative and argumentation, but also the inter-disciplinary potential of my research. I am beyond grateful for all of this input and advice.

This project details the twenty-five-year transformation, decline, and death of the savings and loan industry. To both tell this story accurately and provide the necessary evidence to justify my claims, I incorporated copious amounts of U.S. financial and housing data into my analysis. I would have been unable to do so, however, without Louis Hyman and his History of Capitalism Summer Camp. Those two jam-packed weeks I spent at Cornell during the summer of 2013 provided me with the knowledge, tools, and training necessary to confidently identify, analyze, and explain the various and often competing micro- and macroeconomic factors that influence economic growth and corporate decision-making. Just as important, I learned how to evaluate and understand financial statements, a skillset that proved invaluable as I detailed the slow demise of savings and loan institutions across the United States. So Louis, a hearty thank you!

A special thank you to Jill Jensen, who not only helped make my transition into the graduate program at UC Santa Barbara seamless and exciting, but also provided me critical mentorship and guidance as I looked for teaching assistantships, completed course requirements, prepared for my qualifying exams, applied for grants and fellowships, and drafted this manuscript. Thanks for your willingness to openly share your experiences and insights with me, it made all the difference in the world.

To Darcy Ritzau, thank you for ALL of the things. You are the backbone of UC Santa Barbara's Department of History. A smile and "hey hon," accompanied by your patience and compassion, always immediately eased the worst of anxieties. I am eternally grateful for the work you did on my behalf, specifically, and for the department in general. You're truly an angel.

For helping me maintain my sanity and sense of humor as I completed this journey, I thank Ryan Abrecht, Nate Bullock, Chuck Yahara, Mehgan and Dave Tanner, Malek Guerbaoui, Colleen Ho, Shawn Mack, the Hough and Briggs-Campbell clans, Jeff and Sarah Dinkler, Elijah Bender, Nicole Pacino, Tara Tubb, Don Lubach, Rosella Faye, Chris Keggereis, Sarah Hanson-Keggereis, Sasha Coles, Laura Moore, Chris Nofziger, Brian Tyrrell, James and Rachel Winslow, Jason Ebin, Richard Espinoza, Dave Beltz, Brittney Walker, Noah Faulkner, Alex and Caden Whitehead, and Drew Storen.

To the many individuals who helped ignite and flame my passions for historical inquiry, critical analysis, and intellectual debate, especially during my formative high school and undergraduate years, I thank Dee Tidball, Noel Schaak, Carl Louden, Kevin C. Robbins, Anita (Ashendel) Morgan, Kevin Cramer, Marianne Wokeck, Philip Scarpino, Fred Witzig, Nathan Ringham, Nate Bullock, Mark Lee, and Tim Moriarty.

To my parents, Grandma Edie, and JP, thanks for the genes. Your constant love and support has been foundational as I pursued my dream over the last decade. And to Grandma Edie and Carl, thanks for all the laughs, stories, and card games. Vanessa and I cherish our time with you, whether it's in person, over the phone, or on Skype. As we age hopefully with the grace and excitement for life that you both have, Vanessa and I hope to emulate your sense of adventure and story-telling abilities.

And last, but certainly not least, thank you to my amazing wife Vanessa. Pursuing a PhD can be a very alienating process personally as it requires a dedication and focus that many non-academics may not understand. But you openly embraced me and my dreams, and it was your love, support, understanding, and yes, even those “unwelcomed” distractions, especially the walks on Goleta beach, that made this grueling process bearable. I meant it when I played you the song shortly after we started dating, I meant it when I vowed to love you the rest of my life, and I mean it now more than ever when I say, “How wonderful life is while you’re in the world.”

VITA OF DUSTIN RYAN WALKER
June 2018

EDUCATION AND RESEARCH

PhD, U.S. History and Public Policy
University of California, Santa Barbara
2018
Dissertation: *Unleashing the Financial Sector: Home Loan Deregulation and the Savings and Loan Crisis, 1966-1989*

MA, History
Purdue University
2008

BA, History
Indiana University-Purdue University, Indianapolis
2005

PROFESSIONAL APPOINTMENTS/EMPLOYMENT

University of California, Santa Barbara
Teaching Associate, Department of History
2014

University of California, Santa Barbara
Teaching Associate, Department of History
2013

The Tobin Project
Democracy and Markets Fellow
2012-2013

University of California, Santa Barbara
Instructor, Writing Program
2010-2013

PUBLICATIONS

"The S&L Crisis in its Earliest Days: Banking Reform Rhetoric in the Johnson and Nixon Years," *Federal History Journal* 8 (April 2016): 71-94.

Web-Based Publications

Essay, "To Make You Feel My Love: the 'Hispanic Vote and the Future of the Republican Party." In *Enduring Questions: American Government* (ABC-CLIO).

AWARDS AND HONORS

2014 – 2015
- UCSB University Award of Distinction
- UCSB Department of History Dissertation Fellowship
- UCSB Academic Senate Graduate Student Travel Grant
- UCSB Graduate Student Association Conference Travel Grant

2013 – 2014
- UCSB Graduate Dean's Dissertation Fellowship
- All-UC Group in Economic History Conference Travel Award

2012 – 2013
- UCSB Graduate Dean's Advancement Fellowship
- UCSB Humanities and Social Science Research Grant
- UCSB Department of History Travel Grant

2011 – 2012
- UC Regent's Dissertation Fellowship
- Tobin Project Democracy and Market Fellowship
- UCSB History Associates Fellowship
- All-UC Group in Economic History Research Grant

2010 – 2011
- Robert L. Kelley Fellowship
- All-UC Group in Economic History Research Grant
- UCLA IRLE Collaborative Graduate Student Research Grant
- All-UC Group in Economic History Conference Travel Grant
- Academic Senate Outstanding Teaching Assistant Award Nomination

2004 – 2005
- Undergraduate Research Opportunities Program Grant
- Honors Department Research Grant
- IUPUI Top 10 Male Student
- IUPUI Top 100 Student
- Ronald E. McNair Scholar
- Salutatorian Scholarship

2003 – 2004
- IUPUI Top 100 Student
- Ronald E. McNair Scholar
- Salutatorian Scholarship

2002 – 2003
- Salutatorian Scholarship
- Honors Scholarship

2001 – 2002
Salutatorian Scholarship
Honors Scholarship

CONFERENCE ACTIVITIES

Papers Presented

2016: "The Savings and Loan Industry Deregulated: Out with the Old, In with the New," Center for the Study of Work, Labor, and Democracy, UC Santa Barbara, May 20.

2014: "The Crisis Before the Crisis: The Savings and Loan Industry before the 1980s," The Histories of American Capitalism, Cornell University, November 8.

2013: "Be Bold: The Carter Administration and Deregulation," All-UC Group in Economic History Graduate Student Workshop, UC Berkeley, October 12.

2012: "The Savings and Loans Crisis within its Larger Historical Context," University of California, Washington Center, Washington, D.C., December 11.

2012: "The National Archives Legislative Records and the Savings and Loans Crisis," National Archives Brown Bag Lunch Series, Washington, D.C., November 29.

2012: "A Regulatory Framework for the Savings and Loans," Tobin Project's Graduate Student Forum, Harvard University, November 16.

2011: "All in All, I Think We Hit the Jackpot": Garn-St. Germain and the Reagan Administration's Faith in Deregulation," All-UC Group in Economic History Asia-Pacific Economic and Business History Conference, UC Berkeley, February 20.

2010: "All in All, I Think We Hit the Jackpot": Garn-St. Germain and the Reagan Administration's Faith in Deregulation," Third Biennial Conference of the ECPR Standing Group on Regulatory Governance, University College Dublin, June 19.

2009: "Never Again…and This Time We Really Mean It: A Theory on Genocide Prevention," 1st Annual International Network of Genocide Scholars, Sheffield University, January 7.

2007: "Revolutionary Rhetoric: Virginian Dissent in Religious Petitions, Editorials, and Sermons, 1774-1787," 1st Annual Academic Internal Conference, Purdue University, April 27.

2005: "Jefferson and the Separation of Church and State: An Analysis of Disestablishment by Comparing Thomas Jefferson's Views on Religion with the Provisions about Religion in Select Colonial and State Constitutions," 14th Annual National Ronald E. McNair Research Conference, November 18.

2005: "Veterans History Project," National Conference for Undergraduate Research, Washington and Lee University, April 23.

2004: "Veterans History Project," Summer Research Opportunities Program Committee on Institutional Cooperation Conference, University of Iowa, July 31.

TEACHING EXPERIENCE

University of California, Santa Barbara

Teaching Associate
Courses:
U.S. Wealth and Poverty: 1945- present, Summer 2014
U.S. Wealth and Poverty: 1945- present, Summer 2013

Instructor
Courses:
Introduction to Academic Writing, 2010-2013

Guest Lectures:
"Progressive Era Work, Labor, and Democracy" U.S. Wealth and Poverty, 1865-1945, 2016
"Realpolitik and the Genocide Convention," American People, 1920 – present, 2015
"Critics of Capitalism," U.S. Wealth and Poverty, 1865-1945, 2010

Teaching Assistant
Courses:
The American People, WWI – Present, Department of History, Spring 2015
Great Issues in the History of Public Policy, Department of History, Fall 2014
The American People, WWI – Present, Department of History, Spring 2010
World History, 1700 – Today, Department of History, Fall 2009
The American People, WWI – Present, Department of History, Summer 2009
The American People, WWI – Present, Department of History, Spring 2009
The American People, 1840 – 1920, Department of History, Winter 2009
The American People, 1492 – 1820, Department of History Fall 2008

Reader
Courses:
U.S. in the Twentieth Century, 1900 – 1929, Department of History, Fall 2013
U.S. Wealth and Poverty, 1865 – 1950, Department of History, Spring 2013
U.S. Wealth and Poverty, 1865 – 1950, Department of History, Winter 2010
The U.S. since Watergate, Department of History, Winter 2010
History of the American Working Class, Department of History, Winter 2010

Purdue University

Teaching Assistant:
Modern Middle East, Department of History, Spring 2008
Middle East History and Culture, Department of History, Fall 2007

Indiana University-Purdue University, Indianapolis

Supplemental Instruction Mentor:
Introduction to Criminal Justice, School of Public and Environmental Affairs, Spring 2005
Introduction to Criminal Justice, School of Public and Environmental Affairs, Fall 2004
Introduction to Criminal Justice, School of Public and Environmental Affairs, Spring 2004
Introduction to Criminal Justice, School of Public and Environmental Affairs, Spring 2003
Introduction to Criminal Justice, School of Public and Environmental Affairs, Fall 2002

DEPARTMENTAL/UNIVERSITY SERVICE

2016 – 2017
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB
Member, Advisory Board, Student Medical Emergency Relief Fund, UCSB

2015 – 2016
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB
Member, Advisory Board, Student Medical Emergency Relief Fund, UCSB

2014 – 2015
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB

2013 – 2014
Participant, Economic Methods for Historians Workshop, Cornell University
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB
Representative, H.G.S.A. Comprehensive Examination Committee, UCSB

2012 – 2013
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB
Representative, H.G.S.A. Comprehensive Examination Committee, UCSB

2011 – 2012

President, History Graduate Student Association, UCSB
Member, Advisory Board, G.S.A Graduate Student Emergency Fund, UCSB
Representative, Student Financial Resource Workgroup, UCSB
Representative, Associated Students Food Pantry Council, UCSB

2010 – 2011

Vice President of Student Affairs, G.S.A. Executive Council, UCSB
Chairman, G.S.A. Elections Committee, UCSB
Representative, Student Financial Resource Workgroup, UCSB
Representative, GSHIP Implementation Workgroup, UCSB
Representative, Academic Senate Undergraduate Council, UCSB
Representative, Student Housing Committee, UCSB
Commentator, Senior Honors Seminar Colloquium, UCSB

2009 – 2010

Vice President, History Graduate Student Association, UCSB
Conference liaison, Third Annual Regional Workshop for College Teachers: "The Constitutional Legacy of the American Revolution," Institute for Constitutional History, UCSB
Representative, Graduate Student Assembly, UCSB
Panelist, McNair Scholars Graduate Student Panel, UCSB

2008 – 2009

Representative, Graduate Student Assembly, UCSB
Panelist, History Department's "How to Pursue a Graduate Degree" Panel, UCSB

OTHER PROFESSIONAL EXPERIENCE

Prospect Research Analyst, UC San Diego, 2017-present
Director, Business and Development Services, Development Office, UCSB, 2017
Prospect Development Analyst, Development Office, UCSB, 2015-2016
Panelist, Future Trajectory of the Histories of Capitalism Panel, Cornell University, 2014
Graduate assistant, Office of Development, Science and Engineering, UCSB, 2014
Research assistant, U.S. Presidents and the Environment, UCSB, 2013-2014
Graduate assistant, Center for Research and Learning, IUPUI, 2008
Tax preparer, Storen Tax Service, Brownsburg, IN, 1999-2008
Intern, Indiana House of Representatives, Indianapolis, IN, 2006
Intern, United States Senate, Washington, D.C., 2003
Intern, Indiana Law Enforcement Academy, Indianapolis, IN, 2003

LANGUAGES
Spanish, reading proficiency

PROFESSIONAL/AFFILIATIONS
American Historical Association
Organization of American Historians
Business History Conference
Association of Professional Researchers for Advancement

ABSTRACT

Unleashing the Financial Sector: Home Loan Deregulation and the Savings and Loan Crisis, 1966-1989

by

Dustin Ryan Walker

Unleashing the Financial Sector reveals how policymakers utilized financial regulation for economic and social engineering purposes. Scholars assume that outdated regulations, regulatory capture, and fraud instigated a savings and loans (S&L) crisis that began in 1979. This project challenges those accounts by demonstrating how structural changes to the U.S. financial sector beginning in 1966 thrust the S&L industry into an existential crisis from which it would never recover. I resituate the S&L crisis within a longer historical narrative that explores the socio-economic, political, and intellectual factors that both shaped the trajectory of the U.S. financial sector after World War II and informed policymakers' interpretations of and responses to S&L instability. This work explores how other financial institutions replaced S&Ls as the main conduits of mortgage credit, a change that fundamentally altered the composition and functionality of the financial sector and the U.S. economy. A bipartisan coalition of policymakers, not fully comprehending the changing world around them, heralded deregulation and a return to the market as the only appropriate responses to market failure. Their efforts to implement what I identified as transformational deregulation only worsened the economic and political fallout when the S&L industry collapsed in 1989.

TABLE OF CONTENTS

	Introduction	**1**
Chapter 1	From the Growth and Saver to Second Layer Lender Governance Mechanism: S&Ls after 1966	**31**
Chapter 2	Financial Regulatory Reform in the 1970s: Agendas and Rhetorics, 1970-1974	**74**
Chapter 3	The Battle for Deregulation: Ideology Takes Hold, 1975-1976	**111**
Chapter 4	Transformative Deregulation Reigns Supreme: Carter and Reagan Administration Rhetorical Choices and Policy Pursuits, 1977 – 1982	**150**
Chapter 5	Zombie Industry: FHLBB Chairman Gray Confronts Transformative Deregulation, 1983-1988	**208**
	Conclusion	**263**
	Bibliography	**275**

Introduction

The traditional narrative of the savings and loan crisis is a familiar one.[1] Federal policymakers during the 1930s identified savings and loan institutions (S&Ls a.k.a. thrifts) as the home loan lender of choice, and the Federal Reserve reinforced that decision in 1933 by implementing Regulation Q—an interest rate ceiling that limited the interest rates that commercial banks could offer to depositors—even though S&Ls paid market rates. Fearing continued rate wars with banks and a decline in housing starts, Congress extended Regulation Q to thrifts in 1966, establishing a slight interest rate differential in order to help S&Ls maintain their market niche as mortgage providers and thus guarantee consumers ready access to mortgage credit.[2] The interest rate S&Ls could offer was twenty-five to fifty basis points (0.25 percent – 0.50 percent) higher than commercial banks could pay. The utilization of Regulation Q as an allocative regulatory tool demonstrated the federal government's willingness to actively promote and protect American homeownership. It also provided S&Ls with a competitive advantage by quite explicitly guaranteeing thrifts' access to large amounts of cheap capital at the expense of other financial institutions. That system established by

---

[1] See Martin Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (New York: Charles Scribner's Sons, 1990); Norman Strunk and Fred Case, *Where Deregulation Went Wrong: A Look at the Causes Behind Savings and Loan Failures in the 1980s* (Chicago: United States League of Savings Institutions, 1988); Ned Eichler, *The Thrift Debacle* (Berkeley: University of California Press, 1989); Stephen Pizzo, Mary Fricker, and Paul Muolo, *Inside Job: The Looting of America's Savings and Loan* (New York: McGraw-Hill Publishing Co., 1990); James Adams, *The Big Fix: Inside the S&L Scandal* (New York: John Wiley & Sons, Inc., 1990); William Black, *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry* (Austin: University of Texas Press, 2005); Kitty Calavita, Henry N. Pontell, and Robert Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (Berkeley: University of California Press, 1997); Paul Zane Pilzer, and Robert Deitz, *Other People's Money: How Bad Luck, Worse Judgment and Flagrant Corruption Made Shambles of a $900 Billion Industry* (New York: Simon and Schuster, 1989); Kathleen Day, *S&L Hell: The People and Politics Behind the $1 Trillion Savings and Loan Scandal* (New York: W.W. Norton and Company, 1993); David Mason, *From Buildings and Loans to Bail-outs: A History of the American Savings and Loan Industry, 1831-1995* (Cambridge: Cambridge University Press, 2004); and James Barth, Susanne Trimbath and Glenn Yago, eds., *The Savings and Loan Crisis: Lessons from Regulatory Failure* (Norwell: Kluwer Academic Publishers, 2004).

[2] Housing starts dropped from 1.5 million in 1965 to a projected 900,000 by fall 1966. See Irwin Friend, *Study of the Savings and Loan Industry* (Washington, DC: USGPO, 1969), hereafter cited as the Friend Commission.

Congress worked really well. Savings and loan associations provided millions of mostly white working- and middle-class Americans the opportunity to achieve a component of the "American dream" by owning their own home. Home ownership in the postwar period jumped from 43.6 percent in 1940 to 61.9 percent in 1960 and 65.6 percent by 1980.

The high inflation and high interest rates of the late 1970s and early 1980s, however, threatened the market niche that thrifts filled. The economic circumstances that jeopardized thrifts specifically, and the U.S. financial industry more broadly, forced politicians and academics to consider the degree of government culpability for the current economic crisis, and to debate the appropriate government response(s) to this looming economic disaster. Experts contended that thrifts were losing deposits and profits as a result of legislatively mandated interest rate ceilings (Regulation Q) and regulatory restrictions on the asset and liability portfolios of S&Ls, which limited the types of lending opportunities (assets) and deposit accounts (liabilities) that each S&L could offer. Thrift industry profits, after the Volcker shock in 1979, 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 "technically insolvent" because their total capital reserves had fallen below the required minimum of 5 percent of insured deposits.[3] With the emergence of money-market accounts and nonbank banks such as American Express, Prudential Insurance, and Sears, Roebuck, in addition to the high inflation, many bank and thrift executives argued that federal regulations unduly restricted their ability to expand—both geographically and functionally—into new markets.[4] Thus their

[3] Mason, *From Buildings and Loans*, 214.

[4] A "non-bank bank" is term used throughout the S&L literature that refers to an institution that is not legally a bank because it does not accept deposits **and** offer commercial loans. Thus, it was not subject to banking regulations. Various financial and corporate institutions operated as non-bank banks, including American Express, Prudential Insurance, and Sears, Roebuck. Another term that was incorporated into the "The Financial Crisis Inquiry Report" was the "shadow banking system." It referred to the "investment banks, most prominently, but also other financial institutions—that freely operated in capital markets beyond the reach of

ability to make a profit by investing beyond the housing industry was limited, potentially guaranteeing their ruination.

Addressing this situation, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) with the expressed intention of alleviating this dire situation. DIDMCA authorized thrifts to offer checking accounts bearing market interest rates (liability deregulation), which would help attract new depositors, and it mandated a six-year phase out of Regulation Q, which many political and economic observers blamed for the earnings squeeze thrifts faced. These reforms worked less than optimally. Though the thrifts could compete more aggressively for depositors under DIDMCA, the cost of acquiring new funds increased as they came into competition for depositors with a wider range of financial institutions. Yet they continued to be restricted to almost exclusively lending for fixed-rate home mortgages, and not for financing potentially higher yielding projects. This stopgap solution resulted in $8.5 billion loss for the savings and loan industry between January 1981 and August 1982.

Congressional efforts, led by Senators Jake Garn (R-UT) and William Proxmire (D-WI) and Congressman Fernand St. Germain (D-RI), to revive an ailing thrift industry forced legislators to begin restructuring the American financial sector. In October 1982, both houses of Congress overwhelming passed the Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain), which provided capital (via net worth certificates) to struggling thrifts, eased ownership requirements and restrictions to merge thrifts, and enabled thrifts to invest up to 40 percent of assets in commercial mortgages, 11 percent of assets in secured or

---

the regulatory apparatus that had been put in place in the wake of the crash of 1929 and the Great Depression." I find the two terms to be synonymous. *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (2011), 27.

unsecured commercial loans, and 3 percent of assets as direct equity investments in businesses (asset deregulation).[5]

Many thrifts thereafter began to implement those newly granted powers to diversify their liability and asset portfolios and, subsequently, re-establish institutional solvency. And by the mid-1980s, almost 90 percent of the industry achieved profitability—but not necessarily solvency—once again.[6] A small number of thrift executives, however, took advantage of new tax and regulatory changes and regulatory forbearance (not closing insolvent thrifts) and violated their fiduciary responsibilities by committing fraud and conducting unsafe and unsound lending operations. Their financial malfeasance, in combination with untimely regional recessions in 1986 and 1987, drove the S&L industry into despair once again. But the S&L industry, unlike in the early 1980s, did not recover and, as the Federal Savings and Loan Insurance Corporation (FSLIC) was itself insolvent, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act in 1989. The legislation, among other things, created the largest taxpayer funded bailout to that point in U.S. history, with its $180 billion allocation to wind down the now defunct savings and loan industry.[7]

Political and economic observers who penned traditional narratives have disagreed on particular aspects of the crisis. They have debated which factor or combination of factors,

---

[5] A qualifying thrift, one that maintained a positive net worth but below the 3 percent minimum, could issue net worth certificates to the Federal Savings and Loan Insurance Corporation (FSLIC) in return for FSLIC promissory notes. The notes were subsequently counted as part of the institution's net worth. As the institution regained financial health, it redeemed the net worth certificates by returning the FSLIC's promissory notes.
[6] United States League of Savings Institutions, *1986 Savings Institutions Sourcebook* (Chicago: United States League of Savings Institutions, 1986), 14. I compiled data from *Savings and Loan Factbooks*, years 1965 to 1979, and *Savings and Loan Sourcebooks*, years 1980 to 1989, into Excel spreadsheets that were subsequently named after the tables or graphs from the original texts. Hereafter, I will refer to that data as *S&L Factbook* and the corresponding table name in quotation marks.
[7] Congressional Budget Office, *Resolving the Thrift Crisis* (April 1993), ix.

including forbearance, regulatory capture, "control frauds," and moral hazard, were to blame for the demise of this once heralded financial industry.[8] But regardless of their varying assessments of the causes of the S&L crisis, each journalist, economist, political scientist, former regulator, and historian who has studied the thrift industry has identified the same genesis moment for thrift instability—the inflationary climate of the late 1970s.[9] This was, the general argument goes, a time when high inflation and volatile interest rates forced policymakers to address thrifts' fatal weakness of borrowing short and lending long. It was a time when industry leaders and presidential and legislative policymakers initially realized that if market rates continued to rise above the Federal Reserve-mandated interest rate ceilings on savings deposits, the entire S&L industry would collapse quite quickly. It was, as well, a time when critics of New Deal era financial regulation first experienced a political and financial crisis capable of justifying their ideas for systemic change. The thrift industry, they argued, simply needed to deregulate by diversifying these institutions' asset portfolios and paying market rates to attract deposits. Deregulating the S&L industry, they claimed, would avoid subsequent future earnings squeezes.

But unfortunately for both policymakers at the time and scholars of financial crises, American intellectual development, and U.S. policy history, the "traditional" interpretation of the S&L crisis is wrong for three important reasons. First, it ignores the systemic changes that occurred as a result of congressional responses to economic downturns, among other factors, in the years following the 1966 credit crunch. Those transformations, which

---

[8] George Kaufman, "What Have We Learned from the Thrift and Banking Crises of the 1980s?", in *The Savings and Loan Crisis: Lessons from Regulatory Failure*, eds. James Barth, Susanne Trimbath and Glenn Yago (Norwell: Kluwer Academic Publishers, 2004), 1-14 (forbearance); Adams, *Big Fix* (regulatory capture); Black, *Best Way to Rob a Bank* (control frauds and moral hazard); and Calavita, *Big Money Crime* (moral hazard).
[9] David Mason is the only historian who has extensively studied the S&L industry, and he argued that the crisis occurred between 1979 and 1989.

commenced long before the October 1979 Volcker shock, fundamentally altered the competitive landscape in which thrifts operated. They also forced S&L executives and Federal Home Loan Bank Board (FHLBB) officials to adopt new operational strategies that countered the industry-wide liquidity shortages that occurred every couple of years between 1966 and 1975. Because policymakers failed to identify and understand those systemic changes, they misappropriated blame and subsequently misdiagnosed solutions for thrift problems that commenced between 1979 and 1982.

Second, the traditional narrative's characterization of a previously healthy home loan industry is also highly inaccurate. As many as 1,600 savings and loan institutions closed or merged between 1966 and 1980, and 93 percent of that number disappeared before 1979, a pivotal date for the advocates of the traditional narrative. This consolidation of the thrift industry did indeed coincide with the emergence of stagflation, the oil shocks, price and wage controls, and dollar instability, but barely one hundred commercial banks out of 13,500 (.007 percent) failed during this same period. Something was amiss much earlier with America's S&Ls that was unique to that industry, and whatever it was thrust the savings and loan industry on the path toward an existential crisis that it never recovered from.

Third, the traditional narrative has given insufficient attention to the importance of key developments in economic theory and political ideology that significantly influenced how key shapers of public policy perceived and understood the problems of the thrifts, framed them for others, and imagined deregulatory solutions. This project resituates the savings and loan crisis within a longer historical narrative that explores how policymakers in academia, the U.S. League of Savings Institutions (U.S. League), the U.S. Congress, and several presidential administrations utilized ideological and theoretical interpretations of

opposing regulatory and economic theories to craft rhetorical strategies, legislative programs, and operational initiatives to resolve crises within the S&L industry that, if unresolved, threatened to undermine American homeownership and economic growth and destroy industry solvency.

Such an exploration addresses several inter-related questions. When and why did the S&L industry collapse, and what role, if any, did fluctuating interest rates, moral hazard, forbearance, and regulatory capture play in the industry's demise? What problems did policymakers come to identify in the 1960s, 1970s, and 1980s as crucial to resolving thrift instability, and what did those interpretations and their subsequent policy recommendations reveal about their understanding, or lack thereof, of the thrift industry, specifically, and the U.S. financial sector more broadly? How did debates on S&L reforms highlight changing perceptions of the efficacy of regulation as it related to pursuing a public good via economic and social regulation (public interest theory)? How should scholars explain the similarities and differences in the rhetorical strategies and policy initiatives between public choice advocates and their public interest opponents and how did those competing ideological frameworks reshape how policymakers and American citizens interpreted and pursued antithetical federal and state regulatory agendas? How did S&L executives adapt to shifting socio-economic and political paradigms between 1966 and 1989, and what rhetorical strategies and economic theories did they rely upon as they pursued their own industry's long-term viability? What continuities, if any, existed between approaches by legislative and presidential policymakers as deregulation gained more momentum as a viable policy alternative during the 1970s and 1980s? What insights can an extended interpretation of the S&L crisis provide regarding the financialization of the U.S. economy?

In order to effectively answer these questions, I re-situated thrifts within their larger systemic context, unlike previous interpretations of the crisis, by utilizing the concept of a governance mechanism to frame and interpret the evolution and eventual collapse of the S&L industry. A governance mechanism describes how state actors—using ideological, legal, psychological, and socio-economic inputs—have envisioned, created, and maintained markets through judicial, administrative, and legislative action.[10] In essence, these governance structures reveal and explain the ways that a state develops legal frameworks to construct, facilitate, and regulate markets. Using the concept of a governance mechanism allows us to understand how policymakers in the 1930s crafted a financial regulatory structure that channeled working- and middle-class American savings into savings and loan institutions (via Regulation Q) in the years before 1966. Thrifts then transferred those deposits (liabilities) into mortgages (assets) for a growing number of American families. I used the term "growth and saver" governance mechanism to identify this arrangement. Here's how it worked.

More white- and blue-collar U.S. workers in the immediate postwar period had access to high-paying jobs allowing loanable capital to flow into thrifts.[11] S&Ls provided mortgage credit ($110 billion in loans outstanding by 1965) to the American consumer.[12] Demand for durable goods (cars, washers and dryers, refrigerators) and also for nondurables (gasoline, food, clothing) increased as primarily white Americans flocked to the suburbs. Higher levels of disposable income and consumers' easier access to credit financed increased

[10] Marc Allen Eisner, "Markets in the Shadow of the State: An Appraisal of Deregulation and Implications for Future Research," in *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen & David Moss (Cambridge: Cambridge University Press, 2010), 521-2.
[11] United States Savings and Loan League, *1971 Savings and Loan Fact Book* (Chicago: United States Savings and Loan League, 1971), 68. In 1945, thrifts managed 6.8 million savings accounts with an average account balance of $1,086. By 1965, that number had reached 40.7 million accounts with average balances of $2,711.
[12] *1971 S&L Factbook*, 85.

consumption.[13] In the era of relative union strength, corporate profits and worker pay simultaneously rose, and the virtuous cycle repeated itself.[14]

This system, which enabled capital to move freely between savers (who were increasingly also borrowers), financial intermediaries, debt and equity markets, and corporations, worked almost flawlessly until its structural flaws were suddenly exposed via a number of domestic and international problems that arose beginning in 1966.[15] Many scholars, policymakers, and financial executives, at the time and since, understood the serious problem of thrifts borrowing short and lending long, thereby risking a potential earnings squeeze if short-term interest rates rose too quickly.[16] But few recognized, then or now, another equally problematic structural flaw that threatened to unravel the entire postwar economy. Congress, by functionally segmenting the financial sector, created a regulatory environment capable of producing, rather than preventing, crippling disintermediation (shifting of savings from one type of financial instrument to another) that could easily induce systemic instability.

---

[13] Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton: Princeton University Press, 2011), 132-72. Hyman's discussion of how postwar suburbanization equaled expansion of consumption as ever-larger amounts of consumer debt financed both home purchases and consumer items.

[14] But as the years after 1973 aptly demonstrated, higher corporate profits and increases in productivity did not necessarily raise workers' wages.

[15] Only a handful of historical analyses on the savings and loan industry exist. Mason's *From Building and Loans*, published in 2004, is the most recent, and most thorough, study of thrifts. Mason acknowledged how rising inflation and interest rates, technological changes, a small merger movement, and slower national growth affected thrifts during the late 1960s and 1970s. He did not, however, consider larger structural flaws in the financial sector, show how these flaws were intimately connected to thrift performance, or examine the conceptual framings used to describe, interpret, and resolve these issues.

[16] S&L executives willingly accepted this risk since policymakers, in general, aimed to maintain lower short-term interest rates. See Friend Commission; Reed Hunt, *The Report of the President's Commission on Financial Structure and Regulation* (Washington DC: U.S. Government Publishing Office, 1972), hereafter cited as the Hunt Commission; and House Committee on Banking, Finance, and Urban Affairs, Subcommittee on Financial Institutions Supervision, Regulation, and Insurance, *Financial Institutions and the Nation's Economy (FINE)* (Washington DC: U.S. Government Publishing Office, 1976), hereafter cited as the FINE Study.

With their decision to utilize thrifts as the financial institutions responsible for allocating mortgage credit, Congress designed, quite possibly unknowingly, a financial sector that required two elements of the existing credit structure to continue. Economic growth had to be sustained in order to maintain the higher national savings rates needed to support a liquid mortgage credit market. In addition, policy mechanisms that protected mortgage lenders' profits, such as Regulation Q, loans guaranteed by the Veterans Administration, and loans insured by the Federal Housing Authority, had to be maintained.[17] These risk-reducing housing policies were necessary to sustain the long-term viability of the thrift industry by mitigating the ill effects of mortgage defaults during economic downturns that might otherwise occur in unsustainable numbers.[18] Just as important, if economic conditions changed in such a way as to limit wage growth; or if inflation, interest rates (above Regulation Q), or unemployment increased; or if disposable income (i.e. potential savings) declined, the S&L industry would suffer.[19] And that is exactly what happened in the years following the 1966 credit crunch—wages stagnated, inflation and interest rates increased, and disposable income dropped.

Strains to the growth and saver governance mechanism quickly became evident after 1966 as policymakers responded to the first of several serious episodes of declining mortgage origination in postwar America. Policymakers, in their efforts to remedy perceived regulatory or financial shortcomings toward maintaining American homeownership, quite unknowingly laid the groundwork for the usurpation of the very system they tried to save. Congressional

---

[17] Savings deposits provided approximately fifty percent of mortgage credit that S&Ls distributed. *1971 S&L Factbook*, 82.
[18] 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), 55-6.
[19] In 1945, thrifts managed 6.8 million savings accounts with an average account balance of $1,086. By 1965, that number had reached 40.7 million accounts with average balances of $2,711. *1971 S&L Factbook*, 68.

leaders, beginning in 1968, authorized government-sponsored enterprises to buy and sell mortgage-backed securities (MBS) in a secondary mortgage market by re-chartering the Federal National Mortgage Association (FNMA or Fannie Mae) and creating the Government National Mortgage Association (GNMA or Ginnie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). Those "new" institutions, what the U.S. League of Savings Institutions (U.S. League) called "second layer lenders" because they did not interact with borrowers on a day-to-day basis, initially provided thrifts with the additional liquidity they needed during periods of disintermediation (institutional fund shifting), which corresponded with downturns in the business cycle.

S&L executives, as subsequent recessionary periods wreaked additional havoc on the American housing and savings markets, increasingly turned to the secondary mortgage market and the Federal Home Loan Bank Board to supplement their declining deposit bases. As well, when previous attempts at increasing profitability and operational efficiency failed over the course of the late 1960s and early 1970s, this same problem forced them to initiate a merger movement. Thus as S&Ls encountered rising and volatile interest rates as the 1970s came to a close, they had already been eclipsed in the savings and home loan origination markets by second layer lenders and other financial institutions such as mortgage companies and non-bank banks. The catastrophic effects of the Volcker shock only further exacerbated their lost market share moving forward into the 1980s. As the new decade progressed and more S&Ls took advantage of the expanded asset and liability powers that Congress and the Federal Home Loan Bank Board thought would return S&L solvency and profitability, the death knell for the growth and saver governance mechanism—and its pivotal financial intermediaries, savings and loan institutions—only rang louder and clearer as economic

turmoil in the American Southwest and the U.S. stock market forced policymakers to move beyond their policy of regulatory forbearance and finally lay the S&L industry to rest.

The transition from one governance mechanism to another, as the S&L industry's experience makes perfectly clear, was neither smooth nor linear. Changing socio-economic and political contexts, throughout the 1960s, 1970s, and 1980s, provided new and/or re-imagined sites for the contestation of ideologies, knowledge bases, and regulatory theories and practices. This project thoroughly explores those sites of contestation and, in doing so, identifies the key substantive differences between how advocates of competing deregulatory initiatives rhetorically explained and theoretically justified their efforts. These two particular strands of deregulation—"strategic" deregulation and "transformative" deregulation—help scholars better understand the theoretical frameworks and rhetorical strategies utilized by proponents of deregulation while simultaneously highlighting how some policymakers offered deregulatory-based policy prescriptions for S&L instability that contradicted the deregulatory interpretations of other regulatory and legislative policymakers.

As one can easily imagine, relations between regulation, deregulation, and ideology can be quite complex. The creation of regulatory structures and rules will likely have been justified in terms of their expected effectiveness in achieving public policy outcomes that have been adopted through a process, in representative democracies, that has included recognition of a problem, application of theory and deliberation to the selection of a solution, adjustment of whatever opposing interests may be involved, and legislation, often involving the construction of—or the imposition of political controls upon—institutional structures and methods for enforcement of the goals and rules adopted. However consciously or not,

ideology, along with partisanship, will have been involved in the process of creating and enacting regulation.[20]

Deregulation can take different and ideologically diverse forms. It can be goal sustaining, aimed to adopt changes that are intended to adjust the mechanisms of a regulatory system's operation in order to sustain so far as possible in new circumstances the original purpose of the system of rules, remaining faithful to the goals that it was intended to accomplish and reflecting the ideological or moral values that it aimed to achieve. We might think of this type as "strategic" deregulation.

But deregulation also can take the form of a purposeful and deliberate rejection of the regulatory system previously in place. This rejection may at times, as in the account provided here, result from the rejection of the previously held goals or methods in light of new circumstances, but often this approach to deregulation has been defended by the promotion of new theories regarding how to achieve politically desired and legislatively accessible goals. This form of deregulation will also at times proceed toward accomplishing an avowedly ideologically-based elimination of the system of rules and the goals and methods of enforcement previously in place. Although this approach to deregulation may be no less ideologically rooted than what it aims to alter or eliminate, it will seem more ideologically motivated, typically, if it required claims for the failure, even the wrong-headedness, of the system and structure it aims to supplant. Not merely strategic, this type of regulatory reform effort may better be framed as "transformative" deregulation because its proponents

[20] For a discussion on the relationship between ideology and/or partisanship, social change, and regulatory structures, see Clifford Geertz, *The Interpretation of Cultures* (New York: Basic Books, 1973), 199-233; James Farr, "Understanding Conceptual Change Politically," in *Political Innovation and Conceptual Change*, eds. Terance Ball et al. (Cambridge: Cambridge University Press, 1989), 24-49; Robert Putnam, "Studying Elite Political Culture: The Case of "Ideology," *The American Political Science* Review 65 (1971): 651-81; and Robert Benford and David Snow, "Framing Processes and Social Movements: An Overview and Assessment," *Annual Review of Sociology* 26 (2000): 611-39.

proffered interpretations of and solutions to, in this particular case, S&L instability that they believed were methodologically better advised and grounded in sounder theory. In doing so, they blazed a "deinstitutionalizing" path toward deregulation in the U.S. financial sector.

Seen this way, a defense of a system of control based on claims that greater efficiency and "fairness" will result from deregulation and from reliance on the workings of market competition is thus no less ideological than one that was based initially on claims for a higher morality and/or a more democratic outcome of a system in which government acted positively to give preference to steering loan credit toward the support of home mortgages. But it may seem more intensely ideologically driven in that those who seek to commend the new approach must go on the attack, invoke supposed more reliable new knowledge, and act to displace people, institutions, and practices that are in place and benefitting from the existing regulatory regime.

My analysis of the S&L industry, therefore, demonstrates how legislators, academics, and economic commentators at the time problematically confused what should be classed as transformative deregulation with what would have constituted a strategic deregulation of the S&L industry that allowed thrifts to adapt effectively to changing economic and technological environments without negating their historic responsibility of promoting and enabling American homeownership. Transformative deregulation, in this context, mainly derived from work by intellectuals associated with the Chicago School of Economics, such as Ronald Coase, George Stigler, Milton Friedman, and Richer Posner.[21]

---

[21] For a discussion of how the work of scholars from the Chicago School differed from earlier efforts at restoring laisses-faire market principles, see Angus Burgin, *The Great Persuasion: Reinvesting Free Markets since the Depression* (Cambridge: Harvard University Press, 2012), passim; Yuval Yonay, *The Struggle Over the Soul of Economics: Institutionalist and Neoclassical Economists in America* (Princeton: Princeton University Press, 1998), passim; and Ben Fine and Dimitris Milonakis, *From Political Economy to Economics: Method, the Social and the Historical in the Evolution of Economic Theory* (New York: Routledge, 2009), 216-94.

Starting in the late 1930s, Ronald Coase responded to two prevailing notions that informed how policymakers interpreted and justified regulatory action. He opposed the perception of "public goods" that was generally consistent with its traditional meaning in welfare economics (public interest theory). As A.C. Pigou had first explained in the 1920s, the private value of a good or service occasionally did not equal its social value, and when such a divergence occurred, Pigou argued, the government was justified in creating "extraordinary encouragements"—i.e. subsidies and tax credits—to correct what Francis Bator would later identify, in the 1950s, as a "market failure."[22] Another form of government intervention that public interest theorists supported was government planning, including certain forms of regulation, to prevent negative events such as low homeownership rates in the economy. Many policymakers during the 1930s, in particular, attempted to reverse declining GDP by stimulating demand via increasing U.S. homeownership rates.[23] Further, Coase disagreed with the theoretical and political justifications for New Deal interventionism—the belief that capitalism had failed. In his first professional publication, "The Nature of the Firm," he attacked that interpretation by identifying and explaining what he believed to be the site most conducive for capitalist efficiency—the corporation.[24] At the exact moment when many economists began to turn their analytical gaze toward Keynesian macroeconomic aggregates, Coase offered the opening salvo of a decades-long crusade in which he and others focused almost exclusively on microeconomic problems in an effort to promote and praise the supposed natural efficiencies of market mechanisms.

---

[22] For discussions on Pigou and Bator's work, see John Cassidy, *How Markets Fail: The Logic of Economic Calamities* (New York: Farrar, Straus, & Giroux, 2009), 116-9, 125-8.
[23] Hyman, *Debtor Nation*, 73-97.
[24] Ronald H. Coase, "The Nature of the Firm," *Economica* 16 (1937): 386-405.

In his later work, Coase advocated for a legal system that more rigorously protected the property rights of individuals by weighing the costs and benefits of litigating alleged property damage in order to obtain judicial rulings that assigned blame and required payment to the injured party.[25] Replacing litigation in the courts with direct bargaining between individuals with claims against each other, he argued, would produce more efficient market outcomes by restoring the regulatory function of private contracts. Adding to this Coasian aura of distrust for regulatory outcomes, other "public choice" scholars revealed the unnecessarily high costs of regulation and the ubiquitous presence of "iron triangles"—cozy, capture-enabling relationships between corporate executives, legislators, and regulators that weakened the public's faith in the ability of the government to identify and fairly protect the public interest.[26]

Arguably, the work of these critics of public interest regulation demonstrated ways that federal regulations limited beneficial competition, protected rent-seeking monopolies, produced capture of the regulatory agencies by the industries they regulated, and created unnecessarily expensive public goods. The Chicago School (public choice) promoters of deregulation argued aggressively that their work empirically and irrefutably revealed the inherent downsides of economic planning via federal regulation, mainly through the claim that regulation enabled an environment in which both interest groups and policymakers

---

[25] Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960): 1-44.
[26] Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Brothers, 1957), passim; James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Harbor: University of Michigan Press, 1962), passim; and George Stigler, "The Theory of Economic Regulation," *The Bell Journal of Economics and Management Science 2* (1971): 3-21. Even though Richard Posner didn't publish "The Social Costs of Monopoly and Regulation" until 1975, he joined the University of Chicago Law School faculty in 1969 and became a founding editor of *The Journal of Legal Studies* in 1972. Richard Posner, "The Social Costs of Monopoly and Regulation," *The Journal of Political Economy* 83 (1975): 807-828. For a discussion of Posner's importance within the "Public Choice" movement, see Steven Teles, *The Rise of the Conservative Legal Movement: The Battle for Control of the Law* (Princeton: Princeton University Press, 2008), 95-101.

maximized their utility by exchanging campaign contributions for votes supporting legislation favorable to the industry and the major, high spending firms that led it.[27]

The policymakers who pursued and promoted transformative deregulation incorporated the Chicago School narratives of individual and economic rationality, market efficiency, and utility maximization as defining characteristics of what one political observer would have identified as their "political style." A political style, according to Robert Putnam, revealed "not *what* men think about politics and policy, but *how* they do," including the ways in which policymakers analyzed policy problems by incorporating a "complex of attributes" that reflected his or her economic, political, and theoretical values. The advocates of transformative deregulation, in particular, utilized a political style that appeared highly ideological because, as Putnam explained, it was "guided by an explicit, consciously held belief system…a belief system which distorts or over-simplifies reality, which is biased or irrational." Their ideological tendencies increased as they also relied upon "a philosophy of history and/or a social theory which is applied to everyday questions and issues" while simultaneously being "future-oriented" and only "concerned with abstract principles, not concrete interests." Their feelings of alienation "from established social and political institutions" only further reinforced their decision to be "moral absolutists" who were "prone to believe that the end justifies the means" and "hostile and intolerant toward political opponents."[28] Essentially, many of the proponents of transformative deregulation, according to Putnam's "Ideological Style Index," would be classified as "ideological politicians,"

---

[27] Jessica Leight, "Public Choice: A Critical Assessment," in *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen & David Moss (Cambridge: Cambridge University Press, 2010), 213-24.
[28] Putnam, "Studying Elite Political Culture," 655-6.

individuals who were "generalizers" relying heavily upon deductive reasoning and the "use of utopias as standards for judging policy" and pursuing their regulatory reform agendas.[29]

Pursuing strategic deregulation, on the other hand, required observant policymakers who operated within an agile regulatory framework. Legislators and regulators needed to understand that constantly evolving domestic and international economic and political contexts could potentially require subsequent regulatory interventions. Doing so would have allowed policymakers to appropriately reevaluate the economic and structural consequences of rising inflation on Regulation Q, for example, and potentially realign their expectations for the existing structure of financial regulation.

Efforts to implement strategic deregulation within the context of the S&L industry, in particular, reflected a belief among some policymakers that market forces could not by themselves support politically and economically acceptable levels of U.S. homeownership. The advocates of strategic deregulation, at a fundamental level, utilized a "political style" that demonstrated a clear belief in the existence of what Pigou and others identified as market failure, public goods, externalities, and natural monopolies and the subsequent need for government responses to remedy them.[30] Its advocates also viewed, generally speaking, the U.S. financial sector as unique, given its responsibility of collecting and distributing capital

---

[29] Ibid., 658-65. Putnam defined "ideological politicians" as individuals who "tend to discuss issues in abstract and theoretical terms, referring with some frequency to specific ideologies and to more or less coherent social goals." "Those who rank high on this Ideological Style Index," as Putnam explained, "also tend more frequently to be motivated by ideological satisfactions, to interpret political phenomena such as parties in terms of more abstract schema, and to reject a merely 'possibilist' approach to politics." Putnam also considered ideological politicians to be "fanatic" or "dogmatic" ideologues because they stressed "the importance of political ideas or ideals."

[30] For a discussion on public interest theory, see Mary Furner, "From 'State Interference' to the 'Return to the Market': The Rhetoric of Economic regulation from the Old Gilded Age to the New," in *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen & David Moss (Cambridge: Cambridge University Press, 2010), 92-142; Leight, "Public Choice: A Critical Assessment," 213-7; and Cassidy, *How Markets Fail*, 116-9, 125-8.

in ways that policymakers and citizens alike viewed as politically and socially acceptable. As a longer S&L crisis unfolded, then, the political style of the advocates of strategic deregulation would have appeared less ideological on Putnam's Ideological Style Index because they, generally speaking, remained "particularizers" situated in the "mainstream" who deployed inductive reasoning and focused on "specific details" to resolve "existing problems."[31] Those policymakers, specifically, aimed to modify the operational and institutional practices of S&Ls and the regulatory policies of state and federal agencies in ways that acknowledged and incorporated new knowledges, technologies, and financial instruments and practices without simultaneously abandoning their historic home loan lending niche, which included assisting local working- and middle-class Americans with their savings and housing needs.

Moves toward deregulation can be rooted in both strategic and transformative sources, as these are not neatly or mutually exclusive constructs. Just as important, in the 1960s, and 1970s, and 1980s, as political and economic observers utilized the same deregulatory rhetoric to bemoan the shortcomings of the existing regulatory structure, one could easily conclude that deregulation had become the ubiquitous policy response. When one examines the calls for deregulation, however, in response to S&L instability, obvious theoretical and ideological distinctions emerge despite the overlapping rhetorical strategies—particularly in relation to how policymakers framed, analyzed, and pursued competing regulatory agendas. Thus, attempting to incorporate both strategic deregulation and transformative deregulation as analytical lenses and to differentiate between these elements

[31] Putnam, "Studying Elite Political Culture," 658-66.

gives historians tools useful in interpreting responses to not only S&L problems, but also an evolving U.S. financial sector, in the 1960s, 1970s, and 1980s.

To distinguish between the two, then, requires examining the knowledge bases, theoretical frameworks, and socio-economic and political philosophies, i.e. political style, that each individual policymaker drew upon to identify, interpret, and respond to S&L problems. This task also demands an analysis of the rhetoric(s) policymakers utilized to justify their interpretations of and solutions to thrift instability, specifically, and an evolving U.S. financial sector more broadly. By doing so, scholars can better understand and situate a policymaker's motivations and objectives within larger social, political, and intellectual movements. Just as important, only upon considering the totality of each regulatory reform effort can scholars begin to identify and appreciate the methodological, ideological, and theoretical differences between these two approaches to promoting and pursuing financial sector deregulation. More specifically, separating out the influence of postures provided by anti-regulation, free market experts can help to explain how policymakers could have pursued necessary changes to thrifts specifically, and to financial markets more generally, without simultaneously undermining the theoretical and political justifications for maintaining an American housing policy grounded in a financial regulatory structure.

Additionally, this project, in its examination of how policymakers theoretically framed and justified deregulation, particularly throughout the 1970s, identifies the underlying issues that they attempted to resolve as they responded to industry-level crises at thrifts and larger structural concerns regarding U.S. mortgage, housing, and financial markets. Policymakers debated the creation and allocation of mortgage credit and the structure and regulation of the U.S. financial sector. They also reexamined the appropriate balance of

competing constitutional, socio-economic, and theoretical considerations as they related to dual banking, executive power, and congressional and regulatory agency oversight. These sites of contestation enable four insights into the historical importance of this early stage of the S&L crisis.

First, they reveal the linguistic, intellectual, and ideological currents that policymakers incorporated into their rhetorical repertoires—and then utilized—as they pursued regulatory reform. Policymakers simultaneously interpreted and explained thrift problems and proposed and justified policy responses by drawing upon ambiguous, historically contingent terminology such as competition, efficiency, fairness, and discrimination. This narrative framing repeatedly served the ideological and structural (financial) interests of its proponents, while also reflecting astute politicking and strategically savvy explanations of historical development and/or relevance.

Second, these episodes of policy contestation expose powerful theoretical and structural path dependencies that made it difficult for policymakers to quickly and effectively resolve the gathering S&L crisis. The dual banking system and long-standing fears of economic concentration (interstate branching and banking), for example, limited the conceptual space within which policymakers operated—thereby dooming many economically feasible solutions to remain politically unattainable. And Congress' self-acknowledged inability to legislate without a perceived public crisis also prevented a timelier and less urgent response.[32]

Third, the responses to S&L instability portray the fluidity and dynamism of the American regulatory state. Regulatory reform advocates over the course of the 1970s, many

[32] "Meeting on Extension of Regulation Q," Senate Committee on Banking, Housing, and Urban Affairs, 95th Congress, 1st session, March 1, 1977, 15.

of whom built upon the work of Ronald Coase, questioned the validity of externalities and the effectiveness of regulation in general while simultaneously promoting a conceptual regulatory framework in Congress and elsewhere that pitted market mechanisms against government regulation. Their efforts succeeded in fundamentally altering expectations for the American regulatory governance mechanism by significantly narrowing the acceptable theoretical and political space in which federal regulation could be seen by influential observers to effectively occur—despite the undeniable reality that markets were then and are historically far from natural. The changes in expectations promoted by transformative deregulatory rhetoric in this instance coincided with the growth of second layer lending, which created additional pressures on policymakers to stop (from a regulatory perspective) viewing homeownership as a public good requiring direct government support and, rather, to begin to identify mechanisms in the private sector to allocate mortgage credit.

Fourth, efforts to reform the U.S. financial sector demonstrate how, by the 1970s, policymakers could focus primarily on promoting the convenience afforded by America's financial institutions, rather than continuing to concentrate on ensuring liquidity and stability. After three decades of financial stability and growth since the mid-1940s, many policymakers felt confident that market principles would effectively enable the self-regulation of financial institutions. Their confidence increased even further when many expert economic observers actually blamed Regulation Q and other New Deal era regulations for much of the economic uncertainty experienced by S&Ls in the 1970s.

Each chapter in this project focuses on a time of conflict and/or change for the S&L industry as policymakers identified, debated, and resolved problems within American housing and savings markets. Chapter 1 explains the S&L industry's relationship to the

growth and saver governance mechanism during the first two decades after World War II. It then describes how the 1966 credit crunch, the 1968 economic crisis and urban riots, and policymakers' responses to ways that those crises negatively affected thrifts' ability to maintain their historical housing niche. It chronicles ways that thrift executives fundamentally altered how they operated their institutions over the course of the late 1960s and 1970s.

Chapter 2 examines the burgeoning economic instability in America's savings and loan institutions and, in particular, policymakers' interpretations of and solutions to thrift problems between 1970 and 1974. Previous historical interpretations have described the 1970s as a "decade of nightmares," the "pivotal decade," an "age of limits," "an age of fracture," the "latest crisis of American liberalism," a "great shift in American culture, society and politics," and a transition period when the political pendulum was shifting from left to right.[33] In the setting addressed in this chapter, though, the early 1970s were rather a historical moment when a nascent but strengthening bipartisan movement focused on securing market-based responses (a.k.a. transformative deregulation) to unstable conditions in the American financial sector. It was also a concentrated period in which many policymakers and pundits strove to perfect rhetorical strategies that defended what they styled as a necessary return to the market.[34] When these new justifications were implemented

---

[33] See Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (New Haven: Yale University Press, 2011), passim; Daniel Rodgers, *Contested Truths: Keywords in American Politics Since Independence* (Cambridge: Harvard University Press, 1998), passim; Bruce Schulman, *The Seventies: The Great Shift in American Culture, Society, and Politics* (New York: The Free Press, 2001), passim; Philip Jenkins, *Decade of Nightmares: The End of the 1960s and the Making of Eighties America* (Oxford: Oxford University Press, 2006), passim; and Carl Biven, *Jimmy Carter's Economy: Policy in an Age of Limits* (Chapel Hill: University of North Carolina Press, 2003), passim.

[34] See Mason, *From Buildings and Loans;* Gary Gerstle and Steve Fraser, *The Rise and Fall of the New Deal Order, 1930-1980* (Princeton: Princeton University Press, 1989), passim; Laura Kalman, *Right Star Rising: A New Politics 1974-1980* (New York: W. W. Norton and Company, 2010); Kim Philips-Fein, *Invisible Hands:*

in law, they fundamentally altered the "functionally regulated" governance mechanism in which thrifts operated. Representatives of the thrifts paradoxically pushed the process along by lobbying Congress to deregulate several aspects of the S&L industry even as they argued to maintain Regulation Q, one example of strategic deregulation.

Chapter 3 investigates how policymakers in Congress and the Ford administration and a quite contentious presidential election cycle thrust anti-regulatory rhetoric and deregulatory policy initiatives into the political and economic consciousness of many Americans over the course of 1975 and 1976 as political and economic observers responded to an onslaught of apparent regulatory failures in the trucking and aviation industries. It simultaneously explores Alan Greenspan's faith in market efficiency by charting his career trajectory, which coincided with the rise and solidification (and possible fall) of the American deregulatory ethos.

Chapter 4 explores both the deregulatory rhetoric and deregulatory policy initiatives of Presidents Jimmy Carter and Ronald Reagan. Both promoted transformative deregulation by portraying existing regulatory frameworks as outmoded, undemocratic, and inefficient, thereby perpetuating a narrative purported by the Ford administration and other public choice advocates that pitted the efficacy of markets against that of government regulation. Such a narrative left no theoretical or rhetorical space for using regulation to pursue any public good. The chapter also identifies legislative efforts during the late 1970s to limit and/or eliminate financial executive malfeasance but, unfortunately for American taxpayers, those attempts neither yielded legislative fruits nor significantly influenced the ideologically-

---

The Making of the Conservative Movement from the New Deal to Reagan (New York: W. W. Norton and Company, 2009), passim; Rodgers, *Contested Truths*, passim; and Stein, *Pivotal Decade*, passim.

motivated policy initiatives that produced the Depository Institutions Deregulation and Monetary Control Act (1980) and the Garn-St. Germain Depository Institutions Act (1982).

Chapter 5 demonstrates how the "traditional" narrative of a supposed rapid recovery in the years immediately after Garn-St. Germain was only an illusion. The industry by 1982 had already become, in one analyst's view, a "zombie" industry, but since federal and state regulators instituted a policy of forbearance, they prevented an insolvent industry from collapsing for another six years.[35] Many S&Ls tried to survive by abandoning their historical housing niche and dedication to small savers, only to subsequently further weaken the industry as many thrifts, particularly in Texas, California, and Florida, turned to the higher market returns of commercial real estate projects that eventually failed when a regional recession and stock market "crash" scared investors into safer investments in 1986 and 1987. The chapter also explores how FHLBB Chairman Richard Pratt and other congressional and Reagan administration officials' pursuit of transformative deregulation hamstrung subsequent efforts by Pratt's successor, Edwin Gray, to limit the excesses of transformative deregulation within the S&L industry.

With the chapters outlined above, the dissertation makes four significant historical and theoretical contributions. First, much of the extant literature on the savings and loan

[35] Edward Kane coined the term "zombie institution" in the late 1980s to describe how regulators allowed insolvent financial institutions to continue operating by guaranteeing their debt via deposit insurance and covering up their loss exposure. Such behavior, he claimed, enabled the often times problematic lending policies of these troubled institutions to "escape the ordinary weight of depositor discipline," thereby enabling moral hazard and likely substantially increasing the eventual losses to a deposit insurance fund. Edward Kane, "What Lessons Might Crisis Countries in Asia and Latin America Have Learned from the Savings and Loan Mess," in *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James R. Barth, Susanne Trimbath, and Glenn Yago (Norwell: Kluwer Academic Publishers, 2004), 115. Reagan administration officials also used the term to describe the insolvent thrifts whose negative tangible net worth worsened in 1987 and thereafter. See Memo, Steve Redburn and Lisa Pittman to Carol Crawford, August 27, 1987, FSLIC [Federal Savings and Loan Insurance Corporation] (1), Box 6, Dan Crippen Files, Ronald Reagan Presidential Library. Hereafter RRPL.

crisis, written mainly by journalists, economists, former regulators, and political scientists, emphasizes the poor management policies and criminal actions of the managers of failed thrifts. Given the relatively minimal analyses on the savings and loan crisis done by professional historians, my research provides a more thorough understanding of how and why the thrift industry collapsed by tracing the origins of the thrift instability back to the mid-1960s when policymakers began to alter the systemic arrangements (i.e. governance mechanism) that allowed the industry to thrive in postwar America. Those same and subsequent policymakers failed to grasp how the re-calibration of the secondary mortgage market and the creation of mortgage-backed securities in the late 1960s and early 1970s, in addition to declining national savings rates and crippling recessionary disintermediation, generated systemic anomalies that eventually overrode the entire postwar financial and regulatory structure, thereby transforming the S&L industry itself into an institutional anomaly. Just as important, I demonstrate how political and economic observers did not understand how the ebbs and flows of America's housing and savings markets between 1966 and 1989 led to changes in the competitive environments and operational strategies of S&Ls that detrimentally affected their ability to promote and maintain American housing. I meticulously reveal how those changes also induced a here-to-fore rarely discussed mid-1970s merger movement and forced the thrift industry to increasingly rely upon second layer lenders and FHLBB advances as sources of liquidity and housing finance throughout the late 1960s and 1970s and 1980s.

Second, my interpretation of the postwar American financial sector via "governance mechanisms" has allowed me to identify the various ideological, regulatory, political, socio-economic, and financial inputs that sustained economic growth and increased American

homeownership in the early postwar period, which included booming consumer and housing markets, capping interest rates at depository institutions, and maintaining real wage growth for blue- and white-collar Americans. Doing so also revealed how New Deal and postwar policymakers reinforced that entire edifice with an ideological glue that allowed regulators and other government officials to pursue and produce public goods that rectified market failures. But as new, worsening financial instabilities in the late 1960s and early 1970s provided critics of public interest theorists several opportunities to question the existing regulatory structures, the Volcker shock in 1979 provided public choice theorists the crisis they needed to justify instituting their transformative deregulation agenda.

Just as important, I traced how public choice and efficiency of competition advocates, via promoting transformative deregulation, influenced the substance and trajectory of debates on S&L reforms, particularly in the 1970s, as the Hunt Commission, FINE Study, and other legislative efforts tried to make sense of the new socio-economic and political contexts in which they now operated. Those efforts to deregulate the S&L industry reveal the messiness of paradigm shifts within the American financial sector as the growth and saver governance mechanism and its focus on locally based working- and middle-class depositors who patronized an S&L gave way to its nationally-focused investor class replacement—second layer lenders. This line of analysis also highlights how changing a governance mechanism's ideological and legislative (both state and federal) inputs effects its subsequent functionality.

