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FOUR REPLIES

How do leaders of the financial industry view the nation's capital needs? Spokesmen from commercial banking, investment banking, savings and loan, and insurance discuss the causes and implications of a potential shortage and the problems their industry faces in helping maintain a flourishing economy.

COMMERCIAL BANKING: THE TWIN THREATS TO CAPITAL

by W. LIDDON McPETERS, President, American Bankers Association and President, Security Bank of Corinth, Mississippi

The question of whether or not our nation is heading for a capital shortage is an exceedingly complex one. In this issue of TEMPO, Dr. Freund deals with the question in an especially lucid way. The concerns which he has expressed from his vantage point in the securities industry are widely shared in commercial banking.

About one-fourth of the total credit outstanding in our economy comes directly from the more than 14,000 banks in our nation's commercial banking system. Moreover, a significant amount of the credit provided by several other types of lenders is supported, in part, by bank loans and commitments.

Commercial banking's contribution to the annual supply of new credit fluctuates from year to year, of course, but over a decade or so, it will tend to expand its holdings of debt securities and loans at about the same pace that total debt has grown in our economy.

Federal Fiscal Policy

This year-to-year fluctuation in the volume of credit extended by commercial banks is primarily the result of (1) changes in the demand for credit by individuals, businesses, and governments and (2) shifts in Federal Reserve monetary policy. The availability of bank credit depends on the ease or tightness of the latter.

Dr. Freund's emphasis on the important influence of the federal government in determining whether or not our nation may experience a capital shortage is well placed. A deficit in the federal budget has important implications with respect to the demand and supply of capital. (1) A federal deficit tends to result in a higher level of spending on consumption than would exist if federal revenues and expenditures were in balance. That is, the total of taxes and current savings is less than it should be in relation to total income in the economy. (2) In financing the deficit, the federal government attracts funds away from capital formation in the private sector. Federal deficits thus tend to reduce the supply of capital, while at the same time increasing the demand for it. They have been a major source of inflation in our economy.

The proper and principal use of money is the consumption and alienation of it, whereby it is expended in making purchases. Therefore, in itself, it is unlawful to receive a price for the use of money lent, which is called usury.

—ST. THOMAS ACQUINAS

Because the anti-inflationary weapons of fiscal policy are usually politically unpalatable, the burden of combatting inflation has fallen mainly on Federal Reserve monetary policy. The result has been recurrent periods of tight money over the past 20 years. Since this policy is implemented largely by curtailing the expansion of bank credit, the commercial banks and their customers have been sub-

jected to recurrent swings in the availability of credit. Such swings have contributed to instability in the pace of capital formation.

The most important step that can be taken to help assure a stable pace of capital growth is for the federal government to put its fiscal house in order. Budget deficits should be permitted or encouraged only in periods of recession. Conversely, and with total determination, budget surpluses should be achieved in periods of expansion.

Inflation

The 1974-1975 recession differed in at least one important respect from the other recessions that our economy has experienced since the end of World War II. In the fourth quarter of 1973, disposable personal income in real terms stopped rising and began to decline. The reason was that the purchasing power of the dollar was being eroded by inflation more rapidly than the increase in number of dollars received in after-tax personal income. This decline in real purchasing power continued into early 1975, and it was not until the early months of 1976 that disposable personal income in real terms regained the level of late 1973.

When real purchasing power declines, it contributes directly to the severity of a recession, since it reduces the consumer's ability to take goods off the market. This, in turn, weakens incentives for businesses to expand plant and equipment. The economy thus receives a sharp "one-two" punch.

During previous postwar recessions, consumer spending was not constrained by declines in personal income. Indeed, expansion in consumer spending helped to bring the recessions to an early end and to encourage business spending on plant and equipment. This balance between consumption spending and investment spending thus maintained a capital formation commensurate with our nation's requirements. This balance was disrupted by the 1973-1974 inflation and ensuing recession.

In part, the present concern about a future capital shortage in our nation reflects the fact that an appropriate balance between consumption spending and investment spending has not yet been restored. As Dr. Freund has indicated, continuing expansion in consumption spending, with the currently relatively low level of investment spending, implies that "bottlenecks" will sooner or later be encountered in the production of goods and services. Economic recovery could thus be disrupted.

