SHADOW FINANCIAL REGULATORY COMMITTEE

Administrative Office
c/o Professor George Kaufman
Loyola University of Chicago
820 North Michigan Avenue
Chicago, Illinois 60611
(312) 915-7075
FAX (312) 915-6118

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SARAH SCAIFE FOUNDATION
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For information contact:
Kenneth E. Scott
415-723-3070

George J. Benston
404-727-7831

Statement of the Shadow Financial Regulatory Committee on Concerns About the Availability of Bank Credit

February 11, 1991

Concerns about credit availability have led some in Congress and the Administration to question the standards being applied by the banking supervisory agencies to determinations of loan quality and capital requirements and to urge more leniency as to both. In the view of the Shadow Financial Regulatory Committee, this reasoning confounds issues that should be analyzed separately.

Complaints about a "credit crunch" sometimes seem to mean no more than that borrowers do not now find loan financing -- especially for real estate development projects -- available on terms as liberal as in the recent past. Given the excesses and waste in real estate development in the 1980s, driven by the subsidy to risky lending embodied in the operation of the deposit insurance system and by lax supervision during that period, the Committee believes it very much in the interest of taxpayers that more stringent standards now be followed.

Other references to a credit crunch assert the existence of a major reduction in the supply of lendable funds as banks faced with increased loan losses "downsize" their asset bases as a means of achieving compliance with regulatory capital

requirements. In these terms, there are questions about the factual underpinnings for such an assertion. In any event, this argument identifies a change in the amount of bank credit as a change in the amount of aggregate credit from all sources. Higher capital requirements and numerous other factors, such as regulatory impediments to bank efficiency and profitability, may lead to a loss of market share by banks and a gain in market share by other financial intermediaries or by directly issued and held financial instruments such as commercial paper or asset-backed securities. Likewise, there may be a shift in lending from weakly capitalized banks to more strongly capitalized banks. Such shifts may create temporary transition problems and costs, but in the long run should not be seen as a worrisome credit crunch -- except from the perspective of weak banks and weak borrowers.

The Committee fears that prudential standards are being compromised to deal with the problems of a recession which can better and more appropriately be addressed through fiscal and monetary policy measures. Such reductions in prudential standards threaten to intensify future economic downturns.