CHAPTER 3

NONQUANTIFIABLE RISKS AND FINANCIAL INSTITUTIONS: THE MERCANTILIST LEGAL FRAMEWORK OF BANKS, THRIFTS, AND GOVERNMENT-SPONSORED ENTERPRISES

Thomas H. Stanton

NONQUANTIFIABLE RISKS AND FINANCIAL INSTITUTIONS

The Problem of Nonquantifiable Financial Risk

The concept of risk based capital requirements, once the province of insightful academics,[1] is now being implemented for banks and other financial institutions. Yet there remain substantial risks that cannot be readily quantified that continue to take a serious toll. It almost seems as if financial institution regulators are in an endless cycle of trying to quantify known risks, only to have new types of risk continuously emerge.

The author gratefully acknowledges the financial assistance of the Institute for Policy Innovation in Lewisville, Texas, in preparing an earlier version of this research, published as a monograph, "Taxpayers at Risk: The Moral Hazards of the New Mercantilism" (Lewisville, Texas: Institute for Policy Innovation, June 1992). The views expressed in this paper are solely those of the author.

Charles A. Stone and Anne Zissu, eds., Global Risk Based Capital Regulations, Vol. 1, Irwin Professional Publishing, 1994, reproduced by permission.

The thesis of this paper is that the procession of new kinds of risk is a product of the peculiar legal framework that shapes the activities of banks and similar institutions. These institutions, including savings and loan associations, government-sponsored enterprises (GSEs)[2] such as Fannie Mae and Freddie Mac, and credit unions, can be termed "mercantilist" institutions. They operate under legal charters that are vestiges of the mercantilist period of European history.[3] They are privately owned companies chartered and operating under federal law to serve defined public purposes. The special-purpose charters of mercantilist companies make them fundamentally different from other companies. The creation, evolution, and decline of these institutions follow a distinctive pattern that is different from that of ordinary companies whose character is shaped more by the marketplace and less by legislative and political forces. In today's rapidly changing financial markets, these institutions are especially vulnerable to emerging and nonquantifiable risks that can topple them with surprising speed.

Economists point to risks such as market risk, involving sudden changes in economic environment (Flannery and Guttentag, 1979; Guttentag and Herring, 1988), and management and operations risks (Mullin, 1977; Graham and Horner, 1988; U.S. General Accounting, 1991) that are essentially nonquantifiable. Other kinds of risk have caused significant damage before their dimensions were well understood, including interest rate risk and sovereign risk. Finally, these institutions are constantly subject to unusually severe forms of political risk, as is discussed subsequently at some length.

Some policy analysts properly point to information asymmetries as a major reason why regulators are always playing catch-up to understand the susceptibility to risk of the financial institutions that they supervise (Pierce, 1991, 97–100). While information asymmetries play an important role in a regulator's inability to quantify or even detect some risks, the problem is more fundamental than that. This paper attempts to show that institutions operating under special-purpose charters are uniquely susceptible both to market risks and to management and operations risks. At a certain stage of their existence, these mercantilist financial institutions may be repeatedly confronted by competitors operating under relatively unrestricted charters. These competitors may be able to offer attractive bundles of financial services that the mercantilist institutions are legally precluded from providing.

In the years following the enactment of their enabling legislation, mercantilist institutions may be protected from serious competition by favorable provisions of their legal charters. Yet, as markets and technologies evolve, the legally protected niche can turn into a death trap. Banks, thrifts, and government-sponsored enterprises suddenly find themselves losing market share because their enabling laws prevent them from providing the kinds of new services offered by competitors. If legislative relief is not forthcoming, the resulting stresses then may manifest themselves in often nonquantifiable risks such as high-risk ventures by management or some form of market risk. Moreover, as was seen in the reaction of the thrift industry to the 1982 Garn–St. Germain Act, serious new risks may also accompany legislated expansions of charter authority.

This chapter is organized as follows. This introduction discusses nonquantifiable risks and introduces the concept of a mercantilist institution, such as a bank or thrift, that operates under a special legal charter. The second section looks at the role of mercantilist institutions in the U.S. financial system and provides some historical background. The third section looks at the role of mercantilist institutions as instruments of government policy and presents the concept of political risk. The fourth section reviews the role of politics and markets in shaping the activities of mercantilist institutions. Here, the role of political risks is explored as a factor in the demise of the thrift industry and the growing stresses on banks. And the fifth section concludes by discussing the life cycle of mercantilist institutions and the nonquantifiable kinds of risk that are created or amplified by their peculiar legal structure.

MERCANTILIST INSTITUTIONS: ATTRIBUTES AND HISTORICAL BACKGROUND

Mercantilist Financial Institutions in the United States Today

In mercantilist times, a national government chartered private companies to carry out public purposes. In return for a license of royal privilege, a mercantilist company accepted limits upon its permitted activities and committed itself to undertaking the particular tasks specified in its royal charter.

Since mercantilist times, corporation law has progressed away from particular charters and toward the form of general-purpose corporations. While mercantilist companies were permitted to conduct only those activities specified in their charters, general-purpose corporations today may undertake virtually any kind of activity unless precluded by law. While mercantilist charters were granted to a privileged few incorporators, general-purpose corporations today may be formed by virtually any group of citizens desiring to do so.[4]

Today most corporations organized under state law hold general-purpose charters. A typical state law is that of the state of Delaware, which provides that a corporation may engage in virtually any legitimate activity except where restricted or precluded by law.[5]

Amid the several million general-purpose corporations active in the United States today are a few thousand special-purpose companies created under restrictive state or federal laws. Mercantilist institutions are instrumentalities of government:[6] they are entities (often privately owned) carrying out public purposes specified by state or federal law, or (as in the case of state-chartered banks and thrifts, for example) by both state and federal law. Exhibit 1 provides an overview of various types of mercantilist corporations in the United States today; the most numerous and most important of these companies are financial institutions, and especially banks, thrifts, and government-sponsored enterprises whose risks and vulnerabilities are addressed in this paper.

Some of these corporations are chartered under restrictive state laws, including banks, thrifts, insurance companies, a variety of public utilities and transportation companies, and various nonprofit state authorities and charitable organizations.[7]

In the United States, there is no federal law providing for general-purpose incorporation of companies. All privately owned federal corporations are chartered as special-purpose companies with greater or lesser flexibility under their enabling legislation. Most of these are financial institutions. Besides banks and thrifts, these include credit unions, the Federal Reserve Banks, and government-sponsored enterprises. Today there are six government-sponsored enterprises that fund over a trillion dollars of loans to homeowners, farmers, thrift institutions, and students. Three of the government-sponsored enterprises are privately owned, with stock trading on the New York Stock Exchange. They are the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Student Loan Marketing

EXHIBIT 1
Mercantilist Corporations in the United States Today

	Federally Chartered	*State-Chartered*
Financial institutions	National banks Some thrifts Federal Reserve banks Some credit unions Fannie Mae Freddie Mac Federal Home Loan banks National Consumer Cooperative Bank	Commercial banks Some thrifts Some credit unions Insurance companies Nonprofit state finance authorities
Other companies	Comsat National Corporation for Housing Partnerships	Public utilities (power, telecommunications, transportation) Professional corporations
Other noncommercial	Charitable and nonprofit organizations (e.g., American Red Cross, Boy Scouts of America, National Academy of Public Administration)	Municipal corporations Charitable and nonprofit organizations

Association (Sallie Mae). Some government-sponsored enterprises are structured on more of a cooperative basis. These three GSEs are the Federal Home Loan Bank System, the Farm Credit System, and the Federal Agricultural Mortgage Corporation (Farmer Mac). Other federally chartered corporations with private ownership include the Communications Satellite Corporation (Comsat), the College Construction Loan Insurance Association (Connie Lee), the National Consumer Cooperative Bank, and the National Corporation for Housing Partnerships.

In terms of size and economic impact, the most important mercantilist institutions are those privately owned companies whose obligations are explicitly or implicitly guaranteed by government. There are four categories of such institutions: most banks, thrifts, and credit unions; and government-sponsored enterprises of the federal government. Some state-chartered banks and thrifts and credit unions operate without federal deposit insurance. However, they may benefit from state insurance funds that on occasion have resulted in taxpayer losses. The government guarantee reinforces the mercantilist nature of such institutions: the state or

federal government protects their financial stake by fostering oligopolistic markets for institutions that benefit from it. Policymakers fear that free competition could increase financial failures and taxpayer losses.

As can be seen in Exhibit 2, the federal government provides banks, thrifts, and credit unions with federal deposit insurance and government-sponsored enterprises with an implicit guarantee,[8] together amounting to literally trillions of dollars, so that these institutions can provide credit for the purposes specified in their charters. This study will focus on banks, thrifts, and government-sponsored enterprises, and highlight their special legal attributes that give rise to peculiar vulnerabilities, compared to the usual companies chartered under state law.

Among the roots of bank and thrift failures is the fact that they have retained mercantilist legal characteristics that have long been eliminated from the charters of most American companies. The usual private company can change its activities to adapt to changing markets. This ability to define and redefine lines of business is essential to strategic success, especially over longer time periods. Examples abound of companies succeeding or failing according to their ability to adopt new technologies and new ways of bundling their products and services to meet changes in customer needs and the challenges of competitors (Abell, 1980).

EXHIBIT 2

Federally Backed Financial Institutions (in Trillions of Dollars of Implicit or Explicit Federal Guarantees, FY 1991)

Federal deposit insurance	
Banks	$1.942
Thrifts	0.654
Credit unions	0.197
All deposit insurance	$2.793
Government-sponsored enterprises	
Fannie Mae	$0.456
Freddie Mac	0.369
Federal Home Loan banks	0.107
Farm Credit System	0.074
Sallie Mae	0.043
All GSEs	$1.049
Total federal backing for banks, thrifts, credit unions, and GSEs	$3.842

Source: *Budget of the United States Government, Fiscal Year 1993*, Part I, p. 268 and Appendix I, p. 1062.

By contrast, banks, thrifts, credit unions, and government-sponsored enterprises are chartered by law to serve public purposes; their enabling legislation generally confines them to providing particular kinds of services and to serving only those markets that are specified by law and regulation. Their distinctive legal charters limit the ability of banks and thrifts (and the other mercantilist institutions) to adapt to changing market circumstances.