Third, the study highlights the continuities between the deregulatory rhetorics and policy initiatives of Gerald Ford, Jimmy Carter, and Ronald Reagan, revealing the highly bi-partisan efforts to implement a deregulatory agenda in several sectors of the American economy, including finance. The project details Ford's transformation from an advocate of

strategic deregulation into an enthusiastic proponent of transformative deregulation. And despite the fact that presidential nominee Ronald Reagan attempted to distinguish his regulatory "relief" agenda from that of Jimmy Carter's regulatory "reform," no substantive differences existed between the two.[36] My work highlights how both promoted and pursued transformative deregulation within the U.S. financial sector. Both used deregulation as a political and rhetorical weapon to attack their opponents during their respective presidential campaigns. Both portrayed existing economic and social regulatory structures as outdated, inefficient, expensive, and captured. Both coupled their rhetorical criticisms of existing economic and social regulatory structures with calls to reduce the number of regulations, increase economic efficiency, and promote market-based solutions to industry problems. Both pushed policies that made no distinction between economic and social regulations. Both propounded politically expedient interpretations of and solutions to S&L instability, which included protecting small savers, while not acknowledging structural changes within the American financial sector. And both minimized the potential for political fallout even as they also ignored and/or misidentified thrifts' actual problems—all actions that further worsened the industry's eventual demise.

Fourth, the structural and institutional perspectives offered in previous accounts of the crisis failed to recognize the inter-connectivity between social regulation (control production processes to protect workers and the environment) and economic regulation (regulate markets and stabilize the economy). Many economic and political observers claim that a distinction existed between the two, yet delineating between the two ultimately disembeds economic matters from their cultural and social contexts, a point that Karl Polanyi long ago

[36] George Eads and Michael Fix, *Relief or Reform?: Reagan's Regulatory Dilemma* (Washington D.C., Urban Institute Press, 1984), passim.

correctly asserted cannot be done.[37] The decades-long demise of the S&L industry that I trace in this project only further reinforces Polanyi's assertion, given that this story of promoting housing as a public good reveals the lack of a clear distinction between increasing the social welfare via homeownership, financing production and consumption, creating and facilitating markets, and stabilizing the economy.

Additionally, my research details a separate "disembedding" process initiated by the advocates of transformative deregulation during the 1960s, 1970s, and 1980s who tried to eliminate the theoretical, ideological, and regulatory justifications for maintaining social and economic regulations, in both theoretical and policymaking contexts, in an effort to elevate the market and its inherently efficient allocational mechanisms as the sole distributor of capital, goods, and services in the American economy. By rhetorically blurring the difference between social and economic regulations, these policymakers aimed to minimize, many to the point of extinction, the socio-economic and politically acceptable contexts in which non-market mechanisms and their corresponding regulatory frameworks restricted, what they believed to be, the proper functioning of domestic and international markets.

Ultimately, this study explores the potential of framing the thrift collapse as an aspect of a major turning point in U.S. political and public policy history, in which the narratives of government regulatory incompetence and market regulatory efficiency took shape in the financial sector. It shines new light on the debatable assumptions behind, and the consequences of, past regulatory theories while simultaneously helping to build a much-needed historiography on a critical issue that historians have largely ceded to other disciplines in recent decades. In doing so, my work historicizes our understanding of the

[37] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press Books, 1957), passim.

S&L industry's relationship to the changing nature of the American financial sector and capitalist system as well as the role of changes in regulation theory and practice in a national context.

Chapter One: From the Growth and Saver to Second Layer Lender Governance Mechanism: S&Ls after 1966

The growth and saver governance mechanism, through the first two decades of the postwar era, worked magnificently.[38] U.S. homeownership rates rose from 43.6 percent in 1940 to 62.8 percent by 1965. And savings and loan institutions had originated almost 50 percent of those mortgage loans. But evolving socio-economic, intellectual, and political contexts after 1966 would fundamentally alter the growth and saver governance mechanism and, therefore, the American thrift industry. Industry executives tried adopting new operational and institutional strategies to adapt to those new environments, but the S&L industry found itself increasingly isolated and ill-equipped to successfully navigate in a newly emerging governance mechanism dominated by second layer lenders. The S&L crisis, then, began in 1966 as the Federal Reserve's Federal Open Market Committee attempted to stop budding inflationary pressures.

Savings and Loans Before 1966

With personal savings averaging $18.2 billion per year during the 1950s, thrifts' annual gross receipts (savings deposited plus interest earned on outstanding mortgages) grew from $5.3 billion in 1950 to $21.8 billion by the end of the decade.[39] These steady and expanding funds allowed S&Ls to increase their mortgage portfolio by $40 billion between 1950 and 1959.[40] Even though the national savings rate (as a percentage of disposable

---

[38] Sections of this chapter were previously published by the *Federal History Journal*. See Dustin Walker, "The S&L Crisis in Its Earliest Days: Banking Reform Rhetoric in the Johnson and Nixon Years," *Federal History Journal 8* (2016): 71-94.

[39] United States Savings and Loan League, *1966 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1966), 8, 71.

[40] Ibid., 78. Thrifts' mortgage portfolio in 1950 equaled $13.7 billion. By 1959, it was $53.1 billion.

income) fell to 5.5 percent by 1965, a substantial increase in disposable income allowed thrifts—in just five years—to almost double their mortgage portfolio from $61 billion to $110 billion.[41]

A snapshot of the mortgage market in 1965, then, demonstrated how successful thrifts had become while also revealing the extent to which the 1966 credit crunch would fundamentally alter the trajectory and structure of America's mortgage market. A total of 6,232 savings and loan associations financed 44 percent of American mortgages in 1965 when their biggest competitors—mutual savings banks, commercial banks, and insurance companies—collectively underwrote 42 percent of mortgages. S&Ls' maintained an 11.63 percent profit margin on their $129 billion asset portfolios.[42] They controlled 36 percent of over-the-counter savings, which provided them with $38 billion in gross savings receipts in 1965.[43] Most credit extended by S&Ls came in the form of net savings receipts and loan sales and repayments, which amounted to $8.5 billion and $17 billion respectively. Thrifts also received $5 billion in Federal Home Loan Bank Board (FHLBB) advances.[44] With these funds, thrifts closed $26.7 billion in mortgage loans, financing 1.35 million home purchases and the construction of 24,300 apartment buildings (422,500 units).[45] Construction loans,

---

[41] Ibid. The national savings rate averaged 6.7 percent during the 1950s. Between 1960 and 1965, disposable income jumped 76 percent, $401 billion to $531 billion.

[42] 85 percent of its asset portfolio was mortgages. The industry's asset portfolio was almost 15 times larger than its $8.7 portfolio in 1945.

[43] Over-the-counter savings are monies deposited at financial intermediaries. "Gross savings receipts" were deposits plus interest earned.

[44] FHLBB advances were essentially short-term loans to S&Ls. There were 2,857 FHLBB borrowers in 1965, which totaled 46 percent of institutions.

[45] The 1.35 million home purchases consisted of: 361,000 new homes, 791,000 existing homes, and 197,740 mobile homes. A total of 97 percent of those mortgages were conventional loans. A borrower pays market rates on a conventional loan, and he or she does not receive a government guarantee or insurance on the loan. Even though mobile home purchases were not included in housing start data, in 1965 they equaled 13 percent of private nonfarm house and 21 percent of single-family home purchases. Loan repayments are the funds thrifts received as: 1) payments on amortized principal, 2) prepayments, and 3) loan liquidation (i.e., mortgages being paid off). Withdrawal rates, which were 78 percent in 1965, were the percentage of gross receipts withdrawn

which totaled $6 billion in 1965, helped thrifts maintain a 30 percent repayment ratio since construction loans typically matured much faster than residential mortgages.[46] By year-end 1965, mortgage loans outstanding on one- to four-family homes, which amounted to $221 billion, equaled approximately 46 percent of disposable income in the United States. It was quite clear, then, how savings and loans had become synonymous with providing Americans, especially white suburbanites, with mortgage credit during the postwar period.[47]

The 1966 Credit Crunch

The main catalyst for the 1966 credit crunch was policies adopted by the Federal Reserve. [48] By late 1965, the specter of inflation the Federal Reserve's Federal Open Market Committee (FOMC) had previously feared actually began to materialize.[49] As the FOMC debated the appropriate discount rate and Regulation Q ceilings, they concluded in

---

from a financial intermediary. Net savings equals gross savings coming into a bank minus withdrawals going out.

[46] A repayment ratio represented the percentage of a thrift's asset portfolio that was repaid each year. The average maturity on a new home loan was 24.9 years, while the loan maturity for an existing home was 21.3 years. The American construction industry represented roughly 4 percent of GNP, 25 percent of domestic private investment, and 54 percent of all private construction, which amounted to $27 billion in private residential construction.

[47] Mason, *From Buildings and Loans*, 4-5; and Friend Commission, 3-6.

[48] When the events of 1966 have been discussed in the S&L historiography, the focus has mainly been on the application that year of Regulation Q to the thrifts. See Strunk and Case, *Where Deregulation Went Wrong*, 21; Carron, *The Plight of the Thrift*, 5; and Day, *S&L Hell*, 55-8. David Mason actually identified 1969 as the first instance of disintermediation, or significant loss of deposits by thrifts. His discussion of 1966 did provide a more contextualized interpretation by highlighting the financial intermediary rate wars, slower economic growth, regulatory expansions, and thrift industry infighting that took place throughout that year. But he did not mention the credit crunch at all. Mason, *From Buildings and Loans*, 159-186, 190. The following works do not mention events of 1966: Pizzo, *Inside Job;* Pilzer, *Other People's* Money; Adams, *The Big Fix*; and Calavita, *Big Money Crime*. Hyman's *Debtor Nation,* on the other hand, linked the 1966 credit crunch and the congressional response to it—the creation of mortgage-backed securities. This development was certainly important in the evolution of the mortgage market's governance mechanism over the course of the late 1960s and 1970s, and something I will discuss at length later. But Hyman did not explain (more than likely because it was beyond the purview of his work) the Federal Reserve's causal relationship to the 1966 credit crunch or its effects on the S&L industry. Hyman, *Debtor Nation*, 223-34.

[49] Edwin Dickens, "U.S. Monetary Policy in the 1950s: A Radical Political Economic Approach," *Review of Radical Political Economics* 27 (1995): 83-111.

September 1965, "We should try more decisively than we have done in recent months to check the excessive rate of credit growth; and for this purpose an overt move seems required."[50] After raising the discount rate in December failed to suppress demand for credit (i.e., demand remained interest rate inelastic), the FOMC realized borrowers were unconcerned with the price of credit. The FOMC therefore decided that the "Committee should have less implicit and explicit concerns with the rate structure and more concern with availability" of credit, because it seemed that the "banking system was not doing all that it could to restrain the exuberance of its customers….Bankers were not sure just how far the Committee would go in permitting them to accommodate loan demands." The FOMC further concluded that the "Committee should make it clear that it was not going to make it possible for banks to meet all of the demands placed on them."[51] After its September 23, 1966 meeting the FOMC issued the following directive:

> The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is expanding more rapidly than in the second quarter, despite further weakening in residential construction. Recent wage and price developments suggest that inflationary pressures are becoming more intense. Credit demands continue strong, financial markets have tightened further, and interest rates have risen substantially in an atmosphere of great uncertainty. The balance of payments continues to reflect a sizable underlying deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.
>
> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to supplying the minimum amount of reserves consistent with the maintenance of orderly money market conditions and the moderation of unusual liquidity pressures.[52]

[50] Minutes of the Federal Open Market Committee, Federal Reserve, Federal Open Market Committee Meeting Minutes, Transcripts, and Other Documents, 1923-2014, Fraser, Federal Reserve Archive, September 28, 1965, 37. Hereafter cited as Minutes, Federal Open Market Committee.
[51] Minutes, Federal Open Market Committee, March 1, 1966, 79-80.
[52] Minutes, Federal Open Market Committee, August 23, 1966. Reserve base referred to banks borrowing from the Federal Reserve's Discount Window, which increased individual institution's capital or loanable funds. Essentially, then, the FOMC wanted an inelastic money supply in order to lessen inflationary pressures.

Even though one member "was unhappy that the word 'firming' had been lost from the directive," he "would encourage the Manager to 'skate a little closer to the edge' [the edge being the lowest acceptable amount of credit growth]." And as the FOMC rolled out its next open market transactions, it quickly became apparent that what the governors "wanted was as much restraint as could be achieved without leading to a financial crisis."[53]

The ensuing credit crunch provoked the first serious episode of thrift disintermediation, or shifting of deposits from the S&Ls to other investment sites, in the postwar period as investors could earn higher returns in investment vehicles not covered by Regulation Q. These declines of deposits in thrifts, according to one economic observer, "took place within an economic environment much different from recent prior periods."[54] The opportunity to shift funds from S&Ls and banks to sites of more profitable investment actually occurred because of demand-pull inflationary pressures that resulted from high productivity rates and increased credit demands, and not wage-push inflation as the FOMC speculated. As one example, fifty percent more credit was needed in August 1966 than the previous year, demonstrating how competition for funds "pulled" prices higher rather than annual wage increases "pushing" them upward.[55] In response to commercial banks, thrifts, corporations, and the federal government's need for higher levels of credit, the Federal Reserve—without consulting the Federal Home Loan Bank Board—tightened its monetary

[53] Ibid., 99-100.
[54] Albert Burger, "A Historical Analysis of the Credit Crunch of 1966," *Federal Reserve Bank of St. Louis* (1969): 29.
[55] Ibid., 15.

belt by allowing short-term interest rates on Treasury bills (T-bills) to rise above Regulation Q ceilings, thereby openly encouraging disintermediation.[56]

As the money supply shrank, interest rates jumped to 6.30 percent on commercial loans and 5.85 percent on commercial paper when they had averaged 5 percent and 4.35 percent respectively in the first three quarters of 1965.[57] With S&Ls offering only 4.75 percent on their passbook savings accounts, depositors quickly withdrew their money from thrifts and commercial banks and invested it in the securities markets—the first case of this type of disintermediation in the United States. The U.S. League of Savings Institutions (hereafter U.S. League), the largest and most prominent S&L trade association, estimated that the tight monetary policies of the Federal Reserve, which drastically increased thrifts' withdrawal and turnover ratios, cost S&Ls $7.4 billion in savings deposit receipts.[58] This shift of funds away from thrifts "was so pronounced and unusual," the U.S. League claimed, that "[a] new word—disintermediation—was added to the vocabulary of finance."[59] Subsequently, mortgage credit dried up and housing starts dropped 30 percent in the six months after August, producing the lowest number of starts in twenty years.[60] Just as problematic, and another first for the postwar period, dividends paid to savers accounted for all of the growth in net savings receipts for 1966 (this bearing in mind that dividends were

---

[56] Mason, *From Buildings and Loans*, 183-4. The Friend Commission highlighted how the Federal Reserve failed to discuss its intended policy changes with the FHLBB or to coordinate with them in order to mitigate, as much as possible, its monetary policies' ill effects on mortgage credit and housing starts.
[57] Burger, "Credit Crunch of 1966," 15.
[58] United States Savings and Loan League, *1967 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1967), 60. A turnover ratio measured the stability of funds in associations. The ratio represented the money withdrawn from associations as a percentage of total savings. In the ten years before 1966, the turnover rate hovered annually between 30 percent to 32 percent. It was over 37 percent in 1966. Savings withdrawals between 1962 and 1965 had averaged $3 billion annually; but in 1966, they were $10.2 billion.
[59] Ibid., 10.
[60] Stone, "Housing Dynamics of US Capitalism," 54.

credited to savings accounts and tabulated as part of gross and net savings receipts).[61] After reflecting on this totality of circumstances, the U.S. League described 1966 as a "special case in the history of savings and loan lending."[62]

A key U.S. League report found that the legislative and regulatory responses to the 1966 credit crunch had "altered substantially" the "framework within which savings and loan associations" operated, i.e., had transformed the industry's governance mechanism.[63] In the years before 1966, the American mortgage market, very simply, relied for its stability and general direction upon institutions—savings and loans—to collect and distribute American savings. Building upon their "long success with the monthly amortized loan," thrifts utilized their "thorough knowledge" as "local lenders" to control 44 percent of the $221 billion mortgage market.[64] Thrifts' asset portfolios overwhelmingly reflected their mandate to provide mortgages.[65] Their liability portfolios demonstrated the importance of higher national savings rates.[66] Certain tax provisions and Regulation Q minimized the potential for competitive pressures from other financial intermediaries to threaten thrifts' market share, and federal credit agencies provided only 3 percent of all residential debt.[67]

---

[61] *1967 S&L Factbook*, 66. Dividends as a percentage of net savings receipts averaged 36 percent between 1960-1965; it was 133 percent in 1966.
[62] Ibid., 71.
[63] Ibid., 87.
[64] United States Savings and Loan League, *1965 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1965), 60.
[65] 85 percent of all S&L assets in 1965 were mortgages.
[66] In 1966, 88 percent of S&L liabilities were passbook savings accounts.
[67] Regulation Q, as of August 1966, only applied to commercial banks. Until 1951, S&Ls paid no federal taxes. Between 1951 and 1962, only institutions whose reserve funds exceeded 12 percent of all savings account balances paid federal taxes. The Revenue Act of 1962, however, changed how thrifts calculated their tax assessments. The IRS allowed S&Ls, because of the inherent dangers to borrowing short and lending long, to create a bad debt reserve to pay off possible future losses by allocating an amount equal up to 60 percent into a bad debt reserve fund. If the bad debt reserve fund did not exceed 6 percent of loans outstanding, then the 60 percent was not taxed, but the remaining 40 percent of revenue was taxable. Additionally, the Internal Revenue Service Act of 1962 established a savings requirement and an asset test that stated housing must represent, at minimum, 70 percent of a thrift's asset portfolio in order to qualify for the special bad debt reserve deduction. Congress subsequently debated and changed the asset test minimum percentages (later Qualified Thrift Lender [QTL] test) several times thereafter.

The transition that occurred after 1966 from this growth and saver governance mechanism to a second layer lender system had massive consequences for the nation. Simply put, a second layer lender would be a financial institution that bought mortgages from a primary lender, thus enabling that initial lender to write more mortgage loans. The transition to this new system, the U.S. League concluded, must be "traced to equally dramatic changes in the economic and competitive environment" in which thrifts operated. Previously, since the end of the Second World War, S&L executives and policymakers had enjoyed "20 years of relatively stable annual rates of savings growth"; the next twenty years would be a "period of wide swings and uncertainty."[68] In their not too distant future, S&L executives would encounter more competition from second layer lenders, commercial banks, money market mutual funds, non-bank banks, and mortgage/finance companies that began increasingly to trade in mortgages.[69]

Effects of the 1966 Credit Crunch

The transition dramatically altered the niche that S&Ls occupied in the U.S. financial sector. With this new source of "deposits" or loanable capital funneled to them by second layer lenders and their institutional investor base, the importance of net savings receipts as a source of operating income for the S&Ls declined drastically; as a result, thrifts' liability portfolios evolved from passbook savings into certificates of deposit (CDs), money market certificates, FHLBB advances, and mortgage-backed securities. Over a twenty-five year

---

[68] United States Savings and Loan League, *1972 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1972), 63.

[69] U.S. League officials called the Federal National Mortgage Association (FNMA or Fannie Mae), the Government National Mortgage Association (GNMA or Ginnie Mae), and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) "second layer lenders" since they did not directly interact with individual borrowers on a day-to-day basis.

period, mergers, thrift closures, and S&L failures eliminated over 50 percent of the institutions that existed in 1966. Acquisition, development and construction (ADC) loans, adjustable rate mortgages (ARMs), consumer loans (for purchasing cars, etc.), commercial loans (to businesses rather than to home buyers), and direct investments came to represent a more significant portion of S&L assets. Concurrently, demographic and economic factors altered the composition of U.S. households and therefore changed the nation's housing needs.

In this fluid context, policymakers' ability to regulate efficiently and effectively was questioned, resulting in a more complicated and nuanced regulatory environment. As I will subsequently demonstrate, more actively managed monetary policies produced higher levels of interest rate volatility, and thus created more opportunities for disintermediation and thrift industry weakness. Favorable treatment in the tax code and generous accounting standards remained vital for thrift success, but instead of focusing upon bad-debt reserves and generally accepted accounting principles (GAAP), policymakers attempted to utilize goodwill, depreciation schedules, forbearance, and regulatory accounting principles (RAP) to protect and strengthen the S&L industry. Ultimately, the 1966 credit crunch demonstrated how the Federal Reserve intentionally pursued a monetary policy that it knew would cause disintermediation. It chose to target a 5 percent annual growth rate of bank credit and thus constrain the level of household and business debt "by combining open market sales of Treasury bills [to reduce the money supply] with low Regulation Q ceilings on large denomination CDs," with the hope that firms would shift their working capital from CDs to Treasury bills in order to force "banks to adopt more selective lending policies."[70]

---

[70] Edwin Dickens, "The Great Inflation and U.S. Monetary Policy in the Late 1960s: A Political Economy Approach," *Social Concept* 9 (1995): 68.

The drastic effects of the 1966 credit crunch so startled legislators that shortly thereafter they commissioned Professor Irwin Friend of the Wharton School of Finance and Commerce at the University of Pennsylvania and other academics to "examine the role of the [S&L] industry in the economy and to determine methods for improving its performance, particularly in view of the major difficulties which the industry was having at that time," including several "important recommendations for legislative and regulatory action."[71] Published in July 1969, the commission's report highlighted ways that the U.S.' mortgage market had begun to change in response to the tumultuous events of 1966. It also identified a number of problems that policymakers and thrift executives would be forced to address as they struggled to navigate the economically and politically destabilizing circumstances of the 1970s.

The Friend Commission examined and debated the importance of national savings (thrift credit growth), thrifts' asset and liability structures, financial regulatory approaches, the social costs of regulations, and thrifts' allocational and operational efficiencies. Most troubling for the continued future success of the S&L industry, the commission identified a causal relationship of the S&Ls' "nonmarketable long-term investments" and "highly liquid

---

[71] Friend Commission, iii-iv, 1. Historian David Mason failed to identify and explain the context for the Friend Commission. By missing its connection to 1966, he situated the commission instead mainly within the context of deregulation, which is an oversimplification of the commission's findings. The report did recommend expanding thrifts' asset and liability powers and eliminating Regulation Q (in the long-term), but the report also clearly demonstrated the fundamental role that the government played, and would continue to play, in creating and maintaining the American housing market. Mason, *From Buildings and Loans*, 206. The Commission's participants included: Phoebus Dhrymes (University of Pennsylvania), Paul Taubman (University of Pennsylvania), James Walter (University of Pennsylvania), Paul Cootner (Massachusetts Institute of Technology), Robert Bartell (Washington University), Austin Hoggart (University of California, Berkeley), Stephen Goldfeld (Princeton University), Reuben Kessel (University of Chicago), George Benston (University of Rochester), Edward Herman (University of Pennsylvania), Eugene Brigham (University of Wisconsin), R. Richardson Pettit (University of Pennsylvania), David Huang (Southern Methodist University), Leo Grebler (University of California, Los Angeles), Tom Doyel (University of California, Los Angeles), Irwin Friend (University of Pennsylvania), David Fand (Wayne State University), Jack Guttentag (University of Pennsylvania), Paul Samuelson (Massachusetts Institute of Technology), James Duesenberry (Harvard University), and Ernest Bloch (New York University).

short-term liabilities" to "adverse consequences on the housing markets." In other words, the commission pointed directly to the impact on thrifts of policy-related invitations to disintermediation, or investment locale switching by savers. Bear in mind that a borrower's liabilities, reflecting debt that must be paid, are a bank's assets, reflecting loans that will be paid with interest. But in this period Congress imposed restrictions on thrifts' access to assets (i.e., types of loans they could make) and choice of liabilities (deposits they could expect to receive). Given these restrictions, the commission predicted that S&Ls would experience more episodes of disintermediation and decreased profitability if inflation and interest rates continued to rise *unless* Congress modified the thrifts' lending and borrowing restrictions. Making changes favoring the thrifts "could effect a significant improvement in the industry's overall economic performance without risking a severe adverse impact on the housing market," the Friend group found.[72]

The commission also claimed that 20 percent of the industry was not "well" by 1969 due to a slowing economy, changing tax and regulatory codes, and declining savings growth and thrift profitability—problems thrifts would continue to encounter throughout the 1970s.[73] The combination of having to offer higher interest rates to attract deposits and decreasing profitability, the report suggested, forced "an undue emphasis on growth," which included expensive advertising and solicitation fees, high interest rates on savings, and luxurious office buildings. These more expensive efforts "stimulated the reaching for high yield and risky loans" in order to cover their newly increased costs. Unfortunately for many S&Ls, however, the earnings squeeze that developed during the first years of the 1960s, in addition

---

[72] Friend Commission, 53-4. The commission report recommended thrifts be allowed to invest up to 10 percent of their asset portfolios in consumer loans and offer checking accounts.
[73] Ibid., 43.

to the 1966 credit crunch, imposed larger than normal savings losses upon many institutions that lost depositors at a time when their liquidity was already low. Couple the liquidity shortage with “protracted periods frequently elapsing between the first signs of difficulty and any effective action,” the Friend commission concluded that supervisory responses to “associations in difficulty left much to be desired.”[74] Even with all of the extant structural, regulatory, and allocational problems the Friend Commission described, it also acknowledged it left “several gaps” that they believed required “more detailed studies.”[75]

To counteract these recent developments, the commission detailed how savings and loans could continue to serve as the fulcrum of the American housing and savings markets. They praised both larger-sized thrift institutions and the industry’s asset specialization, claiming they enabled better economies of scale and more efficient operations, a point they believed the FHLBB needed to remember if it were to reevaluate their chartering policies.[76] The Friend Commission, nevertheless, also urged thrifts to diversify both their asset and liability structures, arguing that a “judicious combination of changes both in the lending (assets) and borrowing (liabilities) power of the industry could effect a significant improvement in the industry’s overall economic performance without risking a severe adverse impact on the housing market.”[77] Even though the experts opined that interest rate

---

[74] Ibid., 38-9.
[75] Ibid., 2-3. These included: The income and loss experience of individual loans made by savings and loan associations classified by loan characteristics; 2) the comparative performance of Federal, insured State, and noninsured associations; 3) the adequacy of State regulation and the coordination of State and Federal supervisory policies and procedures; 4) the relative merits of different procedures for dealing with the most severe types of supervisory problems; 5) an examination of the role the savings and loan industry might play in urban reconstruction; 6) a critique of the structure, operations, and performance of the FSLIC, including its system of insurance assessments; 7) an investigation of the organization and administration of the FHLB System (as distinguished from its regulatory and credit policies and procedures); and 8) a detailed study of the tax treatment of the industry.
[76] Ibid., 29-31.
[77] Ibid, 54. The “most promising” options included: expanding consumer lending, offering more multi-family housing unit mortgages, providing longer-term savings accounts and checking accounts, marketing debentures,

ceilings "should gradually be raised relative to free market rates," they accepted their contemporary usefulness while also cautioning that they "should neither be retained indefinitely nor abolished immediately."[78]

Lastly, the commission warned against the central bank practice of relying exclusively upon monetary policy during protracted periods of tight money—"perhaps the most important problem considered" in the study. The commission was critical of over-utilizing monetary policy because it was to a "substantial extent a selective means of credit control impinging in particular on housing," with "particularly large…costs to young families and to disadvantaged groups." They believed that a "prolonged period of inflationary pressure contained mainly by monetary policy and rising interest rates could be disastrous." They therefore concluded, "It seems reasonable to assume that greater reliance should be placed on fiscal policy for counteracting cyclical excesses," which "should make possible a more efficient allocation of resources and a more equitable distribution of the effects of restraint among different groups in the population, as well as provide what could be a more certain and speedier overall impact."[79] The Friend Commission was clearly concerned not only with improving the structural integrity of the American mortgage market, but also with doing so with an eye towards enabling what they perceived to be a moral and equitable

---

creating new mortgage instruments, and minimizing geographical restrictions on thrifts. See also Friend Commission, 15.

[78] Ibid., 23. On the one hand, interest rate ceilings created "a deficiency in the supply of savings in relation to the borrower's demands. This, according to critics, necessitated wasteful and inequitable non-price rationing methods," which also created the opportunity for monopoly profits. These ceilings also helped discriminate against "moderate-income" and "unsophisticated savers," in addition to enabling "serious problems of equity and efficiency." On the other hand, they did "provide an additional policy instrument which may be useful at times. Thus, they provided a mechanism for selective control of (and assistance to) residential construction as opposed to other capital formation." Once ceilings were established, though, their repeal could "cause substantial damage to the interests which have grown up under their protection, and this damage might on occasion assume serious proportions for the economy as a whole." Lastly, interest rate ceilings "may at times be useful to stop an upward spiral of interest rates based on self-fulfilling psychological reactions." Friend Commission, 22.

[79] Ibid., 7-8.

system of distributing mortgage credit. Essentially, the commissioners' efforts represented the first comprehensive attempt at crafting regulatory responses to the changing socio-economic and political contexts in late 1960s America that reflected the goals of strategic deregulation by (re)harnessing the power of federal agencies to promote U.S. homeownership, which entailed recommendations to adjust thrifts' asset and liability powers to ensure they maintained their housing niche.

1968 Economic Crisis

The increased demand for credit in 1966 that so concerned the FOMC, in part, resulted from the need for federal borrowing to finance the Vietnam War. The war escalated throughout 1966 and into 1967; yet President Johnson and Congress refused to increase taxes to fund both the military and Great Society programs. Concurrently, America's already problematic trade deficits worsened. International concerns over America's burgeoning budget and trade deficits were driving inflation higher, destabilizing the dollar, and negatively impacting the international gold market. These factors forced the Johnson administration and Congress in March 1968 to compromise on a tax increase and budget cuts to end the "economic crisis of 1968." This compromise, in the words of a high-ranking Treasury official, also prevented the international monetary system from "going to hell in a handbasket."[80] This often-neglected episode of American financial instability revealed the extent to which international considerations influenced domestic financial policymaking and

[80] Robert Collins, "The Economic Crisis of 1968 and the Waning of the 'American Century,'" *The American Historical Review* 101 (1996): 400-1. Hell quote from Treasury Undersecretary Frederick Deming, quoted in Collins, "Economic Crisis of 1968," 411.

disclosed additional structural instabilities to the postwar economy.[81] Domestic policymakers' decisions on how best to restore and maintain economic growth needed to consider how inflation, budget and trade deficits, and monetary and fiscal policies affected not only GNP but also international perceptions regarding the nation's productive capacities and the strength of the dollar.[82] Again, additional governance mechanism inputs to consider. The 1968 economic crisis, then, "marked the beginning of an awkward transition from the postwar boom to a new era" that culminated with the dismantling of the Bretton Woods agreement that had pegged the developed world's currencies to the dollar.[83] This world of higher inflation and unstable interest rates proved highly problematic for thrift executives as they tried to navigate in this new economic environment.

1960s Urban Riots

One additional factor that would drastically alter the thrift industry's status was the urban riots of the 1960s. With the increasing number of violent urban confrontations during the latter half of the 1960s, particularly in 1968 following the Dr. Martin Luther King assassination, many American policymakers came to interpret black rioters' actions—looting stores, destroying property, and fighting with white police whom they perceived as enemies—as the ultimate expression of frustration over African-Americans' "lack of ownership" within their communities. But Louis Hyman's recent work on the American credit system offered a more detailed explanation. Hyman's research described how "credit

[81] Bivens's *Jimmy Carter's Economy* argued that Carter was the first president in the postwar era forced to consider the domestic and international limitations of the American economy, but Collins persuasively demonstrated that it was indeed Johnson who faced this challenge first.
[82] Ibid., 408.
[83] Ibid., 412.

structured the world of ghetto consumption." He claimed, "It was the structures of the credit system that drew the ire of rioters" on the basis that their options for obtaining credit were limited and higher in cost than what non-minority borrowers paid and thus, he argued, "ghetto consumers needed a financial path out of the closed credit system of their neighborhoods."[84] Key members of the Johnson administration and Congress who concluded that "solving the urban crisis would require solving the housing crisis" prioritized the "ghetto housing problem" and devised a plan that they hoped would channel capital into urban areas and other capital-deprived areas. Their solution was asset-backed securities. Johnson administration officials and Congress utilized the "radical financial innovation" of "making mortgages bond-like" by bundling them into packages to sell in a secondary market, allowing investors in these securities to collect repayment at the rate stated for the security. They were able thus to expand the investor base and identify funds to expand home ownership in American cities.[85] Policy elites believed that doing so provided a new and more reliable source of mortgage funds as well as a potential resolution to urban discontent.

Transitioning into the 1970s

Social spending obligations undertaken to implement the War on Poverty raised citizens' expectations and required substantial increases in government spending and debt. These new government interventions combined to produce housing-related policies that over the next few years fatally affected the savings and loan industry.[86] When credit markets had

[84] Hyman, *Debtor Nation*, 177.
[85] Ibid., 224-5.
[86] Interest Rate Adjustment Act of 1966 (Regulation Q); Housing and Urban Development Act of 1968 (FNMA reorganization and GNMA creation); Rate Control Act of 1969 (Treasury could purchase $4 billion of FHLBB obligations); and the Emergency Home Finance Act of 1970 (created FHLMC).

tightened once again in 1969, many businessmen feared that policymakers would not succeed in eliminating inflationary pressures in a Vietnam-focused United States. They feared that Congress lacked the political wherewithal to do so, especially after the 1968 surtax failed to "achieve significant anti-inflationary results."[87] A growing expectation of inflation—which had jumped from 1.03 percent in 1960 to 5.46 percent in 1969—encouraged many to borrow sooner rather than later, since credit would be more expensive down the road. Such an outlook helped to make rising inflation a self-fulfilling prophecy as lenders demanded higher inflation premiums from potential borrowers who "moved ahead in order to beat price increases." One economic commentator even wondered "whether the tools of economic policy will work at all."[88]

But contrary to 1966, when "acute tightness and very high interest rates were something new, and nobody knew what their effects on the markets or the economy would ultimately be," there was "less panic in the markets and among those who make economic policy" in 1969. One astute observer opined that "financial institutions have made adjustments that have enabled them to weather sharp money tightening with less strain." Commercial banks tapped into Eurodollar and commercial paper markets, while S&Ls utilized FNMA purchases of mortgages they held and FHLBB advances to supplement their liquidity shortages—as Table 1.1 demonstrates.[89]

---

[87] Stephen Packer, "The Credit 'Crunch': 1969 v. 1966," *Financial Analysts Journal* 25 (1969): 20.
[88] Ibid., 19.
[89] Ibid., 18.

Table 1.1. *Second Layer Lender Activity – 1966-1980 (in billions)*

Organization	1966-1970	1971-1975	1976-1980
FHLBB advances	$17	$36	$113
FNMA purchases	$15	$25	$40
FHLMC purchases	-	$7	$21
GNMA pass-through issued	-	$21	$91
Total second layer lender activity	$32	$89	$264
Total loans and participations sold by S&Ls	$4	$18	$73
Total loans closed and purchased by S&Ls	$114	$268	$599

Source: S&L Factbook, "FHLMC, FNMA, and GNMA Activity"; and *S&L Factbook*, "FHLB Lending Operations."

Understanding its "responsibility to sustain the flow of credit into the housing market" and "determined to avoid a repetition of the conditions of 1966," the Federal Home Loan Bank Board provided $5.5 billion in advances to almost 48% of the industry in 1969.[90] Just one year earlier, the FHLBB only advanced $2.7 billion to 37% of institutions. This increase in advance activity led the U.S. League to conclude, "Never in the annals of the savings and loan business had advances supported lending to the extent attained in 1969."[91] S&Ls received another $4.1 billion from FNMA purchases, which "zoomed to record highs" in 1969.[92] Together, these second layer lender resources represented 37% of all residential debt in 1969.[93] This change highlighted a new trend that would come to alter radically the creation and distribution of mortgage credit in the United States. Far from serving as supplementary institutions to S&Ls, over the next two decades second layer lenders replaced thrifts as America's supplier of mortgage credit. This transition, more importantly, was driven in large part by the Federal Reserve's efforts at lowering inflation, a project they

---

[90] *1971 S&L Factbook,* 117.
[91] Ibid., 118.
[92] Ibid., 129.
[93] *1971 S&L Factbook*, 71. The U.S. League estimated that tight monetary conditions in 1966 and 1969 collectively "caused association to lose" $14.6 billion.

conducted with little concern for its effects on the thrift industry or America's housing market.

The credit crunch and inflation issue provided an opportunity to reassess the state of economic knowledge regarding effective methods of economic stabilization. By the end of the 1960s, wrote Stephen Packer, "economists who can be called monetarists to some degree" could not agree upon the "appropriate objectives and techniques of policy."[94] "Money supply economists" such as Milton Friedman criticized the Federal Reserve—the implementers of U.S. monetary policy—for focusing on short-term interest rates. "Money supply economists" labeled this policy choice counterproductive in that, following it, the Fed too frequently and unnecessarily tampered with financial markets, thereby producing lower interest rates in the long run and creating more financial instability.[95] And even though most monetarists agreed that the Federal Reserve Board had previously paid too little attention to the money supply, they disagreed as to whether the money supply was an appropriate target for economic policy, whether changes in the money supply actually caused major changes in economic activity or were merely historically related, and whether a "rigorous relationship" existed between changes in the rate of money supply growth and the rate of economic activity.[96]

Even as monetarists tried to demonstrate the validity and usefulness of targeting the money supply, they encountered a number of criticisms that would continue to plague them over what became the short shelf life of monetarism.[97] By the end of the 1960s, critics

---

[94] Packer, "Credit Crunch," 20-1.
[95] Ibid., 21.
[96] Ibid.
[97] For analyses on monetarism, see Fine and Milonakis, *From Political Economy to* Economics, 245-67; Burgin, *Great Persuasion*, passim; and Charles Kindleberger, *Keynesianism vs. Monetarism and Other Essays in Financial History* (New York: Routledge, 1985), 11-64, 287-92.

suggested, "Monetarists have done a more convincing job showing historical correlations than with their explanations of how things work." Many acknowledged and admired the Fed's flexibility, but "nobody has been able to establish any clear linkages between policy moves and economic effects." Critics bemoaned the "deficiencies inherent in its structure" since the Federal Reserve utilized the country's commercial banking system to implement politically problematic policies whose effects were uneven across various sectors, particularly mortgage and consumer credit; a concern the Friend Commission also aired.[98] One financial analyst even observed, "The question whether the Federal Reserve can control money supply growth is highly technical and remains a subject for active debate." The 1968 crisis demonstrated monetary policymakers could not neglect "real world" problems such as balance of payments, international financial crises, Treasury financing needs, and security market fluctuations. And as one observer astutely noted, "It is not realistic, and may be dangerous, for the economic authorities to follow a rule which disregards these problems."[99] Nevertheless, the demonstrated failure of "new economics"—with its fiscal approach—to produce low-inflation economic growth during the 1960s provided an opportunity for monetarists, problems and all, to reassert their theoretical and disciplinary authority in the 1970s.

Second Layer Lenders and Mortgage-Backed Securities

The 1966 credit crunch and the urban riots, in particular, had revealed—for the first time in the postwar era—the limited capacity of savings and loan institutions specifically, and of the postwar mortgage markets more broadly, to adequately distribute mortgage credit

[98] Packer, "Credit Crunch," 20; and Friend Commission, 7-8.
[99] Packer, "Credit Crunch," 21.

to all Americans. In response, policymakers in Congress reorganized Fannie Mae in 1968 and created Ginnie Mae and Freddie Mac in 1968 and 1970, respectively. Shortly thereafter, less than two months into 1970, the first ever mortgage-backed securities (MBS) were issued by GNMA. These new government-sponsored entities (GSEs, a.k.a. second layer lenders) and innovative financial assets were designed to provide a non-thrift alternative to originating and distributing mortgage credit in the United States.[100]

The U.S. League believed "a new era in the field of residential financing began" with the re-chartering of Fannie Mae and the creation of Ginnie Mae and Freddie Mac. These programs were designed to increase the liquidity and marketability of mortgage loans with the intention of making mortgages "attractive to a broad segment of investors." FNMA, as a "private corporation with a public purpose," provided a secondary market for residential loans by buying, servicing, and selling FHA and VA loans as well as conventional loans after 1970.[101] GNMA was a government-owned entity within the Department of Housing and Urban Development (HUD) that oversaw the special assistance, liquidation, and management programs that Fannie Mae had previously performed. It was also responsible for issuing mortgage-backed securities. Freddie Mac was authorized to purchase participations (portions of individual conventional loans) from savings and loan institutions, conventional mortgage loans, and FHA/VA loans. Freddie Mac was also authorized to re-sell conventional loans and mortgage-backed securities. By partially privatizing Fannie Mae and creating Ginnie and Freddie Mac, both Johnson and Nixon administration officials and congressional and regulatory policymakers permanently altered the growth and saver mortgage market

---

[100] Hyman, *Debtor Nation*, 221.
[101] United States Savings and Loan League, *1973 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1973), 126-30.

governance mechanism by broadening the “sources of funds available for residential mortgage investment…[so as to] rely less on depository institutions that tend to be vulnerable to conditions accompanying general credit restraint.”[102] Congress, specifically, hoped GNMA and the FHLMC would further assist in “increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing” so as to “promote access to mortgage credit throughout the Nation.”[103]

Savings and loan leaders generally approved these steps. The U.S. League claimed that these second layer lenders and mortgage-backed securities would “increase the attractiveness of mortgages as an investment by eliminating the cumbersome paperwork and time-consuming red tape connected with mortgage investment.”[104] But more important, they asserted that second layer lenders “sparked the development of standardized mortgage documents,” “breached regional barriers,” and became “vehicles for the more efficient allocation of residential mortgage funds.” Therefore, the U.S. League concluded, “The mortgage market is no longer a fragmented segment of the economy coping with a highly differentiated product, but now has a high degree of fluidity and increasing homogeneity.” To clarify, then, second layer lenders were intended to establish a new source of mortgage funds available to assist new homebuyers, to enhance the investment potential and marketability of mortgage loans, to decouple monetary policy from housing policy, and to create a more efficient national housing market. It was, therefore, easy to understand why the U.S. League identified a “new era in the field of residential financing” from these institutional innovations, since mortgages could now be considered both a liability and an

[102] Federal Reserve officials, quoted in Hyman, *Debtor Nation*, 225.
[103] Housing and Urban Development Act (1968) and Federal Home Loan Mortgage Corporation Act (1970).
[104] *1971 S&L Factbook*, 131.

asset from an institutional perspective—with short- and long-term earning power; individual savings, economic growth, and local considerations were now less important factors in maintaining a healthy mortgage market; and federal agencies would play a more fundamental role in sustaining American homeownership.[105]

Thrifts' Evolving Operational and Competitive Environments, 1970 - 1976

This radical reconstitution of the American financial sector did not end well for the 5,738 thrifts that existed in 1970. Overseers of the American mortgage market after 1970 faced an increasingly volatile economy, gyrating interest rates, continued disintermediation, and recessions. These issues led to significantly expanded second layer lender activity and further changes in congressionally mandated regulatory policies. Significant remnants of the growth and saver governance mechanism still remained, particularly the institutions that it had relied upon to distribute mortgage credit—savings and loans. And although the thrifts were increasingly displaced by the second layer lenders, they were nevertheless still expected to pursue the growth and saver system's social objective—promoting homeownership. Inevitably systemic contradictions arose that continued to change the operational and competitive environments in which S&Ls functioned.

Many of struggles thrifts faced in the 1970s resulted from the sustained and rising inflation that began in the mid-1960s, a problem the U.S. League blamed on "the success of our economic planners in achieving the full employment of our nation's resources."[106] They believed monetary policies, in particular, "had a profound effect" on S&Ls that reached "into

[105] *1972 S&L Factbook*, 126.
[106] *1973 S&L Factbook*, 63.

all facets of their operations."[107] When money was tight, as it was during the 1966 and 1969 credit crunches and the 1970 and 1973-74 recessions, S&Ls struggled to attract and maintain deposits. As Table 1.2 demonstrates, the industry faced new challenges after 1966, and particularly in the 1970s, as their withdrawal, turnover, and net receipts ratios changed considerably. Thrifts' withdrawal ratio (percentage of gross receipts withdrawn from institutions) averaged 68 percent in the fifteen years before 1966, but they jumped to 87 percent during troubled years of 1966, 1969, 1970, and 1973-74.

Table 1.2. *Key Operational Ratio Averages for Savings and Loans*

	1951-1955 average	1956-1960 average	1961-1965 average	1966-1970 average	1971-1975 average	1976-1980 average
Withdrawal ratio	63%	69%	72%	86%	74%	83%
Net receipts ratio	18%	14%	12%	6%	15%	13%
Turnover ratio	30%	31%	30%	35%	42%	64%

Source: *S&L Factbook*, "Savings Flows at All Savings Associations."

In 1966, for example, when thrifts received $45 billion in deposits, depositors withdrew over $41 billion (a 92 percent withdrawal ratio), $10 billion higher than their previous historical average. The higher withdrawal ratios were a consequence of the disintermediation losses that the thrifts suffered, particularly as Regulation Q prevented S&Ls from paying market rates. The situation in 1966 had also demonstrated that tight monetary conditions cost thrifts billions in investable funds, which in that year translated into the lowest number of housing starts in the postwar era. Rising turnover ratios (withdrawn funds: total savings at the beginning of the year), which nearly doubled between 1966 and 1980, and declining net receipt ratios (net receipts: total savings at the beginning of the year), also confirmed the extent to which tight monetary policies negatively affected the operational and competitive

---

[107] United States Savings and Loan League, *'80 Savings and Loan Sourcebook* (Chicago: United States Savings and Loan League, 1980), 85.

environments of S&Ls since many of their competitors were not affected by the interest rate ceilings established by Regulation Q. But even more important, as escalating withdrawal and turnover ratios and decreasing net receipt ratios transformed from a tight money phenomenon into a yearly occurrence after 1973, as revealed by Table 1.3, thrifts were forced to rely increasingly upon other resources, such as FHLBB advances and the secondary mortgage market, for funds to increase their asset portfolios.[108]

Table 1.3. *Key Operational Ratios for Savings and Loans*

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Withdrawal ratio	78%	92%	78%	84%	92%	83%	64%	66%	82%	87%	72%	73%
Turnover ratio	30%	37%	32%	32%	37%	39%	34%	36%	45%	48%	46%	47%
Net receipts ratio	8%	3%	9%	6%	3%	8%	19%	19%	10%	7%	18%	18%

Source: *S&L Factbook*, "Savings Flows at All Savings Associations."

These changes, which drastically increased operating costs for thrifts, forced the U.S. League to conclude, "The increased volatility of savings flows…has contributed much to the 'boom and bust' nature of the housing industry."[109]

The increased competitiveness of the U.S. savings market confirmed that S&Ls were being replaced as the financial intermediary of choice for American savers. Commercial banks, between 1965 and 1980, received more deposits than S&Ls in eleven of those fifteen years—which was quite the reverse of the fifteen years before 1966, when banks outgained thrifts only twice. Moreover, S&Ls collected $80 billion less in deposits than commercial banks during that same period. And even though thrifts obtained more deposits than the

[108] 1975 and 1976 were anomalous years for both withdrawal and net receipt ratios, which resulted from S&Ls experiencing two of the best years in their history. But the years before and after demonstrated prove that 1975 and 1976 were anomalies, and that both ratios long-term trends drastically differed from their pre-1966 averages.
[109] *'80 S&L Sourcebook*, 55.

credit, equity, and money markets between 1965 and 1980, they only barely did so by garnering $413 billion as compared to the $404 billion that the credit, equity, and money markets collected.[110] It was no wonder, though, that thrifts were losing their market share of American savings to institutions offering market rates when U.S. government bonds and Corporate Aaa bonds, between 1965 and 1980, were earning on average 124 and 193 basis points more than S&L savings accounts.[111] And unfortunately for S&Ls, the imposition of Regulation Q disallowed them from actively competing for deposits, which really hurt thrifts after 1973, when commercial banks and the credit, equity, and money markets collected $83 billion more in deposits than S&Ls.[112]

Even though Regulation Q ultimately limited the amount of deposits S&Ls could obtain, the U.S. League still supported the imposition of interest rate ceilings because of the "significant differences in the asset and liability powers of savings associations and commercial banks." Banks had large portfolios comprised of short-term commercial and consumer credit loans that turned over rather quickly; S&Ls, on the other hand, invested almost exclusively in long-term, fixed-rate mortgages with a slower turnover rate. Commercial banks' ability to "increase their portfolio yield and earnings quickly in response to rising open market conditions" concerned the U.S. League because thrifts' portfolio yield and earnings were "largely frozen during a period of spiraling open market rates"—as happened over the course of the 1970s. And since commercial banks offered a "full array of financial services," allowing them to "compensate for the lower rates they can pay by providing consumers with the convenience of obtaining at one location all the financial

[110] *S&L Factbook*, "Annual Change in Financial Assets of Households."
[111] *S&L Factbook*, "Average Annual Yield on Selected Types of Investments."
[112] *S&L Factbook*, "Annual Change in Financial Assets of Households."

services they may need," the U.S. League surmised that S&Ls needed to pay higher rates on deposits in order to "compete with this advantage."[113]

So not only were thrifts losing a significant portion of American savings to commercial banks and other financial investments, the costs of trying to compete in this new competitive environment were substantially higher than before, which seriously affected thrift executives' operational decisions. S&Ls utilized certificates of deposit (CDs), and other financial innovations, to attract more deposits.[114] Even though CDs and "special accounts" accounted for only 12 percent of S&L deposits in 1966, that number had exploded to 41 percent by 1970. And as Table 1.4 highlights, only three years later, thrifts had more deposits in CDs than passbook savings accounts. Even though thrifts did not and could not offer money market certificates (MMC) until 1976, they quickly became the thrifts major source of funding shortly after being introduced, and by 1980 they accounted for almost 55 percent of all savings liabilities.[115]

---

[113] *1973 S&L Factbook*, 66.
[114] Mason, *From Buildings and Loans*, 161-2. Banks had been utilizing CDs as one mechanism to "steal" away deposits from thrifts. They were aided in this process by the 1962 creation of a secondary market for CDs, which overnight made them highly liquid assets and an attractive source for both short- and long-term loans. Over 50 percent of the growth in bank deposits between 1960 and 1965 resulted from a rapid increase in CDs in their liability portfolios.
[115] MMCs were a regulatory innovation that allowed thrifts to pay something closer to market rates for savings deposits.

Table 1.4. *Savings at Insured Institutions*

	Passbook savings	CDs and special accounts	Money market certificates
1966	88%	12%	-
1970	59%	41%	-
1971	55%	45%	-
1972	51%	49%	-
1973	47%	53%	-
1974	44%	56%	-
1975	43%	57%	-
1976	40%	58%	2%
1977	38%	59%	2%
1978	32%	57%	11%
1979	25%	41%	34%
1980	21%	24%	55%

Source: *S&L* Factbook, "Savings at Insured Associations, by Type of Account."

CDs and MMCs posed multiple problems, however. They transformed deposits from less volatile long-term liabilities into highly volatile short-term liabilities, forcing thrift executives to reconsider the extent to which they maintained asset portfolios that were comprised almost exclusively with fixed-rate, long-term assets that were less liquid than desired.[116] A CD-based liability portfolio was more expensive as thrifts paid higher interest rates to attract funds. In 1978 and 1979, for example, S&Ls paid, on average, between 6.5 percent to 7.9 percent for savings. In 1979 alone, the rates on CDs, MMCs, and passbook savings ranged from 5.75 percent to above 11 percent.[117] As such, the interest S&Ls paid for savings deposits increased 45 percent between 1966 and 1970, and then it shot up 92 percent

---

[116] Compare 1973 and 1979 maturity structures at thrifts, for example. In 1973, S&Ls had $210 billion in deposit liabilities, $104 billion (50 percent) of which were in passbook accounts. Another $50 billion were CDs with less than year to maturity (25 percent); the other $52 billion was in CDs with more than a year to maturity. By September 1979, thrifts had $453 billion in savings, of which only $126 billion (28 percent) was passbook savings. $169 billion (38 percent) was in CDs with less than a year to maturity, and another $152 billion (34 percent) in CDs more than one year to maturity.

[117] *'80 S&L Sourcebook*, 64.

by 1975, and another 106 percent by 1980.[118] This boom in interest payments, ironically enough, occurred as thrifts reduced the importance of savings in their liability portfolios.

In response to increasing costs, thrifts drastically altered their asset and liability portfolios over the course of the 1970s. Table 1.5 reveals the extent to which total inflows (loan repayments plus sales to secondary market) and FHLBB advances replaced savings as a vital component for funding asset purchases. Deposits as a percentage of total liabilities dropped from 83 percent in 1970 to 81 percent by 1980—a difference of roughly $12 billion for thrifts' 1980 liability portfolio.[119]

Table 1.5. *Total Inflows and FHLBB as a Percentage of Loans Closed*

	Total inflows: loans closed[120]	FHLBB advances: loans closed
1965	64%	24%
1970	59%	44%
1971	49%	19%
1972	48%	16%
1973	54%	31%
1974	61%	56%
1975	54%	33%
1976	47%	19%
1977	48%	20%
1978	51%	31%
1979	56%	43%
1980	60%	65%

Source: *S&L Factbook*, "Mortgage Lending Activity of All Savings Associations."

This change also corresponded with a decline in mortgage loans as a percentage S&L assets, affecting both their asset and liability structures. With less income from mortgage loans, thrifts increasingly relied upon FHLBB advances to make up the difference while

[118] *S&L Factbook*, "Statement of Operations of all Savings and Loan Associations." In 1965, S&Ls paid $4.5 billion in interest, that total reached $6.9 billion in 1970, $16 billion in 1975, and $41.6 billion in 1980.
[119] *S&L Factbook*, "Total Liabilities of S&L Associations."
[120] Total inflows equaled the number of mortgage loans and participations an S&L sold plus loan repayments from their existing asset portfolio.

simultaneously turning to investment income to replace the declining income from mortgages. These changes coincided with additional rising expenses as borrowing costs and federal taxes increased on thrifts. Their total interest costs (interest on savings plus interest on borrowed money) jumped from 72 percent of operating costs in 1970 to 85 percent in 1980, and their share of federal taxes rose from 2.8 percent of operating costs in 1970 to a 1970s high of 5.2 percent in 1978 before dropping because of the earnings squeeze in 1979 and 1980.[121] But S&L executives adapted their earnings structure in an effort to adjust to these higher expenses. S&Ls shifted their asset portfolios, just as American households were as well, by investing more in cash and securities, which eventually accounted for more than 20 percent of assets by 1981.[122] Table 1.6 tracks these changes.

Table 1.6. *Key Operational Changes During the 1970s*

	1965	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Mortgage loans: total assets	85%	86%	85%	85%	85%	82%	83%	83%	83%	82%	80%	78%
Cash and investment securities: total assets	14%	14%	15%	15%	15%	16%	18%	17%	16%	16%	18%	20%
Mortgage loan interest: total operating income	87%	84%	83%	83%	84%	82%	82%	81%	81%	81%	79%	81%
Investments: total operating income	5%	8%	9%	8%	8%	9%	9%	8%	7%	8%	9%	10%
FHLBB advances: total liabilities	5%	6%	4%	4%	6%	9%	6%	5%	6%	8%	10%	10%
Interest on borrowed money: total expenses	4%	8%	6%	4%	6%	9%	7%	6%	5%	8%	10%	10%
Total interest costs: operating income	67%	72%	70%	69%	69%	73%	74%	73%	71%	71%	75%	85%

Source: *S&L Factbook*, "Total Operating Income of FSLIC-Insured Savings Institutions"; *S&L Factbook*, "Selected Significant Rations of Federal Insured Savings Institutions"; *S&L Factbook*, "Total Assets of all Savings Associations"; *S&L Factbook*, "Total Expense of FSLIC-Insured Savings Institutions"; *S&L Factbook*, "Total Liabilities of Savings and Loan Associations"; and *S&L Factbook*, "Statement of Operations of All Savings and Loan Associations."

---

[121] Thrifts in 1980 paid 10 percent of their total expenses for interest on borrowed money. FHLBB advances also jumped from 5 percent of total thrift liabilities to 10 percent by 1979.

[122] Income from mortgage loans fell from 87 percent of income in 1965 to 81 percent by 1980, while investment income increased from 5 percent to 10 percent. Their asset portfolio, which totaled $659 billion in 1981, consisted of $146 billion of cash and investments. In 1972, American households invested 42 percent of their resources into financial, as opposed to tangible, assets. That percentage rose to 51 percent in 1976 before dipping to 42 percent in 1979 and then rising again to 63 percent by 1982.

The biggest change for thrifts during the 1970s was second layer lenders. The emerging centrality of second layer lenders and mortgage-backed securities to the post-1966 governance mechanism would prove to be a double-edged sword for thrifts, however. On the one hand, they provided an additional source of liquidity for thrifts. As Tables 1.6 and 1.7 demonstrate, S&Ls benefitted immensely from a robust secondary mortgage market and highly active second layer lenders. The FHLBB more than doubled its advance lending between 1966 and 1970; it then tripled its size by 1975.

Table 1.7. Purchases and Sales of Mortgage Loans, by lender (billions of dollars)

Savings and Loans	1971-1975	1976-1980
Purchases	$39	$64
% of total purchases	27%	19%
Sales	$18	$73
% of total sales	12%	20%
Commercial Banks		
Purchases	$5	$13
% of total purchases	4%	4%
Sales	$14	$35
% of total sales	9%	10%
Mortgage Companies		
Purchases	$5	$20
% of total purchases	3%	6%
Sales	$84	$184
% of total sales	57%	50%
Federal Credit Agencies		
Purchases	$41	$78
% of total purchases	28%	23%
Sales	$25	$57
% of total sales	17%	16%
Mortgage Pools (MBS)		
Purchases	$36	$133
% of total purchases	24%	39%
Sales	$3	$11
% of total sales	2%	3%
Total purchases[123]	$146	$345
Total sales[124]	$148	$365

Source: *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender."

[123] Total purchases do not equal the sum of the five listed secondary market participants.
[124] Total sales do not equal the sum of the five listed secondary market participants.

Fannie Mae and Freddie Mac's mortgage loan purchases increased 379 percent in the ten years after 1966 (even though it really only represented five years of secondary market activity), and mortgage-backed securities added an additional $113 billion of liquidity into America's mortgage market.[125]

Second layer lenders provided a number of additional benefits to borrowers and lenders. They reduced the interest rate premium investors demanded on mortgage loans, a fact the League bemoaned as mortgage loans' average return dropped to within thirty to forty basis points of Aaa corporate and utility bonds.[126] This drop made mortgages cheaper for borrowers while simultaneously less profitable for lenders and investors. Second layer lenders provided "additional inflows" (liquidity) by allowing thrifts to purchase and sell loans and participations, which had only equaled 6% of their total inflows by 1970, but jumped to 13 percent in 1975 and 23 percent by 1980.[127] Second layer lenders also allowed S&Ls to utilize "old, low rate loans to raise new investment funds without having to sell the loans at a loss."[128] They even collaborated with financial service trade associations to computerize listing services for mortgage loan buyers and sellers.[129]

But on the other hand, second layer lenders and mortgage-backed securities represented an alternative approach to funding homeownership in the United States. Instead of the previous, almost monopolistic arrangement whereby S&Ls predominantly converted depositors' savings into mortgage credit, second layer lenders provided thrifts another substantial source of mortgage credit—and competition. Second layer lenders' market share

---

[125] *S&L Factbook*, "FHLMC, FNMA, and GNMA Activity."
[126] *1973 S&L Factbook*, 41; and *1972 S&L Factbook*, 41-2.
[127] *S&L Factbook*, "Inflows from Mortgage Portfolios at Insured Associations."
[128] United States Savings and Loan League, *1976 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1976), 78.
[129] United States Savings and Loan League, *1977 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1977), 112.

of one- to four-family homes rose from 4 percent in 1966 to 14.5 percent by 1976; it would reach 40 percent by 1987.[130] Moreover, a secondary mortgage market and mortgage-backed securities also allowed other financial institutions (commercial banks, finance and mortgage companies, non-bank banks) the opportunity to more openly compete with thrifts in the mortgage market since mortgage loans were now securitized, transforming them into a rather liquid financial asset. Mortgage companies, for example, sold $268 billion worth of mortgages over the course of the 1970s, accounting for over 50 percent of all mortgage loan sales during that decade, and ironically enough, as Table 1.7 demonstrates, S&Ls purchased $103 billion of them.[131]

A healthy secondary mortgage market, more importantly, allowed all mortgage lenders, not just thrifts, to maintain higher levels of liquidity because they could easily sell their mortgage loans on the secondary market. Thrifts took advantage of this newfound liquidity; by 1980 almost one-quarter of their total inflows came from selling mortgages and loan participations, even though that number was less than 6 percent and 8 percent in 1966 and 1970, respectively. But so did commercial banks, which sold $49 billion of mortgage loans during the 1970s.[132]

Second layer lenders, interestingly enough, helped create a countercyclical paradox for thrift executives. As previously noted, the FHLBB increased their advance lending operations after 1965 to provide S&Ls a buffer from declining gross and net savings receipts during times of monetary stringency. Passbook savings account interest as a percentage of

---

[130] *S&L Factbook*, "Mortgage Loans Outstanding on One- to Four-family Nonfarm Homes, by Type of Lender."
[131] Thus contributing to the percentage of assets S&Ls were legally required by Congress and the IRS to maintain. This investment strategy, even as it followed the "letter" of the law, deviated from the "spirit" of the law as many S&Ls were increasingly no longer using deposits to increase homeownership in the U.S.; instead, they were only (re)circulating mortgages packaged as securities.
[132] *S&L Factbook*, "Inflows from Mortgage Portfolios at Insured Associations."

net savings, for example, totaled 138 percent and 163 percent in 1966 and 1969, respectively, which meant that S&Ls netted zero non-dividend savings during those two years.[133] Those advances, however, were short-term loans that thrifts repaid once deposits picked back up. Essentially, S&Ls were borrowing against future deposits, and then using those same future deposits to pay off past liabilities, leaving themselves fewer funds for new mortgage lending. The FHLBB, recognizing "new savings would not enter the housing market" under this arrangement, developed two strategies to "induce associations to maintain their advances." The first, which was instituted in 1970, allowed S&Ls to borrow below-market advances from the FHLBB for 12 months, with the regional FHLB banks absorbing the interest rate difference.[134] The second, building upon a Friend Commission recommendation, encouraged regionally-varied long-term advance policies that "would meet the needs of the member institutions and the housing finance requirements of their districts." As recently as 1968, only 7.5 percent of all FHLBB advances were long-term in nature, but by year-end 1971, that total was 62 percent.[135] Long-term borrowing ultimately helped alleviate the adverse effects of tight monetary policies and the cyclicality of America's housing and mortgage markets, but did so by increasing thrifts' operating costs.