The commercial banking system is fully capable of playing its well established role as a major supplier of credit to individuals, businesses, and governments. There is strong evidence that the trend toward greater reliance on savings and time deposits as a future source of deposit growth in commercial banks will continue. However, the commercial banks do ask when they will be freed from the competitive disadvantage of the savings account interest rate differentials imposed by federal law and regulation. Until then, they will achieve less than their potential as suppliers of credit.

We need more incentives for expanding our industrial capacity. The need goes beyond short-term policy measures. What is needed is a clear assurance that our economy is again on a steady growth path.

The capital requirements of our economy over the coming decade are, indeed, very large. And while I believe our economy has the capacity to meet them, I find that the greatest threat to our nation's ability to meet its capital requirements is irresponsible federal fiscal policy and inflation.

INVESTMENT BANKING: THE RESTRAINTS ON CAPITAL

by ROBERT M. FOMAN, President and Chief Executive Officer, E.F. Hutton & Co., Inc.

Will there be a capital shortage? The issues are complex. Certainly an actual capital shortage will be more a function of economics and politics than of anything the securities industry does or does not do. Indeed, the assumptions underlying the capital shortage thesis are being challenged by serious thinkers. The economists who raised the question may have created another one of those economic trends that have nowhere to go.

Capital shortage or not, investments which are attractive in relation to the prevailing economic and social environment will attract investors. The key issues center not on security industry resources, but rather on the elimination of those forces which dampen returns and increase uncer-

tainty, thereby reducing the attractiveness of investments.

For example, many companies now invest fewer total dollars because they have raised their rate-of-return requirements. These requirements had to be raised to adjust for the effects of inflation, economic uncertainty, and political ambiguity. However, while the increasing rate-of-return requirement eliminates low return investments and reduces the capital shortage problem, if indeed there is one, it certainly does not bode well for our economy.

Moreover, much current investment spending is either non-productive or marginally productive. For example, the government mandated "quality of life" investments. Less of what we call capital in-

The theologians, approaching the question from a legal point of view, made it possible for the bankers to invest their money profitably by switching from lending to exchange. . . . Since a cambium *(exchange contract) was not a straight loan, there was no usury involved.*

—RAYMOND DE ROOVER

vestment is now capital investment in the classical sense. Some observers estimate that these mandated investments comprise as much as 25 percent of the total.

An overriding concern of the investment world is that the social consequences of, for example, greater unemployment—resulting from lower total investment—will focus undue attention on dealing with symptoms rather than on the fundamental economic and political environment that is required for our system to work. Nobody, however, has yet figured out how to satisfy both capital and labor with this trade-off.

Nevertheless, whatever the environment, vast amounts of permanent capital will be required by American industry over the next decade, and the main responsibility for raising it belongs to the investment banking/brokerage community.

America's ability to raise permanent private capital for industry is clearly the best in the world; it has enabled this nation to continue to outpace its competitors in economic and industrial growth for decades. Helping to maintain this economic superiority has been the fact that the investor, whether individual or institution, is far more likely to invest his funds in a corporation if he is secure in the knowledge that there will be an active, stable market into which he can sell in the future. Our capital-raising process depends upon the liquidity of such a secondary market.

The Institutional Investor

The ever-increasing activity of the institutional investor in the equity markets, combined with the legislated restrictions recently imposed on managers of pension monies by ERISA, have caused fundamental changes in this market. Pension fund managers must follow extremely conservative courses in selecting investments, lest they run afoul of the ERISA laws. Investment results themselves become almost less important than being able to defend one's actions.

Consequently, institutional investments have tended, in the equity markets, to go only to those stocks which are conservative, liquid, well-known, and owned by other institutions. This tendency reduces the ability of small and medium-sized companies to gain market recognition, which, in turn, reduces their ability to finance growth through the selling of equity. Unfortunately, these same companies are too small for the public debt markets. They also lack sufficient influence in periods of tight money, like 1974, to depend upon commercial banks to fulfill their financial needs.

The Individual Investor

Another major source of capital, the individual investor, believing that his money will be safer and more productive in the same havens chosen by the well-publicized institutions, has gone more and more toward the same kinds of equity securities. The result for the smaller company is less liquidity and fewer investors—not a good atmosphere for emerging companies to raise and attract investment capital.

This same individual investor, whose individual decisions aggregate to make our capital markets vastly superior to those of other countries, has other factors working against his willingness to invest directly in corporate America. Most of these factors result from congressional and executive branch actions.