Unlike ordinary companies incorporated under state law, these institutions cannot adjust their activities and lines of business as their markets evolve. When they come against a constraint imposed by their charter legislation, they must return to the Congress or to state legislatures, as the case may be, to obtain relief before they can enter new lines of business and provide different kinds of services outside of the scope of their legally permitted activities. Especially in today's environment of rapidly changing technologies and financial markets, this means that the scope and extent of financial services that banks, thrifts, and the other institutions provide often reflect competitive forces in the political arena rather than in the marketplace.

A second, related distinction is also responsible for much of the cost of bank and thrift failures. Unlike the ordinary company, a bank or thrift (or other mercantilist institution) does not automatically go out of business when it fails. If an ordinary company becomes insolvent and unable to pay its creditors, no one else will lend it money and it will be forced to go out of business. Also, it can go bankrupt under the federal bankruptcy code. By contrast, the law provides that a failed bank, thrift, credit union, or other federal instrumentality is not subject to the bankruptcy code; federally chartered institutions generally can be closed only by a governmental regulator. Moreover, deposit insurance and the government's implicit backing of GSE obligations mean that these mercantilist companies may raise money even if they fail in the marketplace. Once again, this distinction turns a financial issue into a political one; regulators who close too many banks or thrifts are liable to be blamed for the fact that these institutions failed. They may be accused of causing a credit crunch and can be subjected to significant political pressure to be more lenient.[9] Exhibit 3 summarizes differences between ordinary corporations and mercantilist companies.

These features of legal structure might be arcane and uninteresting but for the fact that they have cost the American taxpayer hundreds of billions of dollars. For that reason alone, it is worth examining them in greater detail.

EXHIBIT 3
Characteristics of Ordinary Companies versus Mercantilist Companies

Ordinary Companies	*Mercantilist Companies*
Authorized to conduct all activities except as expressly prohibited by law	Authorized to conduct only those activities expressly permitted by their charters
Can obtain a corporate charter easily and inexpensively by registering with a state's department of corporations	Must obtain a charter (1) from Congress or a state legislature or (2) from an administrative agency according to statutory standards
Can freely enter lines of business except where entry is prohibited by law; can freely stop serving markets or customers	Can only enter lines of business expressly authorized by law; may be required to serve particular markets or customers
Can be forced into bankruptcy by unsatisfied creditors	Probably cannot be forced into bankruptcy, even if insolvent
Incorporated under state law to serve private purposes	Incorporated to serve public purposes; is considered an instrumentality of federal or state government
Often unregulated	Usually regulated
Has no unique benefits granted by law	Has unique benefits granted by law to a single company or category of companies

Attributes of Mercantilist Companies

Banks, thrifts, and government-sponsored enterprises are vestiges of an earlier period in the development of Western legal institutions. The government has chartered them to fulfill a public purpose. Their limited corporate charters resemble those granted by monarchs and parliaments in the mercantilist period of history of Western Europe, which extended in England roughly from the late 1400s through the 1700s (Lipson, 1956). Similar to companies chartered in mercantilist times—such as the Bank of England, the Hudson's Bay Company, and the East India Company—these privately owned companies legally are instrumentalities of the government. They benefit from privileges that are generally not available to other kinds of private competitors.

As were the earlier mercantilist companies, banks, thrifts, and government-sponsored enterprises can perform valuable services for people and the nation; also, like early mercantilist companies (and here one

thinks of the financial debacle caused by the collapse of the South Sea Company in 1720), they can cause substantial damage if they fail. The important fact to keep in mind is that today's mercantilist companies are based upon a fundamentally different legal and institutional structure than ordinary companies. Consequently they may involve quite different kinds of risks that can emerge more suddenly and with more impact than risks that affect companies operating under more flexible charters.

Public Purposes of Banks, Thrifts, and Government-Sponsored Enterprises

Banks, thrifts, and government-sponsored enterprises provide advantages to the U.S. government that are similar to those traditionally provided by mercantilist companies to the sovereign. In particular, these private institutions are able to conduct their activities on a more businesslike basis than might be permitted by a governmental body staffed by government officials and owned by the government. To take but one instance, within two years of being sold into the private sector, Fannie Mae had greatly streamlined the staff required to conduct the corporation's business. More significantly, a number of the GSEs have demonstrated financial prowess that has not always been evident in federal government agencies serving similar specialized credit purposes.

These institutions serve a variety of public purposes, as defined in the statutory provisions of their enabling legislation. Thus, national banks were established "to provide a uniform and secure currency for the people, and to facilitate the operations of the Treasury of the United States."[10] Many state-chartered banks have become members of the Federal Reserve System and obtained deposit insurance from the Federal Deposit Insurance Corporation, and thereby have become federal instrumentalities as well. Today, commercial banks are seen as special intermediaries because of the way they provide a means to transform short-term funds into longer-term illiquid investments.[11] Thrift institutions have a statutory public purpose of providing "for the deposit or investment of funds and for the extension of credit for homes and other goods and services."[12] A credit union is chartered "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes."[13]

Finally, the public purpose of each government-sponsored enterprise is contained in the relevant enabling legislation. A good summary of the

public purposes of the major enterprises is provided by the U.S. General Accounting Office (GAO). As the GAO states, the federal government established government-sponsored enterprises:

> because it wanted to ensure that reasonably priced credit was available for borrowers seeking to finance homes, agricultural businesses, and college educations. . . . The GSEs were created to correct what were perceived as flaws in the credit markets. (U.S. General Accounting, 1990, 16).

The charter acts of each of the enterprises specify their public purposes. In general terms, Fannie Mae and Freddie Mac provide a secondary market for residential mortgages, Sallie Mae funds student loans, the Federal Home Loan banks provide credit for thrift institutions, the Farm Credit System provides credit to agricultural borrowers, and Farmer Mac provides a secondary market for agricultural mortgages and loans guaranteed by the Farmers Home Administration.

The public purposes of thrifts and government-sponsored enterprises relate to the functions of specialized lenders. By providing preferential access to credit, through deposit insurance or an implicit government guarantee of borrowings, and through a variety of tax and other benefits, the federal government can encourage the flow of funds into a mercantilist company. When the mercantilist company is limited in its powers to serving a specialized financial market—the residential mortgage market in the case of thrifts, traditionally, and Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System; or agriculture in the case of the Farm Credit System and Farmer Mac; or student loans in the case of Sallie Mae—then the government can attempt to assure that these institutions pass on some of their federally bestowed benefits to support a designated public purpose.

Many of these specialized institutions in their own way have made demonstrable contributions to the markets they are supposed to serve, especially some of the earlier government-sponsored enterprises. The Farm Credit System and Fannie Mae, in particular, have contributed to overcoming serious market imperfections that were impeding the proper flow of funds to agriculture and housing, respectively.

The extent of such contribution changes over time. New technologies and changing markets alter the public benefits of specialized financial services. Fannie Mae, for instance, made an important contribution to mortgage finance in its first 30 to 40 years of operation, when the presence of significant market imperfections restricted the availability of

mortgage money in the growing central and western states, as compared to those in the East. Today, those market imperfections have been overcome, and many competing financial institutions are available to channel mortgage money across the 50 states. This means that the potential contribution of Fannie Mae today is measurably less than it was previously. Similarly, in 1932, the Federal Home Loan Bank System (FHLBS) may have been an important means of restoring financial vitality to the thrift industry devastated by the Great Depression. Today, it is not at all clear how provision of credit to a shrinking number of profitable thrifts serves a significant public purpose. (The FHLBS does not lend to shaky thrift institutions except with very high collateral requirements or unless the federal government guarantees repayment of the loan.)

Finally, the public benefits of mercantilist financial institutions have been diluted by the considerable expansion of federal credit in recent years. Over one third of all nonfederal borrowing today is subsidized by the federal government, directly or indirectly.[14] Increasingly, ad hoc changes to the enabling laws of specialized lenders such as thrifts and GSEs have meant that the public benefits of the federal credit support they provide are diffuse and poorly directed; at the same time, the ability of federal credit to give selected borrowers an advantage is weakened.

A federal credit advantage for everyone means an economic advantage for no one. This raises questions about the extent to which all federal credit subsidies, including those provided through specialized mercantilist institutions, are properly focused to assure that they serve high-priority credit needs and do not offset each other. Vigilance is needed to assure that changing markets and changing public needs do not diminish the benefits provided by mercantilist institutions, and also that they do not increase the potential taxpayer costs.

The Changing Nature of Corporate Charters

Mercantilist Charters

Some sense of historical developments is useful here to show the evolution of corporate charters and the nature of the mercantilist vestiges in today's law. In the early mercantilist period, corporate charters were bestowed by the monarchy. The mercantilist state itself was incapable of undertaking a range of activities that were considered important, including trade, manufacturing, mining, and—especially—banking, and turned instead to the private sector. Business corporations were seen essentially

as agencies of the government (Williston, 1888). Incorporation generally involved the grant of monopoly powers, including the power to regulate business activities in the company's designated economic sector.

Merchants with ideas for new ventures would seek an advocate at the royal court to present a plea for a charter. If granted, the charter would specify permitted activities and special privileges of the new corporation and would provide that the sovereign would be appropriately compensated for the privileges bestowed. Often, the charter would confer exclusive benefits and include a commitment that the crown would not issue similar charters to competitors. In England, as the British Parliament gained in strength, it began to confer an increasing proportion of such charters. Eventually, the Parliament—rather than the monarch—decided when to bestow corporate charters for new ventures. As before, the charter specified the public purpose of the company, its permitted activities and privileges, and the remuneration to be provided to the state. Corporate charters often had a limited life; they might expire upon occurrence of specified events or passage of a prescribed number of years.[15]

Early American Charters

The first American corporations were chartered by the colonies and states, the Continental Congress, and the U.S. Congress in much the same way. In America, there has been an intermittent tradition of strong antagonism toward mercantilist companies.[16] The early corporations were seen as monopolies and beneficiaries of special privilege.[17] The Continental Congress chartered the Bank of North America in 1781; because of questions about the authority of the Continental Congress to charter a bank, the bank also obtained a charter from the state of Pennsylvania. Within a few years, political opposition to the bank's monopoly powers forced the repeal of its state charter and then limited the terms of a new charter granted by the state of Pennsylvania (Davis, 1917, 36–44; Hammond, 1957, 52ff).