The U.S. League, the thrift industry's main advocate, was concerned with how second layer lenders and mortgage-backed securities increased the competitiveness of the mortgage market. They claimed second layer lenders, by tapping into American capital markets, reduced the "resources available in the form of deposits" while simultaneously creating a

---

[133] United States Savings and Loan League, *1970 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1970), 75. Remember: interest payments on savings deposits were incorporated into gross and net savings receipts tabulations.
[134] 72 percent of the $10 billion in outstanding FHLBB advances were converted under this program.
[135] *1972 S&L Factbook*, 118.

"redundancy in mortgage credit," thereby risking oversupply.[136] Even though deposit levels began fluctuating on a regular basis after 1966, that fact had less to do with competition from second layer lenders and more to do with tighter monetary policies and the disintermediation they encouraged by raising interest rates that could be earned on alternate investments.

The U.S. League also wondered, noting that Fannie Mae's "purchases have outrun sales by such a wide margin" whether it had become a "lender with a permanent loans portfolio rather than a secondary market corporation." This was a legitimate concern, given that FNMA purchased $39 billion mortgage loans between 1966 and 1975, but only sold $636 million. The U.S. League's criticism, however, was ironic given how thrifts benefitted from Fannie Mae's ever-expanding portfolio.[137] S&Ls could continue to originate mortgage loans without concerning themselves with whether the market was oversaturated while simultaneously making their asset portfolios more liquid in nature.

But more importantly, the U.S. League was concerned with the extent to which these "new programs operate independently of specialized private mortgage lending institutions," i.e. savings and loans. With "housing subsidies and mortgage market support now flow[ing] around rather than through private mortgage lending institutions," the U.S. League paradoxically concluded in 1975, "private lenders do not now receive any portion of the federal assistance"—a conclusion that was simply inaccurate.[138] By 1975, S&Ls had acquired 41 percent of all pass-through securities, purchasing $43 billion of mortgage loans from second layer lenders and selling $18.8 billion to them.[139] Thrifts increasingly relied

---

[136] *1973 S&L Factbook,* 41.
[137] Ibid., 130. Fannie Mae's portfolio totaled $5 billion in 1965, but only ten years later, it was $30 billion.
[138] United States Savings and Loan League, *1975 Savings and Loan Factbook* (Chicago: United States Savings and Loan League, 1975), 72-3.
[139] Hyman, *Debtor Nation*, 234. Between 1976 and 1980, S&Ls purchased another $64.5 billion and sold $73.3 billion in mortgage loans.

upon FHLBB advances. And thrifts were still protected by Regulation Q. Clearly, thrifts had benefitted from federal assistance programs.

The U.S. League was, however, prescient in its identification of second layer lenders as a serious competitive threat when they declared in 1975,

> The creation of new governmental and quasi-governmental institutions…during the last few years raises the important question of whether or not specialized private mortgage lending institutions can compete successfully with them for both assets and funds….This means that thrift intermediaries specializing in mortgage loans now receive few benefits to compensate them for the constraints put on their asset and liability structures….The evidence accumulated during the last few years indicates that thrift institutions will find it increasingly difficult to compete for mortgages against these agencies….There is cause for concern that during future periods of tight money, the savings and loan business will find itself in a hazardous position as agency efforts to bolster the mortgage market will take their toll in terms of greater disintermediation, and liquidity and earnings problems.[140]

As Table 1.8 highlights, even though thrift's market share of total residential mortgage loans increased from 43 percent in 1971 to 47 percent in 1975 and then fell to 44 percent in 1976 and 1977 before dropping precipitously thereafter, S&Ls percentage of the yearly increase in total new residential spending dropped significantly after 1971, with the exception of 1975 and 1976.

Table 1.8. *Total Residential Mortgage Loans Outstanding and Thrifts' Share*

	1971	1972	1973	1974	1975	1976	1978	1979	1980
S&Ls share of one- to four-home market, year-end	47%	48%	48%	48%	51%	47%	47%	45%	44%
S&Ls share of one- to four-home market, yearly increase	67%	60%	51%	48%	71%	61%	43%	35%	29%
S&Ls share of total market, year-end	43%	44%	44%	44%	46%	44%	44%	43%	42%
S&Ls share of total market, yearly increase	60%	57%	45%	41%	68%	64%	43%	34%	28%

Source: *S&L Factbook*, "Total Residential Mortgage Loans Outstanding and Savings Association's Share."

[140] *1975 S&L Factbook,* 72-4.

And unfortunately for the S&L industry, the Volcker shock would eventually turn the U.S. League's fears of "greater disintermediation" and "liquidity and earnings problems" into a nightmarish reality.

Pre-1980 Thrift Merger Movement

In the twenty years after the end of World War II, the thrift industry slightly increased its number of institutions in the United States, and "mergers played only a minor role in altering the structure of the savings and loan business."[141] There were only 164 mergers between 1960 and 1965; in the five years after 1965, however, there were 365. And another 622 occurred between 1971 and 1975. In total, 1,311 mergers occurred between 1966 and 1980 (see Table 1.9). This merger movement accounted for roughly 80 percent of the 1,600 S&L institutions that disappeared between 1966 and 1980. And even though scholars have identified the Volcker shock in October 1979 and/or its resulting interest rate volatility as the incipiency of the S&L crisis, 987 (75 percent) mergers occurred before 1976.[142] Thus, something was clearly amiss in the industry before 1979, and it was related to the aforementioned structural, operational, and competitive changes that S&Ls faced after 1966.

[141] *1973 S&L Factbook*, 56. There were 6,149 institutions in 1945, and 6,232 in 1965.
[142] Mason, *From Buildings and Loans*, 213-40. Mason titled the chapter, "Deregulation and Disaster, 1979-1988." See also Black, *Best Way to Rob a Bank*, 1-40; Calavita, *Money Crime*, 9-16; and Adams, *The Big Fix*, 17-33.

Table 1.9. Mergers of S&Ls, 1960-1980

	State-chartered	Federal-charter	Total
1960-1965	97	67	164
1966	24	16	40
1967	42	22	64
1968	36	11	47
1969	72	24	96
1970	80	38	118
1971	70	62	132
1972	38	69	107
1973	48	76	128
1974	50	82	136
1975	52	59	119
1976	31	54	88
1977	27	17	43
1978	26	18	46
1979	20	17	38
1980	n/a	n/a	109
1966-1975	512	459	987
1966-1979	616	565	1,202
1966-1980	n/a	n/a	1,311

Source: *S&L Factbook*, "Mergers of FHLB Member Associations."

As S&Ls encountered more competition from commercial banks, second layer lenders, and the capital markets while also dealing with increasing inflation and higher operating costs, oversaturated savings markets became an issue, particularly in the eight states with the most S&Ls. Of the 6,213 thrifts operating in the U.S. in 1966, 3,288 (53 percent) of them were located in just eight states: California, Illinois, Maryland, New Jersey, North Carolina, Ohio, Pennsylvania, and Texas. And as Table 1.10 demonstrates, these states, with the exception of North Carolina and Texas, accounted for almost 70 percent of all mergers and closings between 1966 and 1975. So clearly, S&Ls were over-saturating savings markets within these six states.

Table 1.10. *Closures in 8 States with most S&Ls, 1965-1980*[143]

	CA	IL	MD	NJ	NC	OH	PA	TX	Total	% of all closures
1966-1975 change	-105	-136	-108	-138	-3	-125	-277	31	-861	69%
1966-1980 change	-79	-207	-136	-173	11	-164	-369	45	-1,072	67%

Source: *S&L Factbook, "*Number and Assets of S&Ls, by State."

As the S&L industry began to consolidate after 1965, it was overwhelmingly state-chartered institutions that declined in number and assets. State-chartered S&Ls accounted for 68 percent of all thrifts and 51 percent of S&L assets in 1965, but that dropped to 58 percent and 43 percent, respectively, by 1976. But more importantly, as Table 1.11 shows, non-insured state associations disappeared precipitously after 1965 as their number of institutions fell from 1,703 in 1966 to 777 in 1976, while federally-charted S&Ls actually increased their presence.[144]

Table 1.11. *State-chartered v. Federally-chartered Closures, 1976-1980*

	Insured state-chartered change	Uninsured state-chartered change	State-chartered total change	Federally-chartered change	Total change
1966-1970	-161	-399	-560	16	-544
1971-1975	-192	-350	-542	-1	-543
1976-1980	-8	-166	-174	-34	-208

Source: *S&L* Factbook, "Distribution *of Savings Associations*."

There appeared to be an "informal effort to eliminate very small and marginally successful S&Ls, a high proportion of which were state mutual S&Ls" in Pennsylvania, New Jersey,

[143] A negative number represented a loss in the number of institutions, and conversely, a positive number meant more institutions in the state.
[144] *S&L Factbook*, "Distribution of Savings Associations, by Type of Charter." The 5-year averages for uninsured institution closures reflected the extent to which these thrifts faced the brunt of closings and mergers after 1966. 1966-1970 = 71 percent; 1971-1975 = 65 percent; 1976-1980 = 95 percent.

and Illinois—a trend confirmed by Table 1.10 (previous table). The industry, as such, revealed its "tendency…toward federal regulation" under the purview of the FHLBB, not state regulators.[145]

The bulk of mergers—987 (75 percent)—occurred between 1969 and 1975. A study of a subsample of 1969-1974 mergers revealed the extent to which the industry was consolidating while simultaneously growing its largest institutions.[146] Nearly 75 percent of the institutions acquired between 1969 and 1974 controlled less than $25 million in assets.[147] They chose to merge because they were either too weak or too small to compete, sought younger and better management, reported previous management retired or passed away, or wanted to obtain operating efficiencies. Acquiring these smaller institutions were some of the largest S&Ls in the country.[148] Even though 4,487 institutions (76 percent of associations) possessed less than $25 million in assets, which collectively amounted to 23 percent of industry assets in 1969, only 2,869 S&Ls (56 percent) had $25 million or less in assets by 1974, equaling just 9 percent of industry assets.

This change, in part, reflected S&Ls' asset portfolio growth, which had exploded from $162 billion in 1969 to $288 billion by 1974, increasing the average size of an S&L from $28 million to $59 million. Having fewer associations in the industry with a growing asset base also contributed to this boom in S&L size. But it also portrayed another emerging trend within the industry, the concentration of industry resources within the largest S&Ls.[149]

---

[145] William Bradford, *Mergers in the Savings and Loan Industry: Structural Changes, Financial Comparisons, and the Performance of Merging Savings and Loan Associations* (Ann Harbor: Michigan Business Reports, 1979), 28. Between 1969 and 1974, 112 state-chartered mutual S&Ls were acquired in these three states.
[146] Bradford analyzed 540 out of the 717 mergers that occurred between 1969 and 1974.
[147] Ibid., 29.
[148] *1975 S&L Factbook*, 16.
[149] *S&L Factbook*, "Distribution of Savings Associations, by Asset Size." In 1969, 285 institutions (4.8 percent of associations) collectively controlled 44 percent of the industry's assets, by 1974, 265 S&Ls (5 percent of institutions) possessed 46 percent of assets. And by 1980, 221 thrifts (4.8 percent of institutions) controlled 47

And of all the thrifts that acquired institutions between 1969 and 1974, 32 percent of them had $200 million or more in assets, which were the same institutions that expanded their industry assets from 29 percent to 46 percent.[150] In 1974 alone, two of the four, five of the ten, nine of the twenty, and roughly twenty-five of the hundred largest S&Ls merged, even though the merger rate for the industry, as a whole, was only 3 percent.[151]

The U.S. League claimed in 1972 that this decline in associations resulted from an increasingly complex industry, growing competition, smaller mortgage loan demand, and a shortage of trained personnel.[152] Mergers, they believed, were the answer as they allowed institutions to obtain additional offices without branching, create economies of scale, and lower the demand for experienced managers.[153] One observer concluded that the 1969-1974 mergers allowed larger institutions to gain branches with trained personnel at a relatively low cost, to grow and/or obtain locations for growth, and to strengthen themselves via bigger size and higher reserves.[154] The U.S. League, retrospectively analyzing the industry transformation that occurred during the 1970s, declared that the 1965-1974 merger movement helped alleviate the increasingly problematic cost-earnings squeeze by creating economies of scale and providing a viable alternative to branching. The merger was becoming the Federal Savings and Loan Insurance Corporation's (FSLIC) preferred resolution mechanism. Mergers declined between 1975 and 1979 because of higher levels of

---

percent of industry assets. And to further reveal industry concentration, in 1965, 82 percent of institutions maintained 31 percent of industry assets, but by 1980, that number only totaled 27 percent. It should also not be forgotten that thrifts' asset base grew from $129 billion to $630 billion during that same time period.

[150] Bradford, *Mergers in the S&L Industry*, 29.

[151] *1975 S&L Factbook*, 16.

[152] *1972 S&L Factbook*, 55.

[153] *1973 S&L Factbook*, 56.

[154] Bradford, *Mergers in the S&L Industry*, 37.

savings and inflows that prevailed during the boom years of 1975 and 1976 resulting in a stronger mortgage market and higher industry earnings.[155]

Conclusion

S&Ls experiences in the late 1960s and 1970s highlighted the direct link between monetary policy and S&L disintermediation, the problems associated with fluctuating interest rates and varying levels of mortgage credit created by disintermediation, and industry and congressional responses to the increased competitiveness and higher costs that resulted from the second layer lender governance mechanism. Beginning their narratives in 1979 and 1980, and thereby ignoring the industry and systemic changes that occurred after 1966, authors of the existing S&L literature have failed to understand how issues like withdrawal ratios, asset portfolio turnover, net receipt ratios, and market saturation influenced the trajectory of S&Ls as much as, if not more than, legislated interest rate ceilings and restrictions on the kinds of investments that S&Ls could include in their asset and liability portfolios. By focusing almost exclusively on the latter, *both* policymakers responding to the crisis *and* scholars of the crisis considered only how to strengthen thrifts within the context of a problematic Glass-Steagall-governed financial sector, while virtually ignoring the more serious structural flaws that were central to the crisis. Thus, policymakers, as we will see in the subsequent chapters, provided narrowly tailored industry-specific solutions that were short-sighted, in addition to demonstrating both their inability to fully grasp the systemic nature of the problems they faced and their tendency to reproduce in remedial legislation

---

[155] *'80 S&L Sourcebook*, 53. Net receipts totaled $51 billion in 1976, which was 18 percent higher than 1975's net receipts and 216 percent higher than 1974's, resulted from a waning inflation rate, declining interest rate, and the 1975 tax rebates. See also *1977 S&L Factbook*, 55.

ideological and analytical positions supporting ostensibly “pro-market” solutions, i.e. transformative deregulation.

Chapter Two: Financial Regulatory Reform in the 1970s: Agendas and Rhetorics, 1970-1974

As chapter one demonstrated, thrift executives experienced new economic and competitive challenges in the 1970s.[156] But they also encountered a blossoming "public choice" movement—in gestation since the late 1950s in the production of theory—that sought to reveal what proponents perceived as the undemocratic and burdensome nature of the United States' regulatory apparatus and of regulation in general. As the 1970s progressed, the Keynesian policy apparatus failed to mitigate rising inflation and unemployment and reverse decreasing productivity. Given this opportunity, public choice advocates, among them an intersecting swath of government officials, academics, and journalists, used the moment of apparent Keynesian crisis as an opportunity to significantly alter the intellectual inputs to the American regulatory governance mechanism by fostering a bi-partisan movement that narrowed and/or eliminated the theoretical space in which policymakers could justify government regulation. Over the course of the decade, then, "deregulation" exploded into policymaking and academic circles as a viable regulatory alternative.[157]

Just as public choice theorists and others questioned the benefits of the regulatory structures of the United States' airline, trucking, busing, broadcast, and telephone industries, they also called into question the efficacy of financial sector regulation. As stagflation

---

[156] Sections of this chapter were also in the *Federal History Journal*, see Walker, "Banking Reform Rhetoric."
[157] A search of the *Wall Street Journal* and *New York Times* between 1970 and 1980 revealed that these newspapers mentioned "deregulation" 977 and 1,636 times, respectively. A search of congressional sources, by using ProQuest Congressional, turned up 2,337 congressional references to deregulation, including 2,211 separate hearings and 67 distinct pieces of legislation. Similar searches before 1970, however, demonstrated the extent to which deregulation was not a serious theoretical construct for interpreting regulatory issues in academia or Congress. The *Wall Street Journal*, *New York Times*, JSTOR, and congressional sources only mentioned "deregulation" a total of 144 times. For examples of scholarly works promoting transformative deregulatory discourses, see Coase, "Problem of Social Cost," 1-44; Downs, *Economic Theory of Democracy*, passim; Buchanan and Tullock, *The Calculus of Consent*, passim; Stigler, "Theory of Economic Regulation," 3-21; Posner, "Social Costs of Monopoly," 807-28; and Leight, "Public Choice: A Critical Assessment," 213-65.

intensified and disintermediation (shifting savings from S&LS to banks or to higher paying alternative securities) continued, many policymakers conducted studies that examined the extent to which financial regulations either caused or increased inflation, produced regulatory capture, limited competition, and protected monopolies.[158] Many of these studies cast their deregulatory gaze upon the savings and loan industry and its interest rate ceiling (Regulation Q), congressionally mandated mortgage specialization, congressionally limited asset and liability functions, and the Bank Board ban on mutual charter conversions into stock associations. Most of the parties weighing in on these matters concluded that state and federal regulations—Regulation Q in particular—had indeed adversely affected the equitability and efficiency of savings and mortgage markets.[159] Led by industrialist Reed O. Hunt, Congressmen Fernand St. Germain (D-RI) and Henry Reuss (D-MI), and finance professor Edward Kane, among others, they consequently recommended that both Congress and the Federal Home Loan Bank Board deregulate several aspects of the savings and loan industry. These policymakers, however, failed to differentiate between regulatory responses that acknowledged changing economic circumstances and those that utilized ideologically driven interpretations of regulatory intervention as a basis for limiting, as much as possible, government involvement. Reflecting and implicitly accepting the latter approach, interpretations of the S&L industry crisis carelessly identified deregulation as the appropriate policy response without simultaneously establishing a theoretically and contextually

---

[158] See Coase, "Problem of Social Cost," 1-44; Stigler, "Theory of Economic Regulation," 3-21; Posner, "Social Costs of Monopoly," 807-28; and Murray Weidenbaum, "A New Approach to National Priorities and Governmental Decision-Making," *Business and Society Review* (1975): 1-9.

[159] See Hunt Commission; FINE Study; Edward Kane, "Getting Along Without Regulation Q: Testing the Standard View of Deposit-Rate Competition During the 'Wild-Card Experience,'" *The Journal of Finance* 33 (1977): 921-32.

consistent definition of the concept as applied to a financial regulatory framework. Subsequent treatments by historians for the most part have followed this same pattern.[160]

The Hunt Commission: Offering a Regulatory Reform Agenda

Some have claimed that the Friend Commission, which Congress established in the wake of the 1966 credit crunch in order to better understand its socio-economic and political consequences, represented one of the earliest steps towards the deregulation of the thrift industry.[161] This landmark study provided some deregulatory rhetoric and recommendations of a strategic nature. Its final report centrally recognized government's historical and fundamental role in maintaining the American mortgage market. But far from repudiating government involvement, the Friend Report explained how government assistance had previously "helped to offset the imperfections of the mortgage markets," thus continuing to identify homeownership as a public good and, thereby, encouraging non-market responses to promote and maintain the U.S. housing market.[162] The report offered various suggestions as to how government agencies, programs, and regulatory bodies could help alleviate operational and allocative shortcomings of S&Ls by creating more flexible mortgage instruments, eliminating remaining residual risks associated with FHA loans, offering supplemental funds when supply of savings deposits dropped, and opening more government-owned and operated credit facilities.[163]

It is from this complex historical moment that policymakers and academics began to discuss what would later be identified as deregulation. But make no mistake, the Friend

---

[160] See Mason, *From Buildings and Loans*, 213-40; and Eichler, *The Thrift Debacle*, 55-85.
[161] Mason, *From Buildings and Loans*, 206-7.
[162] Cassidy, *How Markets Fail*, 116. A.C. Pigou explained public goods as the difference between the private (profitability) and social values of economic activity.
[163] Friend Commission, 11. As well as report as a whole.

Commission's proposals represented the first attempt to strategically deregulate several aspects of the S&L industry. Yet it is important to recognize the implications of recommendations for the state's continued strong role in the Friend Commission's key recommendations. These included—to repeat—granting expanded asset and liability powers for thrifts, broadening lending authority for the FHLBB, gradually eliminating Regulation Q, and developing a more effective early detection system to aid regulatory examiners in their oversight function. This body of experts made perfectly clear the view that the government would need to continue to play a fundamental, if not an even greater, role in shaping the contours and direction of the U.S. mortgage and savings markets.[164]

Hardly a year later, in the midst of another episode of recessionary disintermediation that withdrew deposited funds from S&Ls, President Nixon established the President's Commission on Financial Structure and Regulation (Hunt Commission) in spring 1970 to evaluate the "structure, operation, and regulation" of U.S. financial institutions.[165] The president appointed Reed O. Hunt, retired chairman of Crown Zellerbach Corporation, as the committee's chairman. Nixon tasked the Hunt Commission with producing a set of "achievable legislative proposals" that would improve the efficiency and flexibility of the U.S. financial sector.[166]

Officials from the Treasury Department, Council of Economic Advisors, Federal Reserve, Federal Deposit Insurance Corporation (FDIC), Federal Home Loan Bank Board (FHLBB), Office of the Comptroller of the Currency, and the Bureau of the Budget helped Chairman Hunt to identify "issues deserving Commission attention." Yet, interestingly

---

[164] Ibid., 29-34.

[165] Richard Nixon, Special Message to the Congress Proposing Changes in the Nation's Financial System, June 16, 1970. www.presidency.ucsb.edu.

[166] Ibid.

enough, throughout the earliest stages of planning the Hunt commission was intentionally structured so as to prevent commission members from effectively utilizing the institutional histories, knowledge, and capacities of U.S. regulatory agencies as they contemplated reforming America's financial regulatory system.[167] Instead, seventeen corporate and financial executives, two professors, and one labor representative drafted a set of policy recommendations that—if implemented—would fundamentally restructure the American financial sector and the future expectations of policymakers as they identified financial regulatory concerns, interpreted their importance, and subsequently devised and promoted policy solutions.[168] The Hunt Commission's recommendations, then, far from presenting "any genuine regard for the most urgent problems and needs of the nation," only represented, as its lone dissenter AFL-CIO head Lane Kirkland so eloquently stated, "the interests of private financial institutions."[169]

Putting continued inflation and its economic consequences at the forefront of their consideration, the Hunt commissioners aimed to create a more responsive financial sector by offering financial intermediaries the flexibility, efficiency, and preferential specialization (as opposed to mandated specialization) necessary for "well-functioning financial intermediaries…to accommodate themselves to periods of inflation or deflation."[170] The

---

[167] Hunt Commission, 1.
[168] The Hunt Commission's participants included: Reed Hunt (Crown Zellerbach Corporation), Atherton Bean (International Multifoods Corporation), Morgan Earnest (Earnest Homes, Inc.), J. Howard Edgerton (California Federal Savings), Richard Gilbert (Citizens Savings Association), William Grant (Businessmen's Assurance Company), **Alan Greenspan (Townsend-Greenspan & Co., Inc.)**, Walter Holmes Jr. (C.I.T. Financial Corporation), Lane Kirkland (AFL-CIO), Donald MacNaughton (Prudential Insurance Company of America), Edward Malone (General Electric Company), Rex Morthland (Peoples Bank and Trust Company), William Morton (American Express Company), Ellmore Patterson (Morgan Guaranty Trust Co. of New York), K.A. Randall (United Virginia Bankshares Incorporated), Ralph Regula (Attorney – State Senator, Ohio), Ezra Solomon (former Dean Witter Distinguished Professor of Finance, Stanford University), R.J. Saulnier (Professor of Economic, Columbia University), and Robert Stewart III (First National Bank in Dallas).
[169] Ibid., 129.
[170] Ibid., 12. By "preferential specialization," I mean the Commission aimed to provide financial institutions, but especially S&Ls, with the opportunity to choose for themselves whether they would diversify their

Commission proposed to eliminate deposit interest rate ceilings (Regulation Q) and grant S&Ls expanded asset powers (which would allow them to make construction loans, direct real estate investments, equity investments, third party payments) and liability powers (which would let them offer CDs and accept demand deposits). It also advocated for federally chartered mutual and stock associations, for ending statutory restrictions on interstate banking and branching, for consolidating federal regulatory agencies into one regulatory body, and for eliminating preferential institution-based tax codes (thrifts' bad debt reduction).[171] Regarding the specific relationship between their proposals and the future viability of the S&L industry, the Commission was quite clear.

> Without these changes in their operations, there is serious question about the ability of deposit thrift institutions to survive. The power of the rate ceilings to isolate deposit markets from the rest of the short-term money market has eroded with continued reliance on this regulation. In time, they will probably have little effectiveness.[172]

The term "deregulation" did not appear in the Commission's report. Even so, the Hunt Commission clearly premised the need for deregulation on transformative grounds. In a statement reflecting their advocacy of transformative deregulation, the Commission identified its objective to "move as far as possible toward freedom of financial markets."[173] Adequate competition, the commissioners argued, guaranteed institutional flexibility and

---

investment portfolios. They wholeheartedly rejected the forced specialization of the growth and saver governance mechanism.

[171] *1966 S&L Factbook*, 101. The Revenue Act of 1962 changed how thrifts calculated their tax assessments. The IRS allowed S&Ls, because of the inherent dangers to borrowing short and lending long, to create a bad debt reserve to pay off possible future losses by allocating an amount equal up to 60 percent into a bad debt reserve fund. If the bad debt reserve fund did not exceed 6 percent of loans outstanding, then the 60 percent was not taxed, but the remaining 40 percent of revenue was taxable. Additionally, the Internal Revenue Service Act of 1962 established a savings requirement and an asset test that stated housing must represent, at minimum, 70 percent of a thrift's asset portfolio in order to qualify for the special bad debt reserve deduction. Congress subsequently debated and changed the asset test minimum percentages (later Qualified Thrift Lender [QTL] test) several times thereafter.

[172] Hunt Commission, 37.

[173] Ibid., 9.

consumer choice; but it also enabled equitable systems of regulation and taxation by eliminating institutional specialization. Even as Congress identified the need for government support in reaching national housing goals, as it had in 1968 for example, the Commission's report declared that the "marketplace must, in one fashion or another, provide the means to pursue those objectives."[174]

In advocating for market-based solutions, however, the Commission ignored the messy and complicated realities of the workings of markets and the unique historical development of U.S. financial and housing markets. By doing so, they created a regulatory narrative that downplayed, almost to the point of eradication, the extent to which supporting homeownership and mortgage credit had previously been identified in the design of regulation in the United States as public goods. Ironically, they proposed Pigouvian solutions—direct subsidies and investment tax credits—to maintain appropriate levels of U.S. mortgage credit, despite the fact the Commission simultaneously rejected the theoretical framework justifying state responses to market failure and questioned the state's ability to regulate in the public interest, as indicated in the following statement from its final report.

> When the goal of public policy is to increase the availability of particular types of goods, regulation of financial institutions is likely to be unsuccessful. Attempts to force inappropriate functions upon financial institutions waste society's resources, cause them to be inefficient, and, most important, often leave goals unmet.[175]

The Commission also strove to "remove unworkable regulatory restraints as well as provide additional powers and flexibility," thereby proffering solutions that enabled strategic deregulation for S&Ls specifically and for the U.S. financial sector more broadly.[176] After

[174] Ibid., 17.
[175] Ibid., 117.
[176] Ibid., 7-8.

acknowledging the changing socio-economic and technological environments of the late 1960s and early 1970s, the Commission also offered a criticism that Ford, Carter, and Reagan administration officials would later incorporate into their rhetorical arsenals; they bemoaned the negative ramifications of a regulatory framework that was developed to combat the economic instability of the 1930s. The Commission claimed that the provision of effective financial sector services had been "held back by regulations that interfere with the ability of the system to meet public requirements as expeditiously and efficiently as possible."[177] Technological advances such as electronic funds transfers (EFT) and computers, postwar economic growth, new financial institutions (non-bank or shadow banks), and Keynesian-based fiscal and monetary policies, by the early 1970s, had all forced a reconsideration of multiple aspects of the "functionally-regulated" U.S. financial sector.[178] The development of EFT, for example, called into question the legitimacy of state-based geographic barriers on branching and banking. Non-bank banks, among them institutions such as Sears, Roebuck and the General Electric Credit Corporation, offered market rates for deposits, which S&Ls and commercial banks could not do because of rate ceilings mandated by Regulation Q, thereby simultaneously hastening disintermediation (moving funds for higher returns) and destabilizing the still functioning, but increasingly fragile, postwar system of credit allocation. Hunt commissioners, through their multiple affirmations of market efficiency via unmitigated competition, transformed an opportunity to potentially pursue deregulatory responses of a strategic nature into focused efforts at promoting and achieving transformative deregulation.

[177] Ibid., 7.
[178] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry* Report, 27.

The Hunt Commission recommended the following reforms: end Regulation Q, expand S&Ls asset and liability powers, allow federally chartered mutual and stock associations, permit branching and inter-state banking, consolidate federal regulatory agencies into one regulatory body, and eliminate preferential institution-based tax codes. Attempting to encourage Congress toward initiating substantial financial regulatory reform, the Commission warned that if Congress failed to comprehensively enact its recommendations, U.S. financial intermediaries would continue to dampen U.S. economic growth. Without substantive reforms, the existing regulatory structure would continue to limit national savings, foster additional non-price competition, increase operational costs, raise the cost of credit, and lower the rate of return for investors and some savers.[179] "Piece-meal adoption," the Commission warned, "raises the danger of creating new and greater imbalances."[180]

The degree to which regulatory reformers pursued and implemented comprehensive changes remained a hotly contested issue over the course of the decade and beyond, as debates concerning comprehensive versus piece-meal reform signaled, to some, the influence of special interest groups in the policymaking process.[181] To political commentators who ultimately led the legislative process—Bank Board Member Anita Miller, Senator William Proxmire (D-WI), Senator Alan Cranston (D-CA), Senator John Tower (R-TX), Richard Lugar (R-IN), and Jake Garn (R-UT)—merely piece-meal approaches represented nothing more than "discriminatory…patchwork experiments" and "isolated…short-term remedies" that were "bad government policy," of "limited usefulness," and "hardly a substitute for basic

[179] Hunt Commission, 12.
[180] Ibid., 9.
[181] Mark-Up Session: S. 2591, Financial Institutions Act of 1973, 3.

long-term reform."[182] Many thrift executives and some legislators, among them Representative Fernand St. Germain, still promoted short-term and/or piece-meal solutions to resolve S&L problems and larger economic instability over the course of the 1970s.[183]

Establishing a regulatory framework that encouraged individual consumer and institutional decision making, as opposed to the seemingly choice-less financial sector that currently existed, was of vital importance to the Hunt Commission. But creating the "optimum framework of regulation" involved a "choice of trade-offs"; the Commission claimed, "The social cost from possible bank failure must be compared to the social costs imposed" by financial regulations.[184] The choice of charter, regulator, institutional identity, and operational strategies that the Commission's recommendations would enable if implemented, would—they claimed—allow financial executives to achieve higher degrees of efficiency, flexibility, operational freedom, and competition. This would be true even though, they understood, some of those changes were undesirable in the short-term. The Commissioners believed that, through the elimination of interest rate ceilings and institutional restrictions on asset powers controlling what kind of loans they could make, S&Ls would attract and retain more customers. Consumers would simultaneously earn higher rates on their savings and more easily access cheaper credit during periods of

---

[182] Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions, *Depository Institutions Deregulation Act of 1979*, 96th Congress, 1st session, June 21, 1979, 1, 4, and 38; and Report, "Consumer Financial Services Act of 1977," in Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions, *Depository Institutions Deregulation Act of 1979*, 96th Congress, 1st session, June 21, 1979, 89. Commercial bankers, in general, opposed piece-meal solutions because they believed it allowed legislators to produce financial reform legislation that disregarded commercial banking interests.

[183] 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 session, September 21, 1982, 1; and United States Savings and Loan League, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 223.

[184] Hunt Commission, 45.

disintermediation.[185] And with institutions, particularly S&Ls, "offering a wider range of products and services," the Commission's report argued, customers would benefit immensely from "added convenience" and enhanced "elements of competition" as intermediaries provided "better service, greater efficiency and possibly lower prices."[186] Choice, as conceptually interpreted by the Hunt Commission, then, represented the antithesis to regulation. Its utilization as a fundamental component of a restructured financial sector offered policymakers a theoretical justification for allowing financial markets to self-regulate—a change most American financial executives, except those running the thrifts'—apparently clearly welcomed, given the composition of the Hunt Committee.

Providing choice on the recommended scale, however, created a new set of contradictions for policymakers. In light of the "effects of regulation of financial institutions [that] have been amply demonstrated in the field of housing during the past six years," the Commission proposed to replace thrift specialization and Regulation Q with subsidies to citizens qualifying for assistance and tax credits for institutions providing mortgage credit.[187] Both proposals, the Commission reported, would help to "avoid the 'hidden tax' and inflationary effects of special regulations and special agency financing." Their implementation "parallels the allocation of real resources and permits better planning, management, and account."[188] But as Morgan Earnest, the Commission's sole representative from the housing industry, explained in an addendum to the official report, both options fell quite short of the explicit promotion of American homeownership embedded into the growth and saver governance mechanism erected during the 1930s. As Earnest explained,

---

[185] Ibid., 41, 121.
[186] Ibid., 113.
[187] Ibid., 117.
[188] Ibid., 118.

> For more than a quarter of a century, it has been recognized that the greatest single critical deficiency in the financial structure of the nation has been in the mortgage market….The Commission's recommendations in this area failed to come to grips with the overriding problem of providing a more stable flow of funds into the residential mortgage market….The Commission recommendation to turn to the Federal Government to provide direct subsidies to consumers, in the event mortgage financing is not adequate to achieve national housing goals, highlights its failure to recommend means to even the flow of funds in a private enterprise society. Should the residential construction area have to depend on Congress for funds, that would mean the end of the free competitive system under which it now operates.[189]

Even though S&Ls were slowly beginning to lose their share of the U.S. mortgage market to commercial banks, mortgage companies, and second layer lenders at the beginning of the 1970s, the Commission's proposal to eliminate mandated institutional specialization and guarantee competitive equality across all financial intermediaries, if implemented, simultaneously signaled an abrupt end to thrifts' government-created and maintained market niche and further shifted the responsibility of creating mortgage credit onto domestic and international investors.

Just as important, the Commission failed to comprehend three disturbing paradoxes of the existing American mortgage market. First, policymakers promoted market-based solutions at the exact moment that second layer lenders (a.k.a. government-sponsored enterprises) steadily began to increase their importance as the key conduits of mortgage credit in the United States, even though they purchased far more mortgages than they sold. Second, the Hunt Commission advocated the creation of a self-regulating financial sector that coincidentally shifted risks from financial intermediaries onto the Treasury Department or Congress as those two public institutions would increasingly, and occasionally collectively, share the responsibility of remedying, and often times subsidizing, private market failures.

[189] Ibid., 135.

Third, the Commission claimed that dual chartering (federal and state) would mitigate the "dangers" of "over-zealous" entry restrictions and unimaginative regulatory authority, "raise[d] supervisory standards of the state as well as the federal regulatory agencies," and "promote[d] efficiency and assure[d] uniform treatment of depositors."[190]

But as one critic of the Hunt Commission explained, the maintenance of the dual banking system was "political accommodation pure and simple," because "this system could not conceivably be dislodged short of financial disaster." Such accommodation reflected the strength of the structural and ideological expectations regarding the American financial sector that only allowed "unreconstructed optimists among the academic profession" to "afford to dream of a better solution."[191] Of equal importance, thrifts' experiences over the course of the 1970s and 1980s revealed the declining, not enhanced, supervisory standards that resulted from financial executives choosing their charters and regulators (i.e. regulatory arbitrage). And from a theoretical perspective, it is also difficult to imagine how a regulatory system with fifty-two rule makers for S&Ls and fifty-three for commercial banks could ever achieve the efficiency and uniformity the Hunt Commission claimed to have promoted. Federal Reserve Chairman Arthur Burns aired the same concern during a 1974 speech to the American Bankers Association.

> I recognize that there is apprehension among bankers and students of regulation concerning overcentralized authority. Providing for some system of checks and balances is the traditional way of guarding against arbitrary or capricious exercise of authority. But this principle need not mean that banks should continue to be free to choose their regulators. And it certainly does not mean that we should fail to face up to the difficulties created by the diffusion

[190] Ibid., 60, 120.
[191] Roland Robinson, "The Hunt Commission Report: A Search for Politically Feasible Solutions to the Problems of Financial Structure," *The Journal of Finance* 27 (1972): 773-4.

> of authority and accountability that characterizes the present regulatory system.[192]

Submitting its final report to President Nixon in December 1972, the Hunt Commission claimed to have proposed a "number of fundamental changes" that it hoped "would produce a structural and regulatory system which will efficiently and equitably serve the financial needs of the country in the coming decades."[193] In effect, the Hunt Commission had created one of the first opportunities for actors on a government-sanctioned platform to praise and encourage transformative deregulation as it insisted upon promoting competition as the arbiter of institutional survival. Its commissioners sought to fundamentally alter the growth and saver governance mechanism, and they fully understood the difficult road ahead in persuading many thrift and commercial banking executives and legislators that competition and institutional choice among America's financial intermediaries were the most effective policy objectives moving forward. They declared as much in their final report.

> The recommendations provide regulated financial institutions with many more choices than under the presented system….Increased competition within and among the institutional types is a prime objective of the Commission. Not all those subjected to increased competition will regard it enthusiastically. Bank and bank-related product lines can, under the recommendations, be more easily crossed by several types of financial firms. Geographic areas are less protected. Reserve requirement differentials would disappear. Advantages stemming from regulatory disparities would no longer be possible. Tax treatment would become more nearly identical among competing institutions. Each of these changes would have at least temporarily adverse effects on institutions given special protection under the present system. All of the changes are necessary to make competition work.[194]

The Hunt Commission did succeed in producing a regulatory narrative that pitted government regulation against free market solutions—a dichotomy that, if accepted into

---

[192] Arthur Burns, "Maintaining the Soundness of our Banking System," *Federal Reserve Bank of New York Monthly Review* (1974): 267.
[193] Hunt Commission, iii.
[194] Ibid., 121.

popular and political lexicons, established a new criterion for interpreting regulatory successes and failures. But far from instituting a paradigm shift that immediately and irrevocably altered both the "functionally regulated" financial sector and the subsequent expectations of policymakers, the Commission's report sparked serious debates in Congress, at universities and think tanks, and within presidential administrations. Legislators, regulators, financial executives, and academics, well into the 1980s, examined and re-examined the necessity of Regulation Q, the appropriateness of asset and liability restrictions, the effectiveness of the dual banking system, and the importance of interstate banking and branching limitations, but did so with the ideologically derived rhetoric propounded by the Hunt Commission. Policymakers also continued to question the efficacy and necessity of establishing and pursuing federal housing policies with the same types of transformative rhetoric. As they faced additional economic uncertainties during the 1970s and 1980s, they also increasingly relied upon the paradoxical combination of private investment and second layer lenders to replace S&Ls as America's preferred mortgage lender.

Debates over Implementing the Hunt Commission's Recommendations

Many legislators, regulators, Nixon administration officials (in later years Ford and Carter administration officials as well), and financial executives attempted to translate Hunt Commission regulatory reform proposals into lobbying campaigns and congressional and regulatory action over the course of the 1970s. Their efforts would eventually result in a fundamentally altered U.S. financial sector in which three highly interrelated components of American finance were reconceptualized. One, creating and allocating mortgage credit in relation to the tradition of government support for home ownership. Two, identifying and

justifying the federal government's proper role in financial sector regulation. Three, balancing and/or (re)structuring the constitutional, socio-economic, and theoretical considerations regarding the delegation of authority and oversight to executive, judicial, and congressional branches of federal and state governments and federal and state regulators of the financial sector. These legislative and administration proposals and the congressional testimony they engendered help to reveal the contestation in conceptual and rhetorical framing that occurred over the early years of the 1970s. Structural, ideological, and institutional roadblocks, all of which provided the rhetorical fodder for some policymakers to effectively forestall change, prevented a smooth transition toward what some reformers perceived to be a vitally important regulatory reform agenda.

Even before the Hunt Commission issued its final report to President Nixon and Congress in December 1972, economic and political observers had already begun to debate the merits of its preliminary recommendations. The U.S. League of Savings Institutions opposed the report's comprehensive approach because it believed the Commission's promotion of efficiency and choice (transformative deregulation) ultimately reflected a desire to phase S&Ls out of existence. The League did support, however, expanding thrifts' operational and investment powers (strategic deregulation) and maintaining Regulation Q and the interest rate differential.[195] On the other hand, Clifton Luttrell, Assistant Vice President of the Federal Reserve Bank of St. Louis, praised the Commission's utilization of efficiency as a metric of evaluation for American financial intermediaries. He then identified institutional growth and profit as appropriate indicators of efficiency. "Those firms that can buy, service, and sell most efficiently," he claimed, "will tend to grow the fastest and make

---

[195] U.S. League, *Credit Crunch and Reform*, 223.

the greatest profits"—an already questionable assertion that would be utterly invalidated during the 1980s when many of the fastest growing S&Ls failed at alarmingly high rates.[196] Further, these varied assessments hint at conflicting meanings for "efficiency," in the former case relating it to the believed inevitable workings of market allocation, and in the latter relating it to the excellence of internal operation.

Others questioned the report's conceptual consistency. George Benston, a professor of Accounting, Economics, and Finance at the University of Rochester, revealed a theoretical inclination in favor of the need for further transformative deregulation when he suggested that the Hunt Commission "did not go far enough." Its proposals, he stated, "insufficiently emphasized" both "allowing banks to merge more freely" and the "need for freer entry into banking markets as a means of insuring competition."[197] Another professor of Financial Management and Economics criticized the Commission for the political expediency of some of its proposals, especially its perceived capitulation to institutional and individual pressures to maintain the dual banking system.[198] Reflecting upon the "great inertial elements" these capitulations enabled, Almarin Phillips, a Hunt Commission co-director, explained how many federal regulations actually hampered systemic structural changes at the state level, a

---

[196] Clifton Luttrell, "Hunt Commission Report – An Economic View," *Federal Reserve Bank of St. Louis* (June 1972), 9-11.
[197] George Benston, "Discussion of the Hunt Commission Report: Comment," *Journal of Money* 4 (1972): 988-9. Benston worked in the Graduate School of Management and the Center for Research in Government Policy and Business, University of Rochester. The Conference on Financial Institutions, coincidentally, was also held at the University of Rochester, March 17-18, 1972. Benston, along with Edward Kane and George Kaufman, was also commissioned by the American Bankers Association during the 1980s to produce an anthology on the safety and soundness of American banking.
[198] Roland Robinson, "The Hunt Commission Report: A Search for Politically Feasible Solutions to the Problems of Financial Structure," *The Journal of Finance* 27 (1972): 773. See also Paul Horvitz, "The Hunt Commission Report: A Further Comment," *The Journal of Finance* 29 (1974): 267-9.

problem, he claimed, that only further hastened the likelihood of a "crisis-bred" resolution to America's serious financial intermediary problem.[199]

Despite these various reservations, the Nixon administration incorporated many of the Hunt Commission's proposals into its financial regulatory reform agenda—the Financial Institutions Act of 1973. As it formulated its legislative agenda, which it expected would continue increasing American homeownership rates, the Nixon administration and Treasury officials examined a number of highly complex and interrelated theoretical, structural, and economic components of the existing governance mechanism. These policymakers aimed to identify and explain the connection between the supply of mortgage credit and the demand for housing. To achieve that objective, though, they needed to understand the causal relationship between savings and loan institutions and the levels of mortgage credit and housing construction available in the United States. If their proposals failed, they understood full well the administration would face the economic and political consequences of expanding thrifts' asset and liability powers without also guaranteeing to maintain acceptable levels of American homeownership.[200]

Assessing this risk, a 1973 Treasury report declared that most economic and political observers supported the "bottleneck hypothesis," an interpretation that claimed "the rate of housing production to be a captive of the *amount* of mortgage funds available—in both the short and long run." Proponents of this view maintained that financial intermediary specialization—provided by the savings and loan industry—enabled the provision of higher amounts of mortgage credit at lower interest rates than would have been provided otherwise.

---

[199] Almarin Phillips, "Regulatory Reform for the Deposit Financial Institutions—Retrospect and Prospects," *The Journal of Financial and Quantitative Analysis* 9 (1974): 800.
[200] Department of the Treasury, *Recommendations for Change in the U.S. Financial System* (Washington D.C., Government Printing Office, 1973), 12, 20, 29-34.

Treasury officials and eventually the Nixon White House rejected the bottleneck hypothesis. Instead both supported the "interest rate hypothesis," an idea that, according to Treasury officials, "follows most naturally from received economic theory." Its supporters argued, "Mortgage and housing markets are stimulated or contracted simultaneously by outside influences—in the short run notably by fluctuations in general credit conditions." Rising interest rates, from this perspective, were crucial for two reasons. Households deferred long-term borrowing and asset purchases (housing). And, due to the existence of interest rate ceilings on S&Ls and commercial banks, savers moved their deposits from financial intermediaries into marketable securities in order to earn the higher market returns (disintermediation).[201]

The Treasury statement conceded that it was "difficult to design and conduct a definitive empirical test of whether housing demand is more responsive to mortgage flows or interest rates." Rising interest rates simultaneously reduced the demand for housing and the supply of mortgage credit. Having witnessed similar mortgage flow experiences across Europe despite the disparate institutional structures for housing finance there, Treasury officials concluded that the "best available work" validated the interest rate hypothesis. But these economic and political observers did not situate their analyses within a larger structural context that showed they fully understood or considered the growth and saver governance mechanism. By failing to do so, they assumed a degree of mutual exclusiveness between "general credit conditions" and "specific characteristics of the mortgage market" that otherwise could not be justified, thereby creating a problematic conceptual framework rooted in a false dichotomy that pitted interest rate fluctuation against mortgage flows.[202]

[201] Ibid., 30.
[202] Ibid., 30-1.

Unaware of this conceptual inconsistency, the Nixon administration proposed the following changes: expand S&Ls asset powers, offer a mortgage interest tax credit, and improve the secondary mortgage market. Nixon justified his regulatory reform agenda, just as the Hunt Commission had, by claiming the implementation of his legislative agenda would increase competition, eliminate institutional and individual inequities, and decrease operational costs. Just as important, he claimed his proposals would also simultaneously reduce the cyclical variability of housing and enhance the attractiveness of mortgage investment to nontraditional lenders. Treasury officials projected that Nixon's proposals would alleviate thrifts' earnings and disintermediation problems by allowing them to reject specialization. They hoped asset portfolio diversification would allow S&Ls executives to buy and sell new financial products such as mortgage-backed securities and wild-card certificates.[203] S&Ls could then earn higher returns and consequently obtain and retain more deposits by subsequently offering depositors higher interest rates on their savings. As "nearly all economists agree," a Treasury report proclaimed, minimizing cyclical instability was imperative because "in the short run (about a year or less) changes in the availability and flows of mortgage credit importantly influence housing production."[204]

Nixon also proposed ending ceilings on interest rates (Regulation Q) and FHA and VA loans, permitting stock charters, and modifying financial intermediary tax structures. Replacing thrifts' unique tax structure (bad debt reserves) with an income tax credit tied to investments in housing mortgages, Nixon claimed, all lenders and not just S&Ls could be

[203] Mason, *From Buildings and Loans*, 190. "Wild cards" were 4-year $1,000 minimum certificates of deposit that carried no interest rate ceiling. The FHLBB introduced them in 1973 to allow S&Ls to more openly compete with money market accounts and mutual funds. They were discontinued only five months later as they instigated highly problematic rate wars between banks and thrifts.
[204] Treasury, "Recommendations for Change," 31-2. Paradoxically in the 1980s, thrifts advertised higher interest rates to attract deposits, then hoping, and needing, to earn higher returns on their investments.

enticed to originate mortgages, thereby directing more “private funds into mortgage markets.” Those changes, as Nixon explained, also allowed both small savers and institutional investors to receive a “fair return” on their accumulated capital by removing arbitrary constraints and thus reduced the need of “Government support [for S&Ls] required in the past.”[205] Thus beginning the politically expedient narrative expressing concern for the American small saver that Presidents Ford, Carter, and Reagan subsequently echoed during their pursuits of financial regulatory reform. Equally significant, Nixon’s recommendations, along with the Hunt Commission’s proposals, revealed a relatively new expectation of and goal for U.S. financial intermediaries—fostering customer convenience and protecting small savers.[206] With an increasing number of policymakers blaming the S&L troubles and economic instability of the late 1960s and early 1970s on the overregulation of financial institutions since the 1930s, they strove to transform S&Ls into efficient, competitive, and convenient “family financial centers.”[207]

When introducing his legislative agenda to Congress, however, Nixon unintentionally highlighted a paradoxical friction between the conceptualization of homeownership as a public good, as originally understood and pursued by the architects of the growth and saver governance mechanism, and the transformative deregulation of U.S. financial intermediaries as proposed by his administration and the Hunt Commission.

> As the government tries to play its proper role in building a better financial system, we must proceed with one basic assumption: the public interest is generally better served by the free play of competitive forces than by the imposition of rigid and unnecessary regulation.[208]

---

[205] Ibid., 1-3.
[206] Ibid., 32-3. See also Hunt Commission, 113.
[207] James Meigs, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 259.
[208] Richard Nixon, “Special Message to the Congress Proposing Changes in the Nation’s Financial System,” August 3, 1973, www.presidency.ucsb.edu.

Nixon's interpretation, much like the Hunt Commission's, failed to acknowledge how deliberate efforts at creating, promoting, and maintaining postwar housing and savings markets actually allowed those markets, and the larger economy in general, to function freely and efficiently.

Transforming Governance Mechanisms and Financial Sector Regulatory Reform, 1973-1975

Inflation, a contributing factor to the economic instability of the late 1960s and early 1970s that worsened many of thrifts' earnings problems and a key impetus for the Hunt Commission, dipped below four percent in 1972 before almost doubling in 1973, and then almost doubling again in 1974. As legislators, financial executives, and academics evaluated the merits of Nixon's proposals, they did so in a context of rapidly changing expectations regarding the American and international economy. These fluid conditions either realigned or reaffirmed their views, depending on their previous economic and ideological predilections and their interpretations on the importance of and justifications for pursuing anti-inflationary measures, which included financial sector regulatory reform. Even as many economic and political observers agreed that high inflation rates were problematic, they vehemently disagreed on its causes and possible cures.

Explanations for the problematic inflation ranged all over the lot. Representative Henry Reuss (D-WI) identified the investment tax credit and accelerated depreciation as inflationary because these "tax bonanzas" increased inflationary expectations.[209] Lawrence Williams (R-PA) claimed too many dollars chased too few goods, a problem only

[209] House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 3.

exacerbated by increased federal borrowing to finance deficit spending.[210] Similarly, Representative Chalmers Wylie (R-OH) impugned federal budget deficits as the main driver of inflation.[211] The U.S. League blamed a litany of factors: devaluation of the dollar, termination of Phase II of Nixon's price and wage controls, stimulative fiscal and monetary policies, and Federal Reserve credit policies.[212] Federal Reserve Chairman Arthur Burns argued high vacancy rates and unsold inventories (housing over-supply from S&Ls), in addition to federal government borrowing, worsened inflationary pressures.[213] A homebuilder's representative blamed the speculative "wheeler-dealers" for increasing borrowing costs.[214] Policymakers disagreed just as much on the remedies for inflation. Yet across the political and economic spectrum, they understood that fixing America's savings and loan problem meant, at least in part, permanently dampening the inflationary pressures that emerged after 1972.[215] At that moment, as some legislators, academics, and financial executives interpreted this new socio-economic and political landscape, they increasingly drew upon and utilized the rhetorical lexicon of transformative deregulation to explain and justify regulatory reform efforts.

---

[210] *Credit Crunch and Reform*, 211.
[211] House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 9, 1974, 256.
[212] *Credit Crunch and* Reform, 65.
[213] Ibid., 314-5.
[214] Ibid., 205.
[215] Lester Thurow (MIT) suggested only two options existed: markets or complete credit rationing. Lester Thurow, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 267. Representative Albert Johnson (R-PA) claimed higher rates helped dampen demand, which, consequently, lowered inflation. *Credit Crunch and Reform*, 267. Federal Reserve Chairman Arthur Burns argued fiscal policy was too inflexible for economic stabilization, thus, monetary and credit policies were need as "primary line of defense" against excessive demand. Arthur Burns, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 316.

A relatively new Chicago School interpretation of financial markets, the "efficient market hypothesis," held that financial prices are tied to economic fundamentals and, therefore, that markets are self-correcting.[216] Propounding this view, an economist for the National Association of Mutual Savings Associations hoped to assuage legislators' fears of financial intermediary collusion as he reminded them that U.S. capital and housing markets were competitive markets.[217] As a California representative who also believed in the power of competitive markets explained, "The system works very well at present. I really think that if we just let the market operate in an instance like this, that it will be all right."[218] Even the US League proclaimed that "the marketplace is a great equalizer."[219] Thomas Bomar, chairman of the Federal Home Loan Bank Board, opposed the creation of a savings tax credit, a proposal its supporters claimed would keep deposits at S&Ls, because he also believed in the inherent efficiency of markets.

> The reason it will not work is that you cannot fool the market. You are just going to bid up the price of other money to compensate. Money is like water anywhere in the world. It flows to the most productive places depending upon what yield is willing to be paid, and the yield that is willing to be paid is determined by the desire for the utilization of that money.[220]

Somewhat contrary to these expressions of market fundamentalism, at this early stage of ideologically based regulatory reform advocacy many policymakers, despite their faith in the efficiency of markets, still publicly recognized and accounted for market shortcomings.

---

[216] Cassidy, *How Markets Fail*, 86.
[217] Saul Klaman, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 292-3.
[218] *Variable Rate Mortgage and Regulation Q*, 253.
[219] James Hollensteiner, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 8, 1974, 319.
[220] Thomas Bomar, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 8, 1974, 280.

The Milton Friedman-trained Dr. A. James Meigs, who belonged to the Mont Pelerin Society and the Shadow Open Market Committee, confessed to Congress in 1973, "One of the few things that the free market does not do well is to control the total money supply."[221] Federal Reserve Chairman Burns, who supported asset and liability expansion for thrifts, accepted the precarious and complex situation S&Ls found themselves as he outlined the institutional and economic ramifications of the 1973 "wild-card certificates" experiment, which had allowed thrifts and commercial banks to offer four-year certificates of deposit with no interest rate ceilings.

> In all candor, however, I must acknowledge that I see no easy way out of our current dilemma. Competition among the thrift institutions could be restrained by reverting entirely to the former ceilings or by imposing a modest ceiling on the new 4-year certificates. But in that event the loss of funds by depository institutions to market instruments would probably increase greatly [disintermediation]. Alternatively, ceilings could be liberalized further, so as to give the thrift institutions more freedom to compete with market securities. But many savings and loan associations are not in a position to pay appreciably higher rates and their future would be in jeopardy if they tried to do so. In either case, the availability of mortgage credit might be affected very adversely.[222]

But just as important, as the number of policymakers who crafted a regulatory narrative that pitted free market against government intervention grew over the course of the Nixon and Ford administrations, many other political and economic observers rejected the overly simplistic interpretation that American financial and housing markets were inherently efficient, competitive, and self-correcting. Tight monetary conditions, FDIC Chairman Frank Wille argued, forced banks to engage in anomalous practices in order to stay competitive.

---

[221] Meigs, *Credit Crunch and Reform*, 297. The Shadow Open Market Committee (SOMC) was a group of academic and business economists who, beginning in 1973, encouraged "discussion of alternative economic policies" and recommended "policies that promote economic stability." Memo, Allan Meltzer to Interested Parties, Monetary Policy (2/4), OA 10701, William Poole Files, RRPL. William Poole, after leaving the Reagan White House, became a member of the SOMC.
[222] Burns, *Credit Crunch and Reform*, 318-9.

The FDIC chairman understood the structural and institutional reasons that prodded executives to behave in such a manner. The agency view was that a compartmentalized financial sector enabled and possibly encouraged disintermediation. Thus, the FDIC increased its regulatory oversight during times of monetary instability even though their "regulations are so keyed to anticipating any problem areas"—a practice that would change drastically by the early 1980s.[223]

Despite his public statements affirming the general efficacy of markets, FHLBB Chairman Bomar acknowledged the economic ramifications of tight monetary conditions on housing in particular. The "operation of free market forces…in the past," he highlighted, "have often worked to the detriment of the housing market."[224] So detrimental in fact were tight monetary conditions on American housing that Massachusetts Institute of Technology Professor of Economics Lester Thurow urged his fellow academics and legislators at a 1973 hearing to "recognize that free competition among financial intermediaries are not going to solve all of the problems." He publicly disagreed with "the people who say they will get a free market among financial institutions and housing will get as much [housing credit] as it now gets." Thurow rejected that interpretation, as he explained to the committee, on the basis that "every country in the world that I know of has some special program for housing….because housing always comes at the end of the queue. Other countries are not willing to see housing at the end of the queue."[225] Another economist outlined how the American mortgage market was the most "imperfect, disorganized, inefficient market in the

[223] *Credit Crunch and Reform*, 427-8.
[224] Bomar, *Credit Crunch and Reform*, 408-11.
[225] Thurow, *Credit Crunch and Reform*, 254, 300-1.

economy."[226] For that reason, Deputy Treasury Secretary Stephen Gardner encouraged additional congressional action in order to guarantee "innovation and variety" from U.S. financial intermediaries in the future.[227]

Ever mindful of the social and economic consequences of this particular market failure, many legislators in Congress believed in the pursuit of a larger social good, and consequently they still expected that housing should be viewed as a "public good."[228] Their definition of "public goods" was generally consistent with its traditional meaning in welfare economics. As A.C. Pigou had first explained in the 1920s, the private value of a good or service occasionally did not equal its social value, and when such a divergence occurred, Pigou argued, the government was justified in creating "extraordinary encouragements"—i.e. subsidies—to correct what Francis Bator would later identify, in the 1950s, as a "market failure."[229]

Fernand St. Germain (D-RI) and other legislators supported housing subsidies because they believed the social and economic value of homeownership in the United States far exceeded its private value.[230] Delegate Walter Fauntroy (D-DC), for example, identified homeownership as a "bulwark of American life."[231] Other policymakers who agreed with Fauntroy expressed belief in the necessity of legislative proposals to promote and maintain

---

[226] Saul Klaman, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 9, 1974, 302-3.
[227] Stephen Gardner, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 9, 1974, 333.
[228] *Credit Crunch and Reform*, 312. Representative Wright Patman (D-TX) served as the Chairman of the House Committee on Banking and Currency.
[229] Cassidy, *How Markets Fail*, 116-9, 125-8 for discussions on Pigou and Bator's work.
[230] Representative Fernand St. Germain, at the time, was Chairman, Financial Institutions Supervision, Regulation, and Insurance Subcommittee.
[231] *Variable Rate Mortgage and Regulation Q*, 5.

American homeownership. They insisted that federal and state governments, given the undeniable limitations of a "free market" to produce sufficient levels of housing, should continue their historic role in buttressing the U.S. housing market.[232] But given the decade's continued economic instability and the perceived inadequacy of Keynesian responses and explanations, the subsequent push to replace Pigouvian-justified housing policies with more market-based solutions became increasingly more difficult for policymakers to ward off. As thrifts' problems, specifically, and the economy's more generally, worsened as the decade progressed, critics of the existing regulatory structure only increased their calls for change. That transformation of governance mechanisms, however, was far from complete during the early years of the 1970s.

Policy debates to resolve the worsening S&L crisis between 1973 and 1975 highlighted simultaneously a growing discontinuity and increased contestation among American legislators, regulators, and financial executives as they offered both enhanced regulation and market-based solutions to resolve institutional and structural problems. Their regulatory reform proposals, which incorporated both strategic and transformative deregulatory recommendations, included expanding thrifts' asset and liability powers, ending Regulation Q, preserving Regulation Q, tapping into capital markets, and introducing innovative financial products such as variable rate mortgages, "wild-card" certificates (minimum four-year CDs with no interest rate ceilings), and NOW accounts (interest-bearing checking accounts), *inter alia*.[233]

---

[232] Ibid., 279. For others who also supported federal intervention in American housing markets, see *Credit Crunch and Reform*, 301-3 [Representative Pete Stark (D-CA)]; US League, *Credit Crunch and Reform*, 58; *Variable Rate Mortgage and Regulation Q*, 5 [Delegate Walter Fauntroy (D-DC)]; and *Credit Crunch and Reform*, 424 [Representative Robert Stephens (D-GA)].