First, the tax structure, which has always favored capital investment, is now undergoing reforms, many of which disfavor capital investment. For example, the 1976 tax legislation extends the holding period that is required to qualify for long-term capital gains treatment. Further, the Democrats have suggested doing away with the capital gains tax treatment and taxing all capital gains, long or short term, as unearned income. Each of these changes will make equity investment by individuals less attractive, just when more rather than less individual investment is required.

Moreover, the constant promul-

gation of more complex accounting policies by the accounting profession and the Securities and Exchange Commission has bewildered the unsophisticated investor to the point where he is unable to understand corporate financial statements. The changes, which were made in the interest of greater disclosure, have resulted in a plethora of "non-recurring" gains and losses, balance sheets whose footnotes are far lengthier than the financial statements themselves, and income statements whose true meaning is often hidden somewhere between the lines. The investor understands good news and he understands bad news, but what he cannot understand at all he is likely to avoid altogether.

For these and other reasons, there has been a noticeable shrinkage in the number of total individual shareholders in this country since 1968. If this element of our capital formation process deteriorates further, the problems of raising sufficient capital over the next decade, as enumerated by Dr. Freund and other economists, may, indeed, become a problem.

Even with the alleged capital shortage, however, the giant corporations of this nation will retain their access to sufficient capital for their needs, though at times it may be very expensive. As the institutional pools of capital continue to grow, through increasing pension contributions and an already evident return to more normal saving patterns, these funds will be put to work primarily through debt and equity investment in the largest and "safest" corporations.

Whether the other significant parts of our capitalist system, the small and medium-sized corporations, will be able to finance growth will depend primarily on the attitudes of individual investors. Constant publicity of corporate indiscretions, tax legislation favoring consumption over investment, bewildering financial statements, and gyrating, unpredictable markets are slowly destroying the individual's confidence in the process. Whether we can regain this confidence depends primarily on the attitudes and actions of our government. Congress and the President can bring the individual investor back. They should. We need him now, and we will need him even more in the years to come.

SAVINGS AND LOAN: THE COMPETITION FOR AVAILABLE CAPITAL

by Preston Martin, President and Chief Executive Officer, PMI Mortgage Insurance Co.

In his provocative article, William Freund points out that, while the recession has eased current capital requirements, savings flowing into corporations through bond and stock purchases may be insufficient to fund required capital expenditures.

In that event, housing will be competing with corporations for available savings in both the capital markets, through the issuance of mortgage-backed securities and bonds, and the real estate oriented savings institutions, through passbook and certificate savings. Moreover, housing will also compete for personal savings through down payments for homeownership and through the accompanying "issuance" of mortgage debt to these same home purchasers.

Competing Against Corporations

How well will housing be able to compete in the next 10 years? Let us look first at mortgage-backed securities. In the late 1960's, federal housing policy officials examined housing finance markets and found that mortgages were becoming increasingly unattractive to institutional investors compared to corporate bonds and stock. The mortgage was costly to originate, service, and foreclose. Courts were increasingly emphasizing borrower rights—sometimes even when contrary to the mortgage contract. Payments were in cumbersome denominations (e.g. $257.83 per month), included a bothersome monthly return of principal, were for a long contractual maturity with an unpredictable probability of prepayment, and had a fixed interest rate.

Is it any wonder that the pension fund or insurance company investment manager preferred to place a call to his investment broker for $1 million of publicly traded corporate

bonds or to negotiate a high yielding private placement—perhaps with an equity kicker—or to buy common stock offering the prospect of both current dividend and price appreciation? As these diversified investors withdrew, the home mortgage market was increasingly left to savings and loan associations and mutual savings banks. By the late 1960's, many mortgage bankers were finding that Fannie Mae (The Federal National Mortgage Association) moved from being their best customer to being their only customer.

The solution arrived at since 1969 has been to make the mortgage look as much like a corporate bond as possible. First, the Federal Home Loan Banks began to sell large volumes of consolidated obligations. In turn, these banks began to encourage their 4,000 plus members, mostly savings and loans, to borrow for expansion of their mortgage lending. Then Congress authorized the creation of the Federal Home Loan Mortgage Corporation in 1970. The Mortgage Corporation (also called Freddie Mac) and Fannie Mae undertook a landmark assignment, to create a uniform mortgage instrument. The Mortgage Corporation and Fannie Mae began to issue bonds backed by the cash flows from pools of mortgages. The ability to service these bonds was guaranteed by the Government National Mortgage Association (Ginnie Mae). Ginnie Mae also guaranteed securities issued by mortgage originators, where interest and principal were passed through to the investor, beginning in 1970.