Alexander Hamilton, Secretary of the Treasury, proposed creation of the first Bank of the United States and the Congress enacted the legislation in 1791.[18] The bank was patterned upon the Bank of England that had been chartered in 1694 (Hammond, 1957, 128–34). The charter of the Bank of the United States, limited to a term of 20 years, specified the powers and privileges of the company. Under the charter, the U.S. government was a minority shareholder. When Congress failed to extend the charter, the bank expired in 1811.

State legislatures continued to charter banks. Aaron Burr obtained a perpetual bank charter from the New York State legislature in 1799. The legislature chartered the new company, the Manhattan Company, to provide a supply of pure water for the city of New York. Burr used his political skill and influence to obtain a special provision of the charter authorizing the company to use any profits for any purpose not prohibited by the Constitution or laws of the United States or the state of New York. Under this provision, Burr established the Manhattan Bank that later merged into the Chase Manhattan Bank (Davis, 1917, 100–101).

In 1816, the federal government enacted legislation to charter a second Bank of the United States, again with the government as a minority shareholder. The 20-year charter again prescribed the authorized activities of the bank. It also provided that the majority of the directors would be elected by the private shareholders, but that 5 out of the 20 directors of the bank would be appointed by the president of the United States. The federal charter of the Bank of the United States expired in 1836 after President Andrew Jackson's "bank war," in which he vetoed legislation that would have provided for renewal for another 20 years. As with the first bank war, over the Bank of North America, this opposition was fueled by the popular objection to monopoly and privileges bestowed on a favored few shareholders.

In 1862, the federal government chartered a railroad corporation, the Union Pacific Railroad Company, to help build the first transcontinental railway. The federal government subsequently chartered other railroads and also provided financial support to railroad companies operating under state charters.

Meanwhile, state legislatures began an evolution of their corporation laws away from the mercantilist model. New York permitted incorporation under a general law for some business purposes in 1811.[19] However, the state continued to require some special-purpose charters, such as for establishment of banks. In 1837, the state of Michigan enacted the first free banking act, providing that a bank could be incorporated by any group without need for special legislation (Hammond, 1957, 572–604). However, even free banking laws continued to limit the activities permitted to banks under their charters.[20]

After the demise of the Bank of the United States, liberal banking laws in many states, especially in the growing western parts of the country, led to the chartering of hundreds of banks. Many of these were poorly capitalized and poorly managed, and they promptly failed (Hammond, 1957, 600–630).

By the early 20th century, state legislatures had removed virtually all restrictions on general-purpose companies and their ability to obtain corporate charters. Nevertheless, certain activities, including the business of banking, continued to be subject to special charter provisions and, usually, supervision by state authorities.

Federal Bank Legislation

In 1863 and 1864, the federal government, under financial pressure from the Civil War, reentered the business of chartering banks. This time, however, the National Bank Act reflected the forces of democracy that had manifested themselves in the struggle over the Bank of the United States. The new law was based upon the pattern of state free banking laws. Instead of a monopolistic charter, extending benefits to a privileged few bank shareholders and incorporators, the new national bank system offered opportunity to any group of incorporators who could satisfy statutory and regulatory requirements for starting a bank.

Nonetheless, both the national bank system and state banking laws continued to exhibit the mercantilist feature of defining and limiting the activities that could be engaged in by a federally or state-chartered bank. The laws also continued to provide special privileges; most importantly, only commercial banks were permitted to offer demand deposits such as checking accounts. With passage of the Federal Reserve Act of 1913, the federal government imposed upon many state-chartered banks—those that chose to join the Federal Reserve system—additional requirements specified in federal law, and also provided special new benefits to member banks, including the ability to use the Federal Reserve system as a clearinghouse for checking services.

Thrift Institutions

Early thrift institutions included cooperative savings and loan associations that operated on a voluntary and unincorporated basis. In 1875, New York imposed requirements that savings and loan associations submit annual financial reports to the state banking department (Ornstein, 1985, 12). By 1930, most states had enacted legislation prescribing standards and, with greater or lesser degrees of restriction, the eligible activities for savings and loan associations. One of the most important of such restrictions was the requirement by federal law, and most state laws, that savings and loan associations be limited in their activities to making mortgage loans and to serving local market areas (Ornstein, 1985, 49–57; Brumbaugh, 1988, 8–12).

Deposit Insurance and Increased Federal Protection

The 1930s saw a qualitative increase in government involvement with banks and thrift institutions. In 1933 and 1934, the federal government created a system of federal deposit insurance for banks and thrift institutions, respectively. (Only in 1970 did the federal government extend deposit insurance to credit unions, with legislation establishing the National Credit Union Share Insurance Fund and a new federal regulator, the National Credit Union Administration.)

Before the advent of deposit insurance, banks and thrifts had retained a major mercantilist characteristic: even if they were insolvent, they did not formally go out of business until the government (state or federal, as the case might be) terminated their charter. Without deposit insurance, this often remained a technicality. If a failing bank or thrift could not raise money, it ceased to be able to do business even though its charter might continue in formal existence.

Deposit insurance changed this feature from a technicality to a fundamental distinction. Federal deposit insurance gave failing banks and thrifts access to potentially unlimited funds from depositors (Kane, 1985). This meant much greater taxpayer exposure in the event that they became insolvent. While the marketplace would force closure of the ordinary company, federal deposit insurance meant that banks and thrifts could continue operating indefinitely, even though they had failed financially. They went out of business only when their regulator closed them down.

The Great Depression also brought other significant changes to the laws governing banks and thrifts. Laws were enacted to enforce a sharp separation between commercial and investment banking, to cap interest rates that banks (and, after 1966, thrifts) could pay on deposits, and to limit the entry of new banks and thrifts to compete with established institutions.

In summary, the enabling legislation governing most general business corporations in the United States reflects the workings of the forces of democracy in response to events over the past 200 years. Today groups of incorporators can form and dissolve most companies with relative ease. However, amid the large majority of corporations chartered under general corporation laws of the states, there remains a minority of companies chartered with distinctive privileges and restricted activities and powers, created under state or federal law, that retain many of the old mercantilist attributes.

MERCANTILIST FINANCIAL INSTITUTIONS AS INSTRUMENTS OF FEDERAL POLICY

The Role of Federal Law in Providing Privileges and Defining Permitted Activities of Banks, Thrifts, and Government-Sponsored Enterprises

Similar to the royal charters of mercantilist companies, federal law today provides special privileges and benefits and—sometimes in conjunction with state law—defines the permitted activities of banks, thrifts, credit unions, and government-sponsored enterprises. Especially important to mercantilist companies was the exclusive nature of their charter. Federal law, and requirements of federal law implemented by relevant federal regulatory agencies, create special privileges for today's mercantilist financial institutions by imposing barriers to entry by potential competitors.[21] This situation is most pronounced for government-sponsored enterprises because of the inability of competitors to obtain similar federal charters and thereby obtain the same benefits and privileges as existing enterprises.[22] Banks and thrifts for many years have benefited from special privileges. Especially since the creation of federal deposit insurance, their enabling legislation sheltered them from the rigors of open competition. This protection precluded nonbanks or nonthrifts from providing certain services on equal terms with banks and thrifts, and also limited the amount of competition from other banks and thrifts and from new entrants in any particular geographic market.

Federal law has provided other generous benefits as well. Credit unions, for example, are exempt from federal income taxes. Thrift institutions also benefited from a federal income tax exemption for many years. Some government-sponsored enterprises, including some institutions of the Farm Credit System and the Federal Home Loan banks, today have federal income tax exemptions, as did Freddie Mac until recently. Federal law continues to limit the amount of taxes that states and localities may impose upon banks, thrifts, credit unions, and government-sponsored enterprises.

Federal law also preempts other state laws and restrictions that may apply to state-chartered private competitors of banks, thrifts, and government-sponsored enterprises. For example, government-sponsored enterprises are free to serve national markets without being subject to the doing-business laws of the individual states or state securities requirements applicable to competitors.[23]

For years, banks, thrifts, and government-sponsored enterprises have been able to use their governmental privileges to serve their legally restricted markets and to make generous profits for their private owners. As was the original mercantilist system in Europe, this state of affairs is stable until changing markets and technologies and new forms of competition create sudden new kinds of financial risk and vitiate the ability of the government to maintain oligopoly or monopoly profits for its mercantilist institutions.

Rewards and Risks for Mercantilist Companies

Rewards

There are many rewards for being an institution permitted to operate in a federally protected market niche. The thrift business for years was known as a "3-6-3" business: the thrift executive paid 3 percent on passbook deposits, made mortgage loans at 6 percent, and was on the golf course every day by 3 o'clock in the afternoon. The mention of "banker's hours" conveys much the same concept. Federal and state laws gave banks, says Lowell L. Bryan (1991, 12), "the benefits of operating within a very profitable cartel." Today, a number of government-sponsored enterprises are reaping oligopoly profits in their federally protected markets.[24]

Take banks first. Federal and state laws have provided many privileges to national banks and other commercial banks. Most importantly, banks for years had exclusive authority to offer demand deposits and to provide check clearing services and checking accounts and (along with thrifts and credit unions) to provide federally insured deposit accounts. Together, these provisions traditionally have meant that a large amount of money was forced through the banking system (Bryan, 1991, 13, 53).

Federal law has also limited competition from other types of financial service companies. For instance, the Glass-Steagall Act of 1933 provided that securities firms could not engage in commercial banking functions. The Bank Holding Company Act, a federal law, limited the ability of commercial and industrial companies to enter the business of banking through bank affiliates. Finally, federal and state laws also limited the amount of competition among banking institutions themselves by limiting branching within states and across state lines.

Together, these restrictions helped banks for many years to reap oligopoly profits in the local markets that they served. Although the United States possessed thousands of banks, the overlay of federal and

state laws assured that they would not all be able to compete for the same customers.

State and federal laws similarly protected thrift institutions from the rigors of competition. Banks, starting in the 1930s with federal deposit insurance, and thrifts, starting in 1966, were subject to interest rate restrictions on the amount they were permitted to charge on deposit accounts. The law permitted thrifts to pay their depositors one quarter of 1 percent higher interest than banks. With some exceptions at times of disintermediation, this assured a strong flow of savings from depositors into thrift institutions.

