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SAVINGS AND LOANS AND THE ECONOMY: TOUGH CHOICES FOR THE 80's

INTRODUCTION

The 1980's have begun like the first blast of a cold shower in the early morning; shocking us out of drowsiness and confronting us with the chilling realities of a changing world. In this decade, we Americans will be forced to make tough choices and meet complex new challenges. We live in a volatile world with no time for complacency.

Obviously, this alarming truth confronts us most dramatically and dangerously right now in the field of foreign and military affairs. But, we also live in a volatile economy and the economic problems of our nation are linked to world affairs more closely than perhaps ever before.

The experts in international finance warn us of alarming weakness in the structure of the international monetary system. And here at home, respected economists from Wall Street to Washington's Massachusetts Avenue, the home of the liberal think tank, the Brookings Institution, warn us that we have reached the danger point.

Barry Bosworth, formerly director of the Council on Wage and Price Stability and now a Senior Fellow at Brookings, says "inflation has just exploded"; "extreme changes in policy" will be needed to turn it around.

And Henry Kaufman of Soloman Brothers, in a recent speech here in California, made headlines and sent the stock market plummeting with his statement that the inflation and energy situations have pushed us to the point of a "national emergency".

I suspect that few people know better the reality of our present economic danger than the dedicated men and women of the savings and loan industry, who struggle to serve their communities in the face of rapidly mounting difficulties.

As one who comes from a background as a founder and former director of a savings and loan association in my home community in North Carolina, I can well imagine the frustration of savings and loan managers today. They are up against events beyond their control.

I imagine it is something akin to the frustration of this U.S. Senator who came to Washington nearly six years ago convinced that we must stop and turn around the growth of federal power, federal spending and federal bureaucracy. The picture sometimes seems somewhat discouraging.

For savings and loans in particular, and for financial institutions in general, this past decade has been a time of enormous change. There is little doubt that the 1980's will continue to be a time of even greater challenge and change.

In any period of rapid change, I believe we need to keep our heads about us, evaluate proposals carefully, act cautiously and keep our basic principles firmly in mind. This is true in foreign policy and it is equally true for proposals which would drastically alter our basic system of financial institutions. I think we need to keep firmly in mind the basic fact, that after all is said and done, savings and loan's remain our nation's primary public policy instrument to maintain an adequate flow of credit for home ownership. Savings and loans are still the most effective tool we have for carrying out our nation's housing policy. And I believe the 1980s should be a time to renew our basic commitment to the notion that Americans are going to remain a nation of homeowners and that the private sector is going to continue to be the primary vehicle for housing finance.

In the time we have today, I want to discuss briefly some of the proposals for changes in financial regulation, the legislative events of last year, and the outlook for Congressional action this year.

REVIEW OF FINANCIAL REFORM PROPOSALS

When Norman Strunk appeared recently before the House Financial Institutions Subcommittee on behalf of the U.S. League of Savings Associations to discuss Regulation Q, he said, "It seems that I have testified in this room on this subject at least a dozen times, including the first period of disintermediation in 1966 when the Regulation Q authority was extended to include savings and loan associations and savings banks".

I have often felt a bit like Norm Strunk as I have sat in the Senate Banking Committee for the past six years. But, of course, these issues have been with us for much longer. In 1958, the first major study of financial reform in the postwar era in the United States was undertaken by the Commission on Money and Credit (CMC), a private group established by the Committee for Economic Development. The CMC Report suggested a liberalization of the regulations that governed different intermediaries and called for allowing greater portfolio flexibility for thrift institutions.

The CMC Report was the most comprehensive overview of the financial system produced up to that time. However, the total reform package was never seriously considered for implementation. The major reason was that the financial system, especially housing finance, was not perceived to be in any great difficulty at the time the report appeared. Thus the recommendations of the commission never got the political support they needed to become law.

But by the mid-1960s, serious strains had appeared in our financial system and since that time we have witnessed a series of reports, studies, commissions and bills.