[233] Federal regulations had disallowed S&Ls from offering checking accounts since the 1930s.

Supporters of financial sector regulatory reform used various rhetorical frameworks to justify change. Similar to the Hunt Commissioners, many claimed their policies would create more flexible, competitive, and convenient financial markets, thus enabling S&Ls in particular to maintain long-term viability. Others implored legislators to stop "insisting upon the exclusive use of something designed for another time and other conditions"; they begged policymakers to remove the "outdated constraints" on "overregulated" financial institutions.[234] Others still, aware of the political salience of rights rhetoric and civil rights issues, incorporated concerns about discrimination into their rhetorical lexicons as they criticized the arbitrary and increasingly punitive U.S. mortgage market. Chairman Bomar, for instance, aimed to eliminate discrimination in U.S. mortgage markets by issuing a new Federal Home Loan Bank Board regulation in 1974 allowing institutions to offer variable rate mortgages (VRM).

> VRM's are designed to meet and eliminate a problem of substantial discrimination among consumers that has developed under the present system of fixed-rate mortgages. This discrimination has taken several forms. It relates first to a reasonable equality of opportunity for home ownership to consumers, without regard to conditions of the money market at the particular time that they need the housing. Equally importantly, under the present mortgage instrument, home mortgage borrowers during easy credit periods are subsidized by borrowers during tight credit periods. VRM's would help eliminate this subsidization of one group of home owners by another, depending upon the purely fortuitous circumstance of money market conditions when they buy their homes. Similarly, there is presently a parallel subsidization by consumer savers of consumer home owners.[235]

---

[234] Bomar, *Variable Rate and Regulation Q*, 152; Gerald Ford, "Remarks at the White House Conference on Domestic and Economic Affairs," April 18, 1975, www.presidency.ucsb.edu; and Meigs, *Credit Crunch and Reform*, 259.

[235] Bomar, *Variable Rate and Regulation Q*, 157. For similar statements on discrimination in the extant regulatory system, see also *Variable Rate mortgages and Regulation Q*, 259 [Representative Garry Brown, (R-MI)]; Hunt Commission, 18; U.S. League, *Variable Rate Mortgage and Regulation Q*, 220; *Variable Rate Mortgage and Regulation Q*, 280 [Delegate Walter Fauntroy (D-DC)]; and Wille, *Credit Crunch and Reform*, 433.

At this early stage of regulatory reform, policymakers, including Presidents Nixon and Ford, Dr. A. James Meigs, and Chairman Bomar, among many others, identified one group in particular as the most discriminated against, ~~racial minorities~~ small savers. Regulation Q disallowed small savers who put their savings in thrifts from earning market returns even as institutional investors, corporations, and the highly affluent earned market rates by investing their funds in either commercial paper or large certificates of deposit (over $100,000), on which the Federal Reserve removed interest rate ceilings in 1973. A depositor at a savings and loan institution received on average 5.58 percent between 1970 and 1975, whereas investors in Treasury bonds and Aaa corporate bonds earned 7.02 percent and 7.91 percent, respectively, during the same time span.[236] Thus, an individual who deposited her funds at a savings and loan institution in the early 1970s, given the rising inflation rates, actually lost money as the real interest rate (marginal interest rate minus inflation) took a nosedive. Losses were less or non-existent for wealthier Americans as they accessed other higher-yielding investment opportunities.

More than mere political astuteness motivated some policymakers to utilize the injustice of earnings discrimination as a justification for regulatory reform. No doubt some incorporated discriminatory frameworks to also draw attention to inflation's effects because it forced economic and political observers to reflect upon the uneven social and private costs of regulation to those forced to pay them. Representative Garry Brown (R-MI), for example, framed the issue rather succinctly; policymakers could either advantage the disadvantaged or disadvantage the advantaged.[237] A former economist for the Council of Economic Advisors declared policymakers needed specific targets and evaluation criteria to assess the

[236] *S&L Factbook*, "Average Yield on Selected Types of Investments."
[237] *Credit Crunch and Reform*, 203.

effectiveness of public policy.[238] Even as he pointed out the "immoral proposition" of slighting small savers, Dr. Meigs demanded that "we ought to know the cost of what we are doing if we believe that it is necessary to compensate the injured."[239] Such language clearly minimized and/or completely eradicated the regulatory rationale of pursuing a Pigouvian "social good," as their rhetoric narrowed and redirected the political and economic scope of inquiry almost exclusively toward utility maximization, looking at comparative prices, efficiency, regulatory capture, instead of also considering social harm, economic restitution, systemic stabilization, and the interplay of economic aggregates.[240]

In a context of increased media and political attention regarding the plight of African-Americans, women, and Latinos in these crucial years, surprisingly few observers discussed these groups' past or present experiences of discrimination against them in American capital and mortgage markets. Those individuals who did take up this issue, however, described how regulatory reform proposals, particularly variable rate mortgages, would continue to negatively impact minority communities. Kathleen O'Rielly, legislative director for the Consumer Federation of America, opposed them because, in her assessment, they "would institutionalize discrimination against minorities, including the elderly, women, and those seeking loans in older neighborhoods." To emphasize her point, she bemoaned the lack of credit in the District of Columbia due to redlining and suburbanization.[241]

Representative Parren Mitchell (D-MD) expressed ambivalence toward variable rate mortgages as well. Highlighting the extent to which economic theories only offered viable

---

[238] William Gibson, testimony, House Committee on Banking and Currency, *The Credit Crunch and Reform of Financial Institutions*, 93rd Congress, 1st Session, September 10, 1973, 278.
[239] Meigs, *Credit Crunch and Reform*, 302.
[240] Rodgers, *Age of Fracture*, 56-76.
[241] Kathleen O'Rielly, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 9, 1974, 239, 300.

interpretations of white working- and middle-class Americans experiences with markets, he outlined for policymakers at a 1974 congressional hearing the collusive and uncompetitive nature of markets "in the black areas of this country." His observations forced him to conclude that "the savings and loan industry and the Government seem to show all the indications over the years of ripping off the public….I think that greed, and the desire to make money, is the best explanation of what is behind all of this [redlining]."[242]

Responding to an economist's claim that discrimination was not a factor in deciding whether VRMs were going to "help the marketplace," both O'Rielly and Mitchell argued it was improper to separate economic and social critiques when it came to racial discrimination because "when you talk about housing…you are talking about something that has far greater social implications than the economic implications which you have been addressing." Mitchell and O'Rielly knew full well "the kind of people that it is expected will benefit" from VRMs were "relatively young, upwardly mobile people, who, in their early years, will be glad to get this kind of opportunity, and who are willing to take chances, I guess, more or less like you would with term insurance." They also understood, however, how "that very definition excludes a substantial part of the population," an observation Chairman Bomar verified when he acknowledged "blacks" and "low income" Americans could not attain VRMs.[243]

Other opponents of variable rate mortgages offered an array of criticisms that aimed to stymie their implementation. One Democratic representative opposed the Bank Board's

---

[242] *Variable Rate Mortgage and Regulation Q*, 292-3. For a discussion of the disparate ways in which white men (and some white women) and black Americans interacted with U.S. credit markets after World War II, see Hyman, *Debtor Nation*, 132-219.
[243] O'Rielly, *Variable Rate Mortgage and Regulation Q*, 302-3; and *Variable Rate Mortgage and Regulation Q*, 302-3.

proposal for VRMs because, as he claimed, it ended a forty-year congressional policy of providing mortgage credit to American citizens.[244] Because "homeownership is one of the bulwarks of the American way of life," another Democratic congressman rejected the inflationary justification for VRMs, given that they only passed on the higher additional costs on to borrowers.[245] Another refused to support VRMs because they would not help low-income earners or inner city dwellers; he argued for eliminating the second layer lender and financial intermediary middlemen altogether, and instead permitting government lending directly to consumers.[246] Steven Rodhe, representing the Center for National Policy Review of the School of Law at Catholic University, identified VRM proposals as the "most fundamental change" to U.S. mortgage markets in forty years. He argued that they problematically shifted inflationary risks away from financial institutions on to borrowers, made family and individual planning infinitely more difficult, incentivized more restrictive underwriting standards, reduced the availability of mortgage credit, and enhanced the possibility for exploitation of consumers. Given these highly apparent mortgage market imperfections, Rohde concluded, "I do not think there is any doubt that the variable rate mortgage, if it is implemented, will make it much more difficult to get fixed rate loans."[247]

Regulation Q, which had set the interest rate ceiling and the rate differential that could be charged by thrifts and commercial banks, provided another lively site of contestation for S&L regulatory reform. Its critics claimed that a fixed interest rate prevented savers from earning market returns on their deposits and decreased the availability of

---

[244] *Variable Rate Mortgage and Regulation Q*, 5-6.
[245] Ibid., 5.
[246] Ibid., 315-6.
[247] Steven Rohde, testimony, House Committee on Banking, Currency, and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Variable Rate Mortgage Proposal and Regulation Q*, 94th Congress, 1st session, April 9, 1974, 371.

mortgage credit since it did not protect against competition from non-bank banks (disintermediation). They further charged that these features shifted S&L institutional viability onto lower income groups and created more disintermediation, inefficiencies, and higher costs.[248] Representative Edward Koch (D-NY) derided the hypocrisy of the housing and S&L industries that asked for protection against market forces (Regulation Q) even as they rejected the idea of usury ceilings to protect borrowers from the same market forces.[249]

Fernand St. Germain and the U.S. League, on the other hand, argued that Regulation Q simultaneously helped to provide a sustainable level of mortgage credit and stabilized both S&Ls and commercial banks by disallowing ruinous rate wars.[250] By 1974, however, those alleged benefits became increasingly difficult to defend as policymakers faced a crippled construction industry that suffered 24% unemployment and endured three credit crunches in eight years. As chapter one illustrated, those hardships not only forced S&Ls to merge at unprecedented rates; they had also increased the importance of second layer lenders in U.S. mortgage markets—lenders not prohibited from paying higher rates of return.

Conclusion

Attention to rhetoric in this chapter allows a key distinction, between these early debates on S&Ls and those that occurred during the late 1970s and early 1980s. As we shall see in subsequent chapters, one element of the later debates swirled around whether it was still acceptable to publicly offer overtly political justifications and solutions for thrifts' problems, as opposed to expecting financial markets to efficiently self-regulate. Between

---

[248] *Credit Crunch and Reform*, 276; Gardner, *Variable Rate Mortgage and Regulation Q*, 329; and Kaufman, *Variable Rate Mortgage and Regulation Q*, 364.
[249] *Credit Crunch and Reform*, 214.
[250] U.S. League, *Credit Crunch and Reform*, 60; and *Variable Rate Mortgage and Regulation Q*, 2.

1973 and 1975, though, it was still viewed as acceptable for policymakers to reprimand Congress for failing to ensure fairness and equitability in American mortgage markets.[251] At this point, even as legislators and regulators regularly blamed each other for economic instability, MIT economist Lester Thurow seriously advocated for more direct presidential oversight of monetary policy because “inflation and economic instability inflict enormous costs on the public. Whether to inflict these costs or not should be a political decision.”[252] And despite disagreeing on which branch of the government possessed the authority to direct monetary and fiscal policies, congressmen on both sides of the aisle still argued for identifying and promoting a public good that Congress specifically pursued via a regulatory policy that also simultaneously served as a democratic check on executive and regulatory power.[253] Only heterodox economists would continue to utter such heresy by the end of the 1970s and 1980s.

The early 1970s, then, represented a liminal state in which old perceptions and expectations of financial intermediaries and their regulation clashed with new ones. Some legislators, Nixon and Ford administration officials, financial executives, and regulators incorporated new rhetorical devices into political and economic frameworks that criticized legislators for their capture-inducing regulatory meddling. Others, however, rejected those interpretations in favor of continued efforts at promoting American homeownership and maintaining economic and financial intermediary stability. The failure to achieve substantial savings and loan regulatory reform at this early juncture, far from demonstrating only the

---

[251] *Credit Crunch and Reform*, 2.

[252] Thurow, *Credit Crunch and Reform*, 252, 258. Both Lester Thurow (MIT) and A. James Meigs (St. Louis Federal Reserve and Council of Economic Advisors) believed presidential oversight was important.

[253] *Credit Crunch and Reform*, 2; *Credit Crunch and Reform*, 4; *Credit Crunch and Reform*, 240; *Credit Crunch and Reform*, 325; *Variable Rate Mortgage and Regulation Q*, 4; and *Variable Rate Mortgage and Regulation Q*, 255.

U.S. League's lobbying strength or the S&L industry's continued profitability, highlighted the conceptual and theoretical disagreements among policymakers as to the natural efficiency of markets and regarding whether individual American homeownership should continue to be viewed and provided for as a public good. This division heavily factored into the inability to achieve a legislative consensus that pursued a different regulatory agenda.[254] As of 1975, more legislators favored the existing governance mechanism, but that would change as the decade wore on, as the political and economic climates continued to shift, and as contestation in public philosophy accelerated.

This early episode in S&L regulatory reform also reveals the complexities of transitioning from one governance mechanism to another. Replacing the "functionally regulated" governance mechanism required eradicating or fundamentally altering the policy expectations and mechanisms that allowed it to function properly. It is in tracking that process of conceptual, institutional, and structural transition that a distinction between strategic and transformative deregulation becomes more apparent. Inflation forced policymakers to rightfully reconsider Regulation Q and thrifts' asset and liability portfolio restrictions as it increased their operating costs, made mortgages more expensive, intensified competition for deposits, and destabilized the growth and saver governance mechanism. Thus context in important ways demanded strategic change.

But inflation in and of itself did not demand a transformative deregulatory response. As William Greider and others have demonstrated, inflation benefited a large number of Americans.[255] The political agenda of transformative regulatory reformers, who aimed to

[254] Mason, *From Buildings and Loans*, 206-12.
[255] William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon and Schuster, 1987), 11-47.

delegitimize regulation via utility maximization and efficient market tropes, allowed them to capitalize on this moment of economic uncertainty. By choosing to focus on inflation, they were able to establish cost as a critical, if not the most critical, criterion for evaluating the existing policymaking apparatus and future policy projections. By encouraging policymakers to think almost exclusively about the costs of inflation and ignore its benefits for some and the potential costs of deregulation, regulatory reformers at the University of Chicago and in the law and economics movement helped to foster a political and media inflationary crisis that could only be resolved by instituting their own market-based alternatives, which they argued had demonstrated how markets priced and allocated resources efficiently. If they could only convince enough politicians and regulators of the merits of transformative deregulation, their regulatory reform dream would become a political and economic reality. Continued economic instability during a presidential election cycle certainly helped push their regulatory reform agenda forward.

Chapter Three: The Battle for Deregulation: Ideology Takes Hold, 1975-1976

As the worst economic decline since the Great Depression, up to that point, continued to ravage the U.S. economy, and as Keynesian policy prescriptions no longer appeared as viable solutions, policymakers across the political spectrum searched for new answers. Some policymakers, in response to the heightened socio-economic and political instabilities, continued their crusade to promote and implement deregulation. They adopted their own theories of what and whom regulation—or deregulation—should serve and developed their own sets of rhetorical strategies to call for change. In some cases they relied upon a confluence of American and European economic and political traditions that recognized the pivotal role the government played in identifying and protecting public goods, particularly through banking regulation. In other cases, however, individuals drew upon new theories that espoused the benefits of unregulated competition and market efficiencies to justify a transformative deregulation of the financial sector. Advocates on both sides of those debates, though, drew upon the emerging rhetoric of deregulation to interpret and explain their causes, thereby creating confusion among policymakers and voters alike. Just as important, the outcome of those debates would determine the future of the thrift industry and its contribution to the promotion of home ownership.

The years 1975 and 1976 represented a crucial turning point in the battle for transformative deregulation as both the U.S. Congress and President Gerald Ford began to expend serious political capital to transform the American financial sector. Continued economic turmoil, in addition to new social movements and professional methodological developments, helped foster additional distrust in the government's ability to appropriately and effectively resolve socio-economic and political conflicts. These interventions can be

said to have "altered the national mood" and, in the process, transformed the "pipe dream" of ideologically motivated regulatory reform into something close to a political certainty.[256]

Learning to Distrust Government: the 1960s and 1970s

Deregulation's journey into the American political, academic, and economic lexicon was long and tedious. In its conceptual infancy in the 1950s and 1960s and well into the 1970s, as Table 3.1 demonstrates, the U.S. Congress utilized the term more frequently than did the major national newspapers.

Table 3.1 – *Utilization of "Deregulation" by Policymakers, 1950-1989*

	Wall Street Journal	*New York Times*	*Los Angeles Times*	*Washington Post*	JSTOR	Congress
1950-59	1	4	1	1	6	28
1960-64	2	9	1	6	18	23
1965-69	1	3	2	3	28	19
1970-74	82	82	41	91	103	306
1975-79	659	1,134	958	1,013	582	1,600
1980-84	1,680	2,530	2,007	1,996	2,267	2,474
1985-89	1,620	2,098	2,423	1,499	4,154	3,222

Source: *ProQuest Congressional and ProQuest News and Newspapers Databases*.[257]

Between 1950 and 1974, for example, legislators used the word "deregulation" almost four times as often as did journalists at the *Wall Street Journal* and the *New York Times*, and two-and-a-half times more frequently than academics, demonstrating, in large part, the quick ascendancy and vital policy-making influence of American think tanks such as the Heritage Foundation, Institute for Policy Studies, the Brookings Institution, and the American

[256] Joseph Kraft, "Right, for Ford," *New York Times*, April 25, 1976.
[257] I compiled these data by searching "deregulation" in the ProQuest Congressional and News and Newspaper Databases. Even though JSTOR does not include every academic journal in the United States, inquiries searching its 2,000+ academic journals offer a significant insight into the extent to which deregulation talk infiltrated academia between 1970 and 1989.

Enterprise Institute.[258] Before finally exploding into American newspapers, academic and finance journals, presidential initiatives, and Congressional discourse in 1975, the seeds for regulatory reform had been sown by many individuals on the political left and right for well over a decade, and in some circles, for even longer.

Even though much of the social and political contentiousness of the 1960s and early 1970s did not explicitly focus upon the economics of federal regulation or the institutional and structural changes affecting savings and loans, the policy debates and the inequities they highlighted in public policy inclined many Americans to express reluctance to trust government. Each new episode of governmental malfeasance and ineptitude—for example, the *New York Times* publication of the Pentagon Papers, only worsened this disaffection. Americans from all political persuasions questioned, though often for opposing reasons, federal efforts at mitigating civil rights abuses, mandating racial equality, curbing urban and student unrest, and resolving labor disputes. Still others feared the ways that Cold War containment policies, 1960s domestic social welfare programs, and a "multiversity" conceptualization of higher education threatened the individualist and states-rights traditions that so many Americans cherished.[259]

---

[258] James Smith, *The Idea Brokers: Think Tanks and the Rise of the New Policy Elite* (New York: The Free Press, 1991), 147-202; Martha Derthick and Paul Quirk, *Politics of Deregulation* (Washington D.C.: Brookings Institution, 1985), 1-57; Donald Critchlow, "Robert S. Brookings: The Man, the Vision and the Institution," *The Review of Politics* 46 (1984): 561-81; Alice O'Connor, "The Politics of Rich and Rich: Postwar Investigations of Foundations and the Rise of the Philanthropic Right," in *American Capitalism: Social Thought and Political Economy in the Twentieth Century*, ed. Nelson Lichtenstein (Philadelphia: University of Pennsylvania Press, 2006), 228-48; and Mark Blythe, *Great Transformations* (Cambridge: Cambridge University Press, 2002), 152-74.

[259] Joseph Crespino, *In Search For Another Country: Mississippi and the Conservative Counterrevolution* (Princeton: Princeton University Press, 2007); Robert Self, *American Babylon: Race and the Struggle for Postwar Oakland* (Princeton: Princeton University Press, 2003); Thomas Sugrue, *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit* (Princeton: Princeton University Press, 1996); Todd Gitlin, *The Whole World Is Watching: Mass Media in the Making and Unmaking of the New Left, 2nd ed.* (Berkeley: University of California Press, 2003); Maurice Isserman and Michael Kazin, *America Divided: The Civil War of the 1960s, 2nd ed.* (New York: Oxford University Press, 2004); Mary Dudziak, "Desegregation as a Cold War Imperative," *Stanford Law Review* 61 (1988): 61-120; Jacquelyn Dowd Hall, "The Long Civil Rights

This potent concoction of domestic and international instability already had begun to reshape the contours of American politics by the mid-1960s. Ronald Reagan's 1966 gubernatorial campaign, for example, transcended preconceived political boundaries by tapping into many white working- and middle-class Californians' latent fears of a society apparently unhinged by unruly and overbearing federal bureaucrats, racial minorities, and students.[260] Reagan's decisive electoral victory in November 1966 helped fracture the New Deal coalition, in California at least, by building a new bi-partisan coalition of voters who were mainly concerned with social and racial instability, political unrest, and the misappropriation of government power.[261] Those same concerns, according to one political

---

Movement and the Political Uses of the Past," *Journal of American History* 91 (2005): 1233-63; and Paddy Riley, "Clark Kerr: From the Industrial to the Knowledge Economy," in *American Capitalism: Social Thought and Political Economy in the Twentieth Century*, ed. Nelson Lichtenstein (Philadelphia: University of Pennsylvania Press, 2006), 71-87.

[260] One political commentator on Meet the Press identified the 1966 California gubernatorial race as the "year's most important political contest." Transcript, Meet the Press Debate, September 11, 1966, 66 Campaign Debate, Box 31, 1966 Campaign Files, RRPL. Throughout the 1966 gubernatorial campaign, Reagan utilized "rights rhetoric" to introduce himself to California voters, to communicate his values, and to justify his policy positions. When Reagan discussed "rights claims," he referred specifically to the substantive legal rights that he believed all citizens possessed. For example, when defending his support for Proposition 14, a highly controversial but popular ballot initiative to invalidate California's fair housing initiative, he wrote in 1966, "We cannot legislate away the constitutional rights of other citizens just to cure some problem resulting from prejudice and misunderstanding." His comments signaled to potential voters that he believed some rights were absolute, and thus not subject to restriction, even to gain other—even possibly legitimate—ends. His campaign rhetoric also offered insights into his lingering doubts about both the constitutionality and the actual necessity of state and federal efforts to eliminate racial discrimination. Candidate Reagan's political ideology gave him the means to interpret present circumstances, to assign moral, political, and/or social significance to events, and to promote "new" guiding principles. His 1966 California gubernatorial campaign, then, provides a window into how Ronald Reagan created and solidified a political identity by identifying, interpreting, and explaining the rights that he would propose as essential for rectifying the perceived socio-economic ills of California society. Letter, Ronald Reagan to Roy Wingate, March 9, 1966, 66 B&T_Housing 1 of 2, Box 31, 1966 Campaign Files, RRPL. See also Letter, Ronald Reagan to H.R. Gross, January 13, 1966, fol. 66 Campaign_Governor Correspondence Letters of Particular Interest [a-l], Box 29, 1966 Campaign Files, RRPL; Letter, Edgar Hiestand to Ronald Reagan, November 15,1966, 66 Campaign_Gov Personal Correspondence_Letters of Particular Interest[a-l], Box 29, 1966 Campaign Files, RRPL; and Letter, W.S. McBirnie to Ronald Reagan, November 30, 1965, Creative Society, Box 31, 1966 Campaign Files, RRPL.

[261] Gerald De Groot, "'A Goddamned Electable Person': The 1966 California Gubernatorial Campaign of Ronald Reagan," *History* 82 (1997): 429-48; Gerald De Groot, "Ronald Reagan and Student Unrest in California, 1966-1970," *The Pacific Historical Review* 65 (1996): 107-29; Totten Anderson and Eugene Lee, "1966 Election in California," *The Western Political Quarterly* 20 (1967): 535-54; Matthew Dalleck, *The Right Moment: Ronald Reagan's First Victory and the Decisive Turning Point in American Politics* (New York: The Free Press, 2000), passim; and Lou Cannon, *Governor Reagan: His Rise to Power* (New York: Public Affairs, 2003), 115-61.

observer in 1975, had evolved into "prominent national issues."[262] This "dull, fed-up feeling about government, business, and labor" was coupled in the late 1960s and early 1970s with an unpredictable economy and "scientifically" produced data from bureaucrats and academics that stressed the ineffectiveness of government programs.[263] These sentiments further incubated a socio-economic and political environment conducive for accepting subsequent rhetorical efforts to present government regulation as costly, undemocratic, inefficient, and interest-group driven.[264]

Social scientists, since the last decades of the 19th century, used the study of social and economic phenomena to trace social trends and problems, address perceived social ills, and justify new policy experimentation.[265] By the 1960s President Johnson and the Office of Economic Opportunity utilized social science research to interpret the causes of American poverty and justify its eradication. Yet Johnson also understood the natural tendency for social scientists to use those same tools to scrutinize and at times disparage government policies and programs. He suggested as much at the Brookings Institution's fiftieth anniversary celebration.

> So we have seen, in our time, two aspects of intellectual power brought to bear on our Nation's problems: the power to create, to discover and propose

[262] Jon Nordheimer, "Reagan, a Fast Starter, Faces First Test," *New York Times*, December 23, 1975. Historians have identified and explained the political sentiments that both Reagan and other politicians across the country tapped into as they tried to forge new political coalitions. See also Self, *American Babylon* (Oakland and California); Sugrue, *Origins of the Urban Crisis* (Detroit); and Crespino, *In Search for Another Country* (Mississippi).

[263] Smith, *Idea Brokers*, 147-202; Derthick and Quirk, *Politics of Deregulation*, 28-57; Teles, *Conservative Legal Movement*, 95-101; Downs, *An Economic Theory of Democracy*; Stigler, "The Theory of Economic Regulation"; Coase, "Problem of Social Cost"; and Posner, "The Social Costs of Monopoly."

[264] Arlen Large and Albert Hunt, "Grass-Root Gripes About Cost of Living May Tip Congress for Oil Price Controls," *Wall Street Journal*, September 4, 1975; Michael Lassiter, "Political History Beyond the Red-Blue Divide," *Journal of American History* (2011): 760-64; and Lisa McGirr, *Suburban Warriors: The Origins of the New American Right* (Princeton: Princeton University Press, 2001).

[265] Smith, *The Idea Brokers*, 149; Dorothy Ross, *The Origins of American Social Science* (Cambridge: Cambridge University Press, 1991), passim; and Thomas Haskell, *The Emergence of Professional Social Science: The American Social Science Association and the Nineteenth-Century Crisis of Authority* (Baltimore: Johns Hopkins University Press, 2000), passim.

> new remedies for what ails us; and the power then to administer complex programs in a rational way. But there is a third aspect of intellectual power that our country urgently needs tonight, and in my judgment it is being supplied sparingly….This is the power to evaluate….It is the power to say, about public policies or private choices, "This works. But this does not. This costs more than we can afford, or this costs more than it is worth. This is worth more than it costs. This will probably give us an acceptable result. But this will complicate the problem and make it impossible for us to solve."[266]

By 1971, as if to fulfill Johnson's agenda, government bureaucrats working in thirty-six different agencies "engaged in planning and evaluating policies." Though Nixon administration officials likely did not originally intend to undermine the academic expertise that justified poverty programs and regulatory frameworks, their assessments and conclusions often called into question the efficacy and efficiency of government action. As one historian has aptly described their efforts, "the intellectual undoing of American liberalism…began as a crisis from within" liberalism's own intellectual traditions.[267]

American liberalism was not only crumbling from within; it was also besieged from without by an eclectic mix of journalists, politicians, and political observers who utilized a universalistic rhetoric of free markets and rational individualism to politically denounce and ideologically de-legitimate the saliency of its main governance mechanisms. Conservative thinkers, such as Friedrich Hayek, Leo Strauss, Richard Weaver, and Russell Kirk, among many others, had constructed an alternative "intellectual infrastructure" that rejected the positivism and nominalism that undergirded liberal's optimistic faith in historical progress.[268] New Right "political entrepreneurs" in the 1950s, 1960s, and early 1970s founded new think

[266] Lyndon Baines Johnson, "Remarks on the Occasion of the 50th Anniversary of the Brookings Institution," September 29, 1966, presidency.ucsb.edu.
[267] Smith, *Idea Brokers,* 150-1.
[268] Ibid., 168-72. These 1940s and 1950s conservative theorists criticized the pragmatism espoused in the 1920s, for example, and its focus on understanding economic and social forces, because they believed it served as an inadequate substitute for the promotion of social class, order, and custom as pivotal ideals and principles for a proper functioning society. See Burgin, *Great Persuasion*, 87-151.

tanks, established professional networks, produced new scholarly publications, and formed student advocacy groups that collectively aimed to build institutions and structures designed to challenge, and eventually undermine, liberalism's perceived "ideological monopoly" in American culture.[269]

The Marginalism of Economists

Influential economists also reduced society's faith in the efficacy and efficiency of government regulation in two important ways. First, the trajectory of the professionalized discipline shifted from one, a century old, in which the norm was paradigm conflict, involving sustained disagreement among competing "schools." Regarding the early days of academic economics, historians have described a formative and generally healthy disagreement between two schools of thought. Members of an "old school" confessed a dogmatic adherence to a hand's off policy in every instance, if not at least a decided preference for, laissez faire. Meanwhile, a "new school" of academics exposed to historicism while studying in Germany, joined the German historical school in rejecting belief in universal laws and urging state action along a wide front of social problems and conflicts connected with the appearance of monopolistic corporations and a largely low-waged, often under-employed industrial working class.[270]

---

[269] Ibid., 176-78. Smith identified William Baroody as the original "policy entrepreneur," an individual who was "neither a businessman with an interest in politics…nor an academic with a commitment to a particular analytical method." Instead, as Smith explained, a policy entrepreneur aimed to build institutions that promoted and legitimized "market ideas and the concept of limited government" because, at that point in the early 1950s, those ideas had "no defenders in Washington" since liberals maintained a perceived monopoly in the "intellectual marketplace." Baroody, and subsequently many others, aimed to create an institution "with technical skills in public relations and marketing, as well as with large financial resources and solid academic reputations.

[270] Fine and Milokanis, *From Political Economy to Economics*, 1-190.

Over the last decades of the 19th century leading economists across four different national cultures increasingly turned their analytical gaze toward inventing a theory of value that could be defended as more suited to the new realities of highly mechanized, capital intensive production than the labor theory of value previously agreed to across a range of works produced by forbears in the classical tradition ranging from Adam Smith to Karl Marx. Their quest for a new science of income and wealth distribution expanded the focus on labor cost to include the distinguishable costs of each separate factor of production (labor, land, and capital) that could be added at the outer margin of production. The outer margin would be determined by the utility, or degree of satisfaction, that a consumer would derive from the additional unit. Reasoning that all the units of each factor could be presumed, given a single market in which many kinds of goods and services competed, to be interchangeable, these scholars argued that the marginal cost constituted the value added. Thus the fair and defensible price of every unit of each input was determined at the margin, including the fixing of a market wage, based on the new general theory of marginal utility.[271] Here was a new version of natural and universal law for capitalist economies.

Interestingly, the propagation of marginalism did not stamp out other schools of argument and analysis in economics, persuasive accounts argue, until the 1970s. Institutional economists continued before appreciative audiences in debunking the notion of "the" market as anything approaching a historical reality. Instead, they persisted in demonstrating how embedded in, and instituted by, law and government had been the numerous and varied

[271] Ibid, 191-244. See also James Livingston, "The Social Analysis of Economic History and Theory: Conjectures on Late Nineteenth-Century American Development," *The American Historical Review* 92 (1987): 69-95.

iterations of markets constructed in diverse settings over time.[272] Efforts to professionalize and standardize economics via marginalism failed to establish individuals' optimizing behavior through utility maximization as the uncontested paradigm through the decades before the 1970s, and the view of human nature underlying utility theory continues to be challenged in sub-disciplines such as behavioral economics. Still, it is fair to say that marginalism became the orthodox approach to the training of economists, gaining authority through the successful incorporation of justifications for Keynesian methods of demand management into its purview and effectively absorbing macroeconomics into microeconomics.[273] In this not unchallenged, but clearly dominant version of economics as a science, the allocation of scarce resources via individual choices became the basis for all legitimate economic inquiry.

According to a compelling account of the shift involved here "from political economy to economics," the paradigmatic shift to marginalism "confined economics to problems that could be solved by applying the process of logico-mathematical reasoning….At the same time, the use of marginal analysis (an essentially mathematical tool) and the concept of equilibrium (borrowed from statistical mechanics) made economics more susceptible to mathematical analysis, pushing economic science further down the road of abstraction and formalism."[274] Beyond abstracting and narrowing the scope of economic analyses, this turn toward marginalism also wove laissez-faire principles powerfully back into the disciplinarian

[272] Yuval Yonay, "When Black Boxes Clash: Competing Ideas of What Science Is in Economics, 1924-39," *Sociological Forum* 21 (2006): 345-86; Yonay, *The Struggle Over the Soul of* Economics, passim; and John Groenewegen, Antoon Spithoven, and Annette Van Den Berg, *Institutional Economics: An Introduction* (London: Palgrave, 2010), passim.
[273] Fine and Milonakis, *From Political Economy to* Economics, 279-94.
[274] Ibid., 107-10.

identity of economics by imbedding individualistic, asocial, and ahistorical assumptions into its methodological frameworks.

An important event in this long process occurred when a subset of economists at the University of Chicago in the 1960s and early 1970s, as discussed in chapter two above, espoused a version of transformative deregulation. The Chicago school's key figures in those years, led by economists George Stigler and Milton Friedman, extrapolated utility maximization and its corresponding assumptions of individual rationality and market efficiency onto their investigations of congressional regulatory policymaking processes. Since both interest groups and policymakers maximized their utility by exchanging campaign contributions for votes, they concluded, federal regulations ultimately limited competition, protected monopolies, produced regulatory capture, and created unnecessarily expensive public goods—all in an effort on the part of the interest groups to increase monopoly profits and sustain prices and market share.[275] By the mid-1970s, their efforts helped establish a national network of ideologically motivated economists who began to influence policymakers at the White House and across the country.[276] Economists, then, both as professional proponents of marginal utility and advocates of transformative deregulation, provided other academics, legislators, and the consuming public two crucial elements necessary for the subsequent deregulation of several American industries: one, a theoretical and rhetorical repertoire for interpreting and criticizing regulatory regimes. And two, an

---

[275] See Coase, "Problem of Social Costs"; Stigler, "The Theory of Economic Regulation"; "Posner, "The Social Costs of Monopoly"; Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), passim, and Burgin, *Great Persuasion*, 152-185.
[276] William Trombley, "Hoover Institution Makes Impact on Domestic Front," *Los Angeles Times*, September 11, 1975. See also Burgin, *Great Persuasion*, 152-213.

abundance of data on and a rather narrow but convincing range of examples of regulatory misappropriation, misallocation, and malfeasance.[277]

Alan Greenspan: Prophet of Transformative Deregulation

One economist, more than any other during the late decades of the 20th century and the first decade of the 21st, was uniquely positioned to shape the expectations of policymakers, corporate executives, and the general public as they interpreted the intricate web of back and forth relationships between markets and regulation. An Arthur Burns-trained economist, Alan Greenspan served as an economic advisor to Richard Nixon's 1968 and Ronald Reagan's 1980 presidential campaigns. He was chairman of Gerald Ford's Council of Economic Advisors (CEA) and chairman of the Federal Reserve under Presidents Ronald Reagan, George H.W. Bush, Bill Clinton, and George W. Bush, 1987-2006. He also participated on the Hunt Commission (1971), chaired the National Commission on Social Security (1983), and advised (from the Townsend-Greenspan & Co. consulting firm) several Fortune 500 companies (1953-1987).[278]

At the time of his appointment to the CEA, Greenspan represented a unique synergy of economics' marginalism and Ayn Rand's objectivism. Rand, Greenspan later professed, "became a stabilizing force in my life. It hadn't taken long for us to have a meeting of the

---

[277] See also Herbert Stein, "A Successful Accident: Recollections and Speculations about the CEA," *The Journal of Economic Perspectives* 10 (1996): 3-21; and Charles Schultze, "The CEA: An Inside Voice for Mainstream Economics," *The Journal of Economic Perspectives* 10 (1996): 23-39.
[278] Alan Greenspan, *Age of Turbulence: Adventures in a New World* (New York: Penguin Press, 2007), 45,77. Townsend-Greenspan's clients included Republic Steel, U.S. Steel, Armco, Jones & Laughlin, Allegheny-Ludlum, Inland, Kaiser, Alcoa, Reliance Electric, Burlington Industries, Mellon National Bank, Mobil Oil, Tenneco, and many others. Greenspan also served on *Time* magazine's Board of Economists and the Brookings Panel on Economic Activity. He also worked for the National Industrial Conference Board and wrote free-lance for *Fortune*.

minds—mostly my mind meeting hers."[279] When their minds met, Rand explained capitalism this way.

> Capitalism is a social system based on the recognition of individual rights, including property rights, in which all property is privately owned. The cognition of individual rights entails the banishment of physical force from human relationships: basically, rights can be violated only be means of force…The only function of the government, in such a society, is the task of protecting man's rights, i.e. the task of protecting him from physical force; the government acts as the agent of man's right of self-defense, and may use force only in retaliation and only against those who initiate its use; thus the government is the means of placing the retaliatory use of force under *objective control*. It is the basic, metaphysical fact of man's nature—the connection between his survival and his use of reason—that capitalism recognizes and protects. In a capitalist society, all human relationships are *voluntary*…They can deal with one another only in terms of and by means of reason, i.e. by means of discussion, persuasion, and contractual agreement, by voluntary choice to mutual benefit…it is the *right to disagree* that is crucial. It is the institution of private property that protects and implements the right to disagree—and thus keeps the road open to man's most valuable attribute (valuable personally, socially, and objectively): the creative mind….Man is *not* a "national resource" and neither is his mind—and without the creative power of man's intelligence, raw materials remain just so many useless raw materials….The moral justification of capitalism lies in the fact that it is the only system consonant with man's rational nature, that it protects man's survival *qua* man, and that its ruling principle is: *justice*.[280]

With this interpretation of capitalism in mind, Rand penned a "fictitious" justification for her protagonist Howard Roark's bombing of a public housing project in her 1943 novel, *The Fountainhead.*

> I came here to say that I do not recognize anyone's right to one minute of my life…No matter who makes the claim, how large their number or how great their need. I wished to come here and say that I am a man who does not exist for others. It had to be said. The world is perishing from an orgy of self-sacrificing. I wished to come here and say that the integrity of a man's creative work is of greater importance than any charitable endeavor. Those of you who do not understand this are the men who're destroying the world.[281]

---

[279] Ibid., 51-2.
[280] Ayn Rand, *Capitalism: The Unknown Ideal* (New York: Signet Books, 1962), 19-20.
[281] Ayn Rand, *The Fountainhead* (New York: Signet Books, 1943), 742.

"Grateful for the influence she had" on his life, Greenspan believed that this champion of amoral laissez-faire capitalism, whom he invited, along with his mother, to his White House swearing-in-ceremony, successfully persuaded him "to look at human beings, their values, how they work, what they do and why they do it, and how they think and why they think." Even twenty-five years after her death, Greenspan still boasted how Rand "introduced me to a vast realm from which I'd shut myself off." She "broadened my horizons far beyond the models of economics I'd learned. I began to study how societies form and how cultures behave, and to realize that economics and forecasting depend on such knowledge—different cultures grow and create material wealth in profoundly different ways. All of this started for me with Ayn Rand."[282]

In 1962, Greenspan even published three short articles in Rand's *Capitalism: The Unknown Ideal*, a "collection of essays on the *moral aspects of capitalism*."[283] Greenspan's first chapter interpreted the historical and theoretical evolution of antitrust jurisprudence in the United States. He detailed how "the entire structure of antitrust statues in this country is a jumble of economic irrationality and ignorance," thus concluding, "The ultimate regulator of competition in a free economy is the *capital market*. So long as capital is free to flow, it will tend to seek those areas which offer the maximum rate of return." Doing so, Greenspan believed, disallowed the long-term existence of "coercive monopolies."[284] In the second article, he proclaimed the economic and political benefits of maintaining a gold standard, which ultimately prevented the "hidden confiscation of wealth" (taxes) that financed welfare states' chronic deficits and stole savings via inflation. Instead, Greenspan surmised that states

---

[282] Greenspan, *Age of Turbulence*, 51-2.
[283] Rand, *Capitalism*, vii.
[284] Alan Greenspan, "Antitrust," in *Capitalism: The Unknown Ideal*, ed. Ayn Rand (New York: Signet Books, 1962), 63-71.

needed “a free banking system based on gold” since it was “able to extend credit…according to the production requirements of the economy.”[285]

In the last article, which criticized regulation’s “assault on integrity,” Greenspan detailed how profit-seeking businesses, and not the welfare state, actually protected the interests of consumers. Since businessmen needed sound reputations to remain profitable in competitive markets, he decried regulation for substituting fear and force for incentives, thereby disallowing markets to punish unsavory swindlers.[286] These articles collectively revealed that Greenspan, since at least the early 1960s, believed in the efficiency and self-regulatory capacities of competitive markets, identified and bemoaned the consequences of government regulation (coercive monopoly, monopoly pricing, entry restrictions), and espoused a Randian antipathy to the welfare state—all highly anti-state intervention interpretations.

For forty-plus years, thereafter, these methodologically and ideologically informed interpretations of markets remained foundational elements to Greenspan’s worldview. He told a journalist in 1976, “I’ve always been very much aware of the technological efficiency of a free-market system—that is, totally unregulated. She [Rand] demonstrated to my satisfaction that it’s not only practical but moral.”[287] Later, when interpreting the new financial landscape of the early 1980s, Greenspan explained in an op-ed, “Government should seek to promote, not inhibit, the growth of profitable financial services. A small bank or savings and loan association, unable to compete in an increasingly sophisticated market

---

[285] Alan Greenspan, “Gold and Economic Freedom,” in *Capitalism: The Unknown Ideal*, ed. Ayn Rand (New York: Signet Books, 1962), 96-102.
[286] Alan Greenspan, “The Assault on Integrity,” in *Capitalism: The Unknown Ideal*, ed. Ayn Rand (New York: Signet Books, 1962), 118-21.
[287] Kraft, “Right, for Ford.”

for financial services, should not be subsidized through outmoded regulations. It is at the expense of savers, investors, and the economy."[288] Arguing for additional financial deregulation in 1997, he told Congress, "The market-stabilizing private regulatory forces should gradually displace many cumbersome, increasingly ineffective government structures."[289] And then again in 2002, "Those of us who support market capitalism in its more competitive forms might argue that unfettered markets create a degree of wealth that fosters a more civilized existence. I have always found that insight compelling."[290]

Greenspan clearly clung tightly to the ideological and political assumptions that he developed as a Rand acolyte, so much so that when Congressman Henry Waxman (D-CA) questioned him in October 2008, as the global economy once again veered toward complete collapse, as to whether "your view of the world, your ideology, was not right, [whether] it was not working," Greenspan still refused to admit that a theoretical fallacy, and not an episodic example of market exuberance, was to blame for the unraveling crisis.

> So the problem here is something which looked to be a very solid edifice, and, indeed, a critical pillar to market competition and free markets, did break down. And I think that, as I said, shocked me. I still do not fully understand why it happened and, obviously, to the extent that I figure out where it happened and why, I will change my views. If the facts change, I will change….Well, remember, though…ideology is, is a conceptual framework with the way people deal with reality. Everyone has one. You have to. To exist, you need an ideology. The question is whether it is accurate or not. And what I'm saying to you is, yes, I found a flaw. I don't know how significant or permanent it is, but I've been very distressed by that fact….I found a flaw in the model that I perceived is the critical functioning structure that defines how the world works, so to speak…. That's precisely the reason I was shocked, because I had been going for 40 years or more with very considerable evidence that it was working exceptionally well.[291]

---

[288] Alan Greenspan, "Onward the Revolution in Financial Services," *Wall Street Journal*, September 16, 1983.
[289] Financial Crisis Inquiry Commission, *Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Washington, D.C.: U.S. Government Printing Office, 2011), 28.
[290] Ibid., 34.
[291] Alan Greenspan, testimony, House Committee on Oversight and Government Reform, *The Financial Crisis and the Role of Federal Regulators*, 110th Congress, 2nd session, October 23, 2008, 45-6.

It was more than mere coincidence, then, that Greenspan's appointment to the Council of Economic Advisors corresponded with the Ford administration's efforts to pursue transformative deregulation as a centerpiece of its domestic agenda. President Ford's "inner circle of economic advisors," according to Greenspan, included himself, Treasury Secretary William Simon, Budget Director Roy Ash, and Federal Reserve Chairman Arthur Burns.[292] Former CEA chairman Herbert Stein confirmed Greenspan's influence upon Ford; they had, Stein claimed, the "most intimate and personal relationship" between any president and chairman of the CEA.[293] In this context of economic instability and professional and popular skepticism, both the Ford administration and United States Congress, beginning in 1975, substantially increased their efforts to deregulate several aspects of the U.S. economy. Their efforts did not go unnoticed as reporting by journalists on deregulation between 1974 and 1975 increased by 250 percent.[294]

The Economy Worsens: Deregulation's Chance to Shine

The 1973-4 recession continued unabated into the first few months of 1975. Despite policymakers' declaration that the recession officially ended in March, unemployment peaked at 9.1 percent in May (almost 14 percent for minorities).[295] The U.S. gross national

[292] Greenspan, *Age of Turbulence*, 67. Leo Panitch and Sam Gindin highlighted the significant role Simon played internationally in obtaining the political and economic acquiescence of foreign leaders and centrals bankers, which subsequently enabled the free flow of America capital internationally. See Leo Panitch and Sam Gindin, *The Making of Global Capitalism: The Political Economy of American Empire* (Brooklyn: Verso, 2012), 152-59.

[293] Stein, "A Successful Accident," 9. Charles Schultze also confirmed Greenspan's influence upon Ford as well. Schultze, "Inside Voice."

[294] See Table 3.1.

[295] An example of the lag time between the official end of a recession and when businesses see enough economic activity to begin ramping up production again and subsequently hiring new workers.

product fell 9.2 percent in the first quarter of 1975.[296] Inflation dipped slightly from its December 1974 high of 12.34 percent to 11.8 percent in January before it slowly declined over the next two quarters of 1975 and steadily thereafter, ending the year at 6.96 percent.[297] Inflation, however, averaged 9.2 percent in 1975.[298]

The recession was even crueler to the housing sector as housing completions declined 16 percent and housing starts fell 35 percent. Over five hundred thousand construction workers were unemployed (15 percent of the industry).[299] S&Ls average return on assets was 0.47 percent in 1975, an almost 40 percent drop from their 1973 high of 0.77 percent.[300] The number of mortgages S&Ls originated and subsequently sold on the secondary market rose 48 percent between 1974 and 1975, and another 65 percent the following year, simultaneously revealing thrifts' need for more institutional liquidity and providing another reminder of second layer lenders increasing importance in the U.S. mortgage market.[301]

Meanwhile, deregulatory initiatives were picking up on another front. In the midst of the postwar era's worst economic downturn, and encouraged by Stephen Breyer to investigate the desirability of airline deregulation, Senator Edward "Ted" Kennedy began to hold hearings on the Civil Aeronautics Board in February 1975.[302] Influenced by Ralph Nader's budding consumer movement, Kennedy's hearings revealed how airline regulations

---

[296] Kalman, *Right Star Rising*, 56-8.
[297] Inflationdata.com.
[298] Kalman, *Right Star Rising*, 61.
[299] *S&L Factbook 1975*, 8-10.
[300] S*&L Factbook*, "Selected Significant Ratios of Federally Insured Thrift Institutions."
[301] S*&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender."
[302] Breyer, a professor of administrative and antitrust law at Harvard Law School, became the new special counsel to the Subcommittee on Administrative Practice and Procedure of the Judiciary Committee in spring 1974. He coauthored a book with economist Paul MacAvoy, published in 1974, that argued for natural gas deregulation. MacAvoy was subsequently appointed to Ford's CEA. Breyer became an Associate Justice of the United States Supreme Court in 1994, nominated by President William Clinton. Derthick and Quirk, *Politics of Deregulation*, 40.

both increased ticket prices and affected "consumer stuff," such as airlines losing luggage and shipping pets as freight in cold unpressurized cargo holds. These hearings ultimately exposed a larger public audience to the social and economic costs of regulation, thereby confirming the growing number of academic and consumer criticisms that portrayed regulatory actions as pro-business/anti-consumer endeavors. Kennedy's and Nader's efforts, according to two early scholars of deregulation, helped fortify an already persistent right-wing populist disbelief in government, which by the mid-1970s entailed many Americans believing that regulatory capture and government incompetency was commonplace.[303]

President Ford also increased the social and political saliency of deregulation. In the first months of 1975, he first offered deregulation—an example of the strategic variety identified in this study—as one of several options to combat inflation. He actually prioritized lowering food and energy costs above regulatory reform efforts. But by mid- to late-1975, deregulation evolved into an administration policy objective. Given the continued economic uncertainty, Ford's own personal socio-economic and political inclinations, and the ideological beliefs of his closest economic advisors, Ford had become convinced, he noted in several speeches, in what had evolved into advocacy of transformative deregulation, that "federal regulatory commissions…thwarted competition" and "bureaucratic monopolies have tangled business in conflicting policies."[304]

---

[303] Derthick and Quirk, *Politics of Deregulation*, 40-4. They also suggested that historians, who introduced corporatist interpretations of late 19th and early 20th century regulatory development, played a role in promoting a populist skepticism of government regulation. See also Rodgers, *Age of Fracture*, 41-76.
[304] Derthick and Quirk, *Politics of Deregulation*, 45-6; and Gerald Ford, "Remarks in Chicago at the Convention of the American Hardware Manufacturers Association," August 25, 1975, www.presidency.ucsb.edu. When President Ford introduced his infamous WIN anti-inflation campaign to Congress in October 1974, he used "inflation" twenty-seven times. In April 1975, when discussing regulatory reform, he only mentioned inflation six times. By August 1975, in the speech that Alan Greenspan claimed Ford "launched his campaign to eliminate such folly," Ford only uttered the term once. Greenspan, *Age of Turbulence*, 72. See also Gerald Ford, "Address to a Joint Session of the Congress on the Economy," October 8, 1974, www.presidency.ucsb.edu; and Ford, "Domestic and Economic Affairs."

No political novice, Ford understood how socio-economic and political pressures continually shaped and reshaped policymakers' and citizens' expectations of and for regulation. No doubt in an effort to personally begin recalibrating public perceptions, Ford declared to Congress in spring 1975,

> The producers and the costumers in our system are not enemies—but partners. Cooperation is needed to help promote reform of the regulatory system. Producers, who strive to achieve a reputation for fair dealing, are very aware that goodwill with the public is most valuable asset a company can have. Business and consumers must unite for the common good to helped unsnarl the restrictions that encumber our economy….Reforms of our present regulatory structure depend upon a revision in our attitudes. New perceptions are already here, many of them triggered by consumer advocates.[305]

Ford aimed to "cut big government down to size" and begin "unraveling nearly a century of regulations." His framing of the "problem" highlighted a key distinction between those who advocated for strategic deregulation and those who promoted transformative deregulation. Ford framed his response to changing economic circumstances in highly partisan and ideological terms.[306] This rhetorical strategy, which was eventually taken up by many legislators, regulators, financial executives, and Presidents Carter and Reagan, described federal regulations as "archaic and rigid," "outdated constraints," "counter-productive," and "expensive to maintain." He also claimed that regulations "stifle productivity, eliminate competition, increase consumer costs, and contribute to inflation."[307]

As President Ford promoted policies that would "get the federal government as far out of your business, out of your lives, out of your pocketbooks, and out of your hair as I possibly can," it likely became increasingly difficult for other policymakers and ordinary Americans alike to understand the difference between economic and social regulations. Ford

---

[305] Ford, "Domestic and Economic Affairs."
[306] Ford, "American Hardware Manufacturers Association"; and Ford, "Domestic and Economic Affairs."
[307] Ford, "Domestic and Economic Affairs."

in his speeches to Congress and to the American public had differentiated between harmful economic regulations (limited entry, price-fixing, limited substitutes) and the sometimes "necessary and appropriate" social regulations (health, safety, environmental). But this distinction without a difference became increasingly clear as Ford claimed that "the reforms that we seek would eliminate the impractical, the unnecessary, and the obsolete" regulations.[308] Just as confusing, the administration subsequently required that "inflation impact statements" accompany new health, safety, and environmental proposals, only further blurring the supposed distinction between economic and social regulations.[309]

Snowballing into the 1976 Presidential Campaign

Many policymakers entered 1976 excited about the possibilities for even greater regulatory reform successes. Noting the momentum behind the trend, one astute journalist commented, "Regulatory reform nearly became a 'household' phrase in 1975, and it shows signs of remaining a key issue in 1976." Indeed, over the course of 1975, the Supreme Court had ruled that lawyers and other professionals were not exempt from antitrust prosecutions; President Ford had formed the Domestic Council Review Group on Regulatory Reform; legislators, academics, and Ford administration officials had substantively debated trucking, airline, railroad, and natural gas deregulation; the FTC and Justice Department had "stepped up their involvement on behalf of the consumer"; Congress had ended "fair trade laws"; and the SEC had deregulated brokerage fees. These regulatory changes led former FTC chairman Lewis Engman to conclude, "It's going to be a tough struggle, but I am more optimistic about

---

[308] Ford, "American Hardware Manufacturers Association." See Derthick and Quirk, *Politics of Deregulation*, 33, for a discussion of Ford's assault on new social regulations.
[309] "Debate on Regulation," *New York Times*, October 28, 1976.

the results of that struggle today than I was, say, 15 or 18 months ago, when I began talking about some of these issues for the first time."[310]

The increased pressure for additional regulatory reform efforts in 1976 moved beyond the "renewed congressional interest in oversight activities." It included, as interpreted by two political observers, an "increased awareness in the agencies themselves of a more skeptical public that is less convinced that it is getting its tax money's worth." They then concluded that those congressional and regulatory efforts resulted in large part from a "deregulatory snowball" created in 1975. Most initial attempts at regulatory reform centered on only one of several possible aspects of regulation, this study found, a process that made it "difficult for some firms to participate effectively on the still-regulated dimensions." Such "partial deregulation" subsequently produced additional pressures "for further deregulation of other dimensions," hence creating a snowball effect.[311]

The 1976 presidential campaign also stoked the fires of government distrust and deregulation. As early as January 1975, political observers encouraged President Ford, with an eye towards his upcoming reelection bid, to utilize the "emerging policy consensus" to craft an administrative agenda focused on economic deregulation.[312] Aiming through calculated campaign rhetoric either to reflect voter concerns or to project his campaign narrative onto voters, Ford declared as early as July 1975 that the American public wanted "a lot less than what has been thrust at them in many respects. I think they are fed up with some of the over-regulation, and I think they are right. This is why we are trying to do something

---

[310] Carole Shifrin, "Regulation Talk to Turn into Action," *Washington Post*, January 11, 1976; and Lewis Engman, quoted in Shifrin, "Regulation Talk to Turn into Action." See also Derthick and Quirk, *Politics of Deregulation*, 45-53.
[311] Thomas Hammond and Jack Knott, "The Deregulatory Snowball: Explaining Deregulation in the Financial Industry," *The Journal of Politics* 50 (1988): 12.
[312] Douglas Hallett, "The GOP's Ideological Poverty," *Wall Street Journal*, January 3, 1975.

in the area of deregulation."[313] By September 1975 deregulation had become a "major campaign theme" for Ford.[314] At the first presidential debate, he went so far as to blame the Democratically controlled Congress for the "anti-Washington feeling" present in the U.S.[315] Clearly partisan but effectively so, Ford's acknowledgment of this sentiment further strengthened the mutually reinforcing relationship between the public's distrust in government and its support for deregulation. Republican Ronald Reagan's unsuccessful presidential nomination bid also aimed to tap into anti-government sentiments by simultaneously encouraging more deregulation, decrying the problem of "big government," and campaigning as a "citizen politician."[316]

Nor was enthusiasm for deregulation by this time solely a Republican affair. For wavering elements of a splintering Democratic party, the term served equally as a political symbol for the policy tilt it suggested in this twilight era of what scholars of U.S. liberalism have designated as the New Deal order.[317] Most of the Democrats who vied for the presidency in 1976 campaigned for, not against, deregulation. Former Alabama governor George Wallace ridiculed "those pointy-headed bureaucrats" who ran regulatory agencies.[318] Democratic challengers Representative Morris Udall (D-AZ), former senator Fred Harris (D-

---

[313] Bill Anderson, "Ford's Views on the 1976 Election," *Chicago Tribune*, July 24, 1975.
[314] Bill Neikirk, "Blueprint for Fall of Regulators," *Chicago Tribune*, September 19, 1975.
[315] Gerald Ford, Presidential Debate, September 23, 1976, www.presidency.ucsb.edu.
[316] Jon Nordheimer, "Reagan, a Fast Starter, Faces First Test," *New York Times*, December 23, 1975; Neikirk, "Blueprint for Fall of Regulators"; Tom Wicker, "Reagan's Lead May Be Real," *New York Times*, December 23, 1975; Shifrin, "Regulation Talk to Turn Into Action"; Nicholas von Hoffman, "Trucking Along Regulation Road," *Chicago Tribune*, February 15, 1975; Jerald terHorst, "Regulating the Regulators," *Chicago Tribune*, April 21, 1976; and Hobart Rowen, "Ford's Pragmatic Economics," *Washington Post*, May 2, 1976.
[317] Derthick and Quirk, *Politics of Deregulation*, 52-3. Derthick and Quirk identified deregulation as a confusing "political symbol" since it was seen as both an policy option that embodied unfettered competition, free enterprise, and limited government and a feeling that represented cynicism toward government institutions, the latter being utilized, among many others, by a budding consumer movement that clearly hoped to harness the power of the federal government to stop all corporate abuses against American citizens, regardless of their origins.
[318] Neikirk, "Blueprint for Fall of Regulators."

OK), Governor Milton Shapp (D-PA), Senator Lloyd Bensten (D-TX), and Senator Henry "Scoop" Jackson (D-WA) were featured speakers at the January 1976 Consumer Assembly, an event sponsored by the Consumer Federation of America, the country's largest consumer organization. With the exception of Senator Jackson, who "did not stress a break-up of big business," the Democratic candidates "promised consumer leaders…that, if elected, they would take actions ranging from selective antitrust enforcement to full-scale reorganization of concentrated industries." The various regulatory reform efforts, as identified and understood by the Democratic attendees, each represented an opportunity to pursue policy initiatives that promoted efficiency and returned allocative decision-making to the market. Whether these candidates genuinely or only strategically supported regulatory reform efforts to help resolve America's inflation and productivity problems, an apparent Democratic consensus was emerging, so much so that one attendee declared, "I don't really see a lot of difference among them [Democratic candidates]."[319]

Jimmy Carter also astutely recognized the political potential for regulatory reform to catapult him into the White House. In campaign materials, Carter declared, "I am a firm advocate of the private enterprise system. I am a businessman myself. I <u>oppose</u> the type of rigid, bureaucratic centralized planning characteristics of communist countries." For U.S. markets, Carter declared that he favored "government policies that will enable the private market to reach its full potential."[320] Incorporating several deregulation euphemisms into his campaign rhetoric, Carter supported "enthusiastic enforcement of the present antitrust laws," and he hoped to "abbreviate" the procedural requirements of regulations and make

[319] Frances Cerra, "Consumers Hear Antitrust Pledge," *New York Times*, January 23, 1976. Senator Ted Kennedy and Treasury Secretary William Simon also spoke at the event.
[320] Report, "Carter's Economic Program," Economics, Position Papers, Box 12, Pre-Presidential 1976 Presidential Campaign, Jimmy Carter Presidential Library. Hereafter JCPL.

enforcement criteria "more economic." He also pledged to make the federal government more efficient.[321]

Carter campaign officials collected hundreds of pages of Ford administration, congressional, and journalistic materials that purported to document previous cases of regulatory capture, mismanagement, overlap, and impropriety.[322] Campaign officials also contemplated several rhetorical strategies likely to capitalize upon deregulation's political appeal, ultimately recommending three regulatory reform "themes" to Carter that he could incorporate into his stump speeches and debate materials. One highlighted "structural issues" that detailed the wasteful, duplicitous, and conflicting nature of many regulations. Another focused on "process issues," which could be claimed to enable strengthening executive oversight and management of independent regulatory agencies. The recommended steps would promise to minimize the influence of "special interest constituencies," create a consumer advocacy agency, reduce "agency size through elimination of excessive regulatory burdens," eliminate some regulatory agencies altogether (CAB and ICC, for example), expand federal revenue-sharing, and undertake congressional reorganization. The third offered "policy issues" that relied on market mechanisms to supplant regulatory power, such as utilizing "consumer power" or "private remedies" to "reduce the net burden on

---

[321] Nicholas von Hoffman, "Fresh Face but a Stale Mind," *Chicago Tribune*, May 15, 1976.
[322] See folders, "Regulatory Reform – Jack Hopper," "Regulatory Reform – Buck O'Leary," "Regulatory Reform – Ernest Gellhorn," "Regulatory Reform – Ford Record," "Regulatory Reform – Harrison Wellford," "Regulatory Reform – Jack Pearce," "Regulatory Reform – Leonard Weiss and Michael Klass," "Regulatory Reform – Lynn Sutcliffe," "Regulatory Reform – Mark Nadel," "Regulatory Reform – Miscellaneous," and "Regulatory Reform – Congressional Oversight Report – Moss and Lemov," Box 15, Simon Lazarus' 1976 Campaign Transition Files, JC: DPS – Domestic Policy Staff, JCPL. See also Box 16, Simon Lazarus' 1976 Campaign Transition Files, JC: DPS – Domestic Policy Staff, JCPL and Economics, Position Papers, Box 12, Pre-Presidential 1976 Presidential Campaign, JCPL.

taxpayers."[323] Carter officials, once in office, eventually incorporated all three strategies as they strove to make regulation more efficient, cost-effective, and less burdensome.