Under the relevant federal and state laws (until the early 1980s), thrifts were generally limited to making home mortgage loans. Moreover, they were expressly limited to making mortgage loans within local market areas. Once again, the government created thousands of institutions organized into a series of local oligopolies that could reap above-average profits from their legally protected market. Virtually all of this protection came from laws that were enacted at the behest of the thrift industry itself (Brumbaugh, 1988, 20–28).

A third kind of mercantilist company, the government-sponsored enterprise, benefits from even more explicit restrictions on competition than were available to banks and thrifts. Fannie Mae, Freddie Mac, Sallie Mae, and the newer Farmer Mac operate under unique federal charters that are not available to others that might want to compete on similar terms. The Federal Home Loan banks and Farm Credit System institutions are chartered by their federal regulators; in turn, those regulators are limited to chartering a single bank in each geographic region of the country. Instead of deposit insurance, government-sponsored enterprises benefit from an implicit federal guarantee that lowers their borrowing costs and enhances the value of the mortgage-backed securities that they issue.

Political Risks

There are also risks—especially political risks—involved in being a mercantilist company. One risk is that the government will try to change the terms of the mercantilist contract to gain greater public benefits than the companies' stockholders are willing to share. The federal government frequently amends the law governing mercantilist companies. The federal government changed the terms of the contract with thrift institutions and Freddie Mac, for example, when it subjected them to federal income taxation.

Sometimes, legislation may change a mercantilist contract to the advantage of shareholders, and then back again. Thus, in 1981, the

Congress greatly expanded Sallie Mae's charter act, to permit the company to engage in "any . . . activity the Board of Directors of the Association determines to be in furtherance of the programs of insured student loans [or uninsured student loans] authorized under this part or [that] will otherwise support the credit needs of students."[25] When Sallie Mae used this provision to purchase a thrift institution, banks and thrifts objected to this new competition. The Congress thereupon passed new legislation restricting Sallie Mae's authority and expressly providing that Sallie Mae could not own or operate a depository institution.

The second kind of political risk involves the possibility that the federal government will enact legislation greatly diminishing the value of a corporate charter. For example, local community banks actively fought the Bush administration's legislative proposals to expand the authority of banks to branch across state lines. Such expansion would mean that larger banks could enter local markets and compete against local community banks. The Treasury Department argued that relaxing bank branching restrictions would reduce excess bank capacity in many markets and thus enhance the safety and soundness of banks, and would provide important consumer benefits and increase the efficiency of bank operations (U.S. Treasury, 1991a, xvii–17). The community banks saw a threat to their market position. They prevailed, and the 1991 banking legislation omitted the proposed expansion of geographic powers of banks.

Another example comes from Sallie Mae. In 1991, Sallie Mae stock dropped in value when Congress and the Bush administration considered replacing the system of federally guaranteed private student loans with direct federal loans to students. Under its federal charter, Sallie Mae is the single largest participant in the student loan market. Such a change would affect all lenders to the extent that they hold small portfolios of student loans; by contrast, the change could impair all of Sallie Mae's business at once. As one stock analyst warned, "In light of our recent findings regarding political risks, we view the company's prospects as more speculative than we had previously. Developments in the political arena could lead us to quickly alter our investment recommendations either upward or . . . downward."[26]

Moreover, legislative threats can come from state as well as federal governments. In the Great Depression, for example, states enacted moratoriums on the ability of mortgage lenders—primarily thrift institutions at that time—to foreclose on defaulting borrowers. Unless a mercantilist company can use the fact of preemption of such legislation by federal law as protection, such changes may survive judicial scrutiny.

To take an earlier example involving federally assisted railroads including the Union Pacific Railroad Company, the U.S. Pacific Railway Commission observed in 1887 (p. 121) that

> the great variety of bills introduced for the purpose of controlling the business of the railroads, imposing arbitrary rates of freight, limiting their powers, enacting stringent liabilities for accidents, forbidding the exercise of the right of eminent domain, and imposing unequal taxes made it almost impossible for the railroad companies to avoid expending considerable sums of money in causing their interests to be properly represented. Many of these bills doubtless had their origin in the perfectly just belief that the business of the railroads ought to be subjected to supervision and control. Other bills were totally impracticable, and would have inflicted immense loss on the companies affected thereby.

A third kind of risk to mercantilist institutions is much more subtle than the other two, but potentially devastating. The governmentally protected market for a mercantilist company may be profitable for years. Inevitably, however, markets and technologies change. If they change enough, the federally protected niche can become a death trap. Nonmercantilist competitors may drain away customers—borrowers or depositors—with packages of services that the mercantilist companies are legally precluded from providing. This is the subject of the next section.

The various mercantilist companies today are situated at various points along the continuum of this political risk. After the disaster of the late 1970s and 1980s, thrifts may well be dying out as a distinctive kind of financial institution (Bryan, 1991, 75–76). Meanwhile, banks are beginning to fail in serious numbers as they find themselves confined by provisions of their enabling legislation that do not constrain nonbank competitors (Pierce, 1991, 1–2, 13–16, 87). Finally, some of the government-sponsored enterprises remain in the happy period of recouping supernormal profits even as the limits of their enabling legislation begin to become apparent.

THE ROLE OF POLITICS AND MARKETS IN SHAPING THE ACTIVITIES OF MERCANTILIST FINANCIAL INSTITUTIONS

Like any profit-oriented company, a bank, a thrift, or a government-sponsored enterprise must pay attention to its customers and its markets. However, this orientation is somewhat different from that of a company

facing vigorous competition, because the mercantilist company may have the opportunity to earn oligopoly profits and essentially to dominate its legally protected market niche.

Also, similar to other major private companies, mercantilist companies must pay attention to the Congress, state legislatures, and relevant governmental regulators. Again, however, mercantilist companies tend to be different. Unlike ordinary companies, the success or failure of mercantilist institutions rests even more with their success in the political arena than with their success in the marketplace. Only a favored few ordinary companies can obtain governmental support when they falter or fail financially. By contrast, a few changes in enabling legislation of a mercantilist company can revitalize—at least temporarily—even the most moribund institution.[27]

The Role of Markets

Mercantilist institutions can and do fail. Indeed, it was the widespread failure of banks and thrift institutions in the Great Depression that led to deposit insurance and many of the laws and regulations that have shaped the role of banks and thrifts in subsequent decades. In the good times following the Great Depression, most banks and thrifts did not fail. Instead, they served their protected market niches and reaped protected profits. This profitability was possible because laws and regulations essentially entrapped two groups of customers who paid much more for banking and thrift services than was justified by the cost of providing those services. First, federal interest rate ceilings meant that depositors in banks and thrift institutions did not receive full value for their deposits. Second, high-quality corporate borrowers paid commercial banks much more for their loans than their risks would have indicated. Lowell L. Bryan reports a McKinsey and Company study indicating that in the high-inflation environment of the late 1970s, the real return on investment to bank and thrift depositors was actually negative. Such depositors were effectively subsidizing banks and thrifts by tens of billions of dollars a year (Bryan, 1991, 52–53).

On the lending side, banks showed their acumen at protecting their customer base of high-quality borrowers. Federal law prevented institutions other than banks from offering checking accounts and prevented banks from charging interest on such accounts. This essentially forced most funds in the economy to flow through depository institutions and

gave banks leverage over their borrowers. Banks used this leverage to require their borrowers—even their high-quality corporate borrowers—to maintain large compensating (and interest-free) deposit balances. In turn, this cross-subsidy enabled banks to keep their stated interest rates relatively low on loans, and thereby helped to exclude nonbank lenders like finance companies from competition for good credit borrowers (Bryan, 1991). On the deposit side, banks tried to compete with service. They added branches, automated teller machines, and even cash management services for their corporate customers.

For thrift institutions, it was much the same. So long as thrifts had a protected source of low-cost deposits, they could afford to make local mortgage loans and hold these mortgages in their portfolios. Like banks, thrifts were barred from direct price competition in attracting depositors. Banks and thrifts also resorted to unregulated methods of competition. When high interest rates caused the outflow of deposits known as disintermediation, thrifts would offer inducements such as the proverbial toaster and other nonprice benefits for depositors to continue to keep their money in accounts subject to the legally imposed interest rate ceilings (Brumbaugh, 1988, 14–15, 39–40). Some thrifts used their relationships with real estate settlement service providers, such as settlement attorneys and title companies, to provide added profits on their mortgage lending activities, again in markets that were protected from the rigors of full competition.

Federal laws and regulations dampened competition, but could not eliminate it. Especially because of the restrictions on bank and thrift branching, the United States came to have thousands of banks and thrift institutions serving protected local markets. In particular, banks began to adopt distinctive competitive strategies. Larger banks used the bank holding company device to avoid some bank branching restrictions, serve the largest institutional customers, and provide a greater range of services than could be offered by an insured bank itself; regional banks grew to serve regional markets; and local banks actively solicited high-quality small business customers for their loans.

Government-sponsored enterprises have retained the original mercantilist form of privileged charter. They have little or no competition from others with similar corporate privileges and requirements. While other completely private companies can grow by diversifying into a wide range of markets, government-sponsored enterprises are limited to serving their designated markets. Supported by their ability to borrow large

amounts of money on favorable terms, and limited to serving their designated economic market segments (but free to serve large geographic areas), government-sponsored enterprises can be expected to direct their energies toward growth within their permitted markets. If the permitted markets are large enough, government-sponsored enterprises can become huge institutions. In 1991 alone, for example, Fannie Mae grew by over $85 billion dollars. The single company now funds, in portfolio or mortgage-backed securities, over one-half *trillion* dollars of home mortgages.

As they grow in dominance in their permitted lines of business, enterprises also play a major role in shaping their markets. Fannie Mae and Freddie Mac have had a major impact on the residential mortgage market. Almost all mortgage lenders now use standard mortgage instruments drafted by Fannie Mae and Freddie Mac for their residential loans. Fannie Mae and Freddie Mac have helped to increase national uniformity in contracts and procedures for sales and servicing of mortgages. They have helped to increase market efficiency and reduce transaction costs, compared to earlier days when variations among states and regions kept the mortgage market segmented into geographic areas. Finally, along with the Government National Mortgage Association (Ginnie Mae), Fannie Mae and Freddie Mac have helped to pioneer standard terms and conditions related to mortgage-backed securities. Mortgage-backed securities benefit from economies of scale, and their standardization has been important in producing a homogenization of terms for such securities so that such economies can be realized.

