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THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

United States,

HEARING

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

OCTOBER 13, 1993

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THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

WEDNESDAY, OCTOBER 13, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the committee] presiding.

Present: Chairman Gonzalez, Representatives Neal, Schumer, Frank, Kennedy, Flake, Waters, Klein, Maloney, Gutierrez, Roybal-Allard, Barrett, Furse, Velazquez, Hinchey, Dooley, Fingerhut, Leach, McCollum, Roukema, Roth, McCandless, Baker, Nussle, Pryce, Linder, Knollenberg, Bachus, Huffington, and King.

The CHAIRMAN. The committee will please come to order.

We have a couple of members out in the wings, Mr. Chairman. Welcome.

Mr. HAMILTON. Good morning.

The CHAIRMAN. Today we resume our second in a series of four hearings here at the outset on the issues involved in H.R. 28, the Federal Reserve Accountability Act of 1993.

We are honored today to have as our first witness Hon. Lee Hamilton, chairman of the Foreign Affairs Committee. If I am not mistaken, you have also served as chairman of the Joint Economic Committee, if you are not still chairman.

Mr. HAMILTON. No.

The CHAIRMAN. Anyway, he has a considerable background of interest and contribution to this question of Federal Reserve Board restructuring or modernizing our accountability depending on the point of view.

Welcome, Mr. Chairman. We know you are very busy. We know that last week you had to go to the White House so thank you for being with us this morning.

STATEMENT OF HON. LEE HAMILTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA, AND CHAIRMAN, COMMITTEE ON FOREIGN AFFAIRS

Mr. HAMILTON. Thank you very much, Mr. Chairman. I do apologize for not making your hearing last week, which I understand was a very good one, and I appreciate the accommodations you have made for me. Your staff has been extremely cooperative in working out the schedule and I am grateful for that.

I just read in a press release that the Chairman of the Federal Reserve and the chairman of the House Banking Committee are

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going to square off in a financial High Noon this morning. I am glad to slip in here before the shots begin to go back and forth with a modest proposal or two with respect to the Federal Reserve.

The CHAIRMAN. Will you yield to me? Actually, I am hoping it doesn't become confrontational. I am trying to avoid it. Naturally, sometimes stories have to have a little spin. We ought to be grateful for the fact that Chairman Greenspan is going to be here today and has brought the press out. That I think we ought to be grateful for.

Mr. HAMILTON. I don't have any doubt that it will be a constructive hearing.

Mr. Chairman, I appreciate the opportunity to appear before the Committee on Banking, Finance and Urban Affairs this morning to testify on Federal Reserve accountability and Federal Reserve reform. It is an important series of hearings that you are having and I commend you for your efforts to make the Federal Reserve more accountable and more open. I have tried to contribute modestly to that goal over a period of years and I hope these hearings will mark the start of some tangible progress.

I want to begin with one of the most important points that can be made about Federal Reserve reform. The bills being considered today will go a long way toward addressing the accountability issues that concern us without impairing or interfering with the independence of the Fed to conduct monetary policy.

I emphasize that point, because when I introduced my first bill 8 years ago to bring the Federal Reserve's budget into the sunlight, and broader legislation 4 years ago with then-Congressman Dorgan, now Senator Dorgan, to reform certain practices and procedures of the Federal Reserve, these bills were frequently criticized as efforts by Congress to control monetary policy and pressure the Fed to reduce interest rates.

If that were true, then today's lower interest rates would give me little reason to be here this morning or to continue my efforts to reform the practices and procedures of the Federal Reserve.

But I am here, and the reason is that what is appropriate in terms of Federal Reserve openness and accountability is completely independent of what is appropriate in terms of interest rates and monetary policy. Interest rates may be down, but the need for reform of the Federal Reserve System is just as important today as it was when I first addressed this subject.

The Federal Reserve occupies an anomalous position within the Government of the United States. It is an enormously powerful institution, but it does not conform to the normal standards of government accountability. Power without accountability simply does not fit into the American system of democracy.

Through its control over monetary policy, the Federal Reserve affects the lives and well-being of all Americans. The path that the Federal Reserve sets for monetary policy and interest rates affects every business person, worker, consumer, borrower, and lender in the United States.