Hoping to tarnish President Ford's appeal by linking him with Nixon, Carter accused the Ford administration of supporting the "bankrupt ideas" of the Nixon administration. Carter accused both of the previous Republican administrations of a "blatant disregard of the goals of high levels of employment, production and income set forth in the Employment Act of 1946," an approach that "served the nation reasonably well for a quarter century after World War II." Carter clearly understood the role of ideas in explaining and justifying policy expectations and outcomes, and despite his intellectually inconsistent attacks on the Ford administration, as in his charge of "blatant disregard" for job creation, he recognized the U.S. was in the midst of an intellectual paradigm shift. "The failure of Nixon-Ford attempts to wring inflation out of the economy by purposefully depressing the economy" through price and wage controls, Carter argued, "can be attributed to the fact that the old theories about an employment-inflation tradeoff simply do not apply any more. The market place does not work according to the text books and Ford made no effort to make it work better."[324]

Even though some political observers attacked Carter for running a "highly emotional and personal" campaign focused on the public's perceived "general loss of faith in the trustworthiness and competence of government," they failed to realize that other Democratic candidates and President Ford himself also identified a brewing legitimacy crisis as a critical national problem. Just as important, even as the Carter campaign internally debated the most acceptable socio-economic and political solutions to continued inflation, historically high

---

[323] Memo, Peter to Harrison Wellford, August 23, 1976, Box 16, Simon Lazarus' 1976 Campaign Transition Files, DPS – Domestic Policy Staff, JCPL.
[324] Report, "Economy Report," Economics, Position Papers, Box 12, Pre-Presidential 1976 Presidential Campaign, JCPL.

unemployment, and regulatory problems, they too utilized the new ideologically-based "public choice" rhetoric that falsely dichotomized markets and government regulation. In doing so, they rejected the opposing "public interest" interpretation that regulatory frameworks enabled, not disallowed, better functioning markets. Instead, Carter campaign officials claimed "imperfect" markets resulted from market distorting behaviors such as "regulations, subsidies, laws and social attitudes"; thus, they rebuffed, for example, the feasibility of an incomes policy because it represented an "undesirable intrusion of government into the free play of the market."[325]

The politicians' battle for the souls of American voters drew applause and imitation from business elites and intellectual entrepreneurs. Both utilized the 1976 presidential campaign and the American bicentennial as pretexts to exploit the apparent evils of government regulation by employing similar rhetorical strategies. Dr. Murray Weidenbaum, demonstrating how intellectual work proliferated from the ivory tower to corporate managers, white- and blue-collar workers, financial executives, and policymakers, promoted his work in various venues—public talks, academic journals, corporate newsletters, and conservative publications. Weidenbaum, former Assistant Secretary of the Treasury for Nixon who also studied government spending, decried the "hidden taxes" and higher consumer costs of "over-regulation."[326]

---

[325] Report, "Point of View of the Economists and Other Economic Interpretations," Economics, Position Papers, Box 12, Pre-Presidential 1976 Presidential Campaign, JCPL.

[326] Murray Weidenbaum served as Nixon's Assistant Secretary of the Treasury, and would subsequently become Reagan's CEA Chairman between 1982-1984. He published essays in corporate publications such as Ralston Purina's "Special Report to Employees," the National Journal's *Policy Forum*, *Conference Board Economic Forum*, *Aerospace Magazine*, and the *Boardroom Reports* ("Managements Source of Useful Information"). See also Murray Weidenbaum, "Reforming Government Regulation," October 6, 1976; Box 1, Murray L. Weidenbaum Papers, Hoover Institution; and Box 2, Murray L. Weidenbaum Papers, Hoover Institution.

The chairman of Gould, Inc., interestingly suggested, "Our democratic system and the free enterprise system are branches of the same tree, rooted in the belief that the individual possesses rights and a dignity that the state did not confer and cannot take away." Despite acknowledging recent examples of corporate misconduct, he nevertheless chided the "great paradox" that "while we celebrate the economic accomplishments of our nation…we find an alarming increase in hostility toward, and suspicion of, our economic system and business itself and its leaders.[327]

Another C.E.O., J. Stanford Smith, praised Adam Smith for revolting against a "highly government-interventionist, mercantile system" and championing a "free world market, unrestricted by government controls or private monopolies." J.S. Smith then implored his *New York Times* readers to "forget at our peril…that the marketplace is truly a regulatory agency—that it could regulate most economic activities with greater speed, effectiveness, and freedom than could the 'swarms of officers' and 'multitude of new offices' that the Declaration of Independence protested." He also listed for his readers the only acceptable government regulations: protecting the environment, preserving free markets, and overseeing natural monopolies. Just as President Ford had appeared to denounce all regulation before providing ideologically appropriate exceptions, Smith qualified his support for social regulation by advocating the utilization of "non-emotional cost-benefit analysis" because, he mused, sometimes the difference in the cost of regulating smokestacks from 98 percent to 99.8 percent and 0 percent to 98 percent was not in the public interest.[328]

---

[327] William Ylvisaker, "Free Enterprise System: Restoring Faith in the Marketplace," *National Journal Policy Forum* (June 12, 1976): 16.
[328] J. Stanford Smith, "A Perspective on Regulation," *New York Times*, June 14, 1976.

Continuing the trend, O. Pendleton Thomas, the chairman of BF Goodrich, cautioned against the "most self-destructive trend….rooted in politics," which he claimed was blaming large corporations for U.S. economic instability. Thomas then explained, in language clearly influenced by Hayekian reasoning, how Gary Hart's (D-CO) efforts to protect American small businesses by requiring the automatic divesture of companies that attained a legislatively determined size or market share were misguided.

> A desire for this sort of fundamental change to our economic system indicates a failure to comprehend that this system is based on principles which cannot be artificially controlled; principles such as supply and demand cannot be legislated in a democracy. The U.S. Constitution also is based on a set of principles and has undergone countless interpretations to conform to realities of a changing democracy but it has not been altered fundamentally.[329]

Thus, despite efforts by executives from regulation-protected industries such as S&Ls who vehemently opposed their own deregulation, many corporate leaders, just like the chairmen at Gould, Inc., BF Goodrich, and International Paper Co., utilized the rhetoric of transformative deregulation and supported political efforts to promote its implementation.[330]

The day before almost fifty percent of Americans did not vote in the 1976 presidential election, Arthur Schlesinger Jr., the famed U.S. historian, explained why he interpreted the Ford and Carter campaigns as the "shambles of '76." Offering a powerful reflection of the brooding national pessimism the candidates had cited, Schlesinger declared, "Tomorrow our long national nightmare—or at least our most recent one—will be over." Unclear "what in heaven's name is this election about," and upset that both candidates were "unwilling to force serious issues" such as the "urban crisis and racial justice" on the electorate, Schlesinger complained, "Mssrs. Ford and Carter are indistinguishably vociferous in their

---

[329] O. Pendleton Thomas, "The Contradiction," *National Journal Policy Forum*, (June 12, 1976): 18.
[330] See Derthick and Quirk, *Politics of Deregulation*, 1-57.

attacks on big government, their faith in the deregulation of business, their devotion to balanced budgets… [and] they have been indistinguishably mute on such vital problems." Schlesinger failed to realize that most of the fourteen Democratic and the two Republican presidential candidates, in addition to a significant portion of the American public, believed that the inter-related problems of federal regulation, the government's size, and its handling of the economy were legitimate campaign issues.[331] At least one journalist, however, acknowledged the perplexing media silence, arguing, "Rarely has there been much discussion of what many analysts consider new realities: public distrust of programmatic solutions, the growing inability of older cities to provide essential services, and an era of shortages of vital national resources, especially energy resources."[332]

Because of the adversarial nature of elections, Schlesinger and others focused on identifying both perceived and intelligible differences between Ford and Carter. But as historian Matthew Lassiter recently acknowledged, "[In] many of the most important policy debates since the 1960s, a supermajority of the public could be found on one side, suggesting not polarization but [that] something approaching a popular consensus" existed in American society on many "issues." [333] Schlesinger's inability to recognize the socio-economic and political salience of deregulation by 1976 prevented him from understanding the transformation underway in American society. More than just a "Watergate hangover," U.S. public opinion, due to an abundance of perceived and actual economic and political failures by the federal government—among them stagflation, Vietnam, Watergate, busing, oil shocks, and the War on Poverty—began to shift permanently rightward. Citizens had been persuaded

---

[331] Arthur Schlesinger Jr., "Shambles of '76," *New York Times*, November 1, 1976. See also Vernon Jordan, "Running against the Government," *Tri-state Defender*, March 20, 1976.
[332] R.W. Apple, "Campaign '76: Barren and Petty," *New York Times*, October 20, 1976.
[333] Lassiter, "Political History Beyond the Red-Blue Divide," 763.

to conclude, just as the Carter and Ford campaigns had instructed, that "many of our biggest economic problems have been created rather than solved by government."[334] As a result, deregulation, in many respects, had clearly become a bi-partisan cause.

All Isn't FINE: Competing Congressional and FHLBB Regulatory Responses

As policymakers debated the options available to remedy a clearly faltering growth and saver governance mechanism in late 1975 and early 1976, they found themselves in a paradoxical situation. At the exact moment that academic observers, the FHLBB chairman, and legislators decried the thrifts' regulatory framework as "artificial," "outmoded," and "well-intended" but "ill-conceived," S&Ls profitability began to soar once again.[335] As inflation tapered off from a high in 1974 above 12 percent, interest rates declined, and the economy improved, the thrifts' net receipts grew exponentially in 1975 and 1976, providing thrifts with a more than adequate supply of mortgage credit to distribute. As a result, S&Ls experienced enormous growth in their mortgage lending portfolios as the industry's loans outstanding jumped from $249 billion in 1974 to $323 billion by 1976. All the same, such "unprecedented" activity provided one more example of the worsening boom and bust cycles

---

[334] Jim Squires, "Campaign '76: The Epic Struggle Begins," *Chicago Tribune*, January 11, 1976. See also Report, "Point of View of the Economists and Other Economic Interpretations," Economics, Position Papers, Box 12, Pre-Presidential 1976 Presidential Campaign, JCPL. The percentage of Americans who trusted the "government in Washington always or most of the time," according to the Pew Research Center, dropped from a postwar high of 77 percent in 1964 to 36 percent in October 1976, just days before the presidential election. Pew Research Center, "Public Trust in Government: 1958-2017," http://www.people-press.org/2017/05/03/public-trust-in-government-1958-2017 (retrieved June 30, 2017).
[335] House Banking, Currency and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Financial Institutions and the Nation's Economy (FINE) "Discussion Principles*," 94th Congress, 1st and 2nd Sessions, December 2, 1975, 1-225.

that policymakers at the FHLBB and in Congress sought to remedy through regulatory reform.[336]

Officials at the Federal Home Loan Bank Board, by 1975, clearly understood the depths of the industry's problems. A report prepared by the Bank Board's Office of Economic Research identified the changes deemed necessary to make S&Ls viable in the long-term. Concerned that rising interest rates, downward sloping yield curves, and a now-defunct Regulation Q barred the S&Ls from adequately competing with commercial banks, non-bank banks, and other financial competitors during all phases of the business cycle, the FHLBB argued that broadened asset powers would allow thrifts to maintain their focus on housing by becoming "family financial centers" empowered to offer other services. Also aiming to both increase customer convenience and allow thrifts to "compete in competitive free markets," the FHLBB recommended that S&Ls offer consumer loans, demand deposit (checking) accounts, financial counseling, tax preparation services, life insurance, and mutual funds. Thrifts also needed, they argued, variable rate mortgages (VRM) and mortgage-backed securities (MBS) to survive in the new high-inflation American financial sector.[337]

These changes, the FHLBB suggested, more effectively equipped S&Ls to survive in the competitive financial and savings markets that they had so far inadequately encountered. They also allowed the industry, as the FHLBB explained, to "be in a much better position to compete for the consumer savings dollar and, as a result…have a larger and more stable supply of funds to invest in the residential mortgage market," thereby justifying their

[336] *S&L Factbook 1977*, 55-65. Net receipts in 1976 were 18 percent higher than 1975 and 216 percent higher than 1974. Net receipts were one factor to interpret the vitality of S&Ls as they demonstrated how much money was flowing into or out of institutions. 1971 and 1972 previously set industry records for increased net receipts and loans outstanding.

[337] Federal Home Loan Bank Board Office of Economic Research, *A Financial Institution for the Future: An Examination of the Restructuring of the Savings and Loan Industry* (Washington D.C., Government Printing Office, 1975), 1-5.

regulatory reforms efforts within the context of strategic deregulation.[338] Many of these recommendations were incorporated into the Financial Institutions Act of 1975 (S. 1267), which the U.S. Senate passed in December 1975 with overwhelming bipartisan support.[339]

In considering these proposals, however, Chairman Fernand St. Germain's House Subcommittee on Financial Institutions Supervision, Regulation and Insurance feared that the Hunt Commission and the subsequent Nixon and Ford administration reform bills, the Financial Institutions Act of 1973 (FIA '73) and Financial Institutions Act of 1975 (FIA '75) had been "too narrowly focused and perhaps were influenced unduly by [banking] trade associations." To address these concerns, he initiated a new study on financial regulatory reform, which produced in due course the Financial Institutions and the Nation's Economy (FINE) Study.[340] Concerned that its recommendations "benefit consumers" and "better fulfill the projected credit needs of all Americans," the FINE Study, according to its director Dr. James Pierce, identified and resolved the problems that most severely plagued the American financial sector—an unstable savings and loans industry, general economic instability, anticompetitive regulatory policies, and mismanaged monetary policies.[341] The legislators,

---

[338] Ibid., 113.

[339] The Financial Institutions Act of 1975 passed 79-14, with 82 percent of Democrats and 73 percent of Republicans supporting the bill. S. 1267 authorized federal S&Ls to offer NOW accounts, demand deposit (checking) accounts, credit card services, education loans, consumer loans, and development and construction loans. It allowed thrifts to invest in federal, state, and municipal bonds; service corporations; commercial paper; and other corporate debt securities. It also allowed federals to issue capital stock (thus to turn away from historical identity as mutual associations) and hold government deposits. It ended Regulation Q in five and a half years, provided Federal Reserve clearinghouse services to all nonmembers, and extended Federal Reserve reserve requirements to all depository institutions. S. 1267 did not allow S&Ls to offer Variable Rate Mortgages.

[340] James Pierce, "The FINE Study," *Journal of Money, Credit, and Banking* 9 (1977): 606. David Mason argued the FINE study resulted from the inability of Congress to pass FIA '73 and FIA '75. I suggest interpreting FINE as opposition to and critical of the Hunt Commission's policy recommendations, illustrating the continued contestation over financial reform in the United States during the 1970s.

[341] James Pierce, testimony, House Banking, Currency and Housing, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Financial Institutions and the Nation's Economy (FINE) "Discussion Principles*," 94th Congress, 1st and 2nd Sessions, December 2, 1975, 8.

congressional staffers, and economists who collaborated on the FINE Study clearly articulated the view that the "artificial and outmoded constraints which have served to inhibit capital formation required of a flourishing economy must be dealt with comprehensively if the credit needs of this Nation—private individuals, governments, and business—are to be met." Toward this goal, they intended to only offer "proposals for the restructuring of our Nation's financial institutions [that] clearly promote efficiency of financial markets through increased competition among financial institutions," an objective that demonstrated just how deeply the rhetoric of transformative deregulation had fundamentally altered both the expectations of and objectives for financial regulation by the mid-1970s.[342]

Given economists' increased access to policymakers and institutional levers of power, in addition to the aforementioned socio-economic and political changes that reshaped American culture during the postwar period, the increased saliency of deregulation was not surprising. The Council of Economic Advisors, for example, offering as justification "the analytical approach and the views of the mainstream of the economic profession," had advised each president since the early 1960s, according to one previous CEA chairman, to pursue economic deregulation.[343] Economists continued to push a deregulatory agenda onto broader segments of the American public, which included a prominent role in the creation and justification of FINE Study recommendations.

With a clear position on how congressional hearings could help to create narratives that subsequently framed interpretations of and responses to crises, St. Germain's subcommittee called economists as its first seven witnesses during the first two days of

[342] *FINE "Discussion Principles*," 1.
[343] Schultze, "Inside Voice," 26-9.

congressional hearings.[344] Mostly from large public universities, these seven economists, utilizing terms such as "artificial," "outmoded," "undemocratic," "misguided," "ill-conceived," "pernicious," "uncertain," "antiquated," and "sick," simultaneously described the shortcomings of the existing U.S. financial regulatory governance mechanism and provided further rhetorical ammunition that many others would subsequently use to criticize the operation of the American financial sector. These economists considered various proposals that they hoped would simultaneously enable the diverse goals of homeownership, regulatory agency consolidation, Federal Reserve independence and accountability, and international financial stability. In doing so, they repeatedly drew upon the tropes of competition, efficiency, and equitability to promote a new idealized financial sector that created market-based incentives, reflected democratic accountability, and clearly identified the public costs of regulation.[345]

Building upon FINE Study recommendations, Representative St. Germain introduced the Financial Reform Act in March 1976, but the bill died in committee. The Financial Reform Act, if enacted, would have allowed S&Ls to offer acquisition, development, and construction (ADC) loans; consumer loans; student loans; in addition to both investing in and selling federal, state, and local bonds. The legislation also authorized thrifts to participate in

---

[344] Lawrence Nichols and James Nolan, "The Lesson of Lincoln: Regulation as Narrative in the Savings and Loan Crisis," in *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James R. Barth, Susanne Trimbath, and Glenn Yago (Norwell: Kluwer Academic Publishers, 2004), 145-8. Nichols and Nolan defined a "landmark narrative" as a congressionally-created and directed interpretation for a given socio-economic or political crisis that identified key culprits and causal relationships that sufficiently explained how the crisis unfolded and what consequences it wrought. This control over narrative formation allowed Congress to often shape public opinion as crises unfolded. The seven economists who testified on the **first** two days of testimony were: Dr. James Pierce (director of FINE Study), Dr. Thomas Mayer (University of California, Davis), Dr. Allan Meltzer (Maurice Falk Professor of Economic and Social Science, Carnegie-Mellon University), Dr. Edward Kane (Everett D. Reese Professor of Banking and Monetary Economics, Ohio State University), Dr. William Silber (New York University), Dr. Craig Swan (University of Minnesota), and Dr. Franco Modigliani (Massachusetts Institute of Technology).

[345] *FINE "Discussion Principles*," 1-225.

trust activities. And in an effort to provide counter-cyclical support during episodes of tight credit, it also outlined a new FHLBB advance policy. Even as the Financial Reform Act tried to limit mismanagement and malfeasance at an institutional level, its authors outright rejected incorporating FINE Study recommendations to consolidate all federal regulatory agencies and reform the structural and operational components of the Federal Reserve's monetary policymaking.

In the end, the increased sound and fury of multiple deregulation discourses over the course of 1975 and 1976 proved futile. Even after the Senate had passed the Financial Institutions Act of 1975, St. Germain's subcommittee had submitted the FINE Study, and the House Committee on Banking, Currency and Housing had considered the Financial Reform Act of 1976, policymakers failed to produce more substantive legislative reform thereafter. Only a "more severe crisis than the failure of a few large banks," one political observer at the time concluded, "must occur before reform will be achieved."[346] This failure to achieve regulatory reform complicated in significant ways the "regulatory capture" narrative that public choice advocates had pressed to justify transformative deregulation. The S&L industry's success in squashing regulatory reform efforts might have confirmed capture theory advocates' interpretation that industries utilized regulation to protect themselves from competition. But those same theoretical insights could not explain why the FHLBB and many in Congress, over the course of 1975 and 1976, had tirelessly promoted and pursued deregulatory measures to restructure an increasingly fragile savings and loan industry and defang its apparently captured regulatory governance mechanism.[347]

---

[346] Donald Hester, "Special Interests: The FINE Situation," *Journal of Money, Credit and Banking* 9 (1977): 660.
[347] Pierce, "The FINE Study," 606-7.

These regulatory reform efforts revealed the complex and competitive relationships between federal regulators. Congress interceded on three separate occasions, the last one 1975, to prevent the FHLBB from authorizing federal S&Ls to offer variable rate mortgages, despite the fact the FHLBB already possessed the requisite statutory authority to make such a change.[348] As this account demonstrated in chapter two, Congressional opposition to S&L deregulation stemmed only partially from concerns about regulatory capture, but also from competing expectations of financial sector regulation. This conflict between regulators also revealed a hierarchical and sometimes divisive regulatory governance mechanism that provided opponents of change multiple points of access to lobby regulators by drawing upon various political, economic, and cultural rhetorics. Identifying and explaining the causal mechanisms that enabled regulatory capture in such an environment, if it existed at all, became highly difficult; subsequently generalizing any conclusions from that analysis onto other industries remained almost impossible.

The case for ideologically-derived deregulation of S&Ls, then, fell quite far from revealing collusion between regulators and industry officials or highlighting a "cultural capture" where the agency's definition of the "public interest has been colonized by industry." Rather, it can be said to have exposed, quite possibly for the first time, the problem of "industry capture" in which the "captured" were not the *regulators* but rather the various interest groups who felt compelled to craft arguments that catered to the preferences and inclinations they perceived to be favored by *lawmakers*. Contrary to the narrative promoted by Chicago School economists, then, congressional efforts to promote economic stability and homeownership through financial sector regulation actually created industry-wide

[348] Gary Washburn, "Danger of Obsolescence Cited: Changes Needed for S&Ls, Experts Admit," *Chicago Tribune*, November 30, 1975.

constituencies through the governance mechanisms that they constructed, and the long-term survival of those industries depended upon the continued manipulation of markets by Congress.[349] If the United States Congress in the 1930s, for example, had not restricted thrifts' asset powers, or the Congress had not extended Regulation Q to S&Ls in 1966, the S&L industry would not have depended upon and, subsequently fought tooth and nail to protect, Regulation Q and the interest-rate differential during the 1970s.

Conclusion

Even as deregulation became a mainstream political project throughout 1975 and 1976, its political and economic meaning and significance remained ambiguous to many. Such ambiguity stemmed from the fact that deregulation became, according to Martha Derthick and Paul Quirk, a "political symbol" that simultaneously represented competition, free enterprise, and limited government on the one hand, and a consumer movement-based cynicism toward government institutions on the other. Senator Ted Kennedy advanced deregulation to eliminate problematic price controls and entry restrictions. Even though Derthick and Quirk did not categorize Jimmy Carter's support for deregulation as ideologically motivated, both President Ford and candidate Carter espoused ideologically infused justifications for transformative deregulation. Both individuals supported, publicly at least, the theoretical distinction between economic and social regulation as well.[350] But even as Ford, and Carter, and others, utilized universalistic language to warn of negative socio-economic and political consequences of all types of regulation, they provided examples of

[349] James Kwak, "Cultural Capture and the Financial Crisis," in *Preventing Regulatory Capture: Special Interests Influence and How to Limit It*, eds. Daniel Carpenter and David Moss (Cambridge: Cambridge University Press, 2014), 71-98.
[350] Derthick and Quirk, *Politics of Deregulation*, 48-53.

instances when regulation promoted the public interest. Thus they created a confusing and contradictory political discourse that made it hard for voters to distinguish between the two results.

Just as important, I question the soundness of distinguishing between economic and social regulation in the case of financial regulation for two reasons. First, the growth and saver governance mechanism and S&Ls role in that regulatory framework complicate the theoretically difficult task of disaggregating economic from social benefits from a governance mechanism designed by policymakers to utilize price fixing and entry barriers to pursue both the congressionally-identified public interest in widely accessible homeownership and general economic stabilization. Second, the distinction between economic and social regulations, if it ever existed at all, became irrelevant over the course of the 1970s as the financial services industry increased its socio-economic and political importance in the American economy. In a financialized economy, there was no longer a clear distinction between the modes of production, the facilitation of markets, the flow of investments to various sectors of the economy, and the stabilization of the economy as a whole. As financialization proceeded to transform patterns of investment, financial sector firms in a deregulated society produced financial services while simultaneously creating their own markets, and while still—theoretically at least—protecting the national economy and promoting the general welfare. And they were doing this, again theoretically, while their personal financial fortunes remained intimately connected to business profitability. Obviously conflicts of interest did and do abound in such a system.

Nevertheless, just as Thomas Kuhn explained was true for paradigm shifts in scientific revolutions, the shift toward financial sector deregulation was uneven and, at times,

slow going. Holdouts made rearguard attempts at preserving the integrity of the older governance mechanism. Many S&L executives, for example, supported deregulatory reform efforts to expand asset powers even as they fought to maintain Regulation Q. But the tide clearly began to turn by 1976, and Jimmy Carter's aggressive pursuit of transformative deregulation in several sectors of the American economy would soon effectively squash any lingering doubts about whether policymakers could expect markets to self-regulate.

So, contrary to many historiographical interpretations that view the 1970s either as a decade of unresolved contestation between liberals and conservatives for the soul of America or as the crescendo of American conservativism via the reemergence of the Republican Party, the mid-1970s push for deregulation represented the emergence, or quite possibly the continuation, of a bi-partisan movement that increasingly supported market-based solutions for U.S. regulatory and economic problems. It should be recognized as well that by 1976 a significant portion of policymakers and many voters expected negative consequences from government efforts to regulate financial markets. They also increasingly interpreted those efforts, and many other government programs, as unwarranted and intrusive. This anti-government sentiment, which both presidential nominees in 1976 astutely observed had resonated well with voters, signaled a clear shift in American political culture years before Ronald Reagan's 1980 presidential campaign.[351]

---

[351] For examples of ascension/declension narratives, see Kalman, *Right Star Rising*; Philips-Fein, *Invisible Hands*; Rodgers, *Contested Truths*; Stein, *Pivotal Decade*; and Gil Troy, *Morning in America: How Ronald Reagan Invented the 1980s* (Princeton: Princeton University Press, 2005).

Chapter Four: Transformative Deregulation Reigns Supreme: Carter and Reagan Administration Rhetorical Choices and Policy Pursuits, 1977 – 1982

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.[352]

This interpretation understandably linked deregulation to Ronald Reagan's presidency 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. Among the key factors that had already set financial deregulatory action in motion were the Carter administration's extensive regulatory reform initiatives in other policy realms, the rhetorical claims for the benefits of deregulation that became part of President Jimmy Carter's legacy, and 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, as this account has revealed, 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

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

(DIDMCA) into law. The short- and long-term impacts of DIDMCA on the thrifts cannot be overstated. Briefly, this measure created the Depository Institutions Deregulation Committee (DIDC) to oversee the six-year phase-out of Regulation Q, allowed S&Ls to offer credit cards and NOW accounts (interest-bearing checking accounts), permitted thrifts to engage in trust services and operate statewide branches, exempted S&Ls from state usury laws, expanded institutions' ability to make ADC loans, and granted additional asset powers by authorizing S&Ls to hold up to 20 percent of their assets in consumer loans, commercial paper, and corporate bonds. DIDMCA also increased FSLIC deposit insurance coverage from $40,000 to $100,000.

These alleged solutions drew upon directions in economic theory that had originated initially in the 1960s, as outlined in this account. In turn, those theories—regulatory capture, public choice, and market efficiency—became staples of an ideological turn toward anti-statist justifications for across the board reassessment and pro-market revision of regulatory structures in government. Another prime example was the dramatic curtailment of the Interstate Commerce Commission, created as far back as 1887, by the Railroad Revitalization and Regulatory Reform Act of 1976. In its title alone, that act revealed a by then widely accepted view in policy circles that "regulatory reform," viz., deregulation, would revitalize an industry. DIDMCA was thus a sweeping intervention in the realm of financial regulation. Justifications offered for DIDMCA simultaneously participated in the transformative 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, pursued, and in several industries achieved, extensive deregulatory changes. In

fact, Carter's regulatory reform rhetoric closely mirrored that of Gerald Ford and often clearly anticipated the languages later adopted by Ronald Reagan.

Close analysis of regulatory reform rhetoric offered during the Carter and Reagan presidencies for its ideological assumptions reveals 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 all regulation, including financial, focused upon its inflationary, expensive, expansive, and undemocratic effects. Policymakers from those two administrations demonstrated their faith in the inherent efficiency and effectiveness of markets via their proposals to remedy S&L instabilities.

This chapter examines the ideological leanings that were operative in each administration as they pursued financial sector regulation. It records the interactions of a residual commitment to a version of the public good that demanded special government regulatory support for home ownership and an opposing version of the public good, rising in influence across many discursive locations, that insisted on the ineffectiveness of government intervention in this realm and the efficiency of market competition among various lenders to supply the necessary credit. 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: 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 Jimmy

Carter's "respected Georgia friends," J. Robin Harris, sent him a letter.[353] In it he emphasized two critical points concerning the likely roles of 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."[354]

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, mingling recourse to increased competition with protection of the S&L regulated niche, intended to introduce legislation that would allow S&Ls to broaden their consumer services. Doing so would make S&Ls more competitive with commercial banks since additional asset powers would expand the range of services and products individuals could consume at their neighborhood thrift. Carter 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";

---

[353] Memo, Landon Butler to Hamilton Jordan, March 15, 1977, Federal Home Loan Bank Board, 1/25/77-6/22/77 [CF, OA 87], Box 124, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.
[354] Letter, J. Robin Harris to Jimmy Carter, January 3, 1977, Federal Home Loan Bank Board, 1/3/77-3/17/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.

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" in California, as opposed to the "generally smaller in size" institutions "in other parts of the country" that tended to be mutual corporations.[355]

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."[356] 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."[357] Yet months passed after Carter's inauguration, and the FHLBB chairmanship remained vacant. Political observers at the time 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.[358]

---

[355] Memo, Lisbeth Godley to Landon Butler, February 22, 1977, Federal Home Loan Bank Board, 1/3/77-3/2/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.
[356] Ibid.
[357] Ibid.
[358] James Rowe Jr., "Problems Arise from Slow Pace of Appointments," *Washington Post*, July 5, 1977.

More than potential administrative ineptitude, however, was to blame for the slow-moving Carter regulatory appointment apparatus. More than ideology was involved, as 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."[359] Ralph Nader's Consumer Federation of America and other consumer interest groups expected Carter to keep that promise.[360] Additionally, administration officials needed to balance the interests of the U.S. League of Savings Institutions, a key trade association 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).[361]

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

---

[359] Memo, Geno Baroni to Jay Janis, April 26, 1977, Federal Home Loan Bank Board, 1/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; and Staff Reporter, "McKinney Nominated by Carter to Head Home Loan Board," *Wall Street Journal*, June 24, 1977.

[360] Memo, Godley to Butler, February 22, 1977.

[361] Memo, Butler to Jordan, March 15, 1977. See also Memo, Godley to Butler; Memo, "Federal Home Loan Bank Board re: John Heiman," March 4, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; and Memo, Ron Royal to Landon Butler, March 2, 1977, Federal Home Loan Bank Board, 1/3/77-3/17/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.

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 as the S&L industry."[362] 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."[363] As Jordan subsequently advised the president, "I think we can do better."[364]

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 counsel."[365] Finally in June, apparently taking Harris' recommendations to heart, Carter nominated Robert McKinney, a successful lawyer and businessman from Indianapolis. His

---

[362] Memo, Butler to 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."

[363] Memo, Jay Janis to Landon Butler, April 15, 1977, Federal Home Loan Bank Board, 3/3/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Memo, Hamilton Jordan to Jimmy Carter, April 18, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; and Memo, Laurie Lucey to Landon Butler, March 18, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.

[364] Memo, Hamilton to Carter, April 18, 1977.

[365] Letter, Harris to Carter, January 3, 1977.

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."[366]

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.[367] Other civil rights, labor, consumer, and congressional leaders, including the Congressional Black Caucus and Senator William Proxmire (D-WI), strongly opposed McKinney's nomination. They accused

---

[366] Memo, Jordan to Carter, April 18, 1977.

[367] Memo, Baroni to Janis, April 26, 1977. See also Letter, Edgar Campbell to Frank Little Jr., January 20, 1975, Federal Home Loan Bank Board, 1/3/77-3/2/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Letter, Frank Little Jr. to Robert McKinney, February 3, 1975, Federal Home Loan Bank Board, 1/3/77-3/2/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Letter, Frank Little Jr. to David Evans, February 11, 1975, Federal Home Loan Bank Board, 1/3/77-3/2/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; and Report, "Why Do Neighborhoods Deteriorate? Redlining in Indianapolis," Federal Home Loan Bank Board, 1/3/77-3/2/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.

his savings and loan of redlining, identified potential conflicts of interests, and alleged political nepotism.[368]

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 more broadly 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 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

[368] Memo, Jordan to Carter, April 18, 1977; Memo, Baroni to Janis, April 26, 1977; Letter, Vernon Jordan Jr, Kathleen O'Rielly, Ron Shiffman, Robert Corletta, Cushing Dolbeare, Congrad Weiler to Jimmy Carter, May 11, 1977, Federal Home Loan Bank Board, 2/1/77-11/1/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Letter, Parren Mitchell to Jimmy Carter, May 11, 1977; Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Letter, William Taylor to Landon Butler, May 12, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; Letter, William Proxmire to Robert McKinney, June 28, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL; and Letter, Parren Mitchell to Jimmy Carter, May 26, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL. 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. His appointment clearly reflected political nepotism.

> 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) that had created steps to expose and combat racial bias in the provision and cost of home mortgages.[369]

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 <u>only</u> can be successfully accomplished at the <u>local level</u>. It must be a <u>people</u> program, not a federal <u>money</u> program." A life-long Democrat, chairing a small but mightily significant federal regulatory agency, appeared skeptical of federal efforts to oversee efforts to stop racial discrimination within American housing and credit markets. As Bob Dylan had recently proclaimed, "The times they are a-changin'."[370]

Just as important, McKinney expected, after some initial regulatory encouragement from the FHLBB, that the need for "the Board's incentives will fade away."[371] Financial

---

[369] Speech, Robert McKinney, October 21, 1977, Federal Home Loan Bank Board, 3/4/77-12/21/77 [CF, OA 87], Box 99, Chief of Staff Butler, JC: 1005 – Chief of Staff Files, JCPL.
[370] Bob Dylan, "The Times They Are A-Changin'," 1964.
[371] McKinney suggested the Bank Board might implement, for example, some type of credit to reward institutions since he did "not think that this system should be blind to the efforts of associations which are

executives, he hoped, "will find profitable opportunities in urban areas and you will need no prodding from government to seize them." If only S&L executives could realize the vast potential of community reinvestment, he insisted, the moral would merge with the profitable.[372]

Carter's "Reorganization Project": Carter Administration Pursues Transformative Deregulation

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."[373] 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 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

---

helping their cities….I do believe that if you are making a commitment, you should expect a commitment from us." McKinney was also working with Freddie Mac to develop a "program for the purchase of low- and moderate-income loans." Speech, Robert McKinney, October 21, 1977.

[372] Speech, Robert McKinney, October 21, 1977. 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.

[373] 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 Yale Law School, served as the Associate Director, Domestic Policy Staff.

reorganization."[374]

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.[375] 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 their regulatory reform agenda.[376] 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"—all social regulatory agencies. 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."[377] Just as important, he also 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."[378]

Si Lazarus, spokesman for the Regulatory Working Group, offered several proposals

---

[374] Memo, Harrison Wellford and Si Lazarus to Jimmy Carter and Jody Powell, January 6, 1977, Regulatory Reform – Miscellaneous, Box 15, Simon Lazarus' 1976 Campaign Transition Files, JC: DPS – Domestic Policy Staff, JCPL.

[375] Memo, Bert Lance to Jimmy Carter, August 3, 1977, Memoranda: General to Regulatory Reform [1], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL. He did stress in his inaugural, however, the importance of a "competent and compassionate" government.

[376] Memo, Bill Drayton to Harrison Wellford, January 17, 1977, Regulatory Reform – Miscellaneous, Box 15, Simon Lazarus' 1976 Campaign Transition Files, JC: DPS – Domestic Policy Staff, JCPL.

[377] Memo, Jack Watson to Jimmy Carter, January 30, 1977, Memoranda: General to Regulatory Reform [3], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.

[378] Memo, Lance to Carter, August 3, 1977. In another memo, CEA member Lyle Gramley replaced "competition" with "incentive mechanisms." Memo, Lyle Gramley to Charles Schultze, March 25, 1977, Staff Files-Gramley, Lyle [10], Box 154, JC CEA - Council of Economic Advisors, JCPL.

to Carter that aimed to "remake the role of government" itself. 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." Lazarus demonstrated an acute awareness of the ideological paradigm shift underway since the 1960s, a shift that displaced the wide acceptance of the belief that the public good resulted from regulatory laws made by the people's representatives that protected them from greed. For those reasons, Lazarus justified additional regulatory reform efforts when he adeptly acknowledged the public's growing hostility toward the newly remarked "symptoms" of regulation—paperwork, overlap, and duplication—as well as the "many regulatory programs and approaches [that] are fundamentally obsolete, inefficient or ineffective."[379]

In August 1977, the Regulatory Working Group presented to Carter the "President's Reorganization Project," their plan to restructure the American regulatory governance mechanism and reorient the expectations of policymakers, businessmen, and public alike along the lines of transformative deregulation. 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 retrain regulation writers, institute "common sense management strategies," initiate sunset review programs, and improve new regulation development processes.[380] They also proposed to "provide government-wide coordination…to reform the process of issuing new regulations, to review existing

[379] Memo, Si Lazarus to Larry Gilson, June 22, 1977, Memoranda: General to Regulatory Reform [2], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.
[380] Memo, Lance to Carter, August 3, 1977.

regulations and to reduce paperwork."[381] Both explicit and implicit here was the view that the public must be protected from excessive and misguided regulation. 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."[382]

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, could 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.[383]

But even as the Ford administration combated inflation, an effort that clearly involved

---

[381] Ibid.
[382] Executive Order no. 12044, *Code of Federal Regulations*, March 23, 1978. 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.
[383] Executive Order no. 11821, *Code of Federal Regulations,* November 27, 1974. Carter suggested that previous regulations were complex and vague, and they also were not efficient and effective. These traits, he believed, increased regulatory costs and, therefore, the regulatory burden experienced by citizens and business owners alike. Executive Order 12044.

the utilization of political and ideological assumptions regarding the "proper" functioning of the economy, its inflation impact statements had maintained a relatively narrow focus that encouraged policymakers to study inflation's impact on wages, productivity, and competition, and thus on the recognized stimuli to sustained economic growth. 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 policymakers to reconsider the very 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 and thus complicating even further the regulatory implementation process.[384]

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

---

[384] Executive Order 12044; and Larry Gerston, Cynthia Fraleigh, and Robert Schwab, *The Deregulated Society* (Pacific Grove: Brooks/Cole Publishing Company, 1988), 46-7. It also, however, provided an opportunity for public-interest oriented groups to refute claims offered by industry trade groups. Susan Webb Yackee, "Reconsidering Agency Capture During Regulatory Policymaking," in *Preventing Regulatory Capture*: *Special Interest Influence and How to Limit It*, eds. Daniel Carpenter and David Moss (New York: Cambridge University Press, 2014), 292-325.

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 nature."[385] The fact that 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 compliance and allocative 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.[386] 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.[387] Thus, the

---

[385] 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.

[386] 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.

[387] Stigler, "Theory of Economic Regulation"; and Posner, "Social Costs of Regulation." See also Coase, "Problem of Social Cost"; Kenneth Arrow, *Social Choice and Individual Values* (New York: John Wiley and Sons, 1951); Gary Becker, "Competition and Democracy," *Journal of Law and Economics* 1 (1958): 105-9; Gary Becker, "A Theory of Competition Among Pressure Groups for Political Influence," *Quarterly Journal of Economics* (1983): 371-400; Downs, *An Economic Theory of Democracy*, passim; James Buchanan and Gordon Tullock, *The Calculus of Consent*, passim. Arrow demonstrated the undemocratic nature of welfare economics. Downs detailed the likelihood of regulatory capture given the ignorance of voters. Buchanan and Bullock

economic impact statements, the Business Roundtable argued, "should be part of the management process rather than used to justify decision."[388] Their incorporation into E.O. 12044 revealed the increased influence of Chicago School narratives upon the highest level of American policymakers, specifically, and the debate on and trajectory of regulatory reform more generally as the Carter administration pursued transformative 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 the efficacy of markets against that of government regulation, which was not surprising since Carter had 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."[389] Carter and several of his advisors

---

claimed political actors utilize the same utility maximization goals as economic actors. Coase offered a market-based approach for conflict resolution that essentially eliminated any notion of a prevailing public good. Becker modeled how interest groups best exert political influence on policy-making processes, creating and/or worsening market distortions in the process.

[388] 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.

[389] Memo, Stan Morris to Regulatory Working Group, February 11, 1977, Memoranda: General to Regulatory Reform [3], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL. 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).

feared that some appointees lacked the political courage and/or the personal conviction to pursue his regulatory reform agenda over the long haul.[390] 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 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. 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; develop 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."[391]

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

---

[390] Memo, Lance to Carter, August 3, 1977; and Memo, Bert Lance, Stu Eizenstat, and Charles Schultze to Jimmy Carter, June 23, 1977, Memoranda: General to Regulatory Reform [2], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.

[391] Memo, Morris to Regulatory Working Group, February 11, 1977; and Memo, Lance to Carter, August 3, 1977.

its regulatory relief hub would such an arrangement come to fruition.[392]

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, the "natural monopoly" industries save finance.[393] 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.[394] Additional industries were targeted for deregulation between 1978 and 1980.[395]

Carter did appoint regulators who "were sympathetic to the goals of social regulation," including several appointees who publicly supported social regulations that minimized harmful environmental externalities and protected workers' health and safety. His administration, nevertheless, still privately targeted social regulations as part of their larger "reorganization" plans, revealing a troubling disconnect between his administration's public pronouncements that expressed support for social regulatory agendas and their private policy

---

[392] Gerston, *Deregulated Society*, 46-48.

[393] Memo, Si Lazarus to Regulatory Working Group, March 8, 1977, Memoranda: General to Regulatory Reform [3], Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL.

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

[395] The Carter administration also identified between 1978 and 1980 the busing, train, crude oil, broadcast, steel, and maritime industries as possible targets for additional deregulatory efforts. They also used several euphemisms to discuss their deregulatory agenda, which included "regulatory reforms," "competition bill," and "government reorganization." See Box 325, Cabinet Secretary and Intergovernmental Affairs, JCPL; Box 370, Cabinet Secretary and Intergovernmental Affairs, JCPL; Box 393, Cabinet Secretary and Intergovernmental Affairs, JCPL; Box 71, Government Reform – Neustadt Files, JC: DPS – Domestic Policy Staff, JCPL; Box 72, Government Reform – Neustadt Files, JC: DPS – Domestic Policy Staff, JCPL; Box 73, Government Reform – Neustadt Files, JC: DPS – Domestic Policy Staff, JCPL; Box 77, Government Reform – Neustadt Files, JC: DPS – Domestic Policy Staff, JCPL; and Box 78, Government Reform – Neustadt Files, JC: DPS – Domestic Policy Staff, JCPL.

initiatives of significantly reducing the regulatory burden in industries previously interpreted as sacrosanct.[396] 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."[397] The Regulatory Working Group questioned the efficiency and effectiveness of such an arrangement, arguing that the forms it typically took were misguided.

> 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.[398]

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 collaborations, they hoped, would eventually "less[en] reliance on regulation."[399] The Carter administration, then, long before inflationary pressures reignited in 1978, aggressively pursued regulatory reform—thereby demonstrating regulatory reform's increased ideological

---

[396] Douglas Costle (EPA) and Eula Bingham (OSHA) were two Carter administration officials who publicly favored regulatory responses to market failures. Gerston, *Deregulated Society*, 45.

[397] Memo, 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."

[398] Memo, Morris to Regulatory Reform Working Group, February 11, 1977.

[399] Memo, Lance to Carter, August 3, 1977.

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."[400]

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 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

[400] It was argued that the new truth-in-lending requirements, for example, created additional regulations for financial executives. Others argued the Community Reinvestment Act unnecessarily distorted mortgage markets.

offer NOW accounts. He also cautioned against "overaggregating" or "lump thinking," as in attacking one regulation but doing so by critiquing all bank regulations.[401]

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.[402] 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.[403] 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 same kinds of bad resource allocations occur because of unwarranted regulation." Despite the inaccurate interpretation of the Carter administration's efforts at financial deregulation, Laub actually acknowledged the uniqueness of the financial sector, thereby adding the need for an additional layer of scrutiny beyond what had previously been afforded by the other conference attendees.[404] 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

[401] Roy Schotland, "An Overview: New Myths and Old Realities," in *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White (Washington D.C.: Beard Books, 1979), 10.
[402] Michael Redisch, "Comment," in *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White (Washington D.C.: Beard Books, 1979), 103-4. Redisch was an economist in the Program Analysis Division at the General Accounting Office. He claimed banking regulations aimed to achieve one or more of the following goals: soundness of the banking system, depositor safety, allocate credit (particularly to housing), smooth monetary policy mechanism, promote competition and prevent concentrated corporate power, protect borrowers and consumers, and maintain privileged position of status quo.
[403] Ibid., 101.
[404] P. Michael Laub, "The Deregulation of Banking," in *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White (Washington D.C.: Beard Books, 1979), 201.

financial sector regulation because American financial institutions served as the economic intermediaries that collected and distributed credit throughout the economy.

Policymakers Focus Elsewhere: the S&L Industry before DIDMCA and Garn-St. Germain

It was in this context of socio-economic and political confusion and ideological transition that Carter administration officials, congressional leaders, 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 could have become visible to 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. Nevertheless, those structural, institutional, and economic transformations 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.

The financial reform ethos remained strong throughout the 1970s. 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 and House produced three separate studies that each outlined a comprehensive financial regulatory reform agenda. The Senate passed the Financial

Institutions Act of 1975. Representative Fernand St. Germain introduced the Financial Reform Act of 1976. 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." In this milieu, debates continued within the Carter administration and Congress over Regulation Q, NOW accounts (S&L checking accounts), money market certificates, financial disintermediation, variable rate mortgages (VRMs), interstate banking and branching, and the dual banking system, *inter alia*. Yet Congress passed no significant financial sector regulatory reform measures until March 1980, just nine months before Jimmy Carter left the Oval Office; this newfound legislative inertia was perplexing.[405]

S&L historian David Mason blamed a lack of consensus among competing policymakers—particularly federal regulators and thrift executives. He pointed to the impact of S&L asset growth and continued profitability over the course of the 1970s, and the U.S. League's insistence upon maintaining 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.[406] 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

[405]Memo, Godley to Butler, February 22, 1977. Lisbeth Godley served as Associate Director of Presidential Personnel in the Carter White House.
[406] Mason, *From Buildings and Loans*, 209-12.

killed."[407] 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 analysis, 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.[408] But S&Ls also expanded their "savings flows" on average of 23.5 percent per year between 1975 and 1979.[409] They even slightly increased their market share of over-the-counter savings between 1975 and 1979.[410] 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.[411] Funding for government subsidized housing also doubled between

---

[407] 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.

[408] 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 percent in 1975 to 17.3 percent in 1979, expanding S&Ls asset portfolio by $241 billion in those four years. The industry's return on average assets increased from 0.47 percent in 1975 to 0.82 percent in 1978 before falling slightly in 1979 to 0.67 percent and precipitously thereafter, even going negative in 1981 and 1982. See also *S&L Factbook*, "Total Assets of Financial Intermediaries at Year-End"; and *S&L Factbook*, "Selected Significant Ratios of Federally Insured Savings Institutions (by percent)."

[409] *S&L Factbook*, "Savings Association Savings Flows." Thrifts' gross receipts totaled $154 billion in 1975; they rose to $360 billion by 1979.

[410] *S&L Factbook*, "Over the Counter Savings (billions of dollars)." S&Ls over the counter savings market share jumped from 34.2 percent to 36.8 percent in 1979 before dropping to 36 percent in 1980 and 33.7 percent 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.

[411] *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

1975 and 1979.[412] 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.[413] 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 redlining within America's mortgage and savings markets, and fostering more customer choice and convenience within American S&Ls.[414] 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

---

before falling slightly to 4.5 million in 1979 and plummeting thereafter to 3.5 million in 1980 and 2.4 million in 1982. *S&L Factbook*, "New and Existing One-Family Homes Sold."

[412] *S&L Factbook*, "Subsidized Housing Starts." 7.3 percent of housing starts in 1975 were subsidized; that number reached 14.6 percent by 1979 before hitting 5.5 percent in 1981 and less than 1 percent by 1984.

[413] *S&L Factbook*, "Mortgage Foreclosures by All Lenders." Mortgage lenders foreclosed upon 0.5 percent of all mortgages in 1974 and only 0.29 percent 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 percent of their credit to fund home purchases. Only four years later, however, they channeled 70.5 percent of inflows toward mortgage origination.

[414] To address redlining, Congress passed the Community Reinvestment Act (1979) and the Home Mortgage Disclosure Act (1975). Congress also authorized a $10 billion investment fund for the FHLBB to manage. Congress, in an effort to combat individual and institutional malfeasance, passed the Fair Credit Billing Act (1974), Consumer Leasing Act (1976), Truth in Lending Simplification and Reform Act (1980), Financial Reform Act (1976), Institute Regulatory Bill (1978), Financial Institutions Regulatory and Interest Rate Control Act (1978). Additionally, Fernand St. Germain was concerned, among other things, with interlocking directorates. The FHLBB, in order to promote customer convenience and choice, authorized Money Market Certificates (MMCs) in 1976, which quickly grew from 2 percent of deposits in 1977 to 68 percent of deposits by 1981. *S&L Factbook*, "Savings at Insured Associations, by Type of Account (by percent)."

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.[415] Policymakers prioritized what were often competing objectives and acted accordingly; these Democratically-controlled Congresses, led by Senate Majority Leader Robert Byrd (D-WV) and Speaker of the House Tip O'Neill (D-MA), addressed the issues they interpreted as the most economically and politically salient, which did not include a booming S&L industry.

Many economic and political commentators understood that financial regulatory reform often only resulted from "crisis–bred" environments because the "system has great inertial elements in it."[416] An economist from the University of Wisconsin explained the lackluster legislative response to the FINE Study this way.

> 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."[417]

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

[415] 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.
[416] Phillips, "Regulatory Reform for the Deposit Financial Institutions," 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 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."
[417] Hester, "Special Interests," 653.

much for Senators to do, we won't 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."[418]

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.[419] 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.[420] Despite their divergent interpretations, both sides clearly evaluated 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 efficacy of the dual banking system, especially after it appeared the Hunt Commission had acquiesced to political pressures to maintain this bulwark institution of the American financial sector.[421]

---

[418] "Meeting on Extension of Regulation Q," 15.
[419] Report, "Consumer Financial Services Act," 36-73.
[420] Ibid., 77-115. Senators John Tower (R-TX), Richard Lugar (R-IN), and Jake Garn (R-UT) submitted the minority views report. The S&L problems left unresolved by the bill included: asset issues, Regulation Q, and disintermediation.
[421] As discussed in chapter two, 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 Robinson, "The Hunt Commission Report," 773-4.

Collectively resolving these issues made it all that much more difficult to get legislation passed.[422]

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.[423] 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.[424] 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 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

---

[422] *S&L Factbook*, "Statement of Operations of All Savings and Loan Associations." Paying higher interest rates to attract deposits clearly increased the operational costs for depository institutions, which in turn most often 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. Total interest costs at S&Ls, for example, rose from $17.6 billion in 1975 to $24.1 billion in 1977 and $47.4 billion by 1980, almost tripling in five years' time.

[423] House Committee on Government Operations, *Interest Rate Regulation on Small Savings Accounts*, 96th Congress, 1st session, March 20, 1979, 22.

[424] Jimmy Carter, "Financial Reform Legislation Message to the United States Congress," May 22, 1979, www.presidency.ucsb.edu.

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 almost guaranteed that any successful financial sector regulatory reform efforts in 1977, or thereafter, said one expert observer, would "likely to be the outcome of smoky cloakrooms and take the form of inadequately illuminated riders."[425] This interpretation, similar to David 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 Tower (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 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.[426]

[425] Hester, "Special Interests," 655.
[426] "Meeting on Extension of Regulation Q," 6-7. Senator McIntyre chaired the Subcommittee on Financial Institutions.

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. First, Tower 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.[427] 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."[428]

As a second factor obstructing comprehensive and structural reform, 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. 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 by objecting to S&L industry-specific regulatory

---

[427] St. Germain chaired the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance; he subsequently served as Chairman of the House Committee on Banking, Finance and Urban Affairs, 1981-1988.

[428] 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.

reforms.[429] 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—a significant degree of what American political development scholars have termed "state autonomy" and the occasional reality of industry capture. The degree to which either construction of a general public interest motivated a particular actor became difficult to discern in such circumstances. But the tension between a community protection approach and a reliance on market efficiency to achieve fairness, solvency, and growth remained relevant as a crisis finally overwhelmed the industry.

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 to both reveal the systemic shortcomings of the growth and saver governance mechanism and eventually replace it.[430] 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 percent of them; by 1980, however, they only funded 28 percent of new mortgages. Put another way, another financial institution besides a savings and loan provided mortgage credit for 72 percent of mortgages

---

[429] The notion that government bureaucrats pursued their own institutional interests is not new, but few have discussed how regulators actually lobbied financial executives. See Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 19877-1920* (New York: Cambridge University Press, 1982), passim; Daniel Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862-1928* (Princeton: Princeton University Press, 2001), passim; Theda Skocpol, "State Capacity and Economic Intervention in the Early New Deal," *Political Science Quarterly* 97 (1982): 255-78.

[430] For discussion of changes within the housing industry, see Stone, "Housing and the Dynamics of U.S. Capitalism," 41-67.

originated in 1980.[431] The availability of mortgage credit became such a concern by 1979 that the Ad Hoc Task Force on Mortgage Credit, a committee established by the National Association of Realtors, focused their attention on "attracting new types of mortgages investors."[432]

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.[433] Perhaps most significant, the secondary mortgage market grew significantly during the 1970s and exponentially thereafter as Table 4.1 demonstrates. At the beginning of the decade just over $34 billion worth of American mortgages were purchased, sold, and/or re-sold by investors and various financial institutions, including S&Ls, on the secondary mortgage market. In 1980, that number exceeded $155 billion; by 1986, it reached almost a trillion dollars.[434]

---

[431] *S&L Factbook*, "Total Residential Mortgage Loans Outstanding and Savings Associations' Share."

[432] Report, "Recommendations of the Ad Hoc Task Force on Mortgage Credit," in House Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions, *Depository Institutions Deregulation Act of 1979*, 96th Congress, 1st session, June 27, 1979.

[433] 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.

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

Table 4.1. *Purchases and Sales of Mortgage Loans, by Lender (millions of dollars)*

Purchases								
	S&Ls	Savings Banks	Commercial Banks	Mortgage Companies	Fed Credit Agencies	Mortgage Pools	All Others	Total
1970	$3,694	$1,809	$818	$60	$5,687	$2,726	$1,612	$16,406
1971	$7,508	$2,433	$1,312	$415	$4,243	$4,554	$1,203	$21,668
1972	$10,550	$3,222	$1,236	$1,462	$5,553	$5,882	$1,400	$29,305
1973	$7,019	$2,517	$1,176	$1,396	$8,371	$5,007	$2,081	$27,567
1974	$5,865	$1,521	$1,112	$899	$10,151	$7,485	$1,906	$28,939
1975	$8,471	$1,751	$431	$820	$12,526	$12,829	$1,776	$38,604
1976	$13,088	$2,581	$1,022	$2,239	$10,738	$17,855	$1,164	$48,687
1977	$14,791	$3,409	$2,216	$4,236	$11,363	$26,015	$1,974	$64,004
1978	$11,188	$3,244	$2,046	$4,004	$21,884	$26,733	$4,768	$72,867
1979	$12,235	$2,891	$2,410	$5,856	$17,864	$33,423	$7,076	$81,755
1980	$13,189	$1,212	$4,902	$3,445	$16,333	$29,355	$9,708	$78,144
1981	$10,596	$371	$4,150	$4,708	$14,221	$24,110	$7,961	$66,117
1982	$23,724	$1,531	$3,270	$4,953	$20,021	$59,329	$5,793	$118,621
1983	$44,966	$2,748	$5,107	$13,174	$26,923	$88,122	$8,816	$189,856
1984	$64,623	$3,175	$8,133	$11,205	$26,785	$68,218	$8,037	$190,176
1985	$64,992	$2,934	$11,953	$20,944	$32,953	$114,294	$9,604	$257,674
1986	$71,255	$3,385	$12,981	$55,230	$39,530	$260,435	$25,280	$497,894
1987	$64,608	$3,454	$23,217	$50,088	$25,181	$230,681	$31,169	$428,398
1988	$55,613	$3,450	$23,781	$36,292	$31,292	$148,436	$35,371	$334,235
Sales								
	S&Ls	Savings Banks	Commercial Banks	Mortgage Companies	Fed Credit Agencies	Mortgage Pools	All Others	Total
1970	$996	$283	$1,965	$12,509	$2,587	$331	$262	$18,933
1971	$2,013	$270	$2,262	$15,777	$2,464	$438	$675	$23,899
1972	$3,582	$341	$2,727	$17,831	$4,791	$323	$1,052	$30,647
1973	$3,416	$266	$2,723	$17,727	$5,180	$656	$427	$30,395
1974	$3,527	$376	$2,430	$16,164	$3,794	$1,132	$139	$27,562
1975	$5,234	$269	$3,386	$16,324	$8,694	$871	$512	$35,290
1976	$8,641	$548	$4,792	$19,144	$12,842	$850	$248	$47,065
1977	$14,124	$284	$6,844	$33,457	$10,092	$1,916	$757	$67,474
1978	$15,775	$352	$7,638	$42,602	$13,270	$2,505	$673	$82,815
1979	$18,667	$577	$7,733	$51,325	$9,957	$1,279	$615	$90,153
1980	$16,140	$782	$8,403	$36,987	$10,463	$4,059	$295	$77,129
1981	$12,832	$484	$5,458	$30,492	$11,683	$3,829	$464	$65,242
1982	$54,446	$2,218	$8,298	$30,893	$12,697	$4,321	$415	$113,285
1983	$54,194	$3,211	$15,419	$70,362	$13,674	$5,410	$1,140	$163,410
1984	$64,097	$3,374	$13,610	$56,571	$12,244	$6,044	$2,768	$158,708
1985	$103,217	$6,001	$19,173	$78,009	$7,960	$5,535	$4,367	$224,262
1986	$164,585	$12,998	$40,517	$181,155	$15,943	$1,422	$2,280	$418,900
1987	$123,579	$12,868	$52,777	$166,478	$7,240	$277	$3,385	$366,604
1988	$107,208	$10,783	$38,270	$123,125	$6,728	$453	$3,457	$290,024

Source: *S&L Factbook*, “Purchases and Sales of Mortgage Loans, by Lender.”

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.[435] 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," or groups of private investors, consistently bought the most mortgages.[436] 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 market. The federal credit agencies and mortgage pools collectively purchased on average, respectively, 55.5 percent and 59 percent of all mortgages sold on the secondary market in the 1970s and 1980s.[437] 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 entities.[438]

In this second important reorientation of the mortgage market, the Federal Home Loan Bank Board essentially turned private depository institutions into publicly funded

---

[435] *S&L Factbook*, "Inflows from Mortgage Portfolios at Insured Associations"; and *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender." 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 percent of inflows in 1970, but in 1975, they accounted for 15.5 percent, and by 1980 and 1982, 27 percent and 59 percent, respectively. In fact, between 1976 and 1980, S&Ls made roughly 20 percent of all sales to the secondary market.

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

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

[438] *S&L Factbook*, "Mortgage Loans Outstanding on One- to Four-Family Nonfarm Homes, by Types of Lender." Government-sponsored entities (GSEs) only accounted for 3 percent of mortgage loans outstanding in 1965, but 1980, their market share stood at 18 percent, and was almost 30 percent by 1982. Mortgage companies incorporated the secondary markets into their business model as they represented on average, 55 percent and 41 percent 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.

mortgage financiers and, in many instances after 1982, the personal piggy banks of unscrupulous thrift executives who subsequently diverted a significant portion of their asset portfolios into non-mortgage investments. As the chart below illustrates, the FHLBB advance program in the years before 1976 provided cyclical assistance during economic downturns. 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.

Table 4.2. *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%
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.”

Advances increased 242 percent 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 4.2 illustrates, S&Ls would have failed to close an increasing percentage of their loans between 1976 and 1982.[439]

Beyond these two developments—growth of the secondary market and the Bank Board (federal government) expanding mortgage credit and thus bolstering the thrifts—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 ban. FHLBB Chairman Preston Martin eased the conversion rules in 1973 before finally fully repealing the ban in 1975.[440] The impact was immediate. In just one year, stock S&Ls grew their asset portfolios by 23 percent, 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 4.3 highlights. Stock S&Ls, after maintaining roughly 21% of industry assets for the ten years before 1975, controlled almost half of all thrift assets by 1985.

[439] *S&L Factbook*, "FHLB Lending Operations." 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.