Fannie Mae and Freddie Mac have also helped to displace thrift institutions in their role as portfolio lenders. To the extent that Fannie Mae and Freddie Mac pass on some of their borrowing advantages and economies of scale to homebuyers, the consequent reduction in mortgage rates has tended to squeeze less efficient competitors, including many thrift institutions. As economists increasingly agree, the growth of the mortgage-backed securities business ultimately appears to spell the displacement of thrift institutions in the business of holding mortgages in portfolio (Brumbaugh, 1988, 168).

The Role of Politics

While success in the marketplace is important to mercantilist companies, success in the political arena is vital. A mercantilist company that begins to fail in the market can turn to the political process for redemption.[28]

Political Risk and the Demise of the Thrift Industry

Such a scenario happened to thrift institutions in the early 1980s. Ultimately, federal laws and regulations could not stop the emergence in the marketplace of new technologies that facilitated the development of powerful new competitors to banks and thrifts. The growth of money market mutual funds in the 1970s finally provided borrowers an escape from the artificially low interest rates paid on their captive deposits. Then political risks suddenly materialized in deadly form for the thrift industry. In 1979, Federal Reserve chairman Paul Volcker and the Federal Reserve Board attempted to squeeze out rising inflation by increasing the level of interest rates dramatically.

The increase in interest rates was fatal for many thrifts. Locked into portfolios of low-yielding 30-year fixed mortgages, they could not survive in a high interest rate environment. By contrast, banks tended to make adjustable-rate commercial loans tied to the prime rate; with some exceptions such as rural banks whose borrowers were driven out of business by the high interest rates, this helped to protect them from the immediate consequences of the Federal Reserve Board's actions.

Facing unanticipated disaster in its legally restricted lines of business, the thrift industry once again turned to Washington for relief. In 1980 legislation, thrifts and banks obtained deregulation of interest rates and an expansion of federal deposit insurance, from $40,000 per account to $100,000 per account. The first provision permitted thrifts and banks to pay market rates of interest to help keep their depositors from fleeing to money market funds. The second provision expanded the federal safety net for banks and thrifts and encouraged the large-scale flow of brokered deposits into institutions that offered the highest rates.

This was not enough. Locked into their low-yielding portfolios, thrifts could not afford to pay market rates to depositors for any length of time. It is estimated that by 1981 the thrift industry had lost its entire net worth (Brumbaugh, 1988, 40; Bryan, 1991, 66). In 1982, thrifts sought and received additional benefits in the Garn–St Germain Act. The 1982 law expanded the lines of business available to thrift institutions, permitted them to make commercial loans up to specified limits, and removed loan-to-value limits on real estate loans. Finally, the industry exerted continuing pressure on members of Congress, the Reagan administration, and the Federal Home Loan Bank Board to assure that government would not close many thrifts when they failed.

The combination of impaired capital and negligent federal oversight gave managers of failed thrifts the incentive to make large-scale financial gambles. The expanded powers and privileges gave them new ways to roll the dice. As economist R. Dan Brumbaugh (1988, 59) puts it, the thrifts were gambling for resurrection. If a gamble succeeded, it could save an institution. If it failed, the institution felt that nothing had been lost. The institution's demise had been assured after 1979 when the Fed had implemented its new policies and driven up interest rates. Only the government and taxpayer stood to lose when the gambles failed and the losses of failing thrifts were compounded, sometimes by billions of dollars.

Thrifts continued to rely upon their political strength. As late as 1987, their major trade association, the U.S. League of Savings Institutions, successfully blocked legislation to provide funds to recapitalize the insolvent Federal Savings and Loan Insurance Corporation (FSLIC) Fund. The industry argued that most failed institutions deserved the chance to remain in business until the return of better times. Later that year, the Reagan administration and Congress overcame strong political opposition and finally legislated $10.8 billion in funds to close insolvent thrifts. That was far too little money to close the number of failed institutions that continued to gamble with taxpayer money.

By 1987, the Federal Home Loan Bank Board (FHLBB), the nominal thrift regulator, was also trying to restore the quality of regulatory oversight lacking in previous decades. Finally, after the 1988 election, the Bush administration and Congress enacted strong legislation abolishing the FHLBB, creating a new financial regulator, the Office of Thrift Supervision, and providing that regulator with strengthened powers and resources. The new legislation, and legislation in subsequent years, also provided tens of billions of dollars in additional resources to help pay for the closure of insolvent institutions. It is estimated that the final cost of the thrift debacle will be upward of $150 billion to $200 billion to American taxpayers once all failed institutions (and those expected to fail in coming years) are closed (Congressional Budget, 1992, 13).

The experience of the thrifts shows the dangers of expanding powers of mercantilist institutions. Regulators are forced to evaluate risks of new financial products and services that they may not understand. Moreover, expanding powers without limiting deposit insurance may cause an uncontrolled spread of federally supported credit into new sectors of the economy that may not need it. The multitudes of see-through office

buildings funded by failing thrifts are but one manifestation of the problems of excessive federal credit caused by broadened powers and inadequate federal oversight.

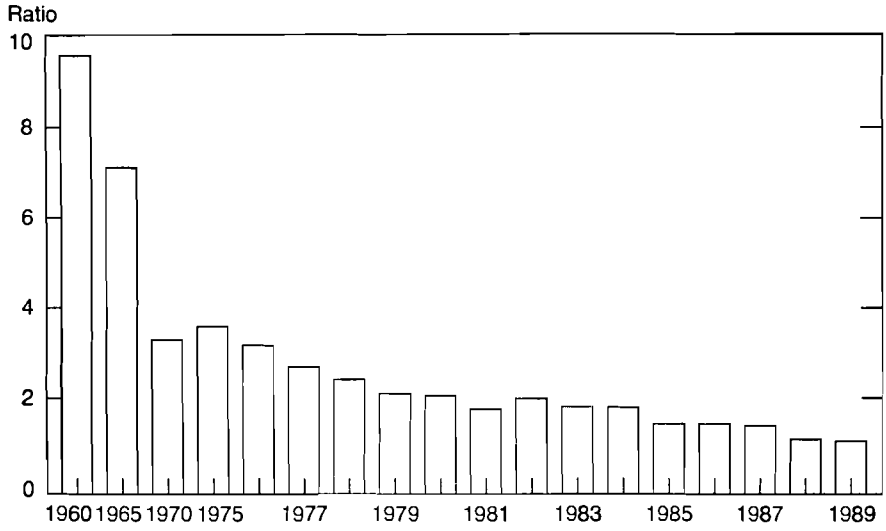
Political Risk and the Decline of Banks

The case of banks provides an interesting contrast to the thrift story because it illustrates the other horn of the dilemma and shows what happens when mercantilist institutions fail to obtain continuing expansions of their legal authority. Banks, as well as thrifts, lost depositors to the burgeoning money market funds starting in the 1970s. By itself, this might have been a manageable difficulty if banks could have retained their captive high-quality borrowers.

Unfortunately for banks, the market changed in that regard as well. Technological developments in information processing permitted the emergence of the commercial paper market (Pierce, 1991, 60–61). Large- and medium-sized high-quality corporate borrowers began to raise money more cheaply in the commercial paper market than they could from banks. Once the new competition was viable, it grew rapidly. Exhibit 4 shows the growth of the commercial paper market. It shows the rapidly declining ratio of bank commercial and industrial loans to commercial paper outstanding in just 20 years. To give some sense of the underlying numbers, at the end of 1960, commercial paper issued by nonfinancial corporations and finance companies amounted to only $4.5 billion. Within 15 years, that figure had multiplied more than 40-fold, to over $200 billion. By contrast, bank lending for commercial and industrial purposes increased only 11-fold in the same period from $43 billion to $494 billion (Litan, 1987, 42).

Some analysts point to banks' decreasing competitive strength in their traditional areas of specialization as the reason that so many institutions turned to other categories of lending that promised high yields (Pierce, 1991, 64). Among these categories were loans to developing countries, highly leveraged loans to commercial corporations, and commercial real estate loans. Together these three categories amount to hundreds of billions of dollars of loans on the books of U.S. banks. In each of these cases, it turned out that banks made bad decisions about the true nature of the risks involved (Bryan, 1991, 101–30). While some bank regulators understood the seriousness of those risks, they were generally powerless to restrain the new activities in advance or to quantify the sovereign risk or other credit risk that these activities entailed.

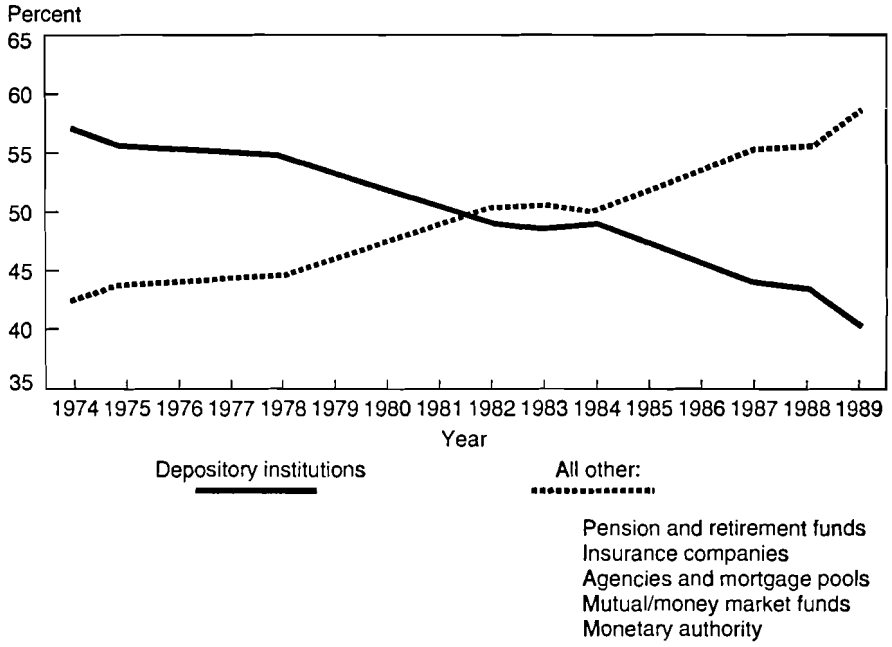
EXHIBIT 4
The Growth of the Commercial Paper Market: Ratio of Bank C&I Loans to Commercial Paper Outstanding, 1960–1989



Source: U.S. Treasury Department, "Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," February 1991.