The most recent event in this cycle has, of course, been the House and Senate conference on H.R. 4986, the Depository Institutions Deregulation Act, which met this week.

MORGAN ROLE ON H.R. 4986

In general, I have viewed the whole trend toward what I have called the "homogenization" of financial institutions with a great deal of concern. I have been very skeptical of various proposals which have been put forward and passed. My fear is that we will end up making all financial institutions more or less alike and that open competition might very well spell the end of the savings and loan industry as we have known it. In the process, I fear we may well destroy the very system which has provided most of the home-ownership in our country.

During the Banking Committee's hearings last year, I asked then Secretary of the Treasury Blumenthal what distinctions would remain between savings and loans and commercial banks. The Secretary answered that as far as functions and powers were concerned, savings and loans and banks "will be much closer together". Under H.R. 4986, he said, "the distinctions would certainly be narrowed".

But one of the best statements of my concerns on this matter came during our Committee mark-up by one of the sponsors of the bill itself, your own very distinguished Senior Senator. When Senator Cranston moved to exempt the savings and loans of California from the NOW account provisions of the bill, he said "I think there is virtue in keeping differences between different types of financial institutions, between banks on the one hand and savings and loans on the other".

"There's strength in diversity. If all financial institutions become identical in their powers and all the things they can do, a strong few will soon dominate the entire industry and community-based home-owned institutions will vanish from the scene."

So in that spirit, I spent hours on the Senate floor late last year leading what was at times a lonely effort to moderate and improve a bill that I believed could have had disastrous consequences for the savings and loan industry if enacted in the form in which it was originally reported by the Senate Banking Committee. I believe we achieved some significant results and I believe the results of this week's conference committee bears that out.

RESULTS OF THE CONFERENCE

1. Extension of Regulation Q

"Regulation Q" has been extended for six years, with no mandatory ratcheting and with targets only set for increasing rates on passbook accounts.

We have to keep in mind the basic fact that Regulation Q was enacted in the first place to preserve the savings and loan associations and the savings banks and thus our home-financing system from being destroyed by a much larger and very competitive commercial banking system.

This extension will allow the industry to make the difficult transition in an orderly way from a controlled environment to a market-rate environment.

2. The conference also increased the insurance account to $100,000, a significant improvement.

3. The conference increased from 1% to 3% the amount of assets which can be placed in a Stock Investment Service Corporation.

4. The conference retained the various expanded trust powers, consumer loans, and credit card powers adopted on the Senate floor and overrode state usury laws on home mortgages on a permanent basis. While I have had great qualms personally about some of these items, and

in particular about overriding state law, the majority in the Congress do not share my view.

Additionally, the conference retained a number of provisions which I had fought for on the Senate floor.

5. Money Market Certificates

The original bill contained Senator Proxmire's amendment mandating a reduction in the denomination of of a money market certificate from $10,000 to $1,000. I heard from most of you and from savings and loans all around the country making it very clear that such a move would put many savings and loans straight out of business. We succeeded in forcing a compromise which allowed the regulators wide latitude in lowering the denomination, when it becomes "economically feasible" to do so.

6. Residential Real Estate Lending

We passed an amendment granting authority to the Federal Home Loan Bank Board to grant residential real estate lending powers for federal savings and loans comparable to those already possessed by national banks; this is in addition to, and not a substitute for, authority already contained in the Home Owners' Loan Act.

7. Insurance Reserves

I offered an amendment which was adopted allowing the FHLBB to vary the Federal Insurance Reserve at FSLIC-insured savings and loans in a range from 3% to no more than 6%. It is my understanding that savings and loans have been the only financial institutions to have to operate under a fixed statutory insurance reserve requirement and I consider my amendment significant.

8. Mutual Capital Certificates

I joined with Senator Stone of Florida in offering an amendment allowing federal associations to issue mutual capital certificates, a move I hope will help to alleviate the capital crunch many mutuals are experiencing.