[440] Mason, *From Building and Loans*, 204-5.

Table 4.3. *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."

This increase in stock associations, an incorporated S&L owned by shareholders, 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, i.e., the rate at which funds held by one institution at the Federal Reserve could be borrowed overnight by another institution, rose over the next eight months from 10.47 percent to 17.61 percent, and by January 1981, it had soared to 19.08 percent. Thrifts lost billions of depository funds as individuals moved their money from low-interest rate passbook accounts, which could only offer the Regulation Q-capped interest rate,

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. 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.[441] By the end of 1980, 141 associations (with assets of $9.8 billion) merged out of existence.[442]

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 since they could only earn Regulation Q-level earnings while wealthier investors earned market rates via high-minimum certificates of deposit, an overwhelming Democratic Congress passed, and President Carter signed, the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) on March 31, 1980. Carter justified DIDMCA in ideological terms, claiming that the new law simultaneously strengthened financial institutions and the free enterprise system.[443]

---

[441] Mason, *From Buildings and Loans*, 214.

[442] Roy Green, testimony, 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 session, September 21 and 22, 1982, 441.

[443] Letter, Jimmy Carter to Henry Gonzalez, April 2, 1980, Executive Correspondence – Pres. Jimmy Carter, Executive Correspondence, Box 2004-127/83, Henry Gonzalez Papers, Briscoe Center for American History.

DIDMCA created the Depository Insurance Deregulation Committee (DIDC) to carry out a six-year phase out of deposit rate ceilings.[444] The legislation also authorized NOW accounts for individuals and nonprofit institutions; 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) in addition to home mortgage loans; increased FSLIC coverage of deposited insurance from $40,000 to $100,000 per account; and authorized credit card lending and trust activities for federal savings and loans. DIDMCA did not allow thrifts, however, to make variable-rate mortgages, preventing S&Ls from earning higher returns on mortgage assets as inflation decreased real earnings. Additionally, the DIDC eliminated interest-rate ceilings on all money market certificates (MMC), exploding thrifts' operational costs in the process since MMCs represented over 40 percent of all S&L deposits.[445]

Policymakers used the elimination of Regulation Q that was 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, a 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."[446] The expansive powers of DIDMCA, according to Janis, provided thrifts with the

[444] The DIDC had five members, the Federal Reserve Board Chairman, Treasury Secretary, Chairmen of the FHLBB and FDIC, and the National Credit Union Administrator.
[445] Mason, *From Buildings and Loans*, 217-8.
[446] Jay Janis, by 1981, had become the President of California Federal Savings and Loan Association, one of the nation's largest thrifts.

"freedom to provide a full range of services in housing and family finance…at least for those that survive."[447]

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.[448] American homebuyers paid more than 15% for a new 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.[449] 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 asset portfolios comprised mostly of lower-yielding mortgages, their profit margins, return on equity, return on average assets, and net worth, as Table 4.4 illustrates, all continued to worsen into 1981, almost bankrupting the industry in the process as S&Ls faced a $4.6 billion net loss.[450]

---

[447] Jay Janis quoted in Thomas Lueck, "The Competitive Era in Savings," *New York Times,* January 18, 1981.
[448] Jimmy Carter, "Remarks on Signing H.R. 4986, the Depository Institutions Deregulation and Monetary Control Act of 1980," March 31, 1980, http://www.presidency.ucsb.edu.
[449] *S&L Factbook*, "New and Existing One-Family Homes Sold"; and *S&L Factbook*, "Public and Private Housing Starts." Total housing starts dropped from 1.75 million in 1979 to 1.1 million by 1982.
[450] Diana Cheseldine, ed., *'83 Savings Institutions Sourcebook* (Chicago: United States League of Savings Institutions Factbook, 1983), 26; and Mason, *From Buildings and Loans*, 218 ($4.6 billion net loss).

Table 4.4. *Significant S&L Operational Ratios, 1979-1982*

	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 *S&L Factbook*, "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 Continues to Pursue Transformative Deregulation

Both the 1980 Republican and Democratic presidential nominees, just as they had in 1976, supported the transformative deregulation of the U.S. financial sector. Even though political and economic commentators at the time, and since, interpreted Carter's regulatory "reform" as distinct from Reagan's regulatory "relief," Carter's and Reagan's views on deregulation aligned more than either candidate probably cared to admit.[451] The perceived distinction between Carter and Reagan resulted, in part, from Reagan's campaign rhetoric, which often revealed a fervency and ideological vigor that Carter's utterances 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." Reagan had bemoaned the size and role of government for years, but his attacks on Carter's "job-destroying regulation" rang truer in

[451] Eads and Fix, *Relief or Reform*, passim.

1980 as Americans encountered higher inflation, struggling S&Ls, and declining industrial productivity.[452] 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."[453]

Reagan wasted no time in demonstrating his administration's commitment to aggressively pursuing transformative deregulation. Just two days into his term, Reagan created the Task Force on Regulatory Relief (TFRR).[454] And on February 17, 1981, Reagan issued Executive Order 12291.[455] Building upon Carter administration efforts to centralize regulatory oversight, Reagan's E.O. 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, a further centralization of oversight beyond what the Carter administration had done.[456]

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

---

[452] Reagan Bush Committee, "Government Regulation," February 1980, Staffing Memorandums February '81 (1), Box 11, CFOA 90-92, 103, Martin Anderson Files, RRPL.
[453] David Stockman, quoted in Gerston, *Deregulated Society*, 50.
[454] Gerston, *Deregulated Society*, 51. 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.
[455] Ronald Reagan, Executive Order 12291, www.ucsb.presidency.edu. E.O. 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 conflict of regulations, and insure well-reasoned regulations."
[456] Gerston, *Deregulated Society*, 52. Remember, Carter administration officials hoped the Regulatory Analysis Review Group and Regulatory Council would help centralize administrative oversight of regulatory creation and enforcement.

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." 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 and aimed to reinforce that notion within American culture.[457]

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." 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.[458] As such,

[457] Donald Regan, "Remarks by Donald T. Regan before the Civic Federation" (speech, Civic Federation, Chicago, IL, September 14, 1981).
[458] Ibid.

Regan concluded, "The time has arrived to look carefully at all the current regulations" because a "national debate on this issue is overdue."[459]

Another influential administrative official, William Poole, Cabinet Council on Economic Affairs member and Brown University economist, demonstrated the political perils of pursuing transformative deregulation.[460] 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."[461] Poole opposed the non-market mechanisms policymakers had developed during and after the Great Depression that, as he claimed, inefficiently and ineffectively promoted a public good. As such, he 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.[462]

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 the ideological presuppositions undergirding Reagan administration proposals to resolve financial instabilities. Impatience, Poole cautioned, "runs the clear risk of destabilizing rather

---

[459] Ibid.

[460] Lou Cannon, *President Reagan: The Role of a Lifetime* (New York: Public Affairs, 1991), 151-2. Reagan utilized a governance-by-cabinet approach to help identify and executive policy initiatives during both his gubernatorial and presidential administrations. Once in Washington D.C., he initially created five subgroups, and then eventually a sixth, called cabinet council that met in the White House and "functioned in specific policy areas. Occasionally a cabinet council briefed President Reagan, providing members an opportunity to quickly instruct Reagan of the complexities of the problem and then allow him to choose one or more solutions.

[461] Memo, William Poole to Cabinet Council on Economic Affairs, October 8, 1982, Cabinet Council for Economic Policy_8/82-6/30/83 (6/8), Box 10699, William Poole Files, RRPL.

[462] Ibid.

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."[463] The Reagan administration chose to follow its ideological commitment to transformative deregulation, as Poole's and Regan's rhetoric implied, even though extant circumstances suggested that such a course might well be imprudent in that moment, especially since historically high interest and unemployment rates continued to ravage several sectors of the American economy, including savings and loan institutions. Just as important, Poole's rhetoric on "market votes" suggested a belief in a self-regulating market that is, in effect, a rational, thinking actor that possessed all the requisite information to make the best decision possible. However, such a position failed to acknowledge how informational asymmetries (unknowable information to buyer), spillover/social costs (pollution, oil spills), and "rational irrationalities" (herding behavior) drastically affected the free-flow of the market.[464]

To achieve the success Poole and Regan envisioned for the S&L industry, specifically, and the U.S. financial sector more broadly, the Cabinet Council on Economic Affairs (CCEA) identified four "broad areas of financial institutions reform" where change 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, a CCEA member opined, the

[463] Ibid.
[464] Cassidy, *How Markets Fail*, 139-91.

administration would "have a better idea…of the work left to be done on thrift institution powers and Glass-Steagall deregulation."[465]

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."[466] 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."[467]

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."[468] Pratt's insistence on thrift self-help, in addition to the eventual lifting of Regulation Q, marked a dramatic shift in the structure and philosophy of 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 long since created and perpetuated by the federal government. Not all thrifts agreed with these changes, as many feared they would "bankrupt scores of institutions already on the brink of insolvency."[469]

---

[465] Memo, Roger Mehle to Cabinet Council on Economic Affairs, November 3, 1981, Financial Institutions Reform Working Group (CM #149), OA 9946, Edwin Meese Files, RRPL.
[466] Ibid.
[467] Ibid.
[468] Michael Quint, "Talking Business: with Pratt of the Home Loan Bank Board," *New York Times*, April 28, 1981.
[469] Deborah Rankin, "Failed Promises in Banking Deregulation," *New York Times*, November 29, 1981.

Ailing thrifts, therefore, "sandbagged" new deregulatory changes throughout 1981 to protect themselves from failure.[470]

Pratt argued that "defective structuring" was the "primary cause of the present economic vulnerability," since particular "constraints," such as the Emergency Banking Act (1933, a.k.a. 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."[471] 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."[472] 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." Given these factors, Pratt believed Congress needed to expand thrift powers to meet these "new era demands."[473] Congressional deliberations over the appropriate response to this escalating savings and loan crisis centered, primarily, on 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.

In opposition to the Reagan administration's pursuit of transformative deregulation, Paul Volcker believed that thrifts needed to maintain their housing specialization, thereby

---

[470] Ibid.
[471] Richard Pratt, testimony, 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 session, September 21, 1982, 594-8. McFadden disallowed interstate banking of commercial banks. Glass-Steagall separated commercial and investment banking. Douglas barred interstate bank acquisitions.
[472] Ibid, 598.
[473] Ibid, 595.

favoring a more strategic response to S&L instability. 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."[474] 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."[475] 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.[476] 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.[477]

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 no more unique than any other business. Instead, Volcker identified, just as many

---

[474] Paul Volcker, testimony, 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 session, September 21, 1982, 637.
[475] Letter, Paul Volcker to David Elliott, 12 April 1983, "Financial Institution Reform (1/3)," Box OA 11843, Edwin Meese Files, RRPL.
[476] Volcker, *Depository Institutions Amendments of 1982*, 616-20.
[477] Ibid, 617.

policymakers had during and after the New Deal, general welfare legislation as a duty and goal of government. He understood the positive and negative ramifications of the Reagan administration's ideologically motivated 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."[478] For a number of reasons, Volcker recommended that Congress disallow banks and thrifts to sponsor and sell money market mutual funds, leaving this function to mutual funds and other non-FDIC/FSLIC covered financial institutions.[479] He maintained that it was "generally accepted that the new powers are of little relevance in relieving the existing earnings pressure on thrift institutions—indeed…the new powers could precipitate greater difficulties."[480] 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.[481] Additionally, he and others actually worried that Reagan administration officials were using the thrift crisis and the "budget emergency" as a "Trojan horse" both to sneak its deregulatory agenda through Congress and to justify inaction by the administration.[482] Given

---

[478] Ibid, 628.
[479] Ibid, 630-2. 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."
[480] Ibid, 635.
[481] Ibid, 637-8.
[482] Henry Gonzalez and Michael Edwards from the Conference of State Bank Supervisors also proffered the "Trojan horse" theory. See 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 session, September 13, 1982, 3. See also Regan, *Depository Institutions Amendments of 1982*, 644, in which Regan claimed that a "budget authorization this large and problematic at a time of budget stringency would be totally inappropriate. Also see Michael Edwards, testimony, 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 session, September 21, 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." Edwards, in large part,

memoranda that were circulated by the Cabinet Council on Economic Affairs, their concerns were justified.[483]

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.[484]

The Garn-St. Germain Depository Institutions Act passed both Houses of Congress by overwhelming margins on October 15, 1982. Reagan administration policymakers, the Democratically-controlled House of Representatives and the newly Republican-controlled Senate hoped it would counter the burgeoning instability in the savings and loan industry. The new law, asserted one administration official, provided the "elbow room" necessary for

---

understood that continued movements toward nationalizing the S&L industry, specifically, and the U.S. financial sector more broadly, violated a fundamental operating principle of American political governance in that concentrated economic power would eventually undermine democratic rule.

[483] See Memo, Thomas Healey and Peter Wallison to Cabinet Council on Economic Affairs, Depository Institution Holding Company Deregulation Act of 1983, Cabinet Council for Economic Policy_8/82 – 6/30/83 (1/8), Box 10699, William Poole Files, RRPL; Memo, Roger Porter to Edwin Meese and Edwin Harper, July 3, 1983, "Depository Institution Holding Company Deregulation Act of 1983," Financial Institution Reform (3/3), Box OA 11843, Edwin Meese Files, RRPL; and Memo, The Working Group on Federal Credit Policy to Cabinet Council on Economic Affairs, June 30, 1983, "Trusts for Investment in Mortgages (TIMs), Cabinet Council for Economic Policy_8/82 – 6/30/83 (2/8), Box 10699, William Poole Files, RRPL. These three memoranda provide specific examples of administration officials presenting legislative proposals in terms of the political and/or ideological effects of their efforts to implement transformative deregulation.

[484] Pratt, *Depository Institutions Amendments of 1982*, 593-4.

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.[485] As Ronald Reagan signed the new deregulatory law on October 15, 1982, he declared that Garn-St. Germain was "the most important legislation for financial institutions in the last 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."[486] Jimmy Carter, interestingly enough, had made similar comments concerning the importance of DIDMCA.[487]

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.[488] Senator Jake Garn (R-UT) and Congressman Fernand St. Germain (D-RI), with much cooperation from FHLBB Chairman Richard Pratt and the U.S. League of Savings Institutions, crafted a bill that Reagan believed "hit the jackpot."[489] Just as important, legislative authorizations incorporated into Garn-St. Germain, according to Assistant Secretary of the Treasury Roger Mehle, reflected a "pro-competitive

---

[485] Edwin Gray, testimony, Senate Committee on Banking, Housing, and Urban Affairs, *Nomination of Edwin Gray*, 98th Congress, 1st session, February 23, 1983, 4. Edwin Gray was a lifelong Republican who served in both Reagan's gubernatorial and presidential administrations.

[486] Ronald Reagan, Signing Ceremony for Garn-St. Germain Depository Institutions Act, October 15, 1982, www.presidency.ucsb.edu.

[487] Carter, Remarks on DIDMCA.

[488] Mason, *From Buildings and Loans*, 219. A qualifying thrift, one that maintained a positive net worth but below the 3 percent minimum, could issue net worth certificates to the Federal Savings and Loan Insurance Corporation in exchange for FSLIC promissory notes. The notes were subsequently counted as part of the institution's net worth. As the institution regained financial health, it redeemed the net worth certificates by returning the FSLIC's promissory notes. The "direct equity investments" also allowed for investment in junk bonds, which were high-risk financial instruments that proved scandalous as well.

[489] Reagan, Signing Ceremony for Garn-St. Germain; and Mason, *From Buildings and Loans*, 220 ("Pratt Bill").

Administration response." Those new asset and liabilities powers, Mehle believed, "largely addressed the crisis confronting the thrift industry" without simultaneously allowing several "radical solutions" which "would have cost billions of dollars or done great damage to the free market principles of the Administration, or both." Since Garn-St. Germain, as Mehle claimed, was "in large part inspired by the Cabinet Council on Economic Affairs (CCEA)," Mehle concluded that the CCEA "should be gratified with the results of its effective and inexpensive handling of this serious situation."[490]

Despite the additional asset powers that 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."[491] 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.

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

---

[490] Memo, Roger Mehle to Cabinet Council of Economic Affairs, February 17, 1983, Financial Deregulation (1), Box 8, OA 19321, Economic Policy Council: Records, RRPL. The "radical solutions" included "granting the full faith and credit of the U.S. Government to insured deposits, increasing the borrowing authority of the insurance agencies, and providing mortgage interest rate subsidies."

[491] Green, *Depository Institutions Amendments of 1982*, 451. William McConnell, President of the U.S. League of Savings Institutions, also declared to Congress in 1983, "There is little question in my mind that the vast majority of savings institutions will continue in the business that they know best, that of residential mortgage lending." William McConnell, testimony, Senate Committee on Banking, Housing, and Urban Affairs, *Financial Services Industry – Oversight,* 98th Congress, 1st session, May 4, 1983, 548-9.

theoretically allowed S&L executives 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 might have allowed them to avoid many of the problems that S&Ls encountered in the later years of the 1980s. Instead they fervently justified their regulatory reform proposals with ideologically predicated arguments that favored market efficiencies and rationality over government regulation and support.

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."[492] McKinney clearly appreciated the operational and economic complexities of allowing, or in this case strongly encouraging, institutional lending into new fields, something his successors at the FHLBB had 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

[492] McKinney, "Savings and Loan Associations and the Cities."

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. Many policymakers, after the S&L industry collapsed, acted surprised that such a "conservative" industry could 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."[493]

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. The legislation also established criteria that disallowed lenders from offering unlimited loans to any one

---

[493] Wille, *Credit Crunch and Reform*, 427. Of the Representatives present for Wille's testimony, Representative Henry Reuss (D-WI), Representative Fernand St. Germain (D-RI), Representative Henry Gonzalez (D-TX), Representative Chalmers Wylie (R-OH), Representative John Rousselot (R-CA), Thomas Ashley (D-OH), William Moorhead (D-PA), and Stewart McKinney (R-RI) all subsequently voted yea on DIDMCA. Representative Reuss, Representative St. Germain, Representative Wylie, and Representative McKinney voted yea on either the original passage of H.R. 6267 in May 1982 and/or the conference report vote in September 1982.

borrower. Those rules were subsequently overturned by the Pratt-led FHLBB and/or eliminated by Garn-St. Germain.[494] 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.[495]

Just as important, policymakers during the 1960s and 1970s witnessed increased 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.[496] 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."[497] The "return to the market" opened new opportunities for speculative

---

[494] St. Germain tried to ban interlocking directorates in the financial sector and establish more rigid limits on loans to one individual or business and loans to financial executives/insiders. See Truth in Lending Simplification and Reform Act (1980), Financial Reform Act (1976), Institute Regulatory Bill (1978), Financial Institutions Regulatory and Interest Rate Control Act (1978).

[495] Memo, Stu Eizenstat and Robert Lipshutz to Jimmy Carter, February 7, 1978, Banking Reform – Banking (General) [OA 6236] [3], Box 150, Stuart Eizenstat Files, JC: DPS – Domestic Policy Staff, JCPL; Memo, Stu Eizenstat and Robert Lipshutz to Jimmy Carter, Feb 15, 1978, Banking Reform – Banking (General) [OA 6236] [3], Box 150, Stuart Eizenstat Files, JC: DPS – Domestic Policy Staff, JCPL; and Senate Committee on Banking, Housing and Urban Affairs, *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*, 94th Congress, 2nd session, December 9, 1976, 124-32. Carter administration officials, including President Carter, internally debated how to best replace Oakley Hunter and Lester Condon as directors of FNMA.

[496] Eichler, *Thrift Debacle*, 16-32; and Strunk and Case, *Where Deregulation Went Wrong*, 10. U.S. League President William O'Connell commissioned Norman Strunk and Fred Case to investigate how deregulation led the S&L industry astray over the course of the 1980s. Strunk was a former U.S. League president who first began working for the U.S. League in 1938 as a research assistant. Since, as McConnell explained, Strunk "led the business during its period of great postwar growth, when it grew from $25 billion to nearly $600 billion in assets and the League grew from a staff of 40 to more than 400." He retired in 1980 and, as such, in my mind he continued to represent the U.S. League as he interpreted and subsequently co-authored *Where Deregulation Went Wrong*. See also Memo, D.L. Parry to M.A. Jessee, April 5, 1977, Federal Home Loans, Box 30, JC CEA – Council of Economic Advisors, JCPL.

[497] Memo, D.L. Parry to M.A. Jessee, April 5, 1977.

behavior. 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.[498] 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 and to 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 the late 1970s and early 1980s through similar ideological lenses. Both pursued transformative 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. In

[498] Mason, *From Buildings and Loans*, 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. Memo, Godley to Butler, February 22, 1977.

this common approach they 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 more nuanced transformative 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 transformative deregulation within the executive agencies they oversaw—so fervently, in fact, they eventually sparked a public backlash.[499] Their differences, however, were of degree and not substance. Jimmy Carter's extensive regulatory reform achievements cleared the beachhead that 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 second layer lender governance mechanism.

---

[499] Eads, *Relief or Reform*, 235-64.

Chapter 5: Zombie Industry: FHLBB Chairman Gray Confronts Transformative Deregulation, 1983-1988

The savings and loan industry struggled mightily after 1982 without the cost-limiting effects of Regulation Q and the monopoly rent they earned from a legally segmented financial sector. Policymakers continued to rely upon the same misinterpretations and transformative deregulatory rhetoric that fueled the passage of DIDMCA and Garn-St. Germain in 1980 and 1982, respectively, as they subsequently tackled the newer, worsening symptoms of thrifts' gradual but fatal demise. Policymakers still failed to understand how the structural, institutional, and operational changes that occurred in the years after the 1966 credit crunch eliminated thrifts' market niche and, consequently, their financial, socio-economic, and political relevance. Thus, industry insiders, congressional leaders, and Reagan administration officials ignored the real, but insurmountable, existential threat to S&L viability, second layer lenders, as they pursued legislative and regulatory responses to continued thrift crises.

Just as important, transformative regulatory changes motivated by the ideologically motivated deregulatory ambitions of FHLBB Chairman Richard Pratt, Reagan administration officials, and several state legislatures also prohibited good-faith efforts by many industry executives from materializing in the years after Garn-St. Germain. Those collective deregulatory efforts, in addition to many policymakers increased utilization of rhetoric and policy justifications undergirded by tropes of market efficiency and rational expectations revealed how quickly the tenets of transformative deregulation had spread given its thorough infusion into the political lexicon over the course of the 1980s, and beyond.

Zombie Industry[500]

The dire circumstances that the S&L industry faced after 1982, as highlighted in Table 5.1, would have justified, political fallout notwithstanding, a decision by congressional and regulatory policymakers to liquidate the entire industry. Insolvent institutions, those with less than the 3 percent net worth capital requirement established by Congress and the Bank Board, managed 58 percent to 69 percent of the entire industry's assets between 1982 and 1986. Put another way, almost two-thirds of customers who applied for and received a loan from an S&L during that time did so at a financial institution that was deemed by its regulators to be financially insolvent.[501]

---

[500] Kane, "What Lessons Might Crisis Countries," 115. Edward Kane coined the term "zombie institution" in the late 1980s to describe how regulators allowed insolvent financial institutions to continue operating by guaranteeing their debt via deposit insurance and covering up their loss exposure. Such behavior, he claimed, enabled the often problematic lending policies of these troubled institutions to "escape the ordinary weight of depositor discipline," thereby enabling moral hazard and likely substantially increasing the eventual losses to a deposit insurance fund. Reagan administration officials also used the term to describe the insolvent thrifts whose negative tangible net worth worsened in 1987 and thereafter. See Memo, Redburn and Pittman to Crawford, August 27, 1987.

[501] The capital identified in Table 5.1 does not include goodwill assets. The FHLBB, beginning in January 1982, modified the reporting requirements and amortization schedules under generally accepted accounting principles (GAAP) and regulatory accounting principles (RAP) to allow goodwill assets. Goodwill was an intangible asset created during the acquisition process that provided the acquiring S&L an asset worth the difference between what the acquiring institution paid for any particular asset or group of assets and its market value. The FHLBB utilized goodwill to encourage healthy institutions to acquire unhealthy thrifts. Goodwill assets became important to many S&Ls because the FHLBB allowed them to include goodwill assets in their minimum net worth calculations. Mason detailed how goodwill enabled institutions to "literally manufacture earnings and capital" via the amortization process. It also provided a means, he argued, for cheaply reducing the number of problem thrifts. Thus, by year-end 1983, goodwill accounted for 67 percent of total RAP equity. Mason, *From Buildings and Loans*, 222.

Table 5.1. *Savings and Loan Capital-to-Asset Categories, 1980 – 1988 ($ in billions)*

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
> 6% Capital										
# of Institutions	1701	1171	787	661	643	806	972	1113	1136	1180
Total Assets	$181	$101	$59	$84	$62	$95	$156	$188	$196	$206
3% to 6% Capital										
# of Institutions	1956	1766	1202	1091	945	1009	995	891	864	813
Total Assets	$379	$348	$190	$222	$227	$259	$316	$356	$418	$480
1.5% to 3% Capital										
# of Institutions	230	524	592	569	526	460	354	277	281	245
Total Assets	$39	$113	$136	$185	$168	$212	$191	$196	$244	$206
0% to 1.5% Capital										
# of Institutions	63	178	291	310	327	266	227	194	160	120
Total Assets	$4	$50	$81	$88	$153	$135	$144	$143	$182	$59
> 0% Capital										
# of Institutions	43	112	415	515	695	705	672	672	508	239
Total Assets	$0.4	$29	$220	$234	$336	$335	$324	$336	$283	$192

Total Institutions	336	814	1,298	1,394	1,548	1,431	1,253	1,143	949	604
Total Assets	3,700	3,129	2,426	2,259	2,245	2,497	2,626	2,679	2,709	2,450
	Thrifts below 3% capital requirement									

Source: James Barth, Susanne Trimbath, Glenn Yago, "The U.S. Savings and Loan Crisis in Hindsight: Twenty Years Later," in *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James Barth, Susanne Trimbath, and Glen Yago (Norwell: Kluwer Academic Publishers, 2004), 221.

Moreover, the industry averaged a -1.76 percent profit margin in the six years after Garn-St. Germain passed. Only in 1983 and 1985 did thrifts manage to generate profit margins higher than 1 percent even though the industry had produced, on average, an 8.73 percent annual profit margin during the 1970s.[502] In response to this marked profitability weakness, congressional leaders and Bank Board regulators instituted a policy known as regulatory forbearance, allowing the insolvent thrifts, which totaled 40+ percent of all institutions in existence, to remain open in 1983, and 1984, and 1985, and 1986, and 1987, and 1988. The

[502] *S&L Factbook*, "Selected Significant Ratios of Federally Insured Savings Institutions."

regulators' intervention via regulatory forbearance and net worth certificates literally stopped the industry from collapsing earlier than 1989.[503]

Despite regulatory forbearance, several S&L institutions, like many of their commercial bank counterparts, did not survive the 1980s. The Bank Board closed or supervised the voluntary and involuntary mergers of 824 institutions between 1983 and 1988, as Table 5.2. illustrates. The 131 institutions that failed between 1983 and 1985 essentially never recovered from the economic calamity associated with high and volatile interest rates at the beginning of the decade.

Table 5.2. *S&L Failures and Mergers, 1982 – 1988*

	Number of Failures	Total Assets (in billions)	Estimated Costs (in billions)	Years Insolvent Before Closure	Supervisory Mergers	Voluntary Mergers
1982	73	$ 22,161	$ 1,500	.67	184	215
1983	51	$ 13,203	$ 418	1.3	34	83
1984	26	$ 5,567	$ 887	1.9	14	31
1985	54	$ 22,574	$ 7,420	2.2	10	47
1986	65	$ 17,567	$ 9,130	2.6	5	45
1987	59	$ 15,045	$ 5,667	2.9	5	74
1988	190	$ 98,083	$ 46,688	3.5	6	25

Source: Federal Deposit Insurance Corporation, *History of the Eighties: Lessons for the Future* (Washington D.C.: Government Printing Office, 1997), 168-9; and Barth, "The U.S. Savings and Loan Crisis in Hindsight."

But the 314 institutions that failed in 1986, 1987, and 1988 actually became insolvent, given the time lag between insolvency and failure, in mid-to-late 1984, thereby operating on borrowed time for several years thereafter. Bank Board regulators did try to identify and

[503] Edwin Gray, testimony, Senate Committee on Banking, Finance and Urban Affairs, Subcommittee on General Oversight and Renegotiation, *Deregulation and the Federal Home Loan Bank Board*, 98th Congress, 1st session, November 9, 1983, 4. Chairman Gray even acknowledged at a congressional hearing in November 1983 that, as of June 1983, four out of ten thrifts were "still in the red."

resolve some troubled institutions, but their efforts were thwarted by budgetary, political, and economic factors, many of which were well beyond their control.[504]

The failure of those several hundred institutions did, however, provide an apt analogy for the eventual death of the entire S&L industry, slow and costly. Nevertheless, the zombie industry lived to die another day, and that death eventually came when policymakers finally understood that the growth and saver system had been replaced by the second layer lender governance mechanism. This mechanism permitted any financial institution, but particularly mortgage companies, to easily originate, securitize, and sell mortgages. Consequently, thrifts were economically, politically, and socially irrelevant as they related to the continued promotion of, and mission to serve as conduits for, American homeownership. The decades-old national commitment to a special, government-ordained institutional provision for enabling homeownership as a public good had ended.

Thrifts Appear to Rebound

Even though congressional and regulatory policymakers could have liquidated the S&L industry after 1982, there was reason to hope at the time, however misguided it might have appeared in retrospect. Political and economic observers incorrectly identified volatile interest rates and undiversified asset portfolios as the causes of thrift instability. Many of those same political observers undoubtedly feared the budgetary and political implications of

---

[504] As Table 5.2 demonstrates, Bank Board regulators closed 328 S&Ls between 1982 and 1987. They conducted "supervisory mergers" for another 252 thrifts. The Bank Board also implemented various strategies for encouraging voluntary mergers for another 495 institutions, which included the "Management Consignment Program" and the "Southwest Plan." See also Black, *Best Way to Rob a Bank*, 41-62, 83-112; Eichler, *Thrift Debacle*, 86-146; and Arthur Leibold, Jr., "Some Hope for the Future, After a Failed National Policy for Thrifts," in *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James Barth, Susanne Trimbrath, and Glen Yago (Norwell: Kluwer Academic Publishers, 2004), 33-60 for examples of political interference and discussions on regulatory forbearance.

allowing the entire S&L industry to fail at the exact moment that President Reagan's supply-side tax cuts and deregulatory measures worked their way through Congress.[505] Additionally, some economic and institutional data could have been interpreted as evidence to indicate that the savings and loan industry had indeed rebounded after a treacherous beginning to the new decade. The S&L business, as seen in Table 5.3, witnessed record growth in its asset and liability portfolios, total inflows, total loans acquired, and net income after the passage of Garn-St. Germain.

Table 5.3. *Key S&L "Boom" Statistics, 1980 – 1988 ($ in billions)*

	Total Assets	Total Liabilities	Total Inflows[506]	Total Loans Acquired[507]	Net Income[508]
1980	$630	$621	$59	$98	$1.2
1981	$664	$659	$55	$73	($6.2)
1982	$706	$700	$92	$84	($5.9)
1983	$772	$819	$127	$197	$2.6
1984	$902	$977	$145	$245	$1.8
1985	$1,081	$1,070	$204	$259	$5.8
1986	N/A	$1,164	$311	$335	$3.3
1987	$1,262	$1,251	$271	$318	($5.1)
1988	$1,352	$1,351	$233	$295	($10.1)

Source: S&L Factbook, "Total Assets of All Savings Associations"; *S&L Factbook*, "Total Liabilities of All Savings Associations"; and *S&L Factbook*, "Statement of Operations of All Savings and Loan Associations."

Thrifts almost doubled, in nominal terms, both their asset and liability portfolios in the six years after 1982, demonstrating a clear faith on the part of American consumers that S&Ls were stable enough to attract new deposits, offer new service lines, and originate mortgages, including the newly authorized adjustable rate mortgages (ARM). Federal and state regulatory agencies even approved charter applications for 377 new institutions between

[505] Memo, Poole to CCEA, October 8, 1982; Regan, *Depository Institutions Amendments of 1982*, 644; and Black, *Best Way to Rob a Bank*, 9, 19.
[506] Total inflows equal mortgage loan repayments plus loans and loan participations sold to the secondary market.
[507] Total loans acquired equals mortgage loans originated plus loans and loan participations purchased from the secondary market.
[508] Net income calculated before tax expenditures deducted.

1983 and 1986.[509] And the U.S. League claimed as late as 1988 that "88 percent of the savings institution business was profitable."[510]

The American housing market, as Table 5.4 demonstrates, also appeared to confirm this economic resurgence. The sale of one-family homes and private apartment starts almost doubled in the four years after 1982.

Table 5.4. *Key Housing Figures, 1980 – 1986 (in thousands)*

	New 1-family Home Sales	Existing 1-family Home Sales	Private Apartment Starts (# of units)	Mobile Home Shipments
1980	545	2,973	331	222
1981	436	2,419	288	241
1982	412	1,990	320	240
1983	623	2,719	522	296
1984	639	2,868	544	296
1985	688	3,214	576	284
1986	750	3,565	542	244

Source: S&L Factbook, "New and Existing One-Family Homes Sold"; *S&L Factbook*, "Private Starts of Apartments"; and *S&L Factbook*, "Mobile Home Shipments."

And mobile home shipments surged as well. Americans, after years of economic and interest rate volatility, began once again to purchase homes in a volume that seemed to strengthen the weakened S&Ls, specifically, and the national economy, more broadly. Thus, the surging American economy, according to the Bank Board's Director of Office of Policy and Economic Research, provided the S&L industry with a projected one-, or two-, or three-year

---

509 Strunk and Case, *Where Deregulation Went Wrong*, 12. State regulatory agencies approved the charters for 245 of those institutions.

510 '89 *S&L Sourcebook*, 14. It is important to remember, however, that profitability did not equal institutional solvency, a difference that U.S. League officials undoubtedly understood as they constructed their yearly factbook. Of the 287 S&Ls identified as RAP insolvent in 1987, for example, all but 15 maintained negative earnings, but of the 480 GAAP insolvent institutions, 138 produced positive income streams. Thus, even though all of those institutions were insolvent, 153 were technically "profitable," and therefore included in the U.S. League's high profitability statistics. Memo, Wright to Crippen, September 16, 1987.

window of "breathing room regarding prices, real economic activity and, hopefully, interest rates."[511]

The Sick Gets Sicker: Thrifts after Garn-St. Germain

Despite the optimism, S&Ls in reality spent the decade sputtering along on life support, only surviving until 1989 because advantageous FHLBB regulatory policies and, paradoxically enough, a vibrant secondary mortgage market prevented the industry from dying sooner.[512] Several key metrics not only reveal how far removed thrifts became from their growth and saver mandate, they also highlight the extent to which the industry never recovered from the effects of the Volcker shock and its aftermath, which included controversial deregulatory measures instituted by FHLBB Chairman Pratt and several state regulatory agencies.[513]

Operational instabilities continued to plague thrift executives after the passage of Garn-St. Germain, despite the fact that the U.S. economy was steadily expanding by the end of 1983. Even as the industry lost 1,645 institutions between 1980 and 1988, executives maintained nearly 3,000 more branch locations, offering S&L leaders the opportunity to expand into new markets when interstate banking and/or branching was still illegal in many

---

[511] Eric Hemel, "The Financial Outlook for the Savings and Loan Industry," *Federal Home Loan Bank Board Journal* 12 (1984): 3.

[512] Mason, *Best Way to Rob a Bank*, 1-40. Several FHLBB regulatory changes allowed many thrifts to survive the 1980s, including lowering the minimum net worth to 3 percent, offering the net worth certificate program, allowing goodwill to count toward minimum net worth, instituting RAP reporting requirements, permitting 20-year phase ins for capital requirements, adjusting and/or eliminating loan-to-value ratios and limits on loans to one borrower, unsuccessfully limiting brokered deposits, permitting loan loss deferrals, and reducing the number of FHLBB examiners. Additionally, the underfunded FHLBB lacked the manpower and political competency to regulate and supervise the increasingly distressed S&L industry as the 1980s progressed.

[513] Ibid., 30-35. Pratt adjusted and/or eliminated loan-to-value ratios and rules limiting loans to one borrower, decreased the number of FHLBB examiners, altered regulations regarding S&L ownership requirements that subsequently allowed one person to own and operate a thrift, removed the 5 percent cap on brokered deposits, loosened conflict-of-interest regulations for S&L executives, reduced minimum net worth requirements to 3 percent, instituted RAP, and authorized a 20-year phase in capital requirement for *de novo* institutions.

states. S&Ls also employed almost 135,000 additional employees, undoubtedly contributing to an increase in employee compensation from 5.6 percent of total expenditures in 1982 to 8.8 percent in 1987.[514]

Table 5.5. *S&L Offices and Employee Totals, 1970 – 1988*

	Savings and Loan Offices		
	Main	Branch	Employees
1970	5,669	4,318	106,000
1975	4,931	10,518	169,700
1980	4,594	16,733	260,100
1981	4,298	17,495	265,000
1982	3,831	18,712	273,500
1983	3,645	18,635	312,900
1984	3,591	18,812	337,400
1985	3,535	19,186	361,100
1986	3,488	19,540	385,300
1987	3,408	19,664	399,400
1988	2,949	19,646	393,300

Source: *S&L Factbook,* "Number of Thrift Institution Offices and Personnel of Thrift Institutions."

And just as S&Ls had turned to Bank Board advances in the 1970s to combat recession-induced disintermediation, thrifts once again relied heavily upon Bank Board advances to compete in a more unstable savings market that simultaneously demanded higher rates of return and produced higher withdrawal ratios, two issues that required thrift executives to maintain more liquid and short-term liability portfolios.[515] In 1981, 1982, and 1988, for example, thrifts used Bank Board advances to cover the cost of all the mortgage loans they closed and purchased on the secondary market.[516] Both the rising costs from the

---

[514] *S&L Factbook,* "Total Expense of FSLIC-Insured Savings Institutions."
[515] *S&L Factbook,* "Savings at Insured Associations, by Type of Account." In 1970, passbook savings accounts represented 59 percent of all savings at S&Ls. They were only 21 percent by 1980 and 8.8 percent in 1988. They were replaced by a myriad of market-rate producing accounts that included money market certificates, NOW and Super NOW accounts, and jumbo certificates of deposit.
[516] *S&L Factbook,* "Mortgage Lending Activity of All Savings Associations." The balance of outstanding Bank Board advances exploded from $49 billion in 1980 to $152.8 billion in 1988. The withdrawal ratio for thrifts during the 1970s averaged 77.5 percent; for the first 5 years of the 1980s, it averaged 91.8 percent. Thus, thrifts were required to focus much more astutely on the short-term nature deposit cycle and maintain more efficient and effective liability management protocols. See *S&L Factbook,* "Savings Flows at All Savings Associations." Thrifts also began to lose market share in both the over-the-counter savings market and financial asset market.

additional branch locations and employees and the increased reliance upon Bank Board advances contributed to the drastic increases in operating costs that S&Ls experienced after 1982. Thrifts paid $5.8 billion in interest on borrowed money from the FHLBB in 1980; that rose to $21.1 billion in 1988.[517]

S&L executives encountered rising costs elsewhere as well. Their tax liabilities and total interest costs, as Table 5.6 demonstrates, rose substantially after 1982.

Table 5.6. *S&L Operational Expenditures, 1970 – 1988 (in millions)*[518]

	Operating Income	Operating Expense	Net Operating Income[519]	Tax Liability	Total Interest Costs
1970	$10,675	$1,902	$8,773	$241	$7,659
1975	$23,719	$3,949	$19,770	$634	$17,620
1980	$56,149	$7,936	$48,213	$409	$47,430
1981	$65,170	$8,883	$56,287	$(1,516)	$63,295
1982	$71,170	$9,936	$61,234	$(1,598)	$69,868
1983	$81,947	$12,534	$69,413	$593	$69,331
1984	$100,669	$15,437	$85,232	$764	$85,420
1985	$110,637	$19,577	$91,060	$2,087	$88,040
1986	$110,775	$22,939	$87,837	$3,141	$83,502
1987	$107,515	$24,176	$83,339	$2,699	$80,641
1988	$113,997	$23,931	$90,066	$1,952	$89,316

Source*: '89 S&L Factbook,* "Statement of Operations of FSLIC-Insured Savings Institutions," 52.

Operational expenses tripled after 1980 even though net income only doubled. Additionally, thrifts' total interest costs in nominal terms almost doubled in just nine years' time. As the DIDC phased out Regulation Q, interest costs as a percentage of net income rose drastically between 1980 and 1988, averaging 101 percent in those years. By way of comparison, over the course of the 1970s, thrifts had spent only 85 percent of their net income on interest

They, for example, held 17.3 percent of all financial assets in 1979, but by 1988, that number shrank to 15.2 percent, which amounted to a $200+ billion difference in the $8.9 trillion U.S. financial market in 1988. See *S&L Factbook,* "Total Assets of Financial Intermediaries at Year-End"; and *S&L Factbook,* "Over-The-Counter Savings."

[517] '89 *S&L Sourcebook*, "Statement of Operations Of FSLIC-Insured Savings Institutions," 52.

[518] To calculate net operating income, accountants tabulated operating income and then subtracted operating expenses. They then subsequently subtracted tax liability and total interest costs from net operating income to project profitability.

[519] Operating income minus operating expense totaled net operating income.

costs.[520] So gone were the days where Regulation Q capped interest rates, thereby limiting interest payments to savers, and therefore operational, costs for S&Ls and their commercial bank brethren. Uncapped rates rose in competition with rates paid by other types of financial institutions that sold alternative interest-bearing products. Unfortunately for thrift industry leaders, then, at the exact moment they attempted to resuscitate their mortally wounded industry, competitive forces created substantially higher operating costs for all American depository institutions.

The industry also intensified its pre-1979 tendency toward institutional concentration, as Tables 5.7 demonstrates. When extreme interest rate volatility first seriously entered the political and economic consciousness of many American policymakers in 1979, 84 S&Ls maintained $1 billion-plus asset portfolios.

Table 5.7. *S&Ls by Asset Size*

Assets > $1 billion, 1979-1988

	# of S&Ls	% of All S&Ls	Assets (in millions)	% of Total S&L Assets
1979	84	1.80%	$174,536	30%
1980	97	2.10%	$210,532	33%
1981	110	2.50%	$250,757	38%
1982	126	3.30%	$321,069	45%
1983	136	3.80%	$372,026	48%
1984	154	4.60%	$474,295	53%
1985	206	6.30%	$613,675	58%
1986	N/A	N/A	N/A	N/A
1987	232	7.40%	$801,852	63%
1988	243	8.30%	$922,835	68%

Assets < $100 million, 1979-1988

	# of S&Ls	% of all S&Ls	Assets (in millions)	% of Total S&L Assets
1979	3,509	75%	$119,450	21%
1980	3,367	73%	$119,197	19%
1981	3,104	71%	$110,554	17%
1982	2,615	68%	$89,310	13%
1983	2,226	63%	$83,311	11%
1984	2,028	60%	$81,087	9%
1985	1,725	53%	$78,076	7%
1986	N/A	N/A	N/A	N/A
1987	1,583	50%	$75,399	6%
1988	1,462	50%	$70,563	5%

Source: *S&L Factbook*, "Distribution of Savings Associations, by Asset Size."

That 1.8 percent of American thrifts controlled approximately 30 percent of the industry's assets, roughly totaling $55 billion more than the collective asset portfolios of the smallest

[520] *S&L Factbook*, "Statement of Operations of All Savings and Loan Associations."

3,509 institutions—or 75 percent of the industry. Not even a decade later, 243 institutions possessed $1 billion-plus asset portfolios, and that $55 billion spread between the country's largest and smallest S&Ls had exploded into a $736 billion disparity by 1988.[521]

The continued consolidation of the industry directly corresponded with and resulted from the conversion of mutual associations to stock charters. Whereas mutual fund associations only increased their capital through identifying new customers or increasing the deposit base of existing customers, stock chartered thrifts relied upon both outside investors and new/existing depositors for capital. Conversion provided desperate thrift executives the opportunity to recapitalize their institutions via the stock market and, particularly, brokered deposits, and many, many institutions did so in the 1980s.[522] The transition to stock charters corresponded with a deluge of money flooding into American thrifts.[523] Industry executives saw their liability portfolios double from $700 billion to almost $1.4 trillion in the five years after Garn-St. Germain. Most of that deposit growth funneled into newly converted stock institutions, which managed almost 74 percent of the industry's $1.4 trillion liability base by 1988.[524] The acute concentration of S&L assets, beyond its violation of longstanding American economic and political traditions that identified economic concentration as a direct threat to American democracy, boded ill for the S&L industry surviving the 1980s.

---

[521] *S&L Factbook*, "Distribution of Savings Associations, by Asset Size."
[522] 133 S&Ls converted from a mutual charter to stock charter between 1975 and 1982; 571 did so 1983-1988. See *S&L Factbook*, "FSLIC-Insured Stock Savings Institutions." Brokered deposits came from "money brokers" who pooled together large amounts of capital and then searched for the highest return. Many S&Ls over the course of the 1980s advertised higher than market returns for brokered deposits, which allowed them to simultaneously grow quite quickly and appear healthy and profitable. See Mayer, *Greatest-Ever Bank Robbery*, 6-7, 34-5, 64-6; Mason, *From Buildings and Loans*, 216-27, 293-4; and Strunk and Case, *Where Deregulation Went Wrong*, 91-3.
[523] Gray, *Deregulation and the FHLBB*, 5. Chairman Gray argued that stock conversions provided thrifts an "important source of new capital" as well as offered "added flexibility to the resulting institution."
[524] *S&L Factbook*, "FSLIC-Insured Stock Savings Institutions."

A stock charter provided institutions the opportunity to grow quite quickly. Since 1960, the industry's asset base grew, on average, 10 percent annually.[525] But due to recent changes in federal and state regulations, approximately one-third of S&Ls, as Table 5.8 highlights, expanded their asset portfolios more than 15 percent annually in the years immediately after Garn-St. Germain.

Table 5.8. *Key Characteristics of Savings Institutions by Annual Growth Rates in 1984*

Annual Asset Growth Rate	# of Institutions	Assets (in billions)	Real Estate as % of Assets	Brokered Deposits as % of Liabilities
< 5%	1,020	$218	1.31	1.83
5% - 10%	585	$109	1.13	0.46
10% - 15%	417	$116	1.20	0.84
15% - 20%	289	$73	1.78	1.39
20% - 25%	176	$82	1.88	2.40
25% - 30%	131	$62	3.54	2.79
30% - 50%	252	$168	3.91	5.85
> 50%	275	$115	7.43	11.24
	3,145	$943		

Source: Strunk and Case, *Where Deregulation Went Wrong*, 132.

Some political and economic observers at the time and since identified those institutions as "high flyers" with annual growth rates that appeared unhealthy and unsustainable.[526] High flyers, as the decade wore on, deteriorated into serious economic and political liabilities that adversely affected the S&L industry's ability to regain its economic vitality. Some 56 percent of high flyers operated in just three states, and those Texas, California, and Florida S&Ls

---

[525] *S&L Factbook*, "Total Assets of All Savings Associations." I calculated average asset growth by decade for the industry. In the 1960s and 1980s, they averaged 10 percent per year growth, even though the industry experienced above average growth 1961-1964 and 1983-1984. During the 1970s, the industry averaged 13 percent annual growth. See Case and Strunk, *Where Deregulation Went Wrong*, 89-97 (high flyers); and Mason, *From Buildings and Loans*, 220-34.

[526] Strunk and Case, *Where Deregulation Went Wrong*, 133. Given that 10 percent annual growth constituted a historically accurate data point for comparison, I identified an institution that grew more than 15 percent as a high flyer, especially given that institutions expanded, on average, at a 7.9 percent annual rate during the 1980s, excluding the anomalous growth years of 1983 and 1984.

managed 76 percent of assets under high flyer control.[527] As fate would have it, many of the most economically and ethically malfeasant thrift executives operated the fastest growing thrifts, and unfortunately for American taxpayers, S&Ls in Texas, California, and Texas produced the highest number and some of the costliest of institutional failures both before and after 1989.[528]

Turbulent U.S. Housing Markets

Long-term interest rates jumped almost 60 percent between 1979 and 1982 after Federal Reserve Chairman set his monetarist experiment in combating inflation in motion. The drastic increase in long-term rates, which averaged between 10.8 and 15.1 percent in the three years after the Volcker shock began, highly suppressed home starts in the U.S., which decreased from 2 million in 1978 to 1.1 million in 1982.[529] The perception of pent up demand, once rates began to drop after 1982, convinced developers to unleash a flurry of housing construction in 1983 and thereafter. Private apartment starts and mobile home shipments expanded significantly.[530] Private housing starts jumped 60 percent between 1982 and 1983 and peaked at 1.8 million starts in 1986. But the 1980s-housing boom looked

[527] Ibid. Many Texas S&Ls, in particular, became even more problematic for the FHLBB in the aftermath of the high-profile closure of Don Dixon's Vernon Savings and Loan, which included several political improprieties by then Speaker of the House Jim Wright (D-TX). See Black, *Best Way to Rob a Bank*, 107-10.

[528] Top 5 Failures by State, 1980 – 1988: Texas (100), Illinois (43), California (35), Louisiana (30), and Ohio (23). Top 5 Costliest Resolutions by State, 1980 – 1988: Texas ($21.9 billion), California ($6.6 billion), Illinois ($2.2 billion), Florida ($2.1 billion), and Louisiana ($1.3 billion). Top 5 Failures by State, 1980 – 1992: Texas (237), Illinois (90), California (90), Louisiana (78), and Florida (54). Top 5 Costliest Resolutions by State, 1980 – 1992: Texas ($49 billion), California ($16.8 billion), Florida ($9.1 billion), Arkansas ($6.3 billion), and Louisiana ($3.8 billion). See Congressional Budget Office, *Resolving the Thrift Crisis*, 90-3.

[529] *S&L Factbook*, "Long-Term Interest Rates." See also *S&L Factbook*, "Private Housing Starts, by Number of Family Units."

[530] *S&L Factbook*, "Mobile Home Shipments"; and *S&L Factbook*, "Private Apartment Starts." Mobile home shipments jumped from 239,600 in 1982 to 295,800 in 1983, a 24 percent increase. Shipments remained relatively steady before consecutive annual declines beginning in 1986. Similarly, the number of private apartments units built steadily rose from 319,600 in 1982 to 576,100 in 1985 before dropping significantly thereafter.

different from its 1970s counterpart. Only 30.5 percent of starts in the 1970s were not single-family homes; that number rose to 36.4 percent in the 1980s, a several hundreds of thousands unit difference.[531] Thus the growth in U.S. housing starts coincided, paradoxically enough, with a downturn in ownership rates, which fell from 65.6 percent in 1980 to 63.8 percent in 1988, the first sustained decline in U.S. homeownership since the 1940s.[532]

Further, the expected high demand for both single-family homes and apartment units never materialized, leaving developers with an oversupply of uninhabited and non-income producing properties whose construction they had funded, as Table 5.9 demonstrates. Many Americans, as interest rates spiked in the early 1980s, turned to rental apartment living to avoid higher interest-rate mortgages.

Table 5.9. *U.S. Housing and Apartment Figures, 1980 – 1988*

	Average # of Unsold Speculatively Built 1-Family Homes (in thousands)[533]	Average Apartment Absorption Rates	Rental Units Vacant	Home Owner Units Vacant
1980	352	74%	5.4%	1.3%
1981	312	80%	5.0%	1.4%
1982	257	72%	5.3%	1.5%
1983	283	68%	5.7%	1.5%
1984	333	67%	5.9%	1.7%
1985	353	65%	6.5%	1.7%
1986	348	66%	7.4%	1.6%
1987	360	63%	7.7%	1.7%
1988	365	66%	7.7%	1.6%

Source: *S&L Factbook*, "Apartment Absorption Rates"; *S&L Factbook*, "Rental Vacancy"; and *S&L Factbook*, "Inventory of Unsold Speculatively Built 1-Family Homes."

Only 20 percent of apartments took longer than ninety days (absorption rate) to become occupied in 1981. It was almost 40 percent six years later. Indeed, as the 1980s progressed,

[531] *S&L Factbook*, "Private Housing Starts, by Number of Family Units." Private housing starts includes 1-family home, 2-family units, 3- to 4-family units, and 5+ family units.
[532] *S&L Factbook*, "U.S. Ownership Rates."
[533] The U.S. League provided data on a monthly basis for the number of unsold speculatively built 1-family homes. I calculated the yearly average by aggregating the monthly totals and dividing by 12.

the speculative housing and rental markets actually worsened, a surprising development given both the decline in long-term interest rates and the incredible drop in the U.S. housing supply between 1979 and 1982. Almost twice as many apartments, for example, remained vacant after 90 days in 1987 than five years earlier. The oversupply of housing eventually proved to be a double whammy for the S&L industry since many institutions that abandoned home loan origination did so for ADC lending (construction loans) and direct investments (the S&L provided equity capital), both of which overwhelming funded real estate development projects, particularly in Texas, California, and Florida.[534]

Second layer lenders, both public and private, bailed out the struggling S&L industry between 1983 and 1986, as Table 5.10 reveals. Purchases by Freddie Mac, Fannie Mae, and mortgage pools (private institutions with mortgage-backed security operations) exploded, growing almost five times, two times, and five times, respectively, totaling $810 billion of purchases in just four years' time.

Table 5.10. *Second Layer Lender Purchases, 1980 – 1988 (in millions)*

	FHLMC		FNMA		Mortgage Pools	
	Purchases	Sales	Purchases	Sales	Purchases	Sales
1980	$3,723	$2,526	$8,099	$-	$29,355	$4,059
1981	$3,744	$3,532	$6,112	$2	$24,110	$3,829
1982	$23,671	$24,170	$15,116	$2	$59,204	$4,321
1983	$22,952	$19,638	$17,554	$3,528	$88,122	$5,410
1984	$21,885	$18,417	$16,721	$978	$68,218	$6,044
1985	$44,012	$38,905	$21,510	$1,289	$114,294	$5,535
1986	$103,474	$102,443	$30,826	$10,868	$260,435	$1,422
1987	$76,840	$75,018	$20,531	$5,020	$230,681	$277
1988	$44,075	$39,776	$23,110	$5,012	$148,436	$453

Source: *S&L Factbook*, "Federal Home Loan Mortgage Corporation Activity"; *S&L Factbook*, "FNMA Activity"; and *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender."

[534] Strunk and Case, *Where Deregulation Went Wrong*, 73-4. A 1986 study of Texas S&Ls, for example, identified 113 thrifts (out of a total of 281) as maintaining a net worth below the 3 percent minimum. Those institutions managed more than $37 billion in assets, totaling over 38 percent of all Texas S&L assets. Of that $37 billion in assets, 49 percent were "apartment, commercial, and land loans." Additionally, those same institutions grew, on average, 33 percent annually between 1982 and 1986.

The total number of mortgage purchases from those institutions, to put it in perspective, equaled the existing asset portfolios of the entire S&L industry at the time of its collapse.[535] Second layer lenders purchases of securitized mortgages, however, abruptly stopped and then dropped a whopping 83 percent after the 1987 stock market crash realigned many investors financial priorities. Thrifts, as a result, were forced to keep larger percentages of their asset portfolios, many of which by that time were full of non-performing and unsound loans.[536] Second layer lenders also increased their mortgage loan re-sales, creating stiffer competition in the secondary mortgage market in 1986 and 1987 at the exact moment when the FSLIC went bankrupt and the industry's non-performing and financially problematic loan portfolios became increasingly hard for policymakers in Congress and the Reagan administration to ignore.

Foreclosures and loan delinquency became an additional problem for thrifts. Roughly 20,300 mortgage loans held by S&Ls went into foreclosure in 1980, a total equaling only one-fifth of one percent of the industry's average balance of loans. By 1987, however, that number rose to 2.8 percent when 99,931 homes, equaling $18.4 billion in loan assets, went into foreclosure. Collectively, FSLIC-insured institutions between 1983 and 1987 saw more than 385,000 homes, totaling more than $51 billion, go into foreclosure.[537] S&Ls had another $149 billion in mortgage loans lapse into delinquency during the same stretch of time; moreover, 5.6 percent of their year-end balance in loans held was delinquent in 1987.[538] Just as problematic, thrifts net non-operating income, the gains or losses produced from atypical

[535] *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender." FNMA, FHLMC, and mortgage pools purchased $1.35 trillion in mortgage loans, 1983 – 1988.
[536] '89 *Savings Institution Sourcebook*, 55. The return on equity, which equals the net after-tax income divided by average capital, for the S&L industry in 1986, 1987, and 1988 was 0.27 percent, -15.77 percent, and -23.46 percent, respectively.
[537] *S&L Factbook*, "Mortgage Foreclosures by FSLIC-Insured Institutions."
[538] *S&L Factbook*, "Delinquent Mortgage Loans at FSLIC-Insured Institutions."

financial transactions, direct investments in real estate for example, generated $20.2 billion in losses in 1986, 1987, and 1988.[539] The confluence of the both U.S. housing and financial markets simultaneously constricting, however briefly, finally revealed to policymakers that the U.S. thrift industry could no longer bear its historical responsibility of promoting and enabling homeownership in an economically sound way and, consequently, must be wound down.

Thrifts Abandon the Growth and Saver System

Thrifts abandoned the small saver as they transitioned into their new deregulatory environment. Passbook savings accounts, which had already begun to fall out of favor during the 1970s, became even less relevant in the years after Garn-St. Germain.[540] Promoters of transformative and strategic deregulation alike claimed throughout the 1970s, as previous chapters demonstrated, that the small saver would benefit immensely from deregulatory changes because they would finally earn market rates on their savings and investment accounts. In reality, however, the average American suffered more than he or she benefitted from deregulatory policies.

Kenneth Thygerson, President and Chief Executive Officer of Freddie Mac, argued in 1983 that DIDMCA, Garn-St. Germain, and several new Bank Board regulations separated asset and liability portfolio management for thrift executives. And by incorporating those new changes into their operational strategies, he claimed, "portfolio strategy need not be

---

[539] Congressional Budget Office, *Resolving the Thrift Crisis*, 87.

[540] *S&L Factbook*, "Savings at Insured Associations, by Type of Account." Passbook savings accounts represented 21 percent of thrifts' liability portfolios in 1980; they dropped to 8.8 percent by 1988.

totally dominated by the consumer demands of the local marketplace."[541] Representative Mickey Leland (D-TX) feared deregulatory changes increased costs of capital and decreased its availability, thereby hurting most consumers and small businesses.[542] And Dr. Nicholas Didow, Professor of Business, University of North Carolina, outlined to Congress how financial institutions were "demarketing," meaning they directed their advertising and product lines toward well-to-do American families while ignoring "poorer" markets.[543]

Additionally, savings deposits interest as a percentage of total expenditures declined drastically, dropping from 72% of total expenditures in 1982 to only 53% by 1988 even as interest on borrowed money increased as a percentage of total S&L expenditures, demonstrating how S&Ls replaced the deposits from working- and middle-class savers with brokered deposits from institutional investors and pension funds.[544] S&Ls, but particularly high flyers, increasingly turned to brokered deposits (an investment instrument managed by a deposit broker who seeks out the highest returns possible), as Table 5.8 reveals, to fund their fast-paced growth, allowing many insolvent and/or malfeasant institutions to simultaneously continue their unethical and/or improper lending practices and distort savings markets by

---

[541] Kenneth Thygerson, "Thrifts and Deregulation: Freddie Mac's Role," *Federal Home Loan Bank Board Journal* 7 (1983): 4.

[542] House Committee on Energy and Commerce, Subcommittee, on Telecommunications, Consumer Protection, and Finance, *Financial Restructuring: The Road Ahead*, 98th Congress, 2nd session, April 4, 1984, 85, 95.

[543] Nicholas Didow, testimony, House Committee on Banking, Finance and Urban Affairs, *How the Financial System Can Best Be Shaped to Meet the Needs of The American People*, 98th Congress, 2nd Session, April 1984, 172. See also Barbara Rehm, "GAO Gives Deregulation Mixed Review," *American Banker*, July 13, 1987; Jack Harris, "Major Issues for Thrifts in the 1980s," *Federal Home Loan Bank Board Journal* 2 (1983): 9-11; and Ann Meyerson, "Deregulation and the Restructuring of the Housing Finance System," in *Critical Perspectives on Housing*, eds. Rachel Bratt, Chester Hartman, and Ann Meyerson (Philadelphia: Temple University Press, 1986), 68-98.