Federal bank regulators have attempted to expand permitted powers of national banks and bank holding companies through liberal interpretations of the incidental powers clauses and other provisions of the relevant enabling laws. Nevertheless, legal restrictions have continued to hamper the ability of banks to adjust their activities and lines of business according to changes in their environment. Legal restrictions mean that banks are not permitted to enter areas related to traditional bank lending where synergies might be available. These include the prohibitions on bank activities relating to underwriting securities, the sale of life insurance products by banks, the provision of real estate brokerage services, and, above all, the geographic restrictions that continue to impede banks from developing economies of scale and from shrinking excess capacity in today's system of over 10,000 individual institutions. Exhibit 5 shows the decline in market share of federally insured depository institutions, and especially banks and thrifts, as a percentage of the total U.S. financial sector.

EXHIBIT 5
Financial Assets Held by Depository Institutions as a Percentage of Total Financial Sector, 1974–1989



Source: U.S. Treasury Department, "Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," February 1991.

The failure of the federal government to expand the law prescribing eligible banking activities puts immense stress on federal regulators. The emergence of nonbank competition means that many existing banks do not have enough profitable business. Instead of a process of market-based elimination of high-cost and low-efficiency banks, the closure of such institutions is left to federal government officials. Not surprisingly, the regulatory system is unable to take the political pressure engendered by such an unpleasant and unpopular task. The failure of the Treasury Department's 1991 proposals to expand bank powers meant that there would be a greater need for federal regulators to deal with faltering banks and to remove excess capacity from the banking industry. Yet, this was followed promptly by political charges of a governmentally induced credit crunch. Senior federal officials and the president of the United States himself

admonished the regulators and called upon them to refrain from being overzealous in applying strict credit standards to faltering institutions.[29]

As was true when the federal government created the preconditions for large-scale failure of thrift institutions while weakening regulatory oversight, this is not a state of affairs that is viable over the long term. Denying banks the freedom to expand into ancillary financial services inevitably will cause many bankers to seek high-yield opportunities that may entail greater risk. It is not pleasant to watch a second set of mercantilist institutions drive up the potential taxpayer exposure involved in their activities.

Political Risk and the Growth of Government-Sponsored Enterprises

Finally, there is the case of government-sponsored enterprises. In recent years, government-sponsored enterprises have exploited significant opportunities to expand their charters. In good part, this appears to be the consequence of a failure of many in government, at least during the 1970s and 1980s, to understand these institutions and how they work. Given the economies of scale and massive size of most enterprises, even minor technical changes in their charters—such as an expansion in the size and kinds of lending Fannie Mae and Freddie Mac are permitted to provide—can have large-scale market consequences.

Moreover, with the failure of the thrift industry and the increasing failure of many banks, as well as the decline of federal departments such as the U.S. Department of Housing and Urban Development, policymakers find government-sponsored enterprises increasingly attractive as substitute lenders, especially for housing. At the moment, at least, while they are earning oligopoly profits, government-sponsored enterprises appear to many members of the congressional banking committees to be institutions somehow free of the structural problems inherent in other mercantilist companies (Zuckman, 1991). This state of affairs is reminiscent of the high regard in which banks were held in the 1980s as contrasted with the progression of failing thrift institutions.

The limits to a federally protected market niche can be seen in the case of Sallie Mae. Sallie Mae expanded eightfold over a single decade, from a $5.2 billion institution in 1981 to a $41 billion institution at the end of 1990. Today Sallie Mae funds, either directly or through advances to primary lenders, over half of all federally guaranteed student loans.

The problem is, of course, that such a rate of growth cannot continue forever. At some point the company must expand its charter authority, so

that it can engage in new activities and new lines of business, or be threatened with the prospect of giving up some of its traditional standards of credit quality, or face a serious reduction in its traditional rates of growth. One glimmering of a possible new field of endeavor for Sallie Mae has been the company's entrance into management of a failed student loan guarantee agency, the Higher Education Assistance Foundation (HEAF), on behalf of the U.S. Department of Education. At the same time, the enterprise has been actively involved in reducing the barriers between its permitted secondary market activities and the primary market, through improvements in technology that permit close computer relationships between Sallie Mae and lenders originating loans to be sold to Sallie Mae.

Finally, the problem of the specialized lending authority of government-sponsored enterprises was most dramatically seen in the failure of the Farm Credit System in the mid-1980s. Like other enterprises, the system is limited to lending to a single business sector. The undiversified portfolios of farm credit institutions are especially vulnerable because of the financial volatility of the agricultural economy. Moreover, farm credit institutions are limited by charter to providing credit within specified regions, so that this limits their ability to diversify risk. As the Treasury Department has pointed out, the performance of a farm credit institution "can rise and fall with the fortunes of a single crop or perhaps with those of a limited number of borrowers" (U.S. Treasury, 1990, p D-15).

As with deposit insurance, the implicit federal guarantee of enterprise obligations dampened market constraints on the Farm Credit System. The system in turn exacerbated its sectoral vulnerability by offering borrowers advantageous interest rates and credit terms that ultimately proved impossible to sustain. In 1985 and 1986, the Farm Credit System reported losses totaling $4.6 billion (Standard & Poor's, 1987), the largest financial institution loss in the United States until that point. After the governor of the Farm Credit Administration, the nominal regulator at that time, announced that the system would be unable to pay its obligations, the federal government enacted legislation authorizing up to $4 billion to bail out the failed system. Although the bailout was accompanied by substantial strengthening of the financial regulator of the Farm Credit System, that regulator too has come under political pressure to refrain from making unpopular decisions about the creditworthiness of loans extended by the Farm Credit System.

The Political Strength of Mercantilist Companies

Mercantilist institutions are created by the political process and perceive that their survival or failure can hinge on that process. This means that mercantilist companies will devote immense resources to assuring their continuing political success.[30] Thus, it was sheer political power that helped much of the thrift industry stay alive in the 1980s despite the financial failure of hundreds of institutions. As late as 1986 and again in early 1987, the U.S. League of Savings Institutions marshaled enough congressional support to stop legislation that would have provided funds for the insolvent federal deposit insurance fund so that it could pay to close failed savings and loan associations. Individual institutions were able to obtain the services of powerful members of the government to pressure regulators to keep their particular institutions open, at great taxpayer expense, long after they had failed.

The history of American mercantilist institutions is replete with such examples of efforts to achieve dominance, by more or less proper means, over the political process. The most powerful mercantilist institution of its day, the second Bank of the United States, precipitated a depression in the early 1830s as a weapon in its war with President Andrew Jackson over rechartering. Historians write of Nicholas Biddle, the president of the bank, that

> when the bank war developed, Biddle proved to be a magnificent fighter. But, in view of his semi-official status, one may ask: Should he have fought as valiantly and as bitterly as he did? He carried the fight to its extreme, and just as he did not recognize there were limits to be observed, he did not see when it was necessary to acknowledge defeat. . . . The struggle for a new charter became bitter war where power was pitched against power; where the end seemed to justify the means; where Biddle became more and more stubborn as it progressed; . . . and for the first time in his life [he] became culpable: he abused the power which he held in trust to engineer the depression of 1833/1834 in order to force his will on the administration and the country. (Redlich, 1947, 151–52, 154).

Later in the 19th century, the U.S. Pacific Railway Commission (1887, 121) found that the transcontinental railroads had exceeded proper bounds in their drive for dominance:

> It is the judgment of the Commission that money[s] of all the bond-aided roads have been used for the purpose of influencing legislation. There is no direct proof, with specifications of time, place, and persons, on which to

> base the assertion that actual bribery was resorted to. But it is impossible to read the evidence of C. P. Huntington and Leland Stanford, and the Colton letters, without reaching the conclusion that very large sums of money have been improperly used in connection with legislation.

In the recent struggle over legislation to set effective capital standards and create meaningful financial supervision for Fannie Mae and Freddie Mac, the mercantilist companies recognized that somewhat more restrained approaches were sufficient to achieve dominance over the House Banking Committee. As the committee's sole dissenter reported:

> It is not surprising that Fannie and Freddie are beginning to exhibit that arrogant characteristic of a duopoly, controlling 90 percent of the market. Such market dominance allows for heavy-handed approaches to competitors, to financial intermediaries, and to consumers. Competitors such as community-based savings and loan associations and commercial banks are also users of GSE services. They are understandably apprehensive about expressing reservations about their practices in fear of retaliation. Likewise, would-be competitors such as securities firms run well-known market risks if they object or attempt to compete with Fannie and Freddie. The two GSEs distribute billions of dollars of business on Wall Street and have a reputation of not cottoning to challengers of the status quo.[31]

Regulatory capture is another frequent consequence of the political power of mercantilist institutions. Harold Seidman's favorite example involves the Comptroller of the Currency. Shortly after World War II, reports surfaced of a pending reorganization of bank supervisory agencies, prompting the following banner front-page headline in a trade publication: "National Banks Need Spokesman, Office of the Comptroller of Currency Should Be Preserved." Seidman concludes, "It is clear from positions taken on banking legislation that the Comptroller of Currency still speaks for the national banks" (Seidman and Gilmour, 1986, 185–86).

While such political strength does have its limits, the fact is that mercantilist institutions are powerful enough to make government supervision difficult at best.[32] This state of affairs is especially risky to taxpayers today because of the increasing extent to which implicit or explicit federal guarantees now back the activities of mercantilist companies such as banks, thrifts, and government-sponsored enterprises. The economic consequences of such a federal guarantee are clear: the federal government must supervise those guarantees to the extent that a private creditor

would supervise the use of its credit.[33] It is because of its failure to supervise and confine misuse of a financial guarantee that the federal government bears considerable culpability for the thrift debacle.

