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In This Issue

The Regulation of Free Banking

Moves underway to reduce regulation in banking are sometimes opposed by people who argue that an unregulated banking system would be unstable. To support their case, they commonly cite the many bank failures and closings that allegedly swept across the nation during the nineteenth century Free Banking Era, the period in which the U.S. banking system had the fewest regulations. In "Banking Instability and Regulation in the U.S. Free Banking Era" (p. 2), Arthur J. Rolnick and Warren E. Weber present new evidence challenging the view that banking was unstable in this period. Their evidence indicates that free bank failures reflected distress in local economies and that the contagion of free bank problems was limited geographically. The authors suggest that contagion was limited because the few regulations in the period provided people with adequate information on the health of individual banks.

The Allure of ARMs

Adjustable rate mortgages (ARMs), mortgages with interest rates adjusted periodically on the basis of current market rates, became increasingly popular after 1982. At the same time that ARM issuance was mushrooming, housing activity was unexpectedly strong. As a result, many concluded that ARMs contributed significantly to the stronger housing activity. In "Adjustable Rate Mortgages: Increasing Efficiency More Than Housing Activity" (p. 10), Michael J. Stutzer and William Roberds present an argument, based on a theory and a statistical investigation, that ARMs did not have a major effect on housing activity. Their theory suggests that ARMs became popular because they allow a more efficient sharing of risk between mortgage borrowers and lenders.