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Statement of the Shadow Financial Regulatory Committee

on

Congress and Financial Reform

December 7, 1997

Again this year, despite considerable efforts almost to the last day of the session, Congress failed to pass financial reform legislation. This has happened so often in recent years that it calls into question the ability of Congress to change national policy in this area, and leads many observers to believe that it is better to rely on actions by regulators than to bother with legislation.

Under these circumstances, it may be time for Congressional leaders--some of whom became deeply involved this year in an effort to craft compromise legislation--to take a step back and consider whether the approach they have been taking is ever likely to bear fruit, and whether it might not be better to scrap the current bill and start over.

H.R. 10, the bill that moved through Congress this year, was a classic illustration of the old joke that a camel is a horse put together by a committee. By the time it had passed through the House Banking and Commerce Committees, the bill was a complex welter of compromises and adjustments. The contending interests--large banks, small banks, foreign banks, securities firms, insurance companies, insurance agents, S&Ls and S&L holding companies, and diversified financial services firms--each got something they wanted in an ultimately unsuccessful effort by Congress to gain their support. No one appears to have asked why all this trading was a benefit to the public.

In the Committee's view, a primary cause of the failure this year--as in years past--was the fallacious notion that banks must be separated from the rest of the commercial world. Misplaced allegiance to the so-called separation of banking and commerce has made it impossible for Congress to create the two-way

street that would meet the needs of all the players and best serve the interests of consumers.

Under a two-way street approach, all the contending interests would be able to compete with one another, with consumers the ultimate beneficiaries. Banks and bank holding companies could engage in securities and insurance activities, just as securities firms and insurance companies could acquire banks. Any company could enter the financial services industry, just as any company engaged in financial services could extend its activities into areas that its management considers more likely to be profitable. Insurance companies could not reasonably complain about banks entering their business if they were free to enter the banking business, and banks could not reasonably complain about the freedoms enjoyed by securities firms if they could also form affiliations without regulatory approval. In other words, many of the inter-industry disputes that made legislation impossible last year would be eliminated, and the way cleared for healthy competition. Existing laws, such as Section 23A and 23B of the Federal Reserve Act, applied to bank transactions with subsidiaries as well as affiliates--coupled with a requirement that nonbank activities be separately capitalized--would prevent transfer of the benefits, if any, of the federal safety net to the nonbanking operations.

On the other hand, Congress can continue on the course it has followed for the last three years--a fruitless search for the formula that will satisfy all the contending interests. Even if such a formula could be found, it will only be a temporary solution. The markets and consumer demand for services will continue to evolve, forcing changes in business strategy on the members of what today we call the financial services industry. In a few years they will be back again before Congress, asking to renegotiate the most recent deal.

The only permanent solution is to eliminate the artificial and unnecessary restraints that arise from the mistaken idea that banking must be separated from commerce. Once this concept is abandoned, Congress can create the competitive two-way street that will lead both to permanent financial reform and the benefits that consumers always get from competition.