Much of the political strength of mercantilist institutions is evident in their dominance over the relevant congressional committees and agencies of government. By contrast, mercantilist institutions are less powerful in relation to other major private political interests. This can be seen in the inability of the larger commercial banks today, for example, to persuade the Congress to permit them to enter new lines of business such as providing insurance and real estate brokerage to their customers or to expand their authority to deal in securities. Proposals to provide such expanded authority have been met by effective opposition from the powerful industry groups whose members already provide such services. Pressure from private competitors was also successful in persuading the Congress to reject requests by Fannie Mae and Freddie Mac for expanded charter powers in the early 1980s.

Thus, politics plays a dual role in expanding the potential risk to taxpayers from activities of mercantilist institutions. First, the political power of the institutions and their constituents helps to prevent the government from gaining the ongoing ability to supervise its guarantees properly. Second, the political power of other industry groups can prevent expansion of authority of a mercantilist institution to provide new services in response to changing technologies and markets. This, in turn, helps to place more burden on the federal supervisory agencies to close institutions that begin to fail when their markets leave them and to prevent excessive risk taking while they fail.

CONCLUSION: VULNERABILITIES ARISING FROM THE PECULIAR LEGAL STRUCTURE OF MERCANTILIST FINANCIAL INSTITUTIONS

Mercantilist companies are different from ordinary companies. They offer valuable public benefits but lack some of the basic forms of market discipline that apply to the usual company chartered under state business corporation laws and that prevent such ordinary companies from causing the kind of damage that has been caused by the collapse of the thrift industry. Most important to taxpayers, the government lacks the ability to provide financial supervision as an effective substitute for missing market

discipline. Also, the mercantilist charter means that the contest among financial competitors too often occurs in a political forum rather than in the marketplace.

The result has been a progression of oligopolistic institutions along the following lines:

- Establishment under a favorable charter.
- Federal protection for oligopoly power in the marketplace.
- Early success in expanding legislated charter powers.
- Later inability to expand charter powers because of opposition of other powerful interests.
- Occurrence of some form of political risk (dramatically seen in the actions of the Federal Reserve Board that drove much of the thrift industry into insolvency within two years, from 1979 to 1981).
- Political pressure on regulators and the government to forebear rather than to protect taxpayers against loss from the government's backing.
- Some form of crisis that makes the status quo untenable.[34]

In the interim, they provided significant public services, often over decades, that the government might not have provided as well through its own agencies. Today, the pace of change in the marketplace, and especially the financial marketplace, has accelerated. That acceleration also means a significant increase in the speed with which the markets erode mercantilist advantages. This decreases the public benefits that mercantilist companies may be able to offer and increases their financial vulnerability.

Many of the kinds of risk that can topple mercantilist financial institutions can be qualitatively different from those that affect other companies. Moreover, they may be inherently nonquantifiable. Consider market risk. Rapid advances in technology create the prospects of unforeseen loss of market share by mercantilist institutions to aggressive new competition. Mercantilist institutions thus have quite a different kind of market risk than other companies. They may enjoy oligopoly profits undisturbed for years, only to be confronted suddenly with new technologies that permit nonmercantilist companies rapidly to take away key portions of their customer base.

As with other companies, management and operations risks also may depend upon new technologies. Unlike such companies, the management risk of a mercantilist institution may jump dramatically when it

runs into the limits of its enabling legislation and managers feel themselves forced to take greater risks within their permitted markets.

Such risks—and other new types of risks that emerge when institutions and their managers become stressed—are largely nonquantifiable, at least until after they have caused large-scale financial damage. Perhaps the greatest of the nonquantifiable risks is political risk. As the cases of thrifts and banks have shown, the government is slow to respond to early warning signals of financial distress. Moreover, the political process reveals a tendency to compound those risks rather than to contain them promptly.

All of this is not to argue against useful efforts to quantify known kinds of risk and set corresponding capital requirements. Rather, it is to point out that large nonquantifiable risks exist for mercantilist institutions and that these must be addressed expressly, in setting capital standards,[35] conducting regulatory supervision,[36] and devising or revising the structure of charter laws governing each kind of institution.[37]

Finally, the law, along with economics, is an academic discipline that can contribute to an understanding of these issues. The distinctive legal basis for their existence and activities makes mercantilist companies fundamentally different from other companies. An understanding of their peculiar corporate nature and the way that their enabling legislation shapes the pattern of their emergence, growth, and decline is essential. This provides a framework for development and implementation of policies to maximize the public benefits of these institutions while protecting the taxpayer against today's unacceptable levels of financial risk.

NOTES

1. For example, see Maisel (1981).
2. A government-sponsored enterprise is a privately owned, federally chartered financial institution with nationwide scope and specialized lending powers, that benefits from an implicit federal guarantee to enhance its ability to borrow money (Stanton, 1991b; Congressional Budget, 1991; U.S. General Accounting 1991; U.S. Treasury, 1990; Stanton, 1991a).
3. This perspective was suggested to me by two people with quite different points of view. I wish to express my thanks to Hernando de Soto, a Peruvian reformer and entrepreneur and author of the insightful book *The Other Path* (1989). See especially Chapter 7, "The Parallel with Mercantilism," in which he traces many of Peru's governmental and economic problems back to mercantilist antecedents. I also offer my thanks to James E. Murray,

formerly the president of Fannie Mae. See his thought-provoking analysis, "FNMA: Perspectives on a Unique Institution" (1978).

4. See Lyon, Watkins, and Abramson (1939, 51–55); Louis K. Liggett Co. v. Lee, 288 U.S. 517, 541 (1933) (dissent of Justice Brandeis).
5. Del. Code Ann. Tit. 8, Section 121(a).
6. The difference between agencies and instrumentalities of government is analyzed in Moe and Stanton (1989, 321–29). Much of the law governing federal instrumentalities derives from two decisions of the U.S. Supreme Court involving the second Bank of the United States: McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), and Osborn v. Bank of the United States, 22 U.S. (9 Wheat.) 738 (1824).
7. Several kinds of instrumentality are not included in this listing. Two examples are municipal corporations chartered by state law, and federally and state-chartered charitable and eleemosynary organizations. They too have their antecedents in early chartered corporations from mercantilist and pre-mercantilist times. Also not included are instrumentalities created by license from the government, such as small business investment companies, 15 U.S.C. Sec. 681 et seq., and government contractors whose institutional structure and public purposes are shaped by federal law. See Seidman (1990).
8. The nature of the implicit guarantee is analyzed in Stanton (1991b, 41–45, 204); see also Congressional Budget Office (1991, 6–11).
9. For a recent example, see Berry (1991).
10. Mercantile National Bank v. City of New York, 121 U.S. 138, 154 (1887).
11. For example, see U.S. Treasury Department (1991a).
12. 12 U.S.C. Sec. 1464(a).
13. 12 U.S.C. Sec. 1752(i).
14. This figure includes direct loans and direct and indirect federal guarantees; it does not include deposit insurance. If deposit insurance is counted as a subsidy, then the federal government supports over 90 percent of all non-federal borrowing. (This latter figure is approximate because of the difficulty of dealing with double counting.)
15. The growth of the joint stock corporation eventually permitted creation of corporations with a longer-term financial base. See Williston (1888, 109–10).
16. An early example comes from the hostility of colonial merchants against the monopoly of the East India Company. The tea dumped into the Boston harbor in December 1773 belonged to the East India Company. See Schlesinger (1918, 279–304).
17. See Lyon, Watkins, and Abramson (1939, 51–55); Louis K. Liggett Co. v. Lee, 288 U.S. 517 at 541 (1933).
18. "Public utility is more truly the object of public banks than private profit. And it is the business of government to constitute them on such principles that, while the latter will result in a sufficient degree to afford competent

motives to engage in them, the former be not made subservient to it. To effect this, a principal object of attention ought to be to give free scope to the creation of an ample capital, and with this view, fixing the bounds which are deemed safe and convenient, to leave no discretion either to stop short of them, or to overpass them." See Hamilton ([1790] 1934, 76–77).

19. Louis K. Liggett Co. v. Lee, 288 U.S. 517 at 541 (1933).

20. A good discussion of the limitations imposed on banks by their enabling legislation is found in Morse (1870).

21. Keeley (1988) discusses the erosion of such competitive barriers that until recently protected the market share of banks.

22. In this regard Fannie Mae and Freddie Mac today are quite different from what was envisioned when the original secondary mortgage market legislation was enacted in the New Deal. The National Housing Act of 1934 authorized establishment of national mortgage associations that could be chartered whenever a group of incorporators presented themselves as ready, willing, and able to organize an institution under terms of the law. Unfortunately, that legislation provided relatively limited benefits. In contrast to the Roosevelt administration's proposals, the legislation as finally enacted had been substantially altered under pressure from the thrift industry, which correctly saw national mortgage associations as potential competitors in the home mortgage finance market. See Eccles (1951, 144–61).

23. Stanton (1991b, 76–81) summarizes competitive advantages of government-sponsored enterprises compared to other private companies active in the same markets.

24. For example, see Hemel (1990), calling Fannie Mae and Freddie Mac a "perfect duopoly"; Stanton (1991b, 83–91).

25. 20 U.S.C. Sec. 1087-2(d)(1)(E).

26. See Hemel (1991). See also Treadway (1991): "This stock is for strong stomachs only and, near term, has a great deal of politically derived risk."

27. See Bryan (1991, 67–72) regarding the effects of the Garn–St Germain Act of 1982 on the thrift industry; Matlack (1992).

28. For a recent example, see Matlack (1992).

29. President George Bush said in his 1992 State of the Union address:

> Further, for the untold number of hardworking, responsible American workers and businessmen and women, who've been forced to go without needed bank loans: The banking credit crunch must end. I won't neglect my responsibility for sound regulations that serve the public good, but regulatory overkill must be stopped. And I have instructed our government regulators to stop it.

30. For a recent example, see Bacon (1992).

31. See U.S. Congress (1991, 115) for dissenting views of Representative Jim Leach.

32. The U.S. Treasury Department (1991b, 8) makes this point about GSEs today:

> The problem of avoiding capture appears to be particularly acute in the case of regulation of GSEs. The principal GSEs are few in number; they have highly qualified staffs; they have strong support for their programs from special interest groups; and they have significant resources with which to influence political outcomes.