[544] *S&L Factbook*, "Total Expense of FSLIC-Insured Savings Institutions"; and *S&L Factbook*, "Savings at Insured Associations, by Type of Account." Interest on borrowed money increased from 10 percent of expenditures in 1980 to over 16 percent by 1988, a difference of hundreds of millions of dollars.

offering higher than market returns in an effort to attract more customers and grow their deposit bases.[545]

Many savings options at S&Ls still required mandatory minimum balances, established by either the Bank Board or the Depository Institutions Deregulation Committee (created by DIDMCA), that ranged between $1,000 and $2,500 until as late as 1986. Savers who sought to earn interest but could not meet those deposit requirements were excluded. Institutions could still establish minimum balances thereafter if a customer wanted to avoid service charges and/or earn interest on their deposits.[546] Jumbo CDs ($100,000+) and "fixed maturity" accounts, those that required considerable capital outlays for extended periods of time, represented almost 75 percent of deposits at thrifts between 1982 and 1988, a significant departure for the practice of institutions whose liability portfolios historically had come from working- and middle-class American families who could not afford to take advantage of new financial instruments such as jumbo CDs.[547]

State Savings and Loan Association, a subsidiary of Financial Corp. of America located in Walterboro, South Carolina, reflected the values and practices of a post-growth and saver S&L institution. State Savings "aggressively" went "after the kinds of loan business that return a solid profit." Their executive team, for example, projected that 70 percent of their $1.3 billion asset portfolio would fund real estate development projects. Charles Knapp, Financial Corp.'s chairman, described other savings and loan managers as "living in yesteryear" and prohibited his staff from attending industry conventions for fear of their being "infected with S&L mentality." State Savings abandoned small savers and home

---

[545] See also Black, *Best Way to Rob a Bank*, 1-16; Mayer, *Greatest-Ever Bank Robbery*, 126-8; and Strunk and Case, *Where Deregulation Went Wrong*, 91-3.
[546] '89 *S&L Sourcebook*, 7.
[547] *S&L Factbook*, "Savings at Insured Associations, by Type of Account."

buyers, “S&Ls’ traditional customers,” and the “traditional branch-office organization” of thrifts, because according to Knapp, “the small saver is gone forever.”[548] Just as important, Joseph Reppert, President of AmeriFirst Mortgage Corporation in Miami, FL, also observed in early 1984 how the “savings and loan business in the last three years…has changed completely.” “Unfortunately,” he explained, “a lot of people are still doing business as they used to, with only modifications.” “Considering today’s situation,” Reppert concluded, “I don't believe that is a viable way to proceed.”[549]

The thrift industry, more generally, and high flyers, in particular, also deviated from its historical housing niche, despite many congressional and thrift executives’ public declarations to the contrary, in the years following the passage of Garn-St. Germain.[550] The lowered importance of home loan origination to S&Ls only further demonstrated their abandonment of their growth and saver mandate. Consequently, as a result of thrifts shift away from mortgage origination, in addition to the unaffordability of mortgages,

---

[548] G. Christian Hill, “Solo Flight,” *Wall Street Journal*, April 6, 1981.

[549] Joseph Reppert, “Competing in the Current Marketplace,” *Federal Home Loan Bank Board Journal* 12 (1984): 20.

[550] Examples of congressional and S&L executives publicly declaring that S&Ls will primarily remain housing lenders. Ken Thygerson claimed mortgage loans “will remain the most important business line by a wide margin.” See Thygerson, “Thrifts and Deregulation,” 4. Edwin Gray, “Gray Urges Congress,” *Federal Home Loan Bank Board Journal* 9 (1983): 2-4. Chairman Gray, for example, aimed to dispel the “misinformation and myth-making” about the ways in which thrift institutions had become synonymous with commercial banks, since the passage of Garn-St. Germain, even though “vast difference” between the two types of depository institutions still existed. See Gray, *Deregulation and the FHLBB*, 2-6. Congressman Frank Annunzio (D-IL) declared in November 1983, “Happy this morning that you reemphasize that this deregulation act was to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions.” See *Deregulation and the FHLBB*, 3. Representatives Joseph Minish (D-NJ) also equated S&Ls with housing. See *Deregulation and the FHLBB*, 1-2. William McConnell, President of the U.S. League of Savings Institutions, declared to Congress in 1983, “There is little question in my mind that the vast majority of savings institutions will continue in the business that they know best, that of residential mortgage lending.” See McConnell, *Financial Services Industry* – Oversight, 548-9. John Zellars, Vice President, U.S. League, advocated to Congress that S&Ls, while operating in such a volatile and expensive economic climate, needed to attract capital and maintain their home loan niche. See John Zellars, testimony, House Committee on Banking, Finance and Urban Affairs, *How the Financial System Can Best Be Shaped to Meet the Needs of The American People*, 98th Congress, 2nd Session, June 7, 1984, 1300-20.

homeownership rates fell from a postwar high of 65.6 percent in 1980 to 63.8 by 1988.[551] Congressman Henry Gonzalez, for example, while attending a congressional oversight hearing on the future relationship between deregulation and the Federal Home Loan Bank Board, lamented the "erosion and final dissolution of the financial institutional underpinning for housing."[552] That decline, in no small part, resulted from S&Ls shifting their investment priorities elsewhere. In 1970, for example, mortgage loans represented almost 86 percent of the industry's total asset portfolio, and as late as 1980 it still remained at 80 percent. These loans fell steadily thereafter, dropping to just 54 percent by 1988.[553] For many high flyers, it declined to just 32 percent of assets.[554] As one more striking example, the U.S. League even maintained three subcategories of mortgage loans: "home construction," "home purchases," and "all other purposes," and within those subgroups, S&Ls experienced a rapid decline in the origination of "mortgage loans" that funded either home construction projects or home purchases, a rate falling from 84 percent in 1980 to 62 percent by 1984.[555]

The decline in S&L home loan lending, in part, denoted the industry's continued loss of market share as the financiers of U.S. homeownership, as Table 5.11 and Table 5.12 reveal.

---

[551] *S&L Factbook*, "U.S Ownership Rates." The cost of housing became increasingly more expensive as the cost of credit rose due to interest rate volatilities. As Stone explained, "During the 1950s, about two-thirds of all families could have afforded the typical new house; by 1970 the proportion had declined to one-half, by 1976 to just one-fourth, and by 1981 to less than one-tenth." See Stone, "Housing and the Dynamics of U.S. Capitalism, 55-6.
[552] Gonzalez, *Deregulation and the FHLBB*, 2.
[553] *S&L Factbook*, "Total Assets of All Savings Associations."
[554] Strunk and Case, *Where Deregulation Went Wrong*, 82.
[555] *S&L Factbook*, "Mortgage Loans Made by FSLIC-Insured Institutions, by Purpose of Loan." The U.S. League created those categories and used them to track the ebb and flows of the mortgage origination business.

Table 5.11. *Total Residential Mortgage Loans Outstanding and Savings Associations' Share*

	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988
S&Ls share of total residential market, year-end	46%	42%	41%	35%	32%	32%	30%	N/A	28%	26%
S&Ls share of total residential market, yearly increase	68%	28%	21%	N/A*	0.6%	32%	12%	N/A	15%	24%

* Incalculable since the thrift industry actually subtracted from 1982's yearly increase.
Source: *S&L Factbook*, "Total Residential Mortgage Loans Outstanding and Savings Associations' Share."

Table 5.12. *Sales of Mortgage Loans, S&Ls versus Mortgage Companies (millions of dollars)*

	S&Ls	S&Ls % of Total	Mortgage Companies	Mortgage Companies % of Total	Total
1970	$996	5%	$12,509	66%	$18,933
1971	$2,013	8%	$15,777	66%	$23,899
1972	$3,582	12%	$17,831	58%	$30,647
1973	$3,416	11%	$17,727	58%	$30,395
1974	$3,527	13%	$16,164	59%	$27,562
1975	$5,234	15%	$16,324	46%	$35,290
1976	$8,641	18%	$19,144	41%	$47,065
1977	$14,124	21%	$33,457	50%	$67,474
1978	$15,775	19%	$42,602	51%	$82,815
1979	$18,667	21%	$51,325	57%	$90,153
1980	$16,140	21%	$36,987	48%	$77,129
1981	$12,832	20%	$30,492	47%	$65,242
1982	$54,446	48%	$30,893	27%	$113,285
1983	$54,194	33%	$70,362	43%	$163,410
1984	$64,097	40%	$56,571	36%	$158,708
1985	$103,217	46%	$78,009	35%	$224,262
1986	$164,585	39%	$181,155	43%	$418,900
1987	$123,579	34%	$166,478	45%	$366,604
1988	$107,208	37%	$123,125	42%	$290,024

Source: *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender."

The steady loss of thrifts' market share of both the year-end S&L mortgage portfolio and the yearly increase in the U.S. housing market began in 1976, and continued essentially unabated thereafter. Mortgage companies, with their easy access to the highly liquid secondary

mortgage market, usurped S&Ls as the industry's key mortgage originator, selling over $1 trillion of mortgages between 1970 and 1988 when S&Ls only sold $776 billion during the same time period. Thrifts, beyond their inability to maintain profitability and solvency due to the volatile, high interest rates of the early 1980s, suffered an additional stroke of bad luck as they could no longer fall back upon their historical bread and butter, home loan origination, to produce new, higher revenues.

Just as problematic, they did not have the resources to originate new home loans as their yearly inflows (mortgage loans repaid plus sales to secondary markets) could not keep pace with demand.[556] Thus, they were forced to rely upon a more expensive form of credit, the Bank Board advance, to make up the difference, just as they had throughout the late 1960s and 1970s when institutions were plagued by recessionary disintermediation. As a result, the industry's annual borrowing from the Bank Board exploded over the course of the 1980s, ballooning 370 percent between 1980 and 1988.[557] So, ironically enough, even as the Reagan administration gutted funding for public housing, America's S&Ls served as semi-public financial intermediaries that indirectly, and albeit insufficiently, subsidized U.S. homeownership, also demonstrating the chimeric nature of the administration's deregulatory agenda.[558]

As the U.S. housing and financial markets became more volatile in the early 1980s, thrifts relationship to the secondary mortgage market fundamentally changed, as Table 5.13

---

[556] *S&L Factbook*, "Mortgage Lending Activity of All Savings Associations." Inflows only generated enough funds to cover, on average, 74 percent of mortgage loans closed and purchased by S&Ls between 1980 and 1988, excluding the anomalous year of 1982.
[557] *S&L Factbook*, "Mortgage Lending Activity of All Savings Associations." Thrifts borrowed $64 billion in advances in 1980, by 1988, it totaled $299 billion.
[558] *S&L Factbook*, "Subsidized Housing Starts"; and *S&L Factbook*, "Public and Private Housing Starts." In 1980, subsidizing housing starts represented almost 10 percent of all housing starts in the U.S. By 1986, however, they fell to just 0.5 percent. Similarly, 16,100 public units were built in 1980, that number dropped to 2,200 by 1987.

highlights. Beyond second layer lenders and mortgage pools, S&Ls purchased the highest percentage of mortgage-backed securities among depository institutions during the 1970s, thereby utilizing the secondary market to help maintain the IRS-mandated percentage of mortgage loans in their asset portfolios.[559] But that all changed in the early 1980s.

Table 5.13. *S&L Purchases and Sales of Mortgage Loans on Secondary Market, 1970 – 1988 (in millions)*

	Purchases			Sales		
	S&Ls	Total	S&L %	S&Ls	Total	S&L %
1970	$3,694	$16,406	23%	$996	$18,933	5%
1971	$7,508	$21,668	35%	$2,013	$23,899	8%
1972	$10,550	$29,305	36%	$3,582	$30,647	12%
1973	$7,019	$27,567	25%	$3,416	$30,395	11%
1974	$5,865	$28,939	20%	$3,527	$27,562	13%
1975	$8,471	$38,604	22%	$5,234	$35,290	15%
1976	$13,088	$48,687	27%	$8,641	$47,065	18%
1977	$14,791	$64,004	23%	$14,124	$67,474	21%
1978	$11,188	$72,867	15%	$15,775	$82,815	19%
1979	$12,235	$81,755	15%	$18,667	$90,153	21%
1980	$13,189	$78,144	17%	$16,140	$77,129	21%
1981	$10,596	$66,117	16%	$12,832	$65,242	20%
1982	$23,724	$118,621	20%	$54,446	$113,285	48%
1983	$44,966	$189,856	24%	$54,194	$163,410	33%
1984	$64,623	$190,176	34%	$64,097	$158,708	40%
1985	$64,992	$257,674	25%	$103,217	$224,262	46%
1986	$71,255	$497,894	14%	$164,585	$418,900	39%
1987	$64,608	$428,398	15%	$123,579	$366,604	34%
1988	$55,613	$334,235	17%	$107,208	$290,024	37%

Source: *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender."

[559] In 1966, IRS regulations on bad debt reserves and asset portfolios affected how S&Ls calculated their federal tax liabilities. An institution could allocate up to 60 percent of its net income after dividends into a bad-debt reserve, the remaining 40 percent of net income was taxable. Additionally, the IRS established an "asset test" to determine whether an institution qualified as an S&L and, therefore, the special taxation on bad-debt reserves, requiring approximately 70 percent of a thrift's assets be home loans. See *S&L Factbook 1967*, 89-90. By 1983, the IRS established three criteria for an S&L to qualify their special tax status as a "domestic building and loan association." One, an institution was supervised by a federal or state regulatory agency (supervisory test). Two, at least 75 percent of an association's deposits were held by the general public and at least 75 percent of gross income derived from mortgage loans (operations test). Three, at least 60 percent of a thrift's assets were cash, residential mortgages and other specified assets (asset test). See *'83 Savings and Loan Sourcebook*, 12. Historically mortgages represented roughly 85 percent of thrifts asset portfolios until 1974, when it began to drop thereafter, falling to 80 percent by 1980 and just 54 percent in 1988. *S&L Factbook*, "Total Assets of All Savings Associations."

S&Ls quickly and decisively turned then the secondary market to supply liquidity for their cash-strapped institutions. The President and Chief Executive Officer of Freddie Mac, for example, claimed that the FHLMC had developed programs and securities that "can greatly assist the thrift industry with asset and liability management in today's volatile economic climate."[560] Thrifts, as a result, evolved into one of the two top sellers of mortgage loans after 1982.[561] As sales to secondary markets exploded from $54 billion in 1982 to $146 billion in 1986, thrifts' total inflows, the funds they relied upon to fund their lending operations, increasingly came from domestic and international investors, not American working- and middle-class savers.[562] But even more important, the secondary market helped the thrift industry appear financially solvent and socially relevant as it provided much needed capital while also serving as a repository for S&Ls to offload significant portions of their asset portfolios. Shifts in the U.S. mortgage market, however, particularly as they related to rising foreclosure and delinquency rates and declining second layer lender activity after the 1987 stock market crash, finally revealed S&Ls pre-existing fatal condition. They also helped expose the problematic lending practices that proliferated after the deregulatory changes initiated by DIDMCA, Garn-St. Germain, and federal and state regulators. Those shifts also initiated the sequence of events that ultimately led to the industry's demise.

---

[560] Thygerson, "Thrifts and Deregulation," 3.
[561] *S&L Factbook*, "Purchases and Sales of Mortgage Loans, by Lender." Mortgage companies and S&Ls competed for the largest seller to the secondary market, with S&Ls selling more in three out of the seven years between 1982 and 1988. Collectively, though, mortgage companies and thrifts sold 75-80 percent of the $1.7 trillion worth of mortgage loans onto the secondary mortgage market 1982-1988.
[562] *S&L Factbook*, "Inflows from Mortgage Portfolios at Insured Associations." Total inflows equaled mortgage loan repayments plus sales to secondary mortgage markets. Secondary mortgage market sales as a percentage of total inflows in 1980 equaled 27 percent. That total almost doubled to 47 percent by 1985. The Trust for Investments in Mortgages (TIM) was one new mortgage instrument the Reagan administration endorsed. TIMs modified the rules governing tax-exempt trusts by re-investing early payoff proceeds instead of distributing prepayments directly to the securities holders, which consequently allowed second layer lenders to offer predictable and timely earnings for their MBS investors. Memo, Roger Porter to Cabinet Council on Economic Affairs, February 28, 1984, FG 010-02 Cabinet Councils, Box 61, Federal Government Organizations, RRPL.

Richard Pratt's Transformative Deregulation

As the S&L industry's condition worsened in the years after Congress passed Garn-St. Germain, policymakers in the Reagan administration, the U.S. League, and federal and state legislatures and regulatory agencies continued to promote several, often contradictory, solutions to the persistent and escalating problem of thrift instability. Most economic and political observers agreed that the impact of technological innovation, unconstrained interest rates, and new financial instruments demanded a reconsideration of the financial regulatory structure, especially given the crisis-driven nature of American regulatory development.[563] Times changed, and hindsight hopefully provided additional socio-economic and historical knowledge and insights that required a reassessment of older regulatory practices, as Council of Economic Advisor member William Poole suggested, to decide "whether the conditions that gave rise to regulatory intervention still exist."[564] The failing thrift industry, then, presented a unique opportunity for the advocates of both strategic and transformative deregulation to pursue policy objectives that would fundamentally reshape the American housing and savings markets, specifically, and the financial sector more broadly.

Most Reagan administration officials advocated for the deregulation of the entire American economy on overtly ideological grounds that looked to market-based solutions. Federal Home Loan Bank Board Chair Richard Pratt was no exception. Chairman Pratt

---

[563] Memo, William Poole to Task Group on Regulation of Financial Services, November 18, 1983, Staff Report of the Task Group on Regulation of Financial Services, 12/10/1983 (11), Box 6, OA 17742, Beryl Sprinkel Files, RRPL, 1-2. The technological innovations and new financial instruments that Poole referenced included: computers, ATMs, NOW accounts, money market mutual funds, and mortgage-backed securities. Much of the regulatory framework that existed in the 1980s had been in place since the 1930s, the last national extended episode of financial distress in the United States. But some researchers, such as Milton Friedman and Anna Schwartz, who questioned the interpretations offered by 1930s policymakers and, subsequently, their policy prescriptions for resolving depository institution instability during the Great Depression. See Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, 1971).
[564] Memo, William Poole to Task Group on Regulation, November 18, 1983, 10.

aimed to revive the struggling thrift industry by focusing on two key factors—institutional size (industry consolidation) and portfolio diversification. S&Ls, he argued, needed to simultaneously diversify their asset portfolios through more varied types of lending, a solution that might resolve thrifts problem of borrowing short and lending long. They also needed to increase their liability portfolios via brokered deposits and stock conversions, thereby growing their way back into solvency and consolidating an inefficient and overextended industry.[565] Garn-St. Germain provided opportunities for both asset and liability modifications as it, among other things, mandated the creation of a thrift money market account, eased charter and conversion processes, and authorized S&Ls to hold up to 75 percent of their assets in commercial mortgages, direct investments, consumer loans, and secured and unsecured commercial loans.[566] Chairman Pratt proudly proclaimed to Congress in early 1983 that the "bi-partisan cooperative effort" that produced Garn-St. Germain had identified and resolved the "underlying structural problems of the S&L industry by providing the industry with the tools to operate effectively over all phases of the economic cycle."[567] The "year 1982 be [sic] looked upon as a major turning point for the S&L industry," Pratt portended, because of the legislation's perceived recuperative powers.[568]

---

[565] Richard Pratt, "1982 Annual Report to Congress," *Federal Home Loan Bank Board Journal* 4 (1983): 4-5. See also Mayer, *Greatest-Ever Bank Robbery*, 57-89; and Sloan, *Reagan Effect*, 187.

[566] *'83 S&L Sourcebook*, 55. The U.S. League identified the key provisions as the following. "For all depository institutions, authorized a new savings account directly competitive with money market funds; authorized public unit NOW accounts; preempted or severely limited state due-on-sale clause and alternative mortgage loan restrictions; granted broader powers to the federal deposit insurance corporations; mandated the phase-out of the savings interest rate different by January 1, 1984. For insured institutions with deficient net worth, provided FSLIC and FDIC assistant to bring net worth to required levels, in the form of insurance corporation notes exchanged for net worth certificates issued by the institution. For savings institutions, eased charter and conversion limits. For federal associations, created or expanded authority to invest in consumer, commercial and agricultural loans and other investments; authorized the acceptance of demand deposits from business and agricultural loan customers; removed mortgage loan-to-value ratio limits; permitted investment in tangible personal property for lease or sale up to 10 percent of assets." *'83 S&L Sourcebook*, 69.

[567] Pratt, "1982 Annual Report to Congress," 4. Many observers identified thrifts' inability to earn higher returns, i.e. their undiversified asset portfolios, as a key problem to overcome in the early 1980s.

[568] Ibid., 5.

Chairman Pratt was no political hack; in fact he had served as an economist at the U.S. League shortly after earning his PhD in Business Administration from Indiana University in 1966.[569] He fully understood, even after Congress passed Garn-St. Germain, that many problems still plagued the S&L industry. He identified the moral hazard associated with deposit insurance since it essentially privatized profits from questionable S&L operational strategies while simultaneously publicly subsidizing losses incurred by the insurance fund, thereby encouraging S&Ls to go for broke regardless of the fiduciary consequences. Additionally, Pratt criticized how "one hundred percent insurance has allowed institutions with substantial operating or credit weaknesses to attract unlimited amount of funds even as the institutions may be rapidly approaching insolvency." The Bank Board and the FSLIC, he suggested, needed to develop strategies to re-introduce market discipline in the S&L industry since the "existence of uninsured providers of funds at the margin is imperative to preserve the viability of the present financial institutions system" by forcing investors to risk suffering significant losses if an institution failed.[570]

Just as important, Pratt comprehended how the "lack of aggressive pursuit of managers who breach their fiduciary responsibility has greatly weakened the discipline associated with the operation" of thrifts. In consequence, he argued institutions needed to "generate better management information" and make it available to both regulators and market observers alike. Pratt also advocated for risk-weighted asset requirements, years before the Basel Committee on Bank Supervision recommended their implementation. Such demands on the thrifts would "assure a better allocation of resources nationally," provide institutions "greater choice as to the risk-return relationships which they may choose, and

[569] Mayer, *Greatest-Ever Bank Robbery*, 60.
[570] Pratt, "1982 Annual Report to Congress," 5.

give thrifts "some control over the insurance premium which they pay, he insisted."[571] If Pratt's Bank Board, ironically enough, had resolved the problems that he identified, the resolution costs of thrift failure would have almost undoubtedly been substantially smaller.

But despite Pratt's economic and financial acumen, his regulatory initiatives as chairman revealed a singular focus—the transformative deregulation of America's 4,298 thrift institutions toward more competition in a variety of asset markets.[572] Toward that end, Pratt's Bank Board aimed to eliminate institutional specialization and end regulation of the American financial sector around a prescribed function for each type of institution. The Bank Board, in 1982 alone, adopted 51 new regulations and proposed an additional 28 that further "streamlined and deregulated" thrifts.[573] Even after the "great amount of deregulation and change" that occurred as of May 1983, Pratt still believed, "we are perhaps only halfway through the process. Previous changes inevitably dictate further reform of the regulatory framework."[574] But many of the regulatory changes instituted under Pratt's leadership negatively affected the thrift industry's ability to reorient itself to the new socio-economic circumstances that it faced and, unfortunately for American taxpayers, substantially increased the eventual resolution costs when Congress and the Bank Board finally laid the S&L industry to rest. The Bank Board, for example, significantly altered S&L ownership

---

[571] Ibid. The Basel Committee on Bank Supervision issued its first risk-weighted asset test in 1988.
[572] Mason, *From Buildings and Loans*, 219-20; and Black, *Best Way to Rob a Bank*, 29. His role as chief architect of Garn-St. Germain, as highlighted by Mason and Black, clearly demonstrated Pratt's intention of moving the industry in a new regulatory direction.
[573] Pratt, "1983 Annual Report to Congress," 5. The Bank Board, for example, authorized S&Ls to exclude from liabilities in computing net worth certain contra-asset accounts, including loans in process, unearned discounts, and deferred fees and credits; borrow outside of the FHLB system (advances); count subordinated debt securities, mutual capital certificates and certain other items toward net worth and statutory reserve requirements; and establish a net worth certificate program that provided forbearance to institutions maintaining between 0.5 percent and 3 percent net worth (still insolvent).
[574] Richard Pratt, testimony, Senate Committee on Banking, Housing, and Urban Affairs, *Financial Services Industry – Oversight*, 98th Congress, 1st session, April 27, 1983,185.

requirements, allowing one person to own and operate a thrift when it previously required 400 stockholders and no one person or ownership group with more than 25 percent ownership stake in an institution.[575]

Other Bank Board regulatory changes under Chairman Pratt also appeared to violate its fiduciary and regulatory responsibility of maintaining a healthy S&L industry. The Bank Board, as early as 1981, adjusted loan-to-value (LTV) ratios to 95 percent on balloon payment mortgage loans, creating a situation where a borrower maintained little to no equity stake in a property. In 1983 the board eliminated LTV ratios on various types of secured loans altogether.[576] It removed the 5 percent limit on brokered deposits in 1981 as well, and barely a year later 485 thrifts acquired $15.6 billion in brokered deposits—a five-fold increase.[577] The industry, due to its newly authorized money market account offerings and increased access to brokered deposits, dramatically expanded its liability portfolio by 1985, growing from $659 billion to $1.1 trillion as Table 5.3 highlighted—a 67 percent increase—in just 4 years. Consequently, the institutional importance of passbook savings accounts continued to decline as they dropped from 21 percent of liabilities in 1980 to just 10 percent in 1985.[578]

---

[575] Mayer, *Greatest-Ever Bank Robbery*, 63. Previous regulations required that 125 shareholders of an S&L reside in the community it served. William Black demonstrated how various Bank Board changes, but particularly S&L ownership requirements, created a "criminogenic" environment that almost demanded that thrift executives recklessly grow their institutions due to the moral hazard associated with deposit insurance and the Bank Board's lax rules regarding net worth tabulation. This change almost unilaterally allowed financial fraud to occur in ways that would have been almost impossible otherwise. See Black, *Best Way to Rob a Bank*, passim. See also Mason, *From Bailouts and Loans*, 213-40.
[576] Black, *Best Way to Rob a Bank*, 1-16. One clear problem of higher LTV ratios was that the borrower maintained little to no equity stake in a property. This became highly problematic once thrifts began lending to commercial developers after the passage of Garn-St. Germain. Many S&Ls, particularly in Texas, California, and Florida, required no down payment and accepted the funded-asset as collateral.
[577] Strunk and Case, *Where Deregulation Went Wrong*, 92.
[578] *S&L Factbook*, "Savings at Insured Associations, by Type of Account."

The Pratt Board also fundamentally restructured how institutions calculated and maintained their net worth in order to make the industry appear more solvent than it might otherwise. The Bank Board lowered the industry's minimum net worth requirement to 3 percent in December 1981; it had been 5 percent just two years earlier.[579] The Bank Board also discontinued an asset-based reserve requirement while simultaneously allowing institutions to utilize accounting metrics from two difference standards, generally accepted accounting principles (GAAP) and regulatory accounting principles (RAP).[580] GAAP, Pratt argued, failed to account for "real changes in the performance of financial institutions," which possibly led to "managerial behavior which seeks certain historical cost accounting results but which actually damages both the institution, the insurance corporation, and the regulator."[581] Chairman Pratt called them "creative regulatory accounting principles," and given how S&L executives utilized those accounting measures to further defraud their institutions, the CRAP acronym seemed fitting. The decision to revise net worth requirements further exacerbated eventual industry losses as they allowed thrift executives to take advantage of "goodwill assets," "appraised equity capital," and loan loss deferrals as accounting mechanisms to arbitrarily bolster their institutional net income and, therefore, their institutional net worth.[582] The accounting gimmick worked, for a time being at least, though as Table 5.14 demonstrates, almost 300 fewer institutions were technically insolvent

---

579 Strunk and Case, *Where Deregulation Went Wrong*, 30. The lower net worth requirement was problematic because the Bank Board maintained a 1972 ruling that "permitted institutions to average year-end savings account balances over five years when computing the savings account base against which the required percentage of reserves had to be determined."
580 Ibid., 30-1.
581 Richard Pratt, "1982 Annual Report to Congress," 5.
582 Black, *The Best Way to Rob a Bank*, 20. Pratt even needed to negotiate with the Financial Accounting Standards Board (FASB) to get the loan loss deferral approved. See Mayer, *Greatest-Ever Bank Robbery*, 67-73.

in 1987 under RAP reporting requirements, and only 21 percent of industry assets were controlled by insolvent institutions instead of almost one-third under GAAP.[583]

Table 5.14. *Current Savings Institution Net Worth Distributions (as of June 30, 1987)*

	RAP Net Worth		GAAP Net Worth	
Range of Net Worth as a % of Assets	Number	Assets (in billions)	Number	Assets (in billions)
Less than 0.0	355	$95	506	$144
0.0 to 1.0	51	$51	97	$76
1.0 to 2.0	92	$41	152	$74
2.0 to 3.0	149	$77	188	$107
Insolvent subtotals	647	$264	943	$401
3.0 to 4.0	318	$180	313	$145
4.0 to 5.0	375	$191	350	$240
5.0 to 6.0	426	$241	351	$165
6.0 and over	1381	$376	1190	$300
Solvent subtotals	2,500	$988	2,204	$850

Source: Strunk and Case, *Where Deregulation Went Wrong*, 6.

In the end, however, the regulatory revisions to net worth requirements, including the net worth certificate program authorized by Garn-St. Germain, collectively represented a program of regulatory forbearance that ultimately cost the industry and American taxpayers dearly as the S&L business almost doubled in size between 1981 and its final collapse in 1989.

Edwin Gray Opposes Transformative Deregulation

Richard Pratt, who intended to return to the private sector to work for Treasury Secretary Regan's former employer, Merrill Lynch, tendered his resignation as Chairman of the Federal Home Loan Bank Board in March 1983. Edwin Gray replaced him as the

[583] Mayer, *Greatest-Ever Bank Robbery*, 71-80. The Federal Deposit Insurance Corporation (FDIC), interestingly enough, who also encountered a level of institutional insolvency not seen since the 1930s, refused to allow its members to use RAP.

Chairman in May 1983.[584] At his nomination hearing in February 1983, Edwin Gray discussed the vital role he played as Reagan's Director of Policy Information and Deputy Assistant to the President in securing the passage of Garn-St. Germain. As a thrift industry veteran, Gray, as he explained to Congress, "recognized the growing need to lift the burden of many constraints which—while they may have served a useful public purpose in a previous era—were strongly and unfavorably affecting the thrift's ability to compete effectively in the rapidly changing financial services environment."[585] In Gray's opinion, the "flexibility" provided by Garn-St. Germain "enable[d] thrifts more effectively to weather future stormy seasons of economic instability, and not to be reduced to relative impotence in serving the needs of housing finance."[586] Gray's interpretation of and responses to thrift instability essentially reflected the tenets of strategic deregulation, which aimed to retool the S&L industry in ways that still allowed it to maintain its historical housing niche. His subsequent four years as Chairman of the Federal Home Loan Bank Board demonstrated time and again his willingness to openly oppose congressional and Reagan administration efforts at implementing transformative deregulation within the industry. He also fought an intransigent U.S. League that preferred a policy of indefinite forbearance and congressional protection from market forces.

Edwin Gray's willingness to openly and continually oppose several Reagan administration financial and/or deregulatory proposals made him an unlikely defector because he worked with Reagan for the better part of twenty years. He served as Governor

[584] Richard Pratt apparently indicated throughout his tenure as Chairman of the FHLBB that he would only serve for two years. See "Gray Tapped by Reagan as Bank Board Member," *Wall Street Journal*, February 18, 1983.
[585] Gray, *Nomination Hearing*, 3.
[586] Ibid., 4.

Reagan's associate press secretary (1967-1972) and his press secretary (1972-1973). He also campaigned for Reagan in 1976 and 1980. And coincidently, assisting the "U.S. League of Savings Associations in its efforts to encourage passage of the Garn-St. Germain Depository Institutions Act of 1982 after he resigned from the White House Staff," was the only lobbying experience Gray reported to Congress during his nomination process.[587] Treasury Secretary Regan, shortly after Gray's confirmation, personally verified Gray's loyalty to the administration by asking him if he was a "team player."[588]

Gray, in addition to his longstanding relationship with Ronald Reagan, possessed an extensive knowledge of the S&L industry, having worked almost a decade as an executive at two different San Diego savings and loan associations.[589] He had also served on several U.S. League and California Savings and Loan League committees and attended Graduate Schools of Savings and Loan at Indiana University. Additionally, he was highly active within traditionally conservative business groups, serving as President of the San Diego Taxpayers Association, President of the San Diego Republican Business and Professional Club, and Director and Vice Chairman of the San Diego Chamber of Commerce.[590] So Reagan administration officials had no reason to believe that Ed Gray would not follow in his predecessor's footsteps, especially given his "team player" status, his longstanding relationship with President Reagan, and his various S&L experiences, but Chairman Gray quickly revealed his opposition to the transformative deregulation of S&Ls.[591]

---

[587] Ibid., 6.
[588] Mayer, *Greatest-Ever Bank Robbery*, 59.
[589] He served as Vice President, San Diego Federal Savings and Loan Association (1973-1981) and First Vice President and Manager, Executive Affairs Group, Great American Federal Savings and Loan Association. (1982-1983).
[590] Gray, *FHLBB and Deregulation*, 36.
[591] Mason, *From Buildings and Loans*, 226. Mason argued that Gray awakened to the sad reality of thrifts with the failure of Empire Savings and Loan of Mesquite, TX closed in July 1984. If you examine Gray's public speeches and congressional testimony, though, it's evident that Gray began warning thrift executives and

Edwin Gray faced a significant uphill battle as he attempted to pull the S&L industry back from the brink of failure. The socio-economic and political contexts in which he operated essentially positioned his Bank Board in opposition to most Reagan administration officials, congressional leaders, and U.S. League executives. Given the separation of powers that existed between the executive and legislative branches of government and the Reagan administration's attempt at restructuring and redefining the American regulatory governance mechanism, Gray regularly found himself at odds, in particular, with Treasury Secretary Donald Regan and the Office of Management and Budget.

As early as June 1983, Gray contacted OMB Director David Stockman and Treasury Secretary Regan to express concerns over the rhetorical justifications and structural implications of Treasury proposals in the Depository Institution Holding Company Deregulation Act of 1983.[592] Regan ignored Gray's protests and neglected to mention them to the President. By October 1983, in response to Regan's refusal to pass along Gray's concerns to President Reagan, Gray publicly warned House and Senate committees, thrift executives, and fellow regulators of the growing need for additional thrift examiners since

---

legislators about examiner shortages and FSLIC solvency issues almost as soon as he became Chairman of the FHLBB in May 1983. Using the strategic/transformative framing provides a more accurate assessment of Gray's deregulatory impulses, which differed fundamentally from those of Pratt, Regan, and others.

[592] Letter, Edwin Gray to David Stockman, June 1983, "Financial Institution Reform (3/3)," Box OA 11843, Edwin Meese Files, RRPL; and Letter, Federal Home Loan Bank Board to Donald Regan, "Financial Institution Reform (3/3)," Box OA 11843, Edwin Meese Files, RRPL. Gray objected, for example, to how the Treasury bill, in its pursuit of "comprehensive deregulation," "is clearly premised upon the assumption that savings institutions are essentially identical to commercial banks." Moreover, the proposed modifications to S&L holding companies, if enacted Gray claimed, "would effectively deprive the thrift industry of a structural option which is critical to the ability of the 490 savings institutions currently held by unitary savings and loan holding companies to survive as successful competitors in the financial marketplace." Gray also opposed language that essentially tried to force mutual institutions to convert to stock charters by threatening to freeze the service corporation activities of any mutual association with more than $100 million in assets.

many S&Ls were quickly taking advantage of the newly authorized asset powers in Garn-St. Germain.[593]

Throughout 1983 and beyond, administration officials stressed the importance of maintaining their transformative deregulatory vigor—an objective that regularly interfered with Gray's and other policymakers' efforts to revive a dying industry that had historically promoted and maintained American homeownership.[594] In response to Chairman Volcker's 1983 proposed moratorium on thrift mergers, for example, which Volcker suggested would provide time to thoroughly investigate the reasons for the continued financial instability, Cabinet Council of Economic Affairs (CCEA) members "hoped to prevent adoption of a legislated moratorium on new depository institution activities that we believe would merely postpone indefinitely any Congressional deregulation of financial institutions."[595] Advisors counseled Reagan accordingly, cautioning the president in July 1983 that the Senate and House had produced bills proposing moratoriums, which could "stop all pressure for reform and simply be extended from year to year."[596] Administration officials subsequently "agreed

---

[593] Edwin Gray, testimony, House Committee on Banking, Finance and Urban Affairs, *The Savings and Loan Crisis*, 101st Congress, 1st session, *January 12, 1989,* 508-50.

[594] Report, "Economic Report of the President," February 1986, Regulation_General (2), Box 2, OA 18894, Thomas Moore Files, RRPL, 166-71; and Poole, "Report of Subcommittee on Goals and Missions." William Poole's Task Group on Regulation of Financial Services issued a several hundred-page staff report providing theoretical, political, and economic justifications for pursuing deposit insurance reform. The language it utilized and the goals it advocated represented a clear pursuit of transformative deregulation. And as late as February 1986, administration officials were still looking for sectors of American industry to deregulate. They were also highly concerned with congressional Democrats smearing the administration's regulatory success and/or "re-regulating" aspects of the American financial sector, as such, they began disseminating informational materials to various administration officials and congressional leaders educating them as to the dangers of ignoring deregulatory successes. See Memo, "Threat of Re-Regulation," November 21, 1986, Box 1, OA 17412, WHO: Records, Public Affairs, RRPL; Memo, Steve Tupper to Tom Gibson, October 17, 1986, Talking Points on Regulation, Box 17, OA 17399, WHO: Records, Public Affairs, RRPL; and Memo, "Threat of Re-Regulation, White House Talking Points," October 29, 1986, Talking Points on Regulation (1), Box 17, OA 17399, WHO: Records, Public Affairs, RRPL.

[595] Memo, Thomas Healey and Peter Wallison to Cabinet Council on Economic Affairs, 1983, Cabinet Council for Economic Policy 8/82-6/30/83 (1/8), Cabinet Council for Economic Policy 8/82-6/30/83, OA 10699, William Poole Files, RRPL.

[596] Memo, Roger Porter to Edwin Meese and Edwin Harper, July 3, 1983, Financial Institution Reform (3/3), OA 11843, Edwin Meese Files, RRPL.

to introduce our Depository Institution Holding Company Deregulation Act at this time so that Congress can act on legislation that will have a positive deregulatory effect on the financial system." Their position concluded, "It is therefore essential that our bill be introduced as soon as possible."[597]

The CCEA, barely a year later, then debated FDIC and FHLBB proposals on deposit insurance reform. The central issue addressed was the extent to which deposit insurance "subsidizes the high level of risk-taking that is possible in a less regulated market for financial services"—i.e. moral hazard. Both FDIC and FHLBB officials concluded that deposit insurance encouraged risk-taking. They reviewed four proposals to help limit that risk: creating risk-based premiums on deposit insurance so that higher premium cost reflected higher risk; increasing risk exposure (monetary losses) to large depositors; privatizing all or part of the deposit insurance system; and/or strengthening capital standards. Both FDIC and FHLBB officials interestingly acknowledged that enforcing capital requirements became "difficult or impossible to enforce without closing a large proportion of institutions in the industry," a problem that highlighted the fragile state of affairs for thrifts just twenty months after the passage of Garn-St. Germain. The CCEA concluded that the administration's solution to lowering risk was to propose and support "legislation that would require depository institutions to use separate holding companies to engage" in high-risk financial activities.[598] This was a solution that hardly appeared concerned with limiting institutions from continuing to perform obviously dangerous financial transactions.

---

[597] Ibid.
[598] Report, William Haraf to Gordon Eastburn, July 12, 1984, CCEA Working Group on Fin. Inst. Reform (2/2), Box OA 10700, William Poole Files, RRPL.

Brent Beesley, the Director of the Federal Savings and Loan Insurance Corporation (FSLIC), speculated in 1983 that up to 20 percent of savings and loan institutions "might run into trouble in the next year or so" since Garn-St. Germain essentially gave them the "freedom to fail." Others speculated that the "potential for such risky activities has risen because, under deregulation, nearly all banks and S&Ls can quickly get large volumes of deposits through brokers simply by offering above-market rates." Agreeing with Edwin Gray, both the FDIC and Comptroller of the Currency declared that their regulatory staffs needed "big increases" in order to "regulate effectively." And FSLIC Chairman Beesley, upon resigning from his post, openly declared that he "did not possess the sufficient authority and control over personnel matters to discharge the Office's responsibilities in a manner consistent with his personal standards."[599]

Gray faced similar hostility from the Reagan administration when he attempted to bolster his examination and supervisory staff at the FHLBB. Paradoxically, when the administration was presented with clear-cut evidence that thrifts needed more oversight, nothing was done to address the understaffing problem at the FSLIC or to legislate new authority to its director.[600] The thrift industry's capital to asset ratios improved in 1983, but those improvements, according to one Treasury official, "reflected regulatory accounting principles (RAP), not GAAP." The FHLBB had reduced the required net worth ratio in 1981 and 1982 because thrift losses had increased dramatically. To counter those losses, savings and loan institutions began—with the powers granted to them by Garn-St. Germain—"investing in loans that could increase their default risks." Additionally, the CCEA declared

[599] Christopher Conte, "Regulators Say Banking Safeguards are Faulty and Need an Overhaul," *Wall Street Journal*, March 21, 1983.
[600] Memo, Thomas Healey to CCEA Working Group on Financial Institutions Reform, June 18, 1984, CCEA Working Group on Fin. Inst. Reform (2/2), Box OA 10700, William Poole Files, RRPL.

that 49 percent of bank and thrift failures in 1983 occurred because of insider loans and internal fraud. Since 44 percent of failures from 1980-1983 resulted from insider loans and internal fraud, the increase in 1983 should have demonstrated the importance of strengthening oversight. The workloads of examiners, however, mushroomed from $10 million in assets in 1981 to $120 million by 1984.[601] And by June 1984, CCEA members acknowledged that "up to 89 percent of the [thrift] industry's aggregate regulatory net worth figure is made up of items not recognized as capital by generally accepted accounting principles (GAAP).[602]

Given the clear evidence of widespread thrift instability, Ed Gray requested an increased budgetary allocation from OMB to hire 750 new examiners since he understood that high staff turnover and ever-increasing asset per examiner workloads would doom his regulatory agency and, subsequently, the S&L industry.[603] But OMB and the Office of Personnel Management officials denied his request, claiming deregulation meant fewer, not more, examiners. So Chairman Gray got creative, and in July 1985 he transferred examination and supervisory authority to the Federal Home Loan District Banks, whose funding came from S&Ls within their respective districts, not the Office of Management and Budget. The move allowed him to double the number of Bank Board examiners from 747 to 1,424 and triple his supervisory staff. An unintended consequence of the decision, however, as one political insider later explained, was that "it had the look of making the fox the policeman of the chicken coop" since each district bank's board of directors consisted

---

[601] Ibid.
[602] Ibid. The report acknowledged that under GAAP, "goodwill, deferred loan losses and some other items would not be included in net worth."
[603] Sloan, *The Reagan Effect*, 173.

primarily of executives from local S&Ls.[604] Nevertheless, Gray clearly took his responsibility as the steward of the S&L industry seriously, and he continued to devise workable, but possibly politically and ideologically inexpedient, solutions to the seemingly non-stop problems he faced during his Bank Board tenure.

Gray insisted that thrifts maintain their historical role as home loan lenders even as he also recognized that changing socio-economic, ideological, and political contexts forced the Bank Board to concede to some deregulatory initiatives. When explaining the importance of the asset and liability diversification authorizations included in Garn-St. Germain, Gray, for example, declared to congressional leaders in 1983,

> Congress took its action to insure that, in the future, 'home mortgage lending institutions'—that is to say…federally chartered thrift institutions—would have the supplementary authorities and diversification options necessary to better cope with future periods of economic instability and interest rate volatility in order to continue to be able to carry out their principal, and indeed critical, housing finance mission….The commitment by thrifts to housing is clear, irrespective of the limited new commercial-type lending authorities conferred on institutions by the Garn-St. Germain legislation.[605]

But Gray rejected Pratt's and other Reagan administration official's faith in the efficacy and rationality of markets that they relied upon to justify fewer government regulations and less regulatory oversight and, as such, he revisited and subsequently reversed several Pratt Bank

---

[604] Mayer, *Greatest-Ever Bank Robbery*, 145-7. Gray played hardball with the OMB, as they initially threatened to legally challenge his examination and supervisory transfer plan, but fortunately for Gray, his friend Ed Meese ran the Justice Department. In the end, OMB offered 45 additional examiners if Gray discontinued the regulatory transfer. He refused. Gray also successfully tripled his supervisory staff. William Proxmire, Speaking on Outgoing Federal Home Loan Bank Board: Chairman Edwin Gray, 100th Congress, 1st session, *Congressional Record* 133 (June 30, 1987): 18121.

[605] Gray, *FHLBB and Deregulation*, 2-6. Gray, for example, when interpreting the importance of asset and liability diversification authorizations provided by Garn-St. Germain, declared to congressional leaders in 1983, "Congress took its action to insure that, in the future, 'home mortgage lending institutions'—that is to say…federally chartered thrift institutions—would have the supplementary authorities and diversification options necessary to better cope with future periods of economic instability and interest rate volatility in order to continue to be able to carry out their principal, and indeed critical, housing finance mission….The commitment by thrifts to housing is clear, irrespective of the limited new commercial-type lending authorities conferred on institutions by the Garn-St. Germain legislation."

Board decisions. Gray's first target: unlimited brokered deposits. Gray became concerned, as early as September 1983, with the growth of brokered deposits, which, as we have seen, involved S&Ls quickly, though not cheaply, accessing large amounts of capital.[606] The "most troubling aspect of deposit brokering," Gray explained to his Bank Board colleagues in January 1984,

> Is that of enabling virtually all institutions to attract large volumes of funds from outside their natural market area irrespective of the institutions' managerial and financial characteristics; the ability to obtain de facto one-hundred percent insurance through the parceling of funds eliminates the need for the depositor to analyze an institution's likelihood of continued financial viability; the availability of brokered funds to all institutions, irrespective of financial and managerial soundness, reduces market discipline; although deposit brokering can provide a helpful source of liquidity to institutions, ongoing brokering practices make it possible for poorly managed institutions to continue operating beyond the time at which natural market forces would otherwise have precipitated their failure; and this impediment to natural market forces results in increased costs to the FDIC and FSLIC in the forms of either greater insurance payments or higher assistance expenditures if the institutions are subsequently closed because of insolvency.[607]

Even the U.S. League expressed "serious concerns over the current unregulated practices of deposit brokers," which forced them to conclude, "The potential problems outweigh the benefits that might result from permitting the continuation of the current practices."[608] Thus, the Bank Board, in coordination with the FDIC, issued regulations restricting deposit insurance coverage for accounts placed by brokers. Treasury Secretary Regan, among others, disagreed with the FHLBB and FDIC because he opposed "re-regulation."[609] A U.S. District Court struck down the new regulation, ruling that the FSLIC and FDIC usurped their

---

[606] Strunk and Case, *Where Deregulation Went Wrong*, 92-3; and Black, *Best Way to Rob a Bank*, 43.
[607] "Brokered Deposits, Limitations on Deposit Insurance," Financial Institution Reform (1/3), Box OA 11843, Edwin Meese Files, RRPL. See also Conte, "Regulators Say Banking Safeguards."
[608] Ibid.
[609] For opposition to "re-regulation," see Letter, Beryl Sprinkel to James Murr, July 22, 1988, Working Group on Financial Markets (2 of 2), Box 6, OA 17742, Beryl Sprinkel Files, RRPL; Memo, "Threat of Re-Regulation," November 21; Memo, Tupper to Gibson, October 17, 1986; Memo, "Threat of Re-Regulation," October 29, 1986; Mayer, *Greatest-Ever Bank Robbery*, 139; and Black, *Best Way to Rob a Bank*, 11-5, 45-7, 56-9, and 74-7.

statutory authority. Gray, in response, requested congressional authorization to subsequently once again limit brokered deposits, but Congress refused and, according to Gray, "The U.S. League and its affiliates never lifted a finger to help us in Congress."[610]

Since all three branches of government disapproved of and/or invalidated the Bank Board's new brokered deposits regulation, Gray astutely turned his attention toward other solutions that limited and slowed the growth of high flying S&Ls.[611] Gray, over the course of 1984 and 1985, eliminated the 5-year averaging rule (with a corresponding phase-out), increased the net worth requirement from 3 percent to 6 percent while also requiring higher minimums for high flyers, and capped direct investments as a percentage of assets.[612] Industry officials strongly opposed his regulatory reforms; one U.S. League official, Gray later claimed, "warned me that my career would be ruined if I went ahead and proposed the critical growth and direct investment regulations."[613]

Regulatory arbitrage also became a serious concern for the Bank Board as several states pursued their own deregulatory agendas, justifying their political endeavors by

---

[610] Gray, *Savings and Loan Crisis*, 115. See also Mayer, *Greatest-Ever Bank Robbery*, 133-5.

[611] Black, *Best Way to Rob a Bank*, 1-16. The fastest growing (and worst) S&Ls were essentially utilizing their ADC loans to execute Ponzi schemes.

[612] Strunk and Case, *Where Deregulation Went Wrong*, 28-30 (FIR 5 percent); and Black, *Best Way to Rob a Bank*, 31-2 (5-year averaging). Gray capped direct investments to 10 percent of assets. The FHLBB, beginning in 1972, stipulated that *de novo* S&Ls had 25 years to fully establish a Federal Insurance Reserve (FIR) that equaled 5 percent of deposits. They simultaneously permitted "institutions to average year-end savings account balances over five years" when calculating the "savings account base against which the required percentage of reserves had to be determined." The Federal Insurance Reserve tabulation was replaced in the 1980s by the minimum net worth requirement, which Pratt lowered to 3 percent in 1981. The 5-year averaging was particularly problematic because, as Black explained, "An S&L's capital requirement could be far less than the nominal requirement because it could, for example, meet the 3 percent requirement by showing that its capital represented 3 percent of its average liabilities over the last five years." Pratt's decision to lower the net worth minimum to 3 percent, Black concluded, "essentially eliminating the capital requirement, and that came on top of the pervasive accounting abuses." Under such an arrangement, an S&L could grow $1 billion in deposits for every $1 million in capital they raised.

[613] Gray, *Savings and Loan Crisis*, 115. By establishing regulatory limits on deposit growth and direct investments, as Black persuasively demonstrated, Gray disallowed S&L executives from continuing the gamble for resurrection strategy that many high flyers had been pursuing. See Black, *Best Way to Rob a Bank*, 1-16, 41-62.

claiming the socio-economic changes kept jobs and investment capital in their respective states.[614] The dual banking system of separately chartered and governed state and national S&Ls and commercial banks, according to its advocates, allowed for regulatory innovation and theoretically limited the possibility of an overbearing federal regulatory agency from exerting too much control.[615] Detractors, however, claimed the dual banking system prevented policymakers from maintaining regulatory continuity and pursuing public policies that promoted a public interest beyond the narrow confines of state lines. Instead, it enabled a "competition of laxity" that in many instances limited regulators' authority to supervise effectively and subsequently only worsened the industry's eventual losses.[616]

The deregulatory efforts in California, Texas, Florida, and Arizona, "four of the most liberal states" according to the U.S. League, represented the worst forms of regulatory arbitrage as their state legislators varyingly removed loan-to-value limits on all loans. These measures also authorized state thrifts to invest higher percentages of their asset portfolios in service corporations, commercial and consumer loans, real estate investments, and corporate bonds and stocks. And they removed or severely altered restrictions on loans to a single borrower, potentially allowing one borrower to sink an entire institution if that individual's loan(s) went into default.[617] Those regulatory changes unnecessarily provided opportunities for systemic financial malfeasance not seen since the 1920s.[618] Even the former U.S. League

---

[614] Timothy Wirth, testimony, House Committee on Energy and Commerce, Subcommittee on Telecommunications, Consumer Protection, and Finance, *Financial Restructuring: The Road Ahead*, 98th Congress, 2nd session, April 4, 1984, 2.
[615] Hunt Commission, 91. The Hunt Commission, in its final report, declared, "The Commission believes that steps taken to strengthen the dual banking system serve the public interest." See also "Benston, "Discussion of the Hunt Commission Report," 988-9.
[616] Wirth, *Financial Restructuring*, 2.
[617] Strunk and Case, *Where Deregulation Went Wrong*, 60-4.
[618] Black, *Best Way to Rob a* Bank, passim; Mayer, *Greatest-Ever Bank* Robbery, passim; and Pizzo, *Inside Job*, passim.

President Norman Strunk, who ran the U.S. League for 30+ years, questioned the efficacy of the "new liberal laws" when he speculated,

> Little thought was given to the possibility that new owners and executives might exploit the liberal law or that supervisors could not prevent the kind of bad lending and abuses that did develop. The new liberal laws for these state-chartered systems went far beyond what the Garn St. Germain Act provided for the federal system and what most people in the business thought was needed. In retrospect, the leadership of the state leagues and savings and loan executives in those states generally should have exercised greater oversight of their state legislatures. If they were following what was happening, they should have considered the consequences more carefully. Ultimately, these laws taxed the ability of the examination and supervisory systems and helped cause major losses at some institutions.[619]

Gray partially stymied the boom in *de novo* state charters, particularly in California and Texas, by refusing to grant them FSLIC coverage until they met more stringent capital requirements. He astutely foresaw the likely negative ramifications of several states' loosening regulatory restrictions and oversight. Such loosening easily enabled a competition in laxity that allowed for the possibility of severe losses to the FSLIC since state-charted institutions, including those with private deposit insurance systems, still received federal deposit insurance coverage. His fear became a reality in 1985, when Ohio and Maryland's private deposit insurance systems went bankrupt, and again in 1989 when some of the largest S&L failures resided in California, Texas, and Florida.[620]

Gray's last and most challenging regulatory effort at the Bank board—recapitalizing the FSLIC—also proved his most successful from the standpoint of saving government funds since his actions ultimately reduced the eventual resolution costs of the industry's collapse by

---

[619] Strunk and Case, *Where Deregulation Went Wrong*, 59-60.

[620] Black, *Best Way to Rob a Bank*, 35-7. The Nolan Bill (California's S&L deregulation legislation), for example, allowed d*e novo* institutions, those with newly granted charters, not converted charters, to invest 100 percent of its assets in anything with the state commissioner's approval. Strunk and Case identified Arizona, Florida, Texas, and California as "four of the most liberal" states in the country in relation to the "broad investment powers" they provided their respective state-chartered institutions. Strunk and Case, *Where Deregulation Went Wrong*, 56-66. See also Gray, *Savings and Loan Crisis*, 508-50.

tens, if not hundreds, of billions of dollars. His attempt to recapitalize the FSLIC simultaneously highlighted the many dangers, including cases of fraud and malfeasance, associated with many high-flying S&Ls and exposed the FSLIC's inability to close them down because the agency itself was insolvent. Most policymakers realized that the FSLIC's $6 billion reserve remained utterly inadequate to resolve the 400-700 institutions that remained insolvent between 1982 and 1985, and thereafter as well.[621] But Gray's initial imposition of a special assessment of one-eighth of 1 percent of deposits in February 1985 signaled to market observers that all was still not well in the S&L industry. When the special assessment and other measures proved futile, which happened quite quickly, Gray requested a still inadequate $15 billion infusion of funds from Congress in October 1985. The subsequent twenty-two month battle to recapitalize the FSLIC, culminating in the August 1987 passage of the Competitive Equality Bank Act, revealed the political, economic, and ideological forces that Gray's Bank Board was combating. It also highlighted how the political had become inseparable from the ideological for many Reagan administration officials, particularly Treasury Secretary/Chief of Staff Don Regan, and as well from the perspective of attempting to make the introduction of competition work for Gray himself. It was Gray's achievement and his misfortune to recognize early and often that a deregulation

[621] As Table 5.1. highlights, 415 S&Ls with $220 billion in assets were insolvent. By 1985, those numbers rose to 705 institutions with $335 billion. Additionally, OMB and CCEA officials, as of February 1983, knew the FHLBB projected that at least 892 S&Ls would participate in the Bank Board's new net worth certificate program, a program that required institutional insolvency to participate. Just as problematic, Gray explained the "fragile" condition of the S&L to many legislators in July 1983 this way," The thrift industry today still faces a long, uphill battle toward recovery….Thrifts remain gravely vulnerable to interest-rate swings. These institutions remain in a very fragile transition, and managers face the tremendous challenge in the future of restructuring their portfolios….nearly 4 out of 10—of all FSLIC-insured institutions were still in the red at the end of the first half (1983)." Memo, Julie Gould to Joe Wright, February 18, 1983, Financial Deregulation (1), Box 8, OA 19321, Economic Policy Council: Records, RRPL (OMB/CCEA); and Gray, *Deregulation and the FHLBB*, 4 ("fragile").

process aimed to introduce competition had been a worthy goal whose implementation had failed, ironically, for a want of regulation.

At the time of Gray's October 1985 proposal, the industry's problems were no secret. Multiple Reagan administration officials, including two Council of Economic Advisors Chairmen, Martin Feldstein and William Niskanen, cautioned against the moral hazard associated with deposit insurance and warned of a catastrophic end for the S&L industry.[622] Assistant Secretary for Domestic Finance Thomas Healey, throughout late 1984 and 1985, directed a study by the Working Group on Financial Institutions Reform that conducted its own assessment of the condition of the federal deposit insurance funds in conjunction with studies commissioned by the FDIC and FSLIC. Healey subsequently presented his findings to Secretary Regan and other CCEA members in January 1985, offering several interesting and inter-related observations regarding the status of both the S&L industry and the FSLIC insurance reserve. He suggested,

> Changes have encouraged banks and thrifts to pursue riskier strategies than they would otherwise do if the institutions were not able to use deposit insurance to underwrite the normal market costs of risk….The charts showed: the declining average return-on-asset position of the thrift industry, the growing disparity in earnings between institutions due to deregulation, the enormous growth in the size of some S&Ls—unmatched by a parallel growth in equity, and the deteriorating position of the FSLIC fund as a percentage of the aggregate net worth of the thrift industry.[623]

As such, Healey urged that the CCEA, "in consultation with representatives of the regulatory agencies, develop five recommendations that, among other goals, "would have the dual benefit of increasing the cost of risk for insured institutions and encouraging market

[622] Sloan, *The Reagan Effect*, 189.
[623] Minutes, Cabinet Council on Economic Affairs, January 10, 1985, 169114, Box 55, FG 010-02 Cabinet Councils, Federal Government Organizations, RRPL. Healey, before his role at the Treasury Department, worked as a Director and Head of Project Finance at Dean Witter. Upon leaving the Reagan administration in 1985, he served as Vice President at Goldman Sachs.

monitoring of the behavior of those institutions. This would mitigate the distortive effects of deposit insurance on normal market discipline."[624] His recommendations included "ensuring that the FDIC and FSLIC funds are sufficiently large and flexible to handle the potential failures of at least one or two of the largest insured institutions" and guaranteeing that "prudential supervision of insured institutions compliments structural changes in the modern deposit insurance system." Healey also suggested creating risk-related insurance premiums (previous Pratt recommendation), increasing capital-to-debt ratios, and mandating uniform accounting standards between banks and S&Ls.[625] Secretary Regan agreed to have CCEA members discuss the recommendations, but deferred "any decisions until a future meeting."[626] Each of Healey's recommendations, interestingly enough, if adopted and implemented as quickly as many deregulatory policies were, would have drastically altered the trajectory of the looming S&L crisis, subsequently limiting the eventual economic and political fallout of the S&L industry's failure.

The U.S. League opposed the recapitalization effort, declaring their opposition as early as January 1986. Many thrift executives, particularly "high rollers" in Texas, opposed all of Gray's reform efforts; their responses included bribery and collusion. Some even paid transformative deregulation stalwarts to get involved. Charles Keating, for example, after failing to successfully entice Gray away from his chairmanship with a lucrative new position at an S&L, commissioned Alan Greenspan to persuade Bank Board officials to exempt Keating's Lincoln Savings from the recently reconfirmed 10 percent limitation on direct investments. Keating also funded research by University of Rochester economist George

[624] Ibid.
[625] Ibid.
[626] Ibid.

Benston to study direct investment's linkage, if any, to S&L institutional failure. Benston found no correlation and Greenspan, coincidentally enough, subsequently publicly praised the study.[627]

Other U.S. League responses to escalating thrift instabilities over the course of 1986 and 1987 appeared to defy logical and economic explanation. An OMB official, for example, warned Budget Director Stockman in June 1987 that the "thrift situation risks becoming a 'rational run,' one based on a steady drumbeat of bad, but accurate, news about savings and loans" because the industry faced severe problems with its bad assets, its declining income, its insolvent insurance fund, and its unscrupulous executives.[628] But the U.S. League, he explained, offered a paradoxical response to the state-wide instability of Texas thrifts. S&Ls in the Lone Star State, by June 1987, faced rising liquidity pressures, lost a disproportionate percentage of the thrift industry's 1986 $8.3 billion loss, and encountered stepped "up fraud enforcement" by the FBI and Justice Department. The U.S. League, in response to such problematic conditions, tried to "persuade some of its healthier members to deposit funds in troubled Texas thrifts."[629] This in a state already suffering from high-profile S&L failures, controversial state regulatory oversight, and drastically declining commercial and real estate markets due to a regional economic recession.[630]

Additionally, U.S. League officials, in their opposition to the Bank Board's various regulatory efforts, demonstrated just how pervasively the rhetoric and policy prescriptions of

---

[627] Mayer, *Greatest-Ever Bank Robbery*, 139-41; Letter, Alan Greenspan to Thomas Sharkey, February 13, 1985, in *Greatest-Ever Bank Robbery*, Mayer, 324; and Jack Anderson and Joseph Spear, "S&L High Rollers Target Reformer," *The Washington Post*, November 6, 1986.
[628] Memo, Ahmad Al-Samarrie to David Stockman, June 19, 1987, FSLIC [Federal Savings and Loan Insurance Corporation], Box 6, Dan Crippen Files, RRPL.
[629] Memo, Al-Samarrie to Stockman, June 19, 1987. 32 Texas S&Ls with assets of $14.1 billion failed between 1980 and 1987. Strunk and Case, *Where Deregulation Went Wrong*, 10.
[630] Black, *Best Way to Rob a Bank*, 134-140.

transformative deregulation had infiltrated the S&L industry. Even as William McConnell, President of the U.S. League, promised congressional leaders that S&Ls would remain home loan lenders, he lobbied those same policymakers to allow federal S&Ls to offer commercial checking accounts and securities underwriting, to include commercial real estate assets when calculating "bad debt" deductions, and to exceed the 3 percent limit on assets in service corporations. He further proposed that the states adopt more lenient state regulations when applicable, discontinue residential loan information from truth-in-lending laws, and eliminate asset limitations on non-residential loans. Finally, he also opposed limiting insurance activities of service corporations and disallowing referrals to subsidiaries.[631] Collectively, those U.S. League-sanctioned recommendations exposed an intention to significantly deviate from thrift's historical lending practices even as the American Savings and Loan League, which represented minority-owned institutions, offered legislative recommendations that proclaimed their continued allegiance to mortgage origination.[632]

Just as important, U.S. League representatives continued to infuse the rhetoric of transformative deregulation into their interpretations of and policy recommendations for new and/or worsened S&L difficulties. As one U.S. League official self-servingly questioned whether deregulation was "necessarily a desirable end in itself," he simultaneously criticized how the Bank Board "provoked re-regulation" with its renewed efforts at saving a mortally

---

[631] McConnell, *Financial Services Industry*, 549-65.