9. Study on Non-Economic Portfolios

With Senator Cranston taking the lead, we also mandated a study by a Presidentially-appointed inter-agency task force to report within 90 days of enactment on the problems of savings and loan portfolios which consist largely of non-economic and low-yielding mortgates. The conference expanded this study to include money market funds.

I want also to discuss the earnings question and our general economic situation.

Earnings - Talking with savings and loan people from my own state of North Carolina and from all over the country, I hear a pretty bleak picture of the earnings picture for the near-term future. Many predict negative earnings and many raise the spectre of a large number of institutions going under. I believe the Congress has to be prepared to act in a responsible way to avoid large numbers of failures. The U.S. League proposed various changes in the tax treatment of earnings to ease the picture for those institutions which may find themselves in serious trouble and is also looking at what the private sector can do on its own. I believe this is an important part of the way to proceed. I welcome the U.S. League's initiative in this area and I welcome the initiative of the California League in formulating proposals for a new mortgage instrument drawing upon the California VRM experience. The basic problem is that we confront a situation in which half of savings and loan liability is now in short-term market rate instruments that didn't even exist five years ago, but the savings and loan asset structure is still locked into 30-year fixed yield loans. It is clear that new mortgage instruments will be needed - instruments which both protect the consumer and which allow for the continued viability of the savings and loan industry.

Tax Incentive for Savers - Throughout the entire last year and the clamor for relief for "small savers", I have felt that we should proceed to offer a tax-incentive for savings, rather than forcing institutions to pay market rates on all deposits. I was an original cosponsor with Senator Bentsen of Texas of the proposal which has now been approved by the conference on the windfall profits tax bill -- in a scaled-down form from our original proposal -- which would exempt the first $200 in interest or dividends ($400 for a joint return) from taxation. The step that will become law will not be as big a step as I would have liked, but it is a step -- and a significant one -- in the right direction. We now have a situation where economic forces are pushing people to spend rather than save and we have to change that. The latest figures I saw show that Americans save only four percent of after-tax income, the lowest rate in decades. That compares with 25 percent for the Japanese and 18 percent for the Germans. If we are to return our economy to a healthy rate of growth and increase "real" wages and incomes, then we simply have to reverse the trend toward undersaving and overspending.

CONCLUSION

In this way, a tax-incentive for savers is also symbolic of the need to change the whole direction of our economy -- by balancing the federal budget, and by coming to grips with the inflation which threatens to undermine much of the basic social foundation of our country. We need to encourage people to plan and save for the future again rather than continuing what is the prevailing attitude these days, an attitude that says, "Buy now -- on credit -- because things will only get more expensive". Over the last 15 years, an underlying level of inflation has thus become built into the expectations of virtually every significant sector of the economy. Sixty percent of union contracts now carry cost of living adjustment (COLA) clauses. Social security payments and other payments are now effectively indexed for inflation. And moreover, many Americans -- and the federal government itself -- now have a vested interest in inflation. Why else do Americans pay outrageous -- even absurd -- prices for homes at double-digit mortgage rates, if they do not completely expect the value of their homes to rise annually at double-digit rates?

And the federal government also has become both the producer and the beneficiary of inflation. There can be no real question that the scale of government borrowing and spending fuels inflation. A full twenty-five cents of every income tax dollar collected by the federal government now goes to pay interest on the ever-mounting federal debt. And similarly, inflation pushes people into higher tax brackets, thus allowing the federal government to collect more taxes. Yet, you and I know all too well that this kind of inflationary cycle and psychology will eventually end in disaster both for individuals and for our society.

Yet, despite the shocks and shakiness with which the 1980s have begun, I believe this can be a decade of growth and prosperity for our country and also for the savings and loan industry. The demographers and economists tell us that some 42 million people will turn 30 years of age between now and 1989, creating an unprecedented demand for housing. In short, the baby boom has grown up. If we are to avoid even greater problems in the future, we must insure that these young people have the opportunity to become homeowners, just as their parents have done.

I deeply hope the savings and loan industry will be there, maintaining the same traditional commitment to housing and home ownership which remains one of the basic pillars of our national stability.