The Mortgage Corporation sold, through Wall Street, participations in the whole loans and mortgages which it held—also beginning in 1970. The Mortgage Corporation issued its Guaranteed Mortgage Certificates beginning in 1975. The GMCs are specifically designed to make the institutional investment manager feel all the comfort and convenience of owning a bond yet having the proceeds fund home mortgages. They are guaranteed by an issuer (The Mortgage Corporation) which is affiliated with the Federal Home Loan Bank System.

Then, in 1975, the first public offering of a mortgage-backed bond by a savings and loan association came to market. As this was taking place, the old prohibitions against originating or buying mortgages beyond 50 miles of the home office were removed for savings and loans and mutual savings banks. The Federal Home Loan Bank Board (FHLBB) secured an IRS ruling facilitating the sale of mortgages while preserving the savings and loan tax status. Thus, encouraged, lenders began to trade mortgages and mortgage loan participations. Mortgage bankers began to replace their lost insurance company correspondents with new savings and loan clients. Mortgage rates and mortgage funds availability began to behave as in a national market rather than a plethora of local markets. All of which helped make mortgages and mortgage-backed securities again competitive with corporate securities.

We, the trustees of the sacred Monte della Pieta of Naples, certify that we hold on deposit in the said sacred bank to the credit of Lucretia da Beneme thirteen ducats which we guarantee will be paid to any party designated by her order at the bottom of this instrument, subject only to the return of this instrument signed in her hand and sealed with the accustomed seal of the said sacred bank.

—A CERTIFICATE OF DEPOSIT, 1574

Competing for Personal Savings

The credit crunch of 1969-70 convinced federal regulators of financial institutions and the savings officers of these institutions that the saving public was discovering Treasury bills and government and corporate bonds.

But just as there needed to be a product for the institutional investor which kept funds in mortgage-related securities, there needed to be a product which would keep savings on deposit in mortgage lending institutions—a product to stem disintermediation. The 6 percent interest, 2 year minimum maturity, $1,000 minimum denomination certificate was introduced in 1969 to savings and loans (with commercial banks being authorized to pay 5¾ percent).

The response must be judged as excellent. Since that time there have been authorized a whole series of certificates, ranging up to 7¾ percent interest. Of the $295 billion on deposit in savings and loans as of March 31, 1976, fully 55 percent was in certificates—an amazing conversion in just over six years. The saving public has now fully accepted a federally insured certificate in a local thrift institution, with a specified maturity and penalty for early redemption, that offers a good substitute for Treasury securities and corporate bonds.

A Look Ahead

What types of mortgage and savings product changes might occur be-

tween now and 1985 to help compete with the corporate securities market?

■ Relatively soon, there are likely to be numerous pools of conventional mortgages, privately insured and meeting pre-described standards, which may well be open ended. Pool administrators will buy mortgages and issue debt and/or participations, like The Mortgage Corporation now does. In some cases, thrift institutions will join together in offering mortgages to a given pool. Some pools will contain only variable rate mortgages; some will have low interest rate mortgages at deep discounts; some will have short remaining contract maturity or high probability of prepayment; and some will offer the individual investor the opportunity to buy or sell at net asset value, plus transaction costs—a mortgage mutual fund.

■ There will be much experimentation with mortgages for young families whose income is expected to rise. These will take the form of variable payments, variable balances, lines of credit mortgages, cost of living mortgages, share of equity mortgages, and so on. For those retiring with limited ability to make rising property tax and maintenance payments, there will be housing annuities and perhaps sale-leaseback financing.

On the savings side of the business, the success of certificates and the recent major moves by Congress to permit tax-deferred, individually tailored pension plans will cause much new product development in savings instruments. Examples might be:

■ A certificate which pays a higher rate each year and that is held. Such an account in the name of an entire family might encourage cooperative family saving, withdrawal by some family members on approval of the others, periodic gifting from those in high tax brackets to those in low brackets, and loans for home purchases from the family savings pool at whatever rate the family wants to charge its members.

■ Certificates with variable interest rates. In some states, there is a convenient flow from savings to checking account (or NOW account) to overdrafting into a loan posture. On the West Coast, at least one institution permits using the equity building up in one's home, as a result of a loan amortization and price appreciation, as a quasi-savings account with easy borrowing of that equity.