33. These lessons have been derived from experiences with a variety of financial institutions whose borrowing is implicitly or explicitly backed by the federal government. See, for example, Flannery (1982, 17–27); Black, Miller, and Posner (1978); Maisel (1981); Furlong and Keeley (1987); U.S. General Accounting Office (1991); and Congressional Budget Office (1991).
34. Analysts with a historical perspective note the crisis orientation of much of the major financial legislation of the United States (Cargill and Garcia, 1985, 38):

> First, reform has frequently been crisis-oriented. Despite an awareness of the structural defects in the financial system or in the monetary authority, little effort is directed toward reform until a crisis has occurred or is about to occur. . . . Second, related to the crisis orientation of reform, financial reform is frequently myopic and backward-looking. It is designed to deal in ad hoc fashion with an immediate set of problems usually within a specific sector of the financial system.

35. The U.S. General Accounting Office (1991, 58–68) makes a comparable point with respect to capital requirements for government-sponsored enterprises.
36. The Federal Deposit Insurance Corporation (1989, 125), for example, articulates the need for forward-looking supervision:

> On-site examinations remain the most important element in the process, but they must be augmented by the best possible system of off-site monitoring and other anticipatory endeavors. Instead of performing on-site examinations based on a fixed examination cycle policy, more emphasis is now placed on identifying economic and industry risk and identifying individual banks that exhibit symptoms of higher risk.

37. For example, Stanton (1991a, 481) suggests that 20-year sunset provisions might usefully be added to the charters of government-sponsored enterprises.

REFERENCES

Abell, Derek F. *Defining the Business: The Starting Point of Strategic Planning.* Englewood Cliffs, N.J.: Prentice Hall, 1980.

Bacon, Kenneth H. "Privileged Position: Fannie Mae Expected to Escape an Attempt at Tighter Regulation." *The Wall Street Journal,* June 19, 1992, p. A1.

Berry, John M. "Examiners Are Urged to Ease Up on Banks: Bush Administration Cites Economy's Health." *Washington Post*, December 17, 1991, p. C1.

Black, Fischer; Merton Miller; and Richard Posner. "An Approach to the Regulation of Bank Holding Companies." *Journal of Business* 51 (1978), pp. 379–412.

Brumbaugh, R. Dan, Jr. *Thrifts under Siege: Restoring Order to American Banking*. Cambridge, Mass.: Ballinger Publishing, 1988.

Bryan, Lowell L. *Bankrupt: Restoring the Health and Profitability of Our Banking System*. New York: Harper Business, 1991.

President George Bush. "Presidential Address: The State of the Union, 1992." January 28, 1992. Typescript.

Cargill, Thomas F., and Gillian G. Garcia. *Financial Reform of the 1980s*. Stanford: Hoover Institution Press, 1985.

Congressional Budget Office. *Controlling the Risks of Government-Sponsored Enterprises*. Washington, D.C.: Government Printing Office, 1991.

_____. *The Economic Effects of the Savings and Loan Crisis*. January 1992.

Davis, Joseph S. *Essays in the Earlier History of American Corporations*. Cambridge, Mass.: Harvard University Press, 1917.

de Soto, Hernando. *The Other Path*. New York: Harper and Row, 1989.

Eccles, M. *Beckoning Frontiers*. New York: Alfred A. Knopf, 1951.

Federal Deposit Insurance Corporation. *Deposit Insurance for the Nineties: Meeting the Challenge*. Staff study. Washington, D.C.: Federal Deposit Insurance Corporation, 1989.

Flannery, Mark J. "Deposit Insurance Creates a Need for Bank Regulation." *Business Review*, January/February 1982, pp. 17–27.

Flannery, Mark J., and Jack M. Guttentag. "Identifying Problem Banks." In *Proceedings of a Conference on Bank Structure and Competition*. Chicago: Federal Reserve Bank of Chicago, 1979.

Furlong, Frederick T., and Michael C. Keeley. "Bank Capital, Regulation and Asset Risk." *Economic Review*, Spring 1987, pp. 20–40.

Graham, Fred C., and James E. Horner. "Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks." In *Proceedings of a Conference on Bank Structure and Competition*. Chicago: Federal Reserve Bank of Chicago, 1988.

Guttentag, Jack M., and Richard Herring. "Prudential Supervision to Manage Systemic Vulnerability." In *Proceedings of a Conference on Bank Structure and Competition*. Chicago: Federal Reserve Bank of Chicago, 1988.

Hamilton, Alexander. "Report on a National Bank" (December 14, 1790). Reprinted in *Papers on Public Credit, Commerce and Finance by Alexander Hamilton*, edited by S. McKee, Jr. New York: Columbia University Press, 1934.

Hammond, Bray. *Banks and Politics in America from the Revolution to the Civil War.* Princeton, N.J.: Princeton University Press, 1957.

Hemel, Eric I. "We Love Freddie Mac at Current Prices which We Believe Fully Discount Political Risks." First Boston Corporation, August 21, 1990.

_____. "Sallie Mae and Congressional Politics: Risks and Rewards." First Boston Corporation, January 21, 1991.

Kane, E. J. *The Gathering Crisis in Federal Deposit Insurance.* Cambridge, Mass.: MIT Press, 1985.

Keeley, Michael C. "Deposit Insurance, Risk, and Market Power in Banking." Working paper 88-07. San Francisco: Federal Reserve Bank of San Francisco, 1988.

Lipson, E. "The Economic History of England." *The Age of Mercantilism.* Vols. 2 and 3. 6th ed. London: Adam and Charles Black, 1956.

Litan, Robert E. *What Should Banks Do?* Washington, D.C.: Brookings Institution, 1987.

Lyon, Leverett S.; Myron W. Watkins; and Victor Abramson. *Government and Economic Life: Development and Current Issues of American Public Policy.* Vol. 1. Washington, D.C.: Brookings Institution, 1939.

Maisel, Sherman J., ed. *Risk and Capital Adequacy in Commercial Banks.* Chicago: University of Chicago Press, 1981.

Matlack, Carol. "Farmer Mac's Lobbyists Save the Day." *National Journal,* January 4, 1992.

Moe, Ronald C., and Thomas H. Stanton. "Government-Sponsored Enterprises As Federal Instrumentalities: Reconciling Private Management with Public Accountability." *Public Administration Review,* July/August 1989, pp. 321–29.

Morse, John T., Jr. *A Treatise on the Law Relating to Banks and Banking.* Boston: Little, Brown and Company, 1870.

Mullin, Robert A. "The National Bank Surveillance System." In *Financial Crises: Institutions and Markets in a Fragile Environment,* edited by Edward I. Altman and Arnold W. Sametz. New York: John Wiley and Sons, 1977.

Murray, James E. "FNMA: Perspectives on a Unique Institution." In *Revitalizing the Cities,* Proceedings of the FNMA/FMLMC General Counsel's Conference, Washington, D.C.: Federal National Mortgage Association, 1978.

Ornstein, Franklin H. *Savings Banking: An Industry in Change.* Reston, Va.: Reston Publishing, 1985.

Pierce, James L. *The Future of Banking.* New Haven, Conn.: Yale University Press, 1991.

Redlich, Fritz. *The Molding of American Banking: Men and Ideas.* Part 1. New York: Hafner Publishing, 1947.

Schlesinger, Arthur M. *Colonial Merchants and the American Revolution, 1763–1776*. New York: Columbia University Press, 1918.

Seidman, Harold. "Public Enterprise versus Privatization in the United States." *International Review of Administrative Science*, 1990, pp. 15–28.

Seidman, Harold, and Robert Gilmour. *Politics, Position, and Power: From the Positive to the Regulatory State*. 4th ed. Oxford: Oxford University Press, 1986.

Standard & Poors Corporation. "Farm Credit System's 'AAA' Eligibility Monitored." *Standard & Poor's Credit Week*, July 20, 1987.

Stanton, Thomas H. "Federal Supervision of Safety and Soundness of Government-Sponsored Enterprises." *Administrative Law Journal*, Summer 1991a, pp. 395–484.

_____. *A State of Risk*. New York: Harper Business, 1991b.

Treadway, Peter. *Sallie Mae (SLM-NYSE)*. Smith Barney Research, October 15, 1991.

U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. *Government-Sponsored Housing Enterprises Financial Safety and Soundness Act of 1991*. 102d Cong., 1st sess. Rep. 102-206.

U.S. General Accounting Office. *Government-Sponsored Enterprises: The Government's Exposure to Risks*. Washington, D.C.: Government Printing Office, 1990.

_____. *Government-Sponsored Enterprises: A Framework for Limiting the Government's Exposure to Risks*. Washington, D.C.: Government Printing Office, 1991.

U.S. Pacific Railway Commission. Report. Washington, D.C.: Government Printing Office, 1887.

U.S. Treasury Department. *Report of the Secretary of the Treasury on Government-Sponsored Enterprises*. Washington, D.C.: Government Printing Office, 1990.

_____. *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks*. Washington, D.C.: Government Printing Office, February 1991a.

_____. *Report of the Secretary of the Treasury on Government-Sponsored Enterprises*. Washington, D.C.: Government Printing Office, 1991b.

Williston, Samuel. "History of the Law of Business Corporations before 1800." *Harvard Law Review* 2 (1888).

Zuckman, Jill. "Bills to Increase GSE Oversight Move Ahead in House, Senate." *Congressional Quarterly*, August 3, 1991, pp. 2138–41.

Thomas H. Stanton is a Washington, D.C., attorney. He is a fellow at the Center for the Study of American Government at the Johns Hopkins University, where he will teach a course on the law of public institutions. Mr. Stanton's practice deals with federal credit programs, federal corporations, and governmental supervision of financial institutions.

Mr. Stanton's book on government-sponsored enterprises, *A State of Risk,* was published by HarperCollins in 1991. His writings on accountability of financial institutions have appeared in *Public Administration Review, The Administrative Law Journal, American Banker,* and other publications.

Mr. Stanton serves on the Standing Panel on Executive Organization and Management of the National Academy of Public Administration (NAPA) and helps to teach the annual NAPA seminar on government enterprises. He has a B.A. degree from the University of California at Davis, M.A. from Yale University, and J.D. from the Harvard Law School.