BOOK REVIEWS

Financial Reform in the 1980s
Thomas F. Cargill and Gillian Garcia
Stanford, Calif.: Hoover Institution Press, 1985, 214 pp.

The financial services industry is in a state of flux. What had been the widely accepted rules of the game are being challenged on many fronts as rapidly changing technological and economic conditions create new profit potentials and competitive pressures for the traditional depository institutions. In their recently published book, *Financial Reform in the 1980s,* Thomas Cargill and Gillian Garcia focus on this shifting environment. They set out to describe what has happened in the volatile years since 1979 and to consider where recent events might lead. In so doing, the authors make two primary contributions.

First, the legal, regulatory, and market-driven changes occurring over the past six years have altered substantially the system of bank regulation and control established during the 1930s. Cargill and Garcia attempt to place these recent events in perspective by, first, providing a brief overview of U.S. financial history through the late 1960s. They then discuss in more detail the events of the 1970s that led to the recent financial reforms. The authors also review the specific changes that have occurred, examining the impact of the Federal Reserve Board policy redirection announced in October 1979 and the unannounced policy shift in the fall of 1982. In addition, they describe and consider the implications of the 1980 and 1982 acts of Congress. For readers confused by the apparently abrupt changes in banking law and structure, this book provides a useful source of information and explanation.

Second, while most academics and policymakers treat monetary policy and financial institution regulation as conceptually separate, Cargill and Garcia emphasize the interdependence of the two. They examine how financial innovation and regulatory reform have affected the Federal Reserve's ability to control the money supply. In fact, the authors note, recent financial innovation has made illogical, incomplete, and to some extent, irrelevant the commonly accepted definitions of money.

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For some readers, the authors will appear to accept too readily the need for a federal role in managing the money supply. Cargill and Garcia remark early on, for example, that "financial and monetary arrangements cannot be left to the market, even in the case of an Adam Smith world of competition" (p. 11). A few pages later they note, "[G]overnment does have a responsibility to determine a stable price level. This cannot be established by the market" (p. 17). And in discussing the recent problems that have plagued the Federal Reserve Board's efforts to control the money supply, Cargill and Garcia seem to imply the Fed can know what monetary growth rate would achieve the final economic goals in terms of growth in real GNP, employment, and the inflation rate.

The difficulty recognized and discussed in depth by the authors is the question of implementation, i.e., how is the Fed to reach its desired goals. In fairness to the authors, however, their goal was not to critique the general premise of a central bank, but rather to describe the changing environment in which our monetary authority has worked during the past few years, and they do that quite well.

Cargill and Garcia do recognize the problems created by extensive regulation of depository institutions in a changing economic and technological setting. In their chapter examining the crisis among thrift institutions, for example, Cargill and Garcia lay much of the blame for the industry's current weaknesses with public policies promoting and subsidizing home ownership, thus restricting the ability of S & Ls to diversify. The authors observe, "The pronounced disintermediation and substantial interest rate risks [faced by savings and loans during the late 1970s and early 1980s] can be regarded as risks undertaken beyond the industry's call of duty; they were also risks imposed on S & Ls by the perverse regulatory structure" (p. 87).

Cargill and Garcia do not only see problems with the thrift industry, however. In reviewing the regulation of depositories across the board, they observe that many of the predictions of regulatory capture theory have been fulfilled. The regulatory structure has been used primarily to protect the property rights and rent-seeking abilities of existing financial institutions. While recent market-driven innovations as well as some legislative and regulatory changes have increased the competition faced by most banks, thrifts, and credit unions, a struggle continues over the powers that specified categories of financial institutions may exercise and where they may open offices. Current debates within the financial services sector can be largely explained as industry efforts to use Congress and the regulators to protect individual markets.

In its later chapters, the Cargill and Garcia book does become a bit technical for the general reader. But the authors make every effort to provide necessary explanations of the models they use as they go along. A reader willing to invest some time and effort should be able to follow the arguments being made.

On the other hand, Cargill and Garcia are able to summarize and simplify some extremely confusing details through the use of tables. In particular, they use tables to trace the development of important private and regulatory innovations in financial services since the turn of the century. They even include information about the sources of these developments—i.e., they identify the depository that was the first to find its way through the regulatory morass and, thus, provide new products and services. Cargill and García also use a table to sort federal and state regulatory agency responsibilities for the many types of regulations applying to a wide range of depository institutions. Finally, the authors provide an excellent bibliography for the student or other reader interested in pursuing further any of the ideas presented.

In short, the Cargill and Garcia book is timely and complete, providing readers confused by the rapidly changing financial services environment a description of the current state of affairs as well as an explanation of how we got here. It is unfortunate that the very nature of its topic may cause the book to be rapidly dated as financial markets and their regulatory environment continue to evolve. The contribution provided by conceptually connecting the structural and monetary sides of Federal Reserve and depository institutions should continue to be of value, however. And while it may bother some readers that the authors implicitly accept a positive role for a central authority in controlling the money supply, given the overall tone and contribution of the book, this is a relatively minor point.

Catherine England
Cato Institute

Inside the Fed: Making Monetary Policy
William C. Melton
Homewood, Ill.: Dow Jones-Irwin, 1984, 226 pp.

William Melton has given us an excellent account of Fed policymaking. His book is written in an uncontrived, forthright, fast-paced, easy flowing style, and was a pleasure to read. After reading it, I knew that I had effortlessly acquired some new insights into the Fed and its conduct of monetary policy.

The author's contribution to the literature derives from his unusually rich experience—four years at the Federal Reserve Bank of New York, a sometime academic, a Fed-watcher at a major New York bank, and now Vice President and Senior Economist at IDS/American Express. The book makes two major contributions. First, it describes and analyzes the interplay between practical and academic issues in the conduct of monetary policy. In particular, the author offers (particularly in Chapters 7 and 8 and in the Appendix) some fascinating insights into the interface between the Federal Reserve and the money markets. Second, the book conveys the Fed's overriding concern for the safety and stability of the financial system. Four vignettes on Fed lender of last resort activities in recent crises illustrate that concern.