■ Counselor selling. While some bemoan the issuance of low minimum denomination debt by government and fight to maintain spreads between accounts of competing types of thrift institutions, there appears to be plenty of room to attract personal savings by finding out what the customer's problem is and then helping him or her solve it.

Dr. Freund says there may be a capital shortage. If so, it would appear clear that thrift institutions and the housing market need not simply let corporations get all the savings they need at the expense of housing.

Mr. Martin, former chairman of the Federal Home Loan Bank Board (1969-1972) and the Federal Savings and Loan Insurance Corporation (1969-1972) was assisted in the preparation of this article by R. Bruce Ricks.

INSURANCE: THE COST OF FINANCING CAPITAL

by DONALD S. MacNAUGHTON, Chairman, Chief Executive Officer, Prudential Insurance Co. of America

Recent studies of the supply of capital have come full circle from the years after World War II. Then, the predominant fear was that the supply of savings might be uncomfortably large relative to the demand for investment. Now, the earlier concern that aggregate demand might fall back to depression levels, if the government did not stimulate consumption relative to saving, has been replaced by fears that government policies have so stimulated consumption at the expense of saving that a capital shortage is in prospect.

The consequences of this "capital gap" are high interest rates that continue to rise and a short-fall in sorely needed investment. The result is slower economic growth, increasing inflation and rising unemployment in the years ahead. *However, given today's conflicting evidence and interpretations it is difficult to judge whether or not such a capital shortage is likely during the next few years and beyond.* And exaggeration of the capital gap idea can detract from thoughtful analysis and lead perhaps to adverse policy reactions.

Three Criteria

There are three aspects of the capital formation issue that deserve attention. One is to distinguish more clearly between putting needed physical capital in place and supplying the funds needed to finance capital additions—that is, to draw a clear distinction between a *physical capital shortage* and a *financial capital shortage*. This distinction is important because some commentators fear that the falling rate of return on the nation's invested capital may be a greater threat to future capital spending than a shortage of financing.

A physical capital shortage (and a declining rate of return on investment capital) might result from a variety of causes: (1) reduced productivity of capital stock reflecting the relatively advanced age of existing plants, the greater investment required for each barrel of offshore oil, and the added costs to meet pollution control and health and safety requirements; (2) excessive government regulation in such areas as apartment rents and oil and natural gas production and distribution; or (3) local resistance to investment in, say, electric generating plants.

Second, even when the analysis is limited to the financial capital shortage, the "gap" approach encounters formidable forecasting difficulties. The potential errors become quite large as the outlook period is extended, and even the most skilled forecasters are frustrated by changing consumer moods that affect future household savings. The capital shortage models, further, may not give sufficient recognition to demand-supply adjustments mandated by the operation of our price system. For example, the energy crisis reduced electric power demands and already has caused reassessment of investment requirements for electric generating capacity. Also, it is hard to separate the "objective" forecast from the subjective social goals of the forecaster—i.e., the proper allocation of resources to investment versus consumption and to private versus public sectors.

Finally, with respect to availability of financing, it seems to me that closing the "gap" through excessive debt financing should cause as much concern, if not more, than the size of the projected capital gap. This issue is central to the increasing fragility of our financial system since the mid-1960s. From the vantage point of the life insurance industry and our function as financial intermediaries involved in making long-term financial investments, the mix, as well as the amount, of future financial demand has an overwhelming significance.

Defining the Term

In my view, a capital shortage is best defined as a situation that emerges when a lack of physical investment prevents the economy from achieving and maintaining full employment at stable prices, and/or when the necessary flow of funds to finance capital investment is not forthcoming at reasonably stable rates of interest. This latter case of a financial capital shortage produces a high and variable interest rate structure; and it results in a "crowding out" of some key economic sectors—for example, the newer and smaller businesses which contribute to the innovative and competitive character of the economy. Indeed, with such debt burdens increasing—characterized by high debt-equity ratios and across-the-board weakening in the quality of corporate balance sheets—the economy is less resilient and less likely to cope with either periodic external shocks or sudden severe shifts in internal economic policies.