[632] William Muse, testimony, Senate Committee on Banking, Housing, and Urban Affairs, *Financial Services Industry – Oversight Hearing*, 98th Congress, 1st session, May 4, 1983, 595-600. American Savings and Loan League represented S&Ls owned by African-Americans, Asian-Americans, women, and Hispanics. Their legislative agenda, on the other hand, opposed the elimination of the mortgage interest deduction that enabled home purchases for low income people. They also opposed commercial bank access to FHLBB advances, demonstrating a fear of red-lining returning with deregulation. And they proposed risk-based deposit insurance premiums and removing limits on second layer lender purchases.

wounded industry.[633] Steps he challenged included imposing new reporting requirements, limiting brokered deposits, tightening capital standards, and establishing risk-based net worth evaluations—all easily justified regulatory responses to obvious managerial and institutional excesses that most economic and political observers at the time accepted as undeniable.[634] Reagan administration officials also aired similar concerns about re-regulation as they navigated the political back and forth during the conference committee for H.R. 27, the FSLIC recapitalization bill. One official identified a "major objection to the Conference Report" of H.R. 27, concluding it "reverses Administration's deregulation policy of the past six years, and contains many anti-competitive, anti-consumer restrictions, including overrides of state banking powers."[635]

Don Regan, now President Reagan's Chief of Staff, and other administration officials still persistently promoted transformative deregulatory solutions to worsening S&L problems, in addition to identifying new sectors of the economy to deregulate.[636] Part of those efforts included Regan waging a bitter personal attack on Edwin Gray, with the assistance of some thrift executives, in order to force Gray out as FHLBB Chairman.[637]

---

[633] The U.S. League, since the early 1970s when the Hunt Commission first released its finding, objected to comprehensive financial regulatory reform and/or complete regulatory parity with commercial banks since most thrift executives understand that meant the disappearance of their industry since they would lose Regulation Q and favorable tax incentives.

[634] Zellars, *How the Financial System*, 1302-4. See also Leonard Shane, testimony, House Committee on Energy and Commerce, Subcommittee on Telecommunications, Consumer Protection, and Finance, *Financial Restructuring: The Road Ahead*, 98th Congress, 2nd session, April 5, 1984, 271-93.

[635] Memo, Ken Duberstein to Dan Crippen, July 8, 1987, FSLIC [Federal Savings and Loan Insurance Corporation] (1), Box 6, Dan Crippen Files, RRPL.

[636] Draft, "Statement to Accompany Executive Order," March 4, 1988, Box 1, FG 258-24 Task Force on Market Mechanisms, Federal Government Organizations, RRPL; Memo, Gregory Wilson to Under Secretary Gould, March 17, 1988, FDIC_FSLIC Scoring, Box 5, Dan Crippen Files, RRPL; Memo, Beryl Sprinkel to Howard Baker, May 5, 1988, Chief of Staff Baker (Baker) [1 of 2], Box 2, OA 17737, Beryl Sprinkel Files, RRPL (recommends Milton Friedman for Presidential Medal of Freedom); Speech, Beryl Sprinkel, "Improving the Free Enterprise System," October 9, 1986, Correspondence_Pat Buchanan, Box 2, OA 17737, Beryl Sprinkel Files, RRPL; and Memo, "Proposed Compromise Modifications in H.R. 27 – FSLIC-Banking Bill," July 29, 1987, FSLIC [Federal Savings and Loan Insurance Corporation] (2), Box 6, Dan Crippen Files, RRPL.

[637] Mayer, *Greatest-Ever Bank Robbery*, 157-8; and Sloan, *Reagan Effect*, 180-1.

Gray's effort to limit brokered deposits and recapitalize the FSLIC, in particular, upset the former Merrill Lynch executive since Regan interpreted Gray's behavior as antithetical to President Reagan's deregulatory agenda. Its timing was also poor since Gray requested the additional $15 billion during the administration's Gramm-Rudman negations with Congress.[638]

So, in response, Regan began circulating rumors in October 1985, at the exact moment Gray requested additional funds from Congress, that Gray intended to resign. The *Wall Street Journal*, in their coverage of Gray's possible departure, highlighted how "Gray's warnings that the insurance fund is nearly depleted and his proposals to shore it up at the thrifts' expense" angered many officials. One industry lobbyist even quite brazenly explained, "There's been a backlash on Ed Gray. His comments are putting a cloud over the entire industry, and we didn't appreciate it."[639] Even after Regan leaked another story to Monica Langley in July 1986 to "convince" Gray to resign, Gray refused.[640]

Chairman Gray, given the open hostility he faced from several Reagan administration officials, U.S. League officials, and S&L executives for almost the entirety of his tenure at the Federal Home Loan Bank Board, concluded in 1989 that "financial deregulation took on some of the attributes of a narcotic."[641] He identified Donald Regan, among others in the Reagan administration, as "ideological crazies who cared more about their pet theories about the so-called [free] market than they did the taxpayers," simultaneously indicating a potency to their ideological fervor and highlighting the degree to which it ultimately guided and

---

[638] Sloan, *Reagan Effect*, 174.
[639] Monica Langley, "Troubled Bank Board's Chairman Gray Is Likely to Resign Soon, Officials Say," *Wall Street Journal*, October 28, 1985.
[640] Ibid.; and Mayer, *Greatest-Ever Bank Robbery*, 157.
[641] Gray, *Savings and Loan Crisis*, 115.

shaped the trajectory of S&L deregulation as well as their solutions to the continued instability of thrifts. Gray's claim that he was branded a "re-regulator" by administration officials only further demonstrated how their faith in deregulation blinded them to its ill effects, even in the face of mounting evidence that the industry was on the brink of failure.[642] And the U.S. League, according to Gray, spent his chairmanship "either killing legislation or opposing it or not getting behind it strongly."[643]

Conclusion

The thrift industry's problems should not have been unidentifiable and indescribable to the most astute political and economic observers, particularly thrift insiders at the U.S. League. The U.S. League, ironically enough, had supplied industry data to policymakers in Washington and around the country on an annual basis since at least the mid-1960s that clearly charted the changing American economic landscape and demonstrated thrift's waning socio-economic and political relevance.[644] Their annual publication contained housing and financial sector data that would have allowed anyone who took the time to critically analyze

---

[642] "Bank Board Chief Said to Resist Resignation," *New York Times*, October 29, 1985. A "well-placed source" believed Reagan's Chief of Staff (former Treasury Secretary) Donald Regan "was behind the move to oust" Gray because of "turmoil in the industry." No doubt neither appreciated the ideological fervor, or lack thereof, of the other, evident by their disagreement in 1983 over holding company deregulation. See also Langley, "Troubled Bank Board's Chairman."

[643] Gray, *Savings and Loan Crisis*, 114.

[644] The U.S. League annually produced the "major data series…grouped by subject area: savings, mortgage lending, housing, savings and loan operations, and federal government agencies." They named it the *Savings and Loan Fact Book* (before 1981) and *Savings and Loan Sourcebook* (after 1981), and it was "distributed to U.S. League member institutions, educators, school and public libraries, financial writers and editors, members of Congress and other government officials, mutual savings banks, life insurance companies, chambers of commerce and home builders." United States League of Savings Institutions, *'81 Savings and Loan Sourcebook* (Chicago: U.S. League of Savings Institutions, 1981), 4. The U.S. League, coincidentally enough, changed the formatting of their annual publication in 1981. In that year, and all subsequent years, they offered little to no interpretative analysis of the housing, financial, and economic data they presented. This change was evidenced by the page count of each year's publication, which shrunk by almost half after 1980. The 1981 volume ran just 64 pages, even though the annual review averaged 136 pages per year over the course of the 1970s.

it to understand how and when second layer lenders and their institutional investors eclipsed the growth and saver governance mechanism's key institutional cog, the savings and loan institution. Just as important, the data demonstrated how S&Ls, as an industry, had turned away from their bread and butter, home loan origination, in the years after Garn-St. Germain and instead financed or directly invested in ADC loans, investment securities, mortgage-backed securities, and non-mortgage loans. It also revealed dramatic changes to the American housing and financial markets that resulted from over-speculation, the 1986 oil price collapse, and the 1987 stock market crash. Thus, the evidence was there, the S&L industry entered the 1980s on life support, and its condition only worsened year by year until regulators and legislators let the industry pass into history in 1989.

The eventual industry bailout raised important questions, particularly in hindsight, as to whether regulators and congressional leaders should have liquidated the industry sooner. Several political and economic observers, then and now, have suggested much lower resolution costs than were eventually paid by American taxpayers. But to answer that question, in part, required a firm understanding of both the role S&Ls played within the growth and saver governance mechanism and the ramifications of systemic changes that began occurring after 1966. Policymakers, across the board, failed in that regard.

In their rush to deregulate various sectors of the American economy, they also neglected to consider the other foundational components of the growth and saver governance mechanism—working- and middle-class savings and low risk homeownership. They failed to recognize how the second layer lender governance mechanism's replacement of the growth and saver model further alienated many, many Americans. Even as S&Ls struggled to save themselves, the industry consolidated in ways that displaced the local for the national and

international elements of society, even as institutional investors at pension funds and brokerage firms replaced working- and middle-class savers as depositors in increasingly stock-chartered S&Ls. Deregulated thrifts built asset portfolios that produced the highest profits in the shortest time possible, clearly excluding residential real estate investment as they turned to commercial investment opportunities. Homeownership, and many other consumer products, became more expensive in the 1980s, and homeowners and other borrowers began to shoulder more risk, given the quick and pervasive turn toward adjustable rate mortgages.[645] The 1980s, then, was not a good time for the many Americans who aspired to gain their share of the American dream by finding and funding affordable homeownership via a savings and loan institution.

[645] *'89 Savings Institutions Sourcebook*, 9. 63 percent of the mortgages originated by S&Ls in 1988 were adjustable rate mortgages.

Conclusion

The evolution and eventual demise of the S&L industry is an important episode in U.S. financial, political, regulatory, and intellectual history. The long and slow decline of American savings and loans institutions was a tragic, unbefitting end to a once powerful financial industry that had provided millions of Americans the opportunity to enjoy the social, cultural, and political benefits of homeownership. Most political and economic observers, at the time of the industry's collapse, and since, have offered narratives that focus on how various U.S. financial regulatory policies both before and after 1980 essentially created an environment that encouraged financially imprudent investment strategies by S&L executives who were either greedy, reckless, or inexperienced, or a combination of the three. They detailed how portfolio specialization, borrowing short and lending long, moral hazard from deposit insurance, regulatory forbearance, and regulatory capture unduly pushed managers at thrifts to take unnecessary risks. This research project, in its pursuit of identifying the historical roots of the S&L crisis, goes further back in time in its analysis than the advocates of the "traditional" narrative who identified the late 1970s as the genesis moment of the S&L crisis. It examined the accuracy of previous historical and scholarly interpretations. It explained how policymakers at the time identified, explained, and offered ideologically-informed policy proposals to resolve industry instability. And it described how S&L executives responded to the increasingly problematic developments in their industry.

My story details how New Deal era policymakers crafted a financial sector regulatory framework, what I called the growth and saver governance mechanism, that channeled working- and middle-class American savings into primarily locally-owned and operated savings and loans institutions that subsequently turned those deposits into mortgage loans—a

systemic arrangement that increased homeownership from 43.6 percent in 1940 to 65.5 percent by 1980. Its success was predicated upon the notion of promoting the general economic welfare of the country through maintaining a “fairer” distribution of profits between management and workers that subsequently increased individual savings and homeownership rates via creating and maintaining a home loan lending niche for S&Ls. I uncovered, through the course of my analysis, how and why systemic weaknesses accrued in the growth and saver mechanism essential to the thrifts smooth functioning as policymakers, beginning in 1966, responded to the challenges posed by deposit shifting as new opportunities for earning interest arose. I then outlined how many legislators, administration officials, regulators, and academics collectively realigned the theoretical, ideological, socio-economic, and political inputs of the existing governance mechanism. I traced the ways that policymakers’ solutions to increased instabilities in the S&L industry were determined in part, and in some degree detrimentally, by ideological leanings informed by the efficient market hypothesis that undergirded deregulatory moves in a number of industries in the Nixon-Ford-Carter-Reagan era.

I assessed the impact of these ideological constraints on several major deregulatory measures while simultaneously distinguishing between strategic and transformative deregulatory moves, which focused on identifying and explaining the ideological and political fervencies of competing advocates of deregulation. I then described how that process of regulatory realignment that coincided with the implementation of new operational and institutional strategies by S&L executives who took advantage of a burgeoning secondary mortgage market, ushered in new regulatory framework over the course of the 1970s and 1980s—the second layer governance mechanism. A system whose intellectual and

political architects viewed mortgages as highly liquid financial instruments and investment opportunities, not the promoters and enablers of a larger public good as the progenitors of its predecessor had believed.

Intellectual and regulatory paradigm shifts, as my portrayal of the S&L industry's decline made abundantly clear, are complicated and messy. The regulatory issues outlined in the "traditional" narratives, beyond drastically increasing the eventual resolution costs of failed thrifts, only tangentially contributed to the S&L crisis. Thrifts had been eclipsed, beginning in the mid 1970s, by second layer lenders and other financial institutions such as mortgage companies that developed innovative business models made successful by a growing reliance upon the securitization of American mortgages. Without the prevailing commitments and regulatory mechanisms that made the growth and saver governance mechanism successful, the S&L industry was doomed to fail. Federal Reserve Chairman Alan Greenspan at this late stage of the crisis understood full well how anachronistic S&Ls had become. As he addressed congressional leaders in February 1989, he questioned rhetorically "whether specialized fixed-rate residential lending institutions are needed today." Responding in the negative, he declared, "It's going to be the markets that are going to determine the banking structure in this country."[646]

Greenspan's statement aligned his position of government regulation with the efficient market hypothesis, related in this study to the economics of the Chicago School, that had since the 1960s offered theoretical justifications for transformative deregulation of many previously regulated sectors of the U.S. economy.[647] Years later, he re-affirmed his initial

[646] Robert Rosenblatt and Tom Redburn, "S&Ls May Have Outlived Need, Greenspan Says," *Los Angeles Times*, February 24, 1989.
[647] Ibid.

assessment of a dying S&L industry within the evolving U.S. financial sector, congratulating mortgage bankers for playing a "key role in maintaining the uninterrupted flow of mortgage credit during the then-biggest financial debacle since the Great Depression—the S&L crisis of the late 1980s."[648]

The misinterpretation and misdiagnosis of the causes for, manifestations of, and solutions to S&L instability that I outlined throughout this study provides scholars of U.S. financial, regulatory, and political crises with several inter-related lessons. First, interpretations to and solutions for thrift problems during the 1970s and 1980s demonstrated the potentially detrimental political, socio-economic, and intellectual shortcomings of crafting regulatory responses in an immediate post-crisis environment. Legislators often have neither the time nor the expertise to fully grasp the intricacies of the industry (or industries) problems they are tasked with resolving or to detect the interconnectivities between that industry (or group of industries) and national and international markets. As was the case with S&L instability, policymakers understood that thrifts promoted and maintained U.S. homeownership without realizing how essential Regulation Q and a steady flow of working- and middle-class savings were to the continued effectiveness of the governance mechanism. As the crisis unfolded in the 1970s and the theoretical, political, and financial inputs to the growth and saver governance mechanism also shifted, most policymakers neither identified nor understood those fundamental systemic changes as they interpreted the newest chapter of the continuing S&L crisis that emerged in the late 1970s and early 1980s.

The competing legislative and Bush administration responses to the S&L industry's collapse in 1989, a situation that ultimately produced the Financial Institutions Reform,

[648] Alan Greenspan, "Remarks Before a conference on Mortgage Markets and Economic Activity Sponsored by American's Community Bankers," Washington, D.C., 1999.

Recovery, and Enforcement Act (FIRREA), effectively demonstrates the perils of crisis-driven regulatory responses. Congressional legislators and Bush administration officials, despite the obvious need for a quick and decisive political intervention, could not identify workable solutions for the worsening S&L industry throughout much of 1989. Their inaction created a serious economic and political problem as insolvent S&Ls collectively hemorrhaged $20 million each day that they remained open.[649] The House and Senate passed their respective S&L industry clean-up bills on June 15 and June 21, but conferees fiercely debated key provisions of the bills for nearly two months thereafter. Conferees also faced serious time constraints as an August 5 congressional recess loomed large. Tension ran so high, even as late as August 4, that some conferees refused to speak to one another even as they failed to find common ground on a litany of contentious issues.[650] The last-minute compromises barely satisfied many House Representatives members as a significant bi-partisan coalition actually opposed the conference bill; it narrowly passed by a vote of 201-175.[651] Just as problematic, many political and economic observers disagreed as to whether the crisis was indeed a crisis at all. Optimists interpreted thrift instability as an aberration exacerbated by thrift regulators. Pessimists, on the other hand, saw the "deeply seated" problems of a "moribund" industry facing overcapacity and lax regulations.[652]

---

[649] Sharon Walsh and Kirstin Downey, "Conferees Set on S&L Plan: Bill Faces Senate Challenge, Veto Threat," *The Washington Post*, July 28, 1989.
[650] Legislators fought over whether to include the clean-up costs as a budgetary or non-budgetary expenditure, whether to allow S&Ls to participate in the junk bond market, whether Danny Wall should retain his role as chief federal regulator of S&Ls, and which federal agency maintained authority over state-chartered thrifts. Sharon Walsh, "Dispute Among Senators Mires S&L Conference Talks," *The Washington Post*, July 25, 1989; Kirstin Downey, "Even Lawmakers Who Voted for S&L Bill Say Problems Remain," *The Washington Post*, August 6, 1989; and Walsh, "Conferees Set on S&L Plan."
[651] 135 Democrats and 40 Republicans cast nay votes and an additional 50 legislators (34 Democrats and 16 Republicans) abstained from voting altogether.
[652] CBO, "Resolving the Thrift Crisis," 20-1.

Congress, despite the high level of contentiousness, eventually passed FIRREA, and it became law on August 9, 1989. FIRREA authorized the newly created Resolution Trust Corporation to clean up the thrift industry by acquiring failed thrifts, disposing of their assets and liabilities, and compensating insured depositors accordingly. Legislators also re-organized several aspects of the thrift regulatory structure as they eliminated the previously independent Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Fund and replaced them with two new government agencies: the Office of Thrift Supervision (OTS) and the Federal Housing Finance Board. Legislators authorized the OTS, situated in the Treasury Department, to regulate and supervise S&Ls and the Federal Housing Finance Board, an independent executive branch agency, to administer the Federal Home Loan Bank system.

Additionally, congressional leaders, as they tried to limit the political and economic fallout from a rapidly declining S&L industry, incorporated regulatory changes into FIRREA that addressed many issues that political and economic observers at the time identified as having contributed to the crisis, including several proposals Chairman Gray had unsuccessfully pursued as FHLBB Chairman. The legislation allowed bank holding companies to acquire both sick and healthy S&Ls; instituted the regulatory practice of prompt corrective action; established minimum capital requirements when S&Ls acquired brokered deposits; and re-established limits on loans to a single borrower and tightened loan-to-value requirements. It also prevented S&Ls future participation in the U.S. junk bond market; re-adjusted the qualified thrift lender (QTL) test to 70 percent of assets; created risk-based capital requirements for the S&L industry; and severely limited the potential for future episodes of regulatory arbitrage, in the S&L industry at least, as it restricted the permitted

activities of state-chartered institutions with federal deposit insurance coverage to those of federally chartered institutions.[653]

Yet, even at the hour of the thrift industry's reckoning, some legislators, including House Banking Chairman Henry Gonzalez (T-TX), still believed S&Ls could maintain their status as the main conduits for American mortgage credit.[654] FIRREA's upward adjustment of QTL tests, for example, also revealed a continued faith in thrifts' historical housing mandate. Just as problematically, policymakers at this late stage of the crisis fashioned narratives of the industry's downfall that averted attention away from the systemic shifts that occurred in the U.S. financial sector beginning in 1966. Several congressional committees, as the industry's condition worsened over the course of 1988 and 1989, conducted, at a minimum, seventy-eight separate hearings, spanning 158 days of testimony, to investigate the demise of S&Ls.[655] Those hearings, as one interpretation of congressional responses demonstrated, crafted a "landmark narrative" of the crisis that elevated the fraud and financial malfeasance of some S&L operators above other potential explanations. Lincoln Savings and Loan and its owner Charles Keating, the authors claimed, epitomized the "alleged abuses and criminal violations" of an "archetypal villain" whose actions, and those of others like him, toppled the entire industry.[656] Legislators who were "eager to displace

---

[653] The 70 percent benchmark of the Qualified Thrift Lender (QTL) established whether S&Ls could borrow from its district Federal Home Loan Bank. Historically, an asset test also decided whether thrifts qualified for the bad debt deduction. The Competitive Equality Banking Act (1987) formally created the "QTL" test in 1987 even as the FHLBB and IRS had instituted asset tests since the 1950s and 1960s. Thrifts, since 1975, had been required to maintain at least 60 percent of an "association's assets…in cash, residential mortgages and certain other specified investments." Between 1962 and 1975, it was 82 percent. CBO, "Resolving the Thrift Crisis," 20 (QTL and 70 percent); *Savings and Loan Sourcebook*, 12 (60 percent); and *1973 S&L Factbook*, 101-2 (82 percent).

[654] Walsh, "Dispute Among Senators"; and Downey, "Even Lawmakers Who Voted."

[655] Congress, between 1988 and 1993, held at least 78 separate hearings that spanned 158 days of witness testimony. I searched "S&L," "Savings and Loan," "Financial Institutions Reform, Recovery, and Enforcement," "Federal Home Loan Bank Board," and "FSLIC" in ProQuest Congressional to ascertain these numbers.

[656] Nichols and Nolan, "The Lesson of Lincoln," 145-6.

blame," the authors concluded, rushed to indict the Lincoln Savings of the industry while simultaneously portraying themselves as the "fearless champions of the public interest who set aside petty partisanship to reveal the truth and prevent the recurrence of evil….The congressional inquisitors proclaimed justice for the oppressed and called for judgment against the rich and powerful."[657]

It is not difficult to understand why congressional leaders tailored a self-serving narrative that focused on fraud. Congress had spent the better part of the two previous decades promoting both strategic and transformative deregulation as regulatory responses to thrift instabilities. Advocates of those competing deregulatory approaches, the former attempted to maintain housing's 40+ year old status as a public good while they simultaneously acknowledged how technological, political, and intellectual factors demonstrated why regulators needed to institute new regulatory policies that adapted to these new circumstances. The latter insisted upon fundamentally restructuring the regulatory framework of the U.S. financial sector, and other sectors of the American economy, because rational markets allocated resources, goods, and services more effectively, more efficiently, and more cheaply than government regulatory agencies. Thus, in an effort to implement transformative deregulatory changes, Congress had passed DIDMCA and Garn-St. Germain in 1980 and 1982 respectively, instituting regulatory forbearance and authorizing asset powers that many political and economic observers later claimed laid the groundwork for the financial malfeasance that ensued thereafter. Moreover, several political careers, including those of Speaker of the House Jim Wright (D-TX), Senator John McCain (R-AZ), Senator Dennis DeConcini (D-AZ), Senator John Glenn (D-OH), Senator Alan Cranston (D-CA),

[657] Ibid., 167-8.

Senator Donald Riegle (D-MI), and Representative Fernand St. Germain (D-RI), were significantly derailed and/or prematurely ended due to allegations of obstruction of justice and improprieties with unsavory S&L executives. So even though it is understandable that policymakers, for self-interested and ideological reasons, diverted attention elsewhere, its nevertheless highly problematic that they created a new regulatory structure based upon several wrongheaded and counterproductive interpretations of how U.S. and international financial markets operated.

Second, much of the existing literature on the crisis also, as the old proverb goes, missed the forest for the trees. It too emphasizes the poor management policies and criminal actions of the managers of failed thrifts. Additionally, most interpretations reflect an underlining acceptance of the efficient market hypothesis that is highly troubling. Their narratives assume that lacking the greed and regulatory failure thrifts would have averted a crisis. Instead, as they have claimed, "criminogenic environments," a "casino economy," forbearance, and regulatory capture (the "fix") had prevented financial markets from working their natural magic, thus inferring the S&L industry unnecessarily collapsed.[658]

This study shows that those assertions are simply not true. The S&L industry, as originally conceived by the architects of the growth and saver governance mechanism, would be eclipsed regardless of whether Congress demanded forbearance or Charles Keating swindled millions with his junk bonds. It actually already had been. Though fraud and malfeasance may have worsened its demise, the S&L industry had in fact entered the 1980s terminally ill. As Alan Greenspan so succinctly acknowledged, second layer lenders and other market forces prevented thrifts from maintaining their historic housing niche moving

---

[658] Black, *Best Way to Rob a Bank* (criminogenic environments); Calavita, *Big Money Crime* (casino economy); Barth, *The Savings and Loan Crisis* (forbearance); and Adams, *The Fix* (regulatory capture).

forward into the 1980s and beyond. Thus, both congressional and earlier scholarly accounts failed to identify and evaluate the larger systemic issues that this project highlighted as vital to understanding each stage of a longer S&L crisis. It is important for scholars of financial and political crises, as much as time and resources allow, to identify and understand the governance mechanism or governance mechanisms in which the institutions under examination operated. Doing so will ideally reveal the original systemic arrangements that allowed the industry to function within national and international markets, in addition to identifying and explaining change over time as various legal, economic, social, intellectual, and ideological inputs shift. It also hopefully forces policymakers and scholars to project how changing one or more ideological, socio-economic, political, and/or intellectual inputs to a governance mechanism will affect its existing policy objectives and future systemic operations.

Third, scholars and policymakers, by incorporating the logic of distinguishing between strategic and transformative into their analytic and methodological frameworks as they examine additional episodes of deregulatory fervor, will allow them to identify how interpretations of and justifications for deregulation differed, particularly deregulatory strands that are antithetical to one another. Additionally, but just as important, thinking about the distinctions between the two regulatory approaches can encourage both academics and policymakers to develop ways to construct a nimbler and more fluid regulatory framework. A system that does not essentially build a static view of technology, ideas, regulatory approaches, etc. into its operational and theoretical frameworks. Socio-economic, political, intellectual, and technological contexts, as the S&L crisis clearly demonstrates, can change in fundamentally important ways, and political and economic observers should be more

effective at identifying and adapting to those situations as to allow for smaller, quicker responses instead of waiting until for highly destructive and costly crises to fix a given set of problems.

Fourth, economic and political observers need more effective mechanisms for evaluating the health of financial institutions beyond their profitability. Despite the fact that the U.S. League identified almost 90 percent of S&Ls as profitable as late as 1988, the profitability of hundreds of institutions was an accounting ruse allowed by regulators and other policymakers who feared the political and economic fallout of a collapsed S&L industry. It seems counter-intuitive to suspect that consistently healthy and/or high earnings are an aberration, but as the accounting scandals of the early 2000s or the subprime crisis of 2007/2008 also demonstrated, rapid declines after years of high returns are not an anomaly. Just as important, they are rarely spontaneous events; the economic signals most often are readily available, as was the case for the operational and institutional changes that S&L executives implemented over the late 1960s and 1970, if only economic and political observers take the time to look close enough.

Lastly, scholars and policymakers at state and federal levels need to continue to reevaluate how political dynamics allow, or often disallow, regulators and other state actors from resolving burgeoning economic problems. Just as policymakers had several opportunities to effect significantly meaningful and lasting change for the S&L industry during the 1970s and 1980s, they failed to act because they apparently lacked the requisite political or economic crisis or feared the political fallout. As was also true for the S&L crisis, the failure to act proved much costlier than addressing the institutional and/or systemic financial instabilities at the time they emerged as problems. But that recommendation

assumes that policymakers have accurately assessed the causes and consequences of a problem, understand the socio-economic, political, and theoretical ramifications of their recommendations, and established the social and political support necessary to enact its proposal. Unfortunately, however, as the long S&L crisis demonstrated at several pain points over the course of the 1960s, and 1970s, and 1980s, that is painfully hard to accomplish.

BIBLIOGRAPHY

ARCHIVAL COLLECTIONS

Ronald Reagan Presidential Library
1966 Campaign Files
Beryl Sprinkel Files
Dan Crippen Files
Edwin Meese Files
Economic Policy Council: Records
Federal Government Operations
Martin Anderson Files
Thomas Moore Files
WHO Records: Public Affairs
William Poole Files

Jimmy Carter Presidential Library
Cabinet Secretary and Intergovernmental Affairs
Chief of Staff Butler
Government Reform – Neustadt Files
JC CEA – Council of Economic Advisors
Pre-Presidential 1976 Presidential Campaign
Simon Lazarus' 1976 Campaign Transition Files
Stuart Eizenstat Files

Hoover Institution
Murray L. Weidenbaum Papers

Briscoe Center for American History
Henry Gonzalez Papers

CONGRESSIONAL AND EXECUTIVE SOURCES

Carter, Jimmy. "Financial Reform Legislation Message to the United States Congress." Speech,
Washington, DC, May 22, 1979.
_____. "Remarks on Signing H.R. 4986, the Depository Institutions Deregulation and Monetary Control Act of 1980." Speech, Washington, DC, March 31, 1980.
Congressional Budget Office. *Resolving the Thrift Crisis*. Washington, DC: U.S. Government
Publishing Office, 1993.
Executive Order no. 11821. *Code of Federal Regulations.* November 27, 1974.
Executive Order no. 12044. *Code of Federal Regulations*. March 23, 1978.
Executive Order no. 12291. *Code of Federal Regulations*. February 17, 1981.

Federal Open Market Committee of the Federal Reserve System. *Minutes*. Washington, DC, September 28, 1965.

Federal Open Market Committee of the Federal Reserve System. *Minutes*. Washington, DC, March 1, 1966.

Federal Open Market Committee of the Federal Reserve System. *Minutes*. Washington, DC, August 23, 1966.

Federal Home Loan Bank Board Office of Economic Research. *A Financial Institution for the Future: An Examination of the Restructuring of the Savings and Loan Industry.* Washington, DC, Government Printing Office, 1975.

Financial Crisis Inquiry Commission. *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*. Washington, DC: U.S. Government Publishing Office, 2011.

Ford. Gerald. "Address to a Joint Session of the Congress on the Economy." Speech, Washington, DC, October 8, 1974.

_____. "Presidential Campaign Debate." Speech, Philadelphia, PA, September 23, 1976.

_____. "Remarks at the White House Conference on Domestic and Economic Affairs." Speech, Washington, DC, April 18, 1975.

_____. "Remarks in Chicago at the Convention of the American Hardware Manufacturers Association," Speech, Chicago, IL, August 25, 1975.

Friend, Irwin. *Study of the Savings and Loan Industry*. Washington, DC: U.S. Government Publishing Office, 1969.

Hunt, Reed. *The Report of the President's Commission on Financial Structure and Regulation*. Washington, DC: U.S. Government Publishing Office, 1972.

Johnson, Lyndon. "Remarks on the Occasion of the 50th Anniversary of the Brookings Institution." Speech, Washington, DC, September 29, 1966.

Nixon, Richard. "Special Message to the Congress Proposing Changes in the Nation's Financial System." Speech, Washington, DC, June 16, 1970.

_____. "Special Message to the Congress Proposing Changes in the Nation's Financial System." Speech, Washington, DC, August 3, 1973.

Proxmire, William. "Speaking on Outgoing Federal Home Loan Bank Board: Chairman Edwin Gray." 100th Congress, 1st session, *Congressional Record* 133 (June 30, 1987): 18121.

Reagan, Ronald. "Signing Ceremony for Garn-St. Germain Depository Institutions Act." Speech, Washington, DC, October 15, 1982.

Regan, Donald. "Remarks by Donald T. Regan before the Civic Federation." Speech, Chicago, IL, September 14, 1981.

U.S. Congress. House. Committee on Banking and Currency. *The Credit Crunch and Reform of Financial Institutions*. 93rd Congress, 1st session, September 10, 1973.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. *Mark-Up Session: S. 2591, Financial Institutions Act of 1973*. 93rd Congress, 1st session, November 5, 1973.

U.S. Congress. House. Committee on Banking, Currency, and Housing. Subcommittee on Financial Institutions Supervision, Regulation and Insurance. *Variable Rate Mortgage Proposal and Regulation Q*. 94th Congress, 1st session, April 9, 1974.

U.S. Congress. House. Banking, Currency and Housing. Subcommittee on Financial

Institutions Supervision, Regulation and Insurance. *Financial Institutions and the Nation's Economy (FINE) "Discussion Principles*." 94th Congress, 1st and 2nd Sessions, December 2, 1975.

U.S. Congress. House. Committee on Banking, Finance, and Urban Affairs. Subcommittee on Financial Institutions Supervision, Regulation, and Insurance. *Financial Institutions and the Nation's Economy.* Washington, DC: U.S. Government Publishing Office, 1976.

U.S. Congress. Senate. Committee on Banking, Housing and Urban Affairs. *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*. 94th Congress, 2nd session, December 9, 1976.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. "Meeting on Extension of Regulation Q." 95th Congress, 1st session, March 1, 1977.

U.S. Congress. House. Committee on Banking, Housing, and Urban Affairs. Subcommittee on Financial Institutions. *Recommendations of the Ad Hoc Task Force on Mortgage Credit*. Washington, DC: Government Printing Office, 1979.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. *Report on Consumer Financial Services Act of 1977*. Washington, DC: Government Printing Office, 1979.

U.S. Congress. House. Committee on Government Operations. *Interest Rate Regulation on Small Savings Accounts*. 96th Congress, 1st session, March 20, 1979.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. Subcommittee on Financial Institutions. *Depository Institutions Deregulation Act of 1979*. 96th Congress, 1st session, June 21, 1979.

U.S. Congress. 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 session, September 13, 1982.

U.S. Congress. 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 session, September 21, 1982.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. *Nomination of Edwin Gray*. 98th Congress, 1st session, February 23, 1983.

U.S. Congress. Senate. Committee on Banking, Housing, and Urban Affairs. *Financial Services Industry – Oversight*. 98th Congress, 1st session, May 4, 1983.

U.S. Congress. Senate. Committee on Banking, Finance and Urban Affairs. Subcommittee on General Oversight and Renegotiation. *Deregulation and the Federal Home Loan Bank Board*. 98th Congress, 1st session, November 9, 1983.

U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. *How the Financial System Can Best Be Shaped to Meet the Needs of The American People*. 98th Congress, 2nd Session, April 1984.

U.S. Congress. House. Committee on Energy and Commerce. Subcommittee, on Telecommunications, Consumer Protection, and Finance. *Financial Restructuring: The Road Ahead*. 98th Congress, 2nd session, April 4, 1984.

U. S. Congress. House. Committee on Banking, Finance and Urban Affairs. *The Savings and Loan Crisis*. 101st Congress, 1st Session, January 12 and 13, 1989.

U.S. Congress. House. Committee on Oversight and Government Reform. *The Financial Crisis and the Role of Federal Regulators*. 110th Congress, 2nd session, October 23, 2008.
U.S. Department of the Treasury. *Recommendations for Change in the U.S. Financial System.* Washington, DC, Government Printing Office, 1973.

PERIODICALS

Apple, R.W. "Campaign '76: Barren and Petty." *New York Times*. October 20, 1976.
Anderson, Bill. "Ford's Views on the 1976 Election." *Chicago Tribune*. July 24, 1975.
Anderson, Jack and Joseph Spear. "S&L High Rollers Target Reformer." *The Washington Post*. November 6, 1986.
"Bank Board Chief Said to Resist Resignation." *New York Times*. October 29, 1985.
Cerra, Frances. "Consumers Hear Antitrust Pledge." *New York Times*. January 23, 1976.
Conte, Christopher. "Regulators Say Banking Safeguards are Faulty and Need an Overhaul." *Wall Street Journal*. March 21, 1983.
"Debate on Regulation." *New York Times*. October 28, 1976.
Downey, Kirstin. "Even Lawmakers Who Voted for S&L Bill Say Problems Remain." *The Washington Post*. August 6, 1989.
"Gray Tapped by Reagan as Bank Board Member." *Wall Street Journal*. February 18, 1983.
Greenspan, Alan. "Onward the Revolution in Financial Services." *Wall Street Journal*. September 16, 1983.
Hallett, Douglas. "The GOP's Ideological Poverty." *Wall Street Journal*. January 3, 1975.
Hill, G. Christian. "Solo Flight." *Wall Street Journal*. April 6, 1981.
Jackson, Brooks and Paulette Thomas. "As S&L Crisis Grows, U.S. Savings League Loses Lobbying Clout." *Wall Street Journal*. March 7, 1989.
Jordan, Vernon. "Running against the Government." *Tri-State Defender*. March 20, 1976.
Kraft, Joseph. "Right, for Ford." *New York Times*. April 25, 1976.
Large, Arlen and Albert Hunt. "Grass-Root Gripes About Cost of Living May Tip Congress for Oil Price Controls." *Wall Street Journal*. September 4, 1975.
Langley, Monica. "Troubled Bank Board's Chairman Gray Is Likely to Resign Soon, Officials Say." *Wall Street Journal*. October 28, 1985.
Lueck, Thomas. "The Competitive Era in Savings." *New York Times.* January 18, 1981.
"McKinney Nominated by Carter to Head Home Loan Board." *Wall Street Journal*. June 24, 1977.
Neikirk, Bill. "Blueprint for Fall of Regulators." *Chicago Tribune*. September 19, 1975.
Nordheimer, Jon. "Reagan, a Fast Starter, Faces First Test." *New York Times*. December 23, 1975.
Quint, Michael. "Talking Business: with Pratt of the Home Loan Bank Board." *New York Times*.April 28, 1981.
Rankin, Deborah. "Failed Promises in Banking Deregulation." *New York Times*. November 29, 1981.
Rehm, Barbara. "GAO Gives Deregulation Mixed Review." *American Banker*. July 13, 1987.
Rosenblatt, Robert and Tom Redburn. "S&Ls May Have Outlived Need, Greenspan Says."

Los Angeles Times. February 24, 1989.
Rowe Jr., James. "Problems Arise from Slow Pace of Appointments." *Washington Post*. July 5, 1977.
Rowen, Hobart. "Ford's Pragmatic Economics." *Washington Post*. May 2, 1976.
Schlesinger Jr., Arthur. "Shambles of '76." *New York Times*. November 1, 1976.
Shifrin, Carole. "Regulation Talk to Turn into Action." *Washington Post*. January 11, 1976.
Smith, J. Stanford. "A Perspective on Regulation." *New York Times*. June 14, 1976.
Squires, Jim. "Campaign '76: The Epic Struggle Begins." *Chicago Tribune*. January 11, 1976.
terHorst, Jerald. "Regulating the Regulators." *Chicago Tribune*. April 21, 1976.
Trombley, William. "Hoover Institution Makes Impact on Domestic Front." *Los Angeles Times*. September 11, 1975.
Villchur, Edgar. "Reagan Set Table for Savings and Loan Orgy." *New York Times*. August 23, 1990.
von Hoffman, Nicholas. "Fresh Face but a Stale Mind." *Chicago Tribune*. May 15, 1976.
_____. "Trucking Along Regulation Road." *Chicago Tribune*. February 15, 1975.
Walsh, Sharon. "Dispute Among Senators Mires S&L Conference Talks." *The Washington Post*. July 25, 1989.
Walsh, Sharon and Kirstin Downey. "Conferees Set on S&L Plan: Bill Faces Senate Challenge, Veto Threat." *The Washington Post*. July 28, 1989.
Washburn, Gary. "Danger of Obsolescence Cited: Changes Needed for S&Ls, Experts Admit." *Chicago Tribune*. November 30, 1975.
Wicker, Tom. "Reagan's Lead May Be Real." *New York Times*. December 23, 1975.

BOOKS AND ACADEMIC ARTICLES

Adams, James. *The Big Fix: Inside the S&L Scandal*. New York: John Wiley and Sons, Inc., 1990.
Anderson, Totten and Eugene Lee. "The 1966 Election in California." *The Western Political Quarterly* 20 (1967): 535-554.
Arrow, Kenneth. *Social Choice and Individual Values*. New York: John Wiley and Sons, 1951.
Balderston, Frederick. *Thrifts in Crisis: Structural Transformation of the Savings and Loan Industry*. Cambridge: Ballinger Publishing Company, 1985.
Barth, James, Susanne Trimbath, and Glenn Yago, eds. *The Savings and Loan Crisis: Lessons from a Regulatory Failure*. Santa Monica: Milken Institute, 2004.
Becker, Gary. "A Theory of Competition Among Pressure Groups for Political Influence." *Quarterly Journal of Economics* (1983): 371-400.
_____. "Competition and Democracy." *Journal of Law and Economics* 1 (1958): 105-9.
Benford, Robert and David Snow. "Framing Processes and Social Movements: An Overview and Assessment." *Annual Review of Sociology* 26 (2000): 611-39.
Benston, George. "Discussion of the Hunt Commission Report: Comment." *Journal of Money* 4 (1972): 985-9.
Biven, Carl. *Jimmy Carter's Economy: Policy in an Age of Limits*. Chapel Hill: University of North Carolina Press, 2003.

Black, William. *The Best Way to Rob a Bank is to Own One*. Austin: University of Texas Press, 2005.
Blythe, Mark. *Great Transformations*. Cambridge: Cambridge University Press, 2002.
Bradford, William. *Mergers in the Savings and Loan Industry: Structural Changes, Financial Comparisons, and the Performance of Merging Savings and Loan Associations*. Ann Harbor: Michigan Business Reports, 1979.
Buchanan, James and Gordon Tullock. *The Calculus of Consent.* Ann Harbor: University of Michigan Press, 1962.
Burger, Albert. "A Historical Analysis of the Credit Crunch of 1966." *Federal Reserve Bank of St. Louis* (1969): 13-30.
Burgin, Angus. *The Great Persuasion: Reinvesting Free Markets since the Depression*. Cambridge: Harvard University Press, 2012.
Burns, Arthur. "Maintaining the Soundness of our Banking System." *Federal Reserve Bank of New York Monthly Review* (1974): 263-7.
Calavita, Kitty, Henry Pontell, and Robert Tillman. *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis*. Berkeley: University of California Press, 1997.
Cannon, Lou. *Governor Reagan: His Rise to Power*. New York: Public Affairs, 2003.
_____. *President Reagan: The Role of a Lifetime*. New York: Public Affairs, 1991.
Carpenter, Daniel. *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862-1928*. Princeton: Princeton University Press, 2001.
Carron, Andrew. *The Plight of the Thrift Industry*. Washington, DC: The Brookings Institution, 1982.
Cassidy, John. *How Markets Fail: The Logic of Economic Calamities*. New York: Farrar, Straus and Giroux, 2009.
Chritchlow, Donald. "Robert S. Brookings: The Man, the Vision and the Institution." *The Review of Politics* 46 (1984): 561-81.
Coase, Ronald. "The Nature of the Firm." *Economica* 16 (1937): 386-405.
_____. "The Problem of Social Cost." *Journal of Law and Economics* 3 (1960): 1-44.
Collins, Robert. "The Economic Crisis of 1968 and the Waning of the 'American Century.'" *The American Historical Review* 101 (1996): 396-422.
Crespino, Joseph. *In Search of Another Country: Mississippi and the Conservative Counterrevolution*. Princeton: Princeton University Press, 2007.
Dalleck, Matthew. *The Right Moment: Ronald Reagan's First Victory and the Decisive Turning Point in American Politics*. New York: The Free Press, 2000.
Day, Kathleen. *S&L Hell: The People and Politics Behind the $1 Trillion Savings and Loan Scandal*. New York: W.W. Norton and Company, 1993.
De Groot, Gerald. "'A Goddamned Electable Person': The 1966 California Gubernatorial Campaign of Ronald Reagan." *History* 82 (1997): 429-48.
_____. "Ronald Reagan and Student Unrest in California, 1966-1970." *The Pacific Historical Review* 65 (1996): 107-29.
Derthick, Martha, and Paul Quirk. *The Politics of Deregulation*. Washington, DC: The Brookings Institution, 1985.
Dickens, Edwin. "The Great Inflation and U.S. Monetary Policy in the Late 1960s: A Political Economy Approach." *Social Concept* 9 (1995): 49-82.
_____. "U.S. Monetary Policy in the 1950s: A Radical Political Economic Approach."

Review of Radical Political Economics 27 (1995): 83-111.
Downs, Anthony. *An Economic Theory of Democracy*. New York: Harper & Brothers, 1957.
Dudziak, Mary. "Desegregation as a Cold War Imperative." *Stanford Law Review* 61 (1988): 61-120.
Eads, George, and Michael Fix. *Relief or Reform? Reagan's Regulatory Dilemma*. Washington, DC: Urban Institute Press, 1985.
Eichler, Ned. *The Thrift Debacle*. Berkeley: University of California Press, 1989.
Eisner, Marc Allen. "Markets in the Shadow of the State: An Appraisal of Deregulation and Implications for Future Research." In *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen & David Moss, 512-37. Cambridge: Cambridge University Press, 2010.
Farr, James. "Understanding Conceptual Change Politically." In *Political Innovation and Conceptual Change*, eds. Terance Ball et al, 24-49. Cambridge: Cambridge University Press, 1989.
Fine, Ben and Dimitris Milonakis. *From Political Economy to Economics: Method, the Social and the Historical in the Evolution of Economic Theory*. New York: Routledge, 2009.
Furner, Mary. "From 'State Interference' to the 'Return to the Market': The Rhetoric of Economic regulation from the Old Gilded Age to the New," in *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen & David Moss, 92-142. Cambridge: Cambridge University Press, 2010.
Geertz, Clifford. *The Interpretation of Cultures*. New York: Basic Books Inc., 1973.
Gerstle, Gary and Steve Fraser. *The Rise and Fall of the New Deal Order, 1930-1980.* Princeton: Princeton University Press, 1989.
Gerston, Larry, Cynthia Fraleigh, and Robert Schwab. *The Deregulated Society*. Pacific Grove: Brooks/Cole Publishing Co., 1988.
Gitlin, Todd. *The Whole World Is Watching: Mass Media in the Making and Unmaking of the New Left, 2nd ed.* Berkeley: University of California Press, 2003.
Gray, Edwin. "Gray Urges Congress." *Federal Home Loan Bank Board Journal* 9 (1983): 2-4.
Greenspan, Alan. *Age of Turbulence: Adventures in a New World.* New York: Penguin Press, 2007.
_____. "Antitrust." In *Capitalism: The Unknown Ideal*, ed. Ayn Rand, 63-71. New York: Signet Books, 1962.
_____. "Gold and Economic Freedom." In *Capitalism: The Unknown Ideal*, ed. Ayn Rand, 96-101. New York: Signet Books, 1962.
_____. "Remarks Before a conference on Mortgage Markets and Economic Activity Sponsored by American's Community Bankers," Washington, DC, 1999.
_____. "The Assault on Integrity." In *Capitalism: The Unknown Ideal*, ed. Ayn Rand, 118-21. New York: Signet Books, 1962.
Greider, William. *Secrets of the Temple: How the Federal Reserve Runs the Country*. New York: Simon and Schuster, 1987.
Groenewegen, John, Antoon Spithoven, and Annette Van Den Berg. *Institutional Economics: An Introduction*. London: Palgrave, 2010.
Friedman, Milton. *Capitalism and Freedom.* Chicago: University of Chicago Press, 1962.
Friedman, Milton and Anna Schwartz. *A Monetary History of the United States, 1867-*

1960. Princeton: Princeton University Press, 1971.
Hall, Jacquelyn Dowd. "The Long Civil Rights Movement and the Political Uses of the Past." *Journal of American History* 91 (2005): 1233-63.
Hammond, Thomas and Jack Knott. "The Deregulatory Snowball: Explaining Deregulation in the Financial Industry." *The Journal of Politics* 50 (1988): 3-30.
Harris, Jack. "Major Issues for Thrifts in the 1980s." *Federal Home Loan Bank Board Journal* 2 (1983): 7-11.
Haskell, Thomas. *The Emergence of Professional Social Science: The American Social Science Association and the Nineteenth-Century Crisis of Authority*. Baltimore: Johns Hopkins University Press, 2000.
Hemel, Eric. "The Financial Outlook for the Savings and Loan Industry," *Federal Home Loan Bank Board Journal* 12 (1984): 3.
Hester, Donald. "Special Interests: The FINE Situation." *Journal of Money, Credit and Banking* 9 (1977): 652-61.
Horvitz, Paul. "The Hunt Commission Report: A Further Comment." *The Journal of Finance* 29 (1974): 267-9.
Hyman, Louis. *Debtor Nation: The History of America in Red Ink*. Princeton: Princeton University Press, 2011.
Isserman, Maurice and Michael Kazin. *America Divided: The Civil War of the 1960s, 2nd ed.* New York: Oxford University Press, 2004.
Jenkins, Philip. *Decade of Nightmares: The End of the 1960s and the Making of Eighties America.* Oxford: Oxford University Press, 2006.
Kalman, Laura. *Right Star Rising: A New Politics, 1974-1980.* New York: W.W. Norton, 2010.
Kane, Edward. "Getting Along Without Regulation Q: Testing the Standard View of Deposit-Rate Competition During the 'Wild-Card Experience.'" *The Journal of Finance* 33 (1977): 921-32.
_____. "What Lessons Might Crisis Countries in Asia and Latin America Have Learned from the Savings and Loan Mess." In *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James R. Barth, Susanne Trimbath, and Glenn Yago, 113-132. Norwell: Kluwer Academic Publishers, 2004.
Kaufman, George. "What Have We Learned from the Thrift and Banking Crises of the 1980s?" In *The Savings and Loan Crisis: Lessons from Regulatory Failure*, eds. James Barth, Susanne Trimbath and Glenn Yago, 1-14. Norwell: Kluwer Academic Publishers, 2004.
Kindleberger, Charles. *Keynesianism vs. Monetarism and Other Essays in Financial History*. New York: Routledge, 1985.
Kwak, James. "Cultural Capture and the Financial Crisis." In *Preventing Regulatory Capture: Special Interests Influence and How to Limit It*, eds. Daniel Carpenter and David Moss, 71-98. Cambridge: Cambridge University Press, 2014.
Lassiter, Michael. "Political History Beyond the Red-Blue Divide." *Journal of American History* (2011): 760-64.
Laub, P. Michael. "The Deregulation of Banking." In *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White, 201-18. Washington DC: Beard Books, 1979.
Leight, Jessica. "Public Choice: A Critical Assessment." In *Government and Markets:*

Toward a New Theory of Regulation, eds. Edward Balleisen & David Moss, 213-55. Cambridge: Cambridge University Press, 2010.

Leibold, Jr., Arthur. "Some Hope for the Future, After a Failed National Policy for Thrifts." In *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James Barth, Susanne Trimbrath, and Glen Yago, 31-60. Norwell: Kluwer Academic Publishers, 2004.

Livingston, James. "The Social Analysis of Economic History and Theory: Conjectures on Late Nineteenth-Century American Development." *The American Historical Review* 92 (1987): 69-95.

Luttrell, Clifton. "Hunt Commission Report – An Economic View." *Federal Reserve Bank of St. Louis* (June 1972), 8-12.

Mason, David. *From Buildings and Loans to Bail-outs: A History of the American Savings and Loan Industry, 1831-1995*. Cambridge: Cambridge University Press, 2004.

Mayer, Martin. *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry*. New York: Charles Scribner's Sons, 1990.

McGirr, Lisa. *Suburban Warriors: The Origins of the New American Right*. Princeton: Princeton University Press, 2001.

Meyerson, Ann. "Deregulation and the Restructuring of the Housing Finance System." In *Critical Perspectives on Housing*, eds. Rachel Bratt, Chester Hartman, and Ann Meyerson, 68-98. Philadelphia: Temple University Press, 1986.

Nichols, Lawrence and James Nolan. "The Lesson of Lincoln: Regulation as Narrative in the Savings and Loan Crisis." In *The Savings and Loan Crisis: Lessons from a Regulatory Failure*, eds. James R. Barth, Susanne Trimbath, and Glenn Yago, 143-172. Norwell: Kluwer Academic Publishers, 2004.

O'Connor, Alice. "The Politics of Rich and Rich: Postwar Investigations of Foundations and the Rise of the Philanthropic Right." In *American Capitalism: Social Thought and Political Economy in the Twentieth Century*, ed. Nelson Lichtenstein, 228-48. Philadelphia: University of Pennsylvania Press, 2006.

Packer, Stephen. "The Credit 'Crunch': 1969 v. 1966." *Financial Analysts Journal* 25 (1969): 18-24.

Panitch Leo and Sam Gindin. *The Making of Global Capitalism: The Political Economy of American Empire.* Brooklyn: Verso, 2012.

Pew Research Center. "Public Trust in Government: 1958-2017." People-press.org. http://www.people-press.org/2017/05/03/public-trust-in-government-1958-2017 (accessed June 30, 2017).

Phillips, Almarin, "Regulatory Reform for the Deposit Financial Institutions—Retrospect and Prospects." *The Journal of Financial and Quantitative Analysis* 9 (1974): 795-802.

Phillips-Fein, Kim. *Invisible Hands: The Making of the Conservative Movement from the New Deal to Reagan*. New York: W.W. Norton, 2009.

Pierce, James. "The FINE Study." *Journal of Money, Credit, and Banking* 9 (1977): 605-18.

Pilzer, Paul Zane, and Robert Deitz. *Other People's Money: How Bad Luck, Worse Management, and Flagrant Corruption Made a Shambles of a $900 Billion Industry*. New York: Simon and Schuster, 1989.

Pizzo, Stephen, Mary Fricker, and Paul Muolo. *Inside Job: The Looting of America's Savings and Loans*. New York: McGraw-Hill Publishing Co., 1990.

Polanyi, Karl. *The Great Transformation: The Political and Economic Origins of Our Time*. Boston: Beacon Press Books, 1957.
Posner, Richard. "The Social Costs of Monopoly and Regulation." *The Journal of Political Economy* 83 (1975): 807-828.
Pratt, Richard. "1982 Annual Report to Congress." *Federal Home Loan Bank Board Journal* 4 (1983): 4-5.
Putnam, Robert. "Studying Elite Political Culture: The Case of "Ideology." *The American Political Science* Review 65 (1971): 651-81.
Rand, Ayn. *Capitalism: The Unknown Ideal.* New York: Signet Books, 1962.
_____. *The Fountainhead.* New York: Signet Books, 1943.
Redisch, Michael. "Comment." In *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White, 101-4. Washington DC: Beard Books, 1979.
Reppert, Joseph. "Competing in the Current Marketplace." *Federal Home Loan Bank Board Journal* 12 (1984): 20.
Riley, Paddy. "Clark Kerr: From the Industrial to the Knowledge Economy." In *American Capitalism: Social Thought and Political Economy in the Twentieth Century*, ed. Nelson Lichtenstein, 71-87. Philadelphia: University of Pennsylvania Press, 2006.
Robinson, Roland. "The Hunt Commission Report: A Search for Politically Feasible Solutions to the Problems of Financial Structure." *The Journal of Finance* 27 (1972): 765-77.
Rodgers, Daniel. *Age of Fracture*. Cambridge: Belknap Press, 2011.
_____. *Contested Truths: Keywords in American Politics Since Independence*. New York: Basic Books, Inc., 1987.
Rom, Mark Carl. *Public Spirit in the Thrift Tragedy*. Pittsburgh: University of Pittsburgh Press, 1996.
Ross, Dorothy. *The Origins of American Social Science*. Cambridge: Cambridge University Press, 1991.
Schotland, Roy. "An Overview: New Myths and Old Realities." In *The Deregulation of the Banking and Securities Industries*, eds. Lawrence Goldberg and Lawrence White, 9-30. Washington DC: Beard Books, 1979.
Schulman, Bruce. *The Seventies: The Great Shift in American Culture, Society, and Politics.* New York: The Free Press, 2001.
Schultze, Charles. "The CEA: An Inside Voice for Mainstream Economics." *The Journal of Economic Perspectives* 10 (1996): 23-39.
Self, Robert. *American Babylon: Race and the Struggle for Postwar Oakland*. Princeton: Princeton University Press, 2003.
Skocpol, Theda. "State Capacity and Economic Intervention in the Early New Deal." *Political Science Quarterly* 97 (1982): 255-78.
Skowronek, Stephen. *Building a New American State: The Expansion of National Administrative Capacities, 19877-1920*. New York: Cambridge University Press, 1982.
Smith, James. *The Idea Brokers: Think Tanks and the Rise of the New Policy Elite*. New York: The Free Press, 1991.
Stein, Herbert. "A Successful Accident: Recollections and Speculations about the CEA." *The Journal of Economic Perspectives* 10 (1996): 3-21.

Stein, Judith. *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies*. New Haven: Yale University Press, 2010.
Stigler, George. "The Theory of Economic Regulation." *The Bell Journal of Economics and Management Science 2* (1971): 3-21.
Stone, Michael. "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.
Strunk, Norman and Fred Case. *Where Deregulation Went Wrong: A Look at the Causes Behind Savings and Loan Failures in the 1980s*. Chicago: United States League of Savings Institutions, 1988.
Sugrue, Thomas. *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit*. Princeton: Princeton University Press, 1996.
Teles, Steven. *The Rise of the Conservative Legal Movement: The Battle for Control of the Law*. Princeton: Princeton University Press, 2008.
Thomas, O. Pendleton. "The Contradiction." *National Journal Policy Forum*, (June 12, 1976): 18-9.
Thygerson, Kenneth. "Thrifts and Deregulation: Freddie Mac's Role." *Federal Home Loan Bank Board Journal* 7 (1983): 4-5.
Troy, Gil. *Morning in America: How Ronald Reagan Invented the 1980s*. Princeton: Princeton University Press, 2005.
U.S. League of Savings Institutions. *1965 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1965.
U.S. League of Savings Institutions. *1966 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1966.
U.S. League of Savings Institutions. *1967 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1967.
U.S. League of Savings Institutions. *1968 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1968.
U.S. League of Savings Institutions. *1969 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1969.
U.S. League of Savings Institutions. *1970 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1970.
U.S. League of Savings Institutions. *1971 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1971.
U.S. League of Savings Institutions. *1972 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1972.
U.S. League of Savings Institutions. *1973 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1973.
U.S. League of Savings Institutions. *1974 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1974.
U.S. League of Savings Institutions. *1975 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1975.
U.S. League of Savings Institutions. *1976 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1976.
U.S. League of Savings Institutions. *1977 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1977.

U.S. League of Savings Institutions. *1978 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1978.
U.S. League of Savings Institutions. *1979 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1979.
U.S. League of Savings Institutions. *1980 Savings and Loan Factbook.* Chicago: U.S. League of Savings Institutions, 1980.
U.S. League of Savings Institutions. *1981 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1981.
U.S. League of Savings Institutions. *1982 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1982.
U.S. League of Savings Institutions. *1983 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1983.
U.S. League of Savings Institutions. *1984 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1984.
U.S. League of Savings Institutions. *1985 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1985.
U.S. League of Savings Institutions. *1986 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1986.
U.S. League of Savings Institutions. *1987 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1987.
U.S. League of Savings Institutions. *1988 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1988.
U.S. League of Savings Institutions. *1989 Savings and Loan Sourcebook.* Chicago: U.S. League of Savings Institutions, 1989.
Walker, Dustin. "The S&L Crisis in Its Earliest Days: Banking Reform Rhetoric in the Johnson and Nixon Years," *Federal History Journal 8* (2016): 71-94.
Weidenbaum, Murray. "A New Approach to National Priorities and Governmental Decision-Making," *Business and Society Review* (1975): 1-9.
Woerheide, Walter. *The Savings and Loan Industry: Current Problems and Possible Solutions*. Westport: Quorum Books, 1984.
Yackee, Susan Webb. "Reconsidering Agency Capture During Regulatory Policymaking." In *Preventing Regulatory Capture*: *Special Interest Influence and How to Limit It*, eds. Daniel Carpenter and David Moss, 292-325. New York: Cambridge University Press, 2014.
Ylvisaker, William. "Free Enterprise System: Restoring Faith in the Marketplace." *National Journal Policy Forum* (June 12, 1976): 16-7.
Yonay, Yuval. *The Struggle Over the Soul of Economics: Institutionalist and Neoclassical Economists in America*. Princeton: Princeton University Press, 1998.
_____. "When Black Boxes Clash: Competing Ideas of What Science Is in Economics, 1924-39." *Sociological Forum* 21 (2006): 345-86.