The dilemma created by this concentration of power is that the independence which the Federal Reserve must have in order to insulate monetary policy from political pressures also serves to re-

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move the Fed from the normal processes of accountability that apply to every other agency of government.

Monetary policy is decided in secret, behind closed doors. There are no transcripts of meetings and the Fed waits 6 weeks before releasing policy decisions to the Congress and the public. There are no formal lines of communication between the Fed and the administration. The President must often wait until late in his term to appoint a Chairman of the Board of Governors.

Of the 12 members of the Federal Open Market Committee who vote on monetary policy, only 7 are duly appointed public officials. The other five are representatives of the private interests of the banking system.

Much of the Fed's financial activities are off limits to General Accounting Office auditors and the Fed's budget is not published with the budget for the rest of the government.

I have introduced two bills that address many of these problems. The first bill, the Federal Reserve Reform Act, has five major provisions.

First, consultation with the administration. It would require the Secretary of the Treasury, the Chair of the Council of Economic Advisors, and the Director of the Office of Management and Budget to meet three times a year on a nonvoting basis with the Federal Open Market Committee to consult on monetary and fiscal policy.

Chairman Greenspan opposes this provision on the grounds that the Federal Reserve and the administration already communicate through informal channels. Informal channels of communication certainly do exist. For example, Chairman Greenspan and Treasury Secretary Bentsen, I am told, meet about once a week.

Over the years, however, the success of such informal meetings has varied depending on the personalities involved. This ad hoc approach to making decisions which affect the economic well-being of all Americans is not the best way for a great economic power to conduct its business.

It is simply astonishing that the world's greatest economic power does not have a formal channel of communication between key makers of economic policy. My bill would establish a channel of communication that would not depend on personalities for success.

Second, the term of the Federal Reserve Chairman. The bill would make the Federal Reserve Chairman's term roughly coterminus with the term of Office of the President of the United States. Alan Greenspan was appointed to his current term as Chairman by President Bush and will hold that office until March 2, 1996, more than 3 years into President Clinton's term.

Fortunately, Chairman Greenspan and President Clinton have a cordial relationship, but if they were unable to work together, the result could be serious damage to the American economy and paralysis of economic policymaking. Why take that risk?

My bill would address this by having the President appoint the Fed Chairman to a 4-year term beginning 1 year after taking office when there would be a new vacancy on the Board in any event. The Chairman would still be subject to Senate confirmation as under current law.

The Federal Reserve's position on this issue has varied over the years. Chairman Greenspan opposes it, but former Chairmen Wil-

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liam McChesney Martin and Paul Volcker supported it while Arthur Burns took different sides at different times during his chairmanship.

Third, disclosure of monetary policy decisions. The bill would require the Federal Open Market Committee to disclose immediately any major monetary policy decisions. The Federal Open Market Committee currently keeps major policy decisions secret for 6 weeks after they are made and carried out.

Such secrecy has two economic costs. First, secrecy makes capital markets operate less efficiently because investors do not have the information they need to make wise and informed decisions.

Second, secrecy is unfair to small investors, who do not have the resources of large Wall Street firms to hire full-time professional Fed watchers. The solution; immediate release of Federal Reserve policy decisions, I think is widely supported by economists and participants in financial markets.

Mr. Chairman, your bill, H.R. 28, would supplement this by requiring the Federal Open Market Committee to make a video transcript of each meeting and air it after 60 days. Years ago, the Fed published minutes of its meetings, a practice that was discontinued during the 1970's. Both Houses of Congress publish a full verbatim transcript of our deliberations on the floor and in committees. There is no reason why the Fed should not do the same thing.

The next part is the GAO audits. The Federal Reserve Reform Act would permit the Comptroller General to conduct more thorough reviews and studies of Federal Reserve operations by removing selected current restrictions on GAO audits. Every government agency that takes in and spends billions of dollars a year each year ought to be subject periodically to outside review.

My bill would give the GAO more complete access to the Federal Reserve's financial statements. Your bill, Mr. Chairman, would complement this by requiring an annual GAO audit of the Fed's open market operations.