Defining a capital shortage in this way avoids the problems inherent in trying to quantify a so-called "capital gap." In these exercises, a big shortfall almost inevitably develops, because available future financing is almost sure to be much less than a shopping list of the nation's investment aspirations. Indeed, this broader definition of the problem also emphasizes the point that the size of the projected capital gap is not nearly as important as are its implications for the future structure of interest rates and rates of inflation. As Dr. Freund points out, in actuality no such gap will occur, since prices and interest rates will move in a direction that will equilibrate the supply of and the demand for funds. What is important is to relate the projections of the capital shortfall with the implied interest rate and price structure that will eliminate this gap. *In*

In order to remedy inconveniences [of counterfeit coins], a [public] bank was established in 1609 under the guarantee of the City [of Amsterdam]. This bank received both foreign coins, and the light worn coin of the country at its real intrinsic value in the good standard money of the country. . . . It was at the same time enacted that all bills drawn upon or negotiated at Amsterdam of the value of 600 guilders and upwards should be paid in bank money, which at once took away all uncertainty in the value of those bills.

—ADAM SMITH

brief, to assess the seriousness of a shortfall requires determining whether or not the costs of financing increase too rapidly to insure financial and economic stability, and/or whether financing costs reach levels that are too high to maintain a fully employed labor force at stable prices.

Going beyond definitions, there is sufficient evidence based on past economic performance to be concerned about the capital shortage problem. Based on my own company's experience as a major lender of long-term funds, I am struck by the seemingly huge capital outlays needed for achieving normal expansion, as well as for replacing outmoded and inefficient facilities, developing new sources of raw materials and energy, preserving the natural environment, improving worker safety, and expanding agricultural production. I am also impressed, however, by the host of questions that challenge alarmist views and that have yet to be fully resolved. For example, while the dollar magnitudes of investment necessary to fully employ our labor force seem to be enormous, does the apparent declining rate of return on capital suggest that we have on hand an excessive amount of capital stock in certain industries? Many have argued that economic policy seems to favor consumption over investment, which carries the implication that government policy will hamper the financing of needed investment projects. How is this position reconciled with the fact that personal saving rates throughout the 1970's have been at historically high levels?

Proponents of the capital shortage thesis have argued that increasing shares of GNP must go for investment; otherwise as the economy expands, capacity constraints will be reached too quickly, once again setting off inflation pressures. But, to what extent can we rely on our financial system to find new ways to shift capital to growth areas (such as energy requirements) where investment needs are greatest?

> *I have the honor to transmit an ordinance passed by the United States in Congress assembled the 31st day of December, 1781, incorporating the subscribers of the Bank of North America. . . . It affords me great satisfaction to inform you that this [first national] Bank commenced its operations yesterday.*
>
> —ROBERT MORRIS

New Research Projects

It should be evident that the concept of a capital shortage and the empirical evidence brought to bear on the issue are sufficiently complex to require an in-depth analysis which is beyond the purpose of this article. I would note, however, that the life insurance industry, through its Investment Research Program conducted by the American Council of Life Insurance, anticipated the current concern about capital formation. In 1973, it commissioned a New York University group to project demand and supply conditions in the US capital markets out to 1985. The full results of this study will soon be available, but preliminary indications show that a number of "pressure points" will build up over the next decade.

This work has led to a more recent comprehensive research effort, sponsored by the industry, to deal with the basic determinants of and motivations for capital formation and saving. This is an ambitious project. It will examine the nation's commitment to economic growth as necessary background in formulating capital investment and savings requirements; it will investigate the roles of government, business, and private savings in the capital formation process.

This article has dealt with technical aspects of the capital shortage question. There are obviously national policy considerations also involved. In this regard, I feel there is a pressing need to recognize that economic growth through private investment and savings is as much a national priority as are the more politically popular human concerns of income security, income redistribution, consumer rights, environmental safeguards and health care and maintenance—which have been the driving force in the rising share of government in the economy.

Also, it is important to recognize that the inevitable trade-offs that have to be made among these competing priorities will most likely be the final determinants of the relative seriousness of our capital formation problem. In its concern for the well-being of the nation, government must not allow the sheer volume and momentum of socially mandated programs to make severe inroads into the rate of capital formation in the private sector. In turn, private borrowers and lenders must face up to their responsibility to allocate scarce capital to useful purposes and to avoid wasteful ventures and frivolous products.

Economist Paul McCracken summed up the broad policy implications of the problem by saying: "The future can and will be financed. Our task is to improve the probability that the future we finance is the future citizens generally want."