Finally, my bill would require the Federal Reserve's annual $1.7 billion budget to be published in the budget of the U.S. Government. Despite the fact that the Federal Reserve takes in and spends billions of dollars each year, the Federal Reserve's budget is not conveniently available to Congress or to the public. Only a small fraction of the Fed's $1.7 billion of operating expenses is included in the U.S. Government budget, just the $133 million of expenses incurred by the Board of Governors in Washington, about 8 percent of the total.

My bill would require that all the data be published conveniently in the U.S. Government budget where spending by every other government agency is already listed. I might just point out here, Mr. Chairman, that the Supreme Court—which, of course, values its independence—has its budget published in the government budget without any loss of independence and I don't see why the Fed cannot do the same.

The second bill, the Monetary Policy Reform Act, would assign sole responsibility for open market operations to the Board of Governors. Currently, the Federal Open Market Committee consists of the 7 members of the Board of Governors plus 5 of the 12 presi-

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dents of the regional Federal Reserve Banks who serve on a rotating basis.

The Governors are appointed by the President and confirmed by the Senate to 14-year terms and are thus duly appointed government officials. By contrast, the Federal Reserve Bank presidents owe their jobs to the boards of directors of the regional banks. Neither the President nor the Congress has any role in selecting them. Nonetheless, they participate in monetary policy decisions through their membership on the Federal Open Market Committee where they cast 5 of the 12 votes that determine monetary policy and interest rates.

This situation in which private individuals participate in monetary policy decisions of immense importance is an anomaly in a system of democratic government. The Monetary Policy Reform Act would assign the conduct of monetary policy to the seven-member Board of Governors, thus lodging this responsibility with properly appointed public officials.

It would also create a Federal Open Market Advisory Committee through which the presidents of the regional Federal Reserve Banks could continue to advise the Board on monetary policy.

Mr. Chairman, your bill would also address this problem by having the President appoint and the Senate confirm the Federal Reserve Bank presidents, thus making them government officials. Either way would put important monetary policy decisions solely in the hands of responsible public officials where they belong, rather than in the hands of individuals representing private interests.

Before concluding, Mr. Chairman, I want to address a more general argument frequently used to oppose efforts to reform the Federal Reserve. The argument is that "if it ain't broke you don't fix it." People who raise this objection completely miss the point of my proposals. They assume the purpose of my bills is to pressure the Federal Reserve to alter its conduct of monetary policy, which could harm the economy of the United States.

When they say "if it ain't broke, don't fix it," they usually refer to monetary policy, but such an objection I think is based on a misreading of my bills. These bills are not directed at the Federal Reserve's conduct of monetary policy. There is no provision in either one that would give Congress or the President any more influence over monetary policy than they have at this very moment.

If someone wanted to politicize monetary policy, and I do not, these bills would not be the way to do it. Nonetheless, the system is broken in a different way because many of the Federal Reserve's practices and procedures violate the normal standards of accountability in a democratic society. They are just not widely recognized because they are not widely publicized.

How can someone argue that the system is not broken when the Fed conducts its business in secret, refuses to keep minutes, and fails to inform the Congress and the public of its decisions until weeks after they are carried out?

How can someone argue that the system is not broken when no formal communication channel exists between decisionmakers at the Federal Reserve and the top economic policymakers in the administration?

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How can someone argue that the system is not broken when trillions of dollars of transactions by the Fed are borrowed from outside review and most of the Federal Reserve's $1.7 billion budget does not even show up in the official budget documents of the U.S. Government?

How can someone argue that the system is not broken when private interests have a direct vote on monetary policy, in violation of the most basic democratic principle that public decisions should be made solely by properly appointed and elected and accountable public officials?

The system is broken in these ways and it needs to be fixed. My bills would do that without jeopardizing the Federal Reserve's independence or injecting politics into monetary policy. Congress should not wait until a monetary crisis to reform the Federal Reserve. These bills take advantage of a period of high regard for the Fed and a moment of economic calm to bring Fed procedures up to date. If we wait to make the necessary adjustments until a time of economic turbulence and controversy, the results may be far less measured.

Mr. Chairman, I commend you for your efforts to make the Federal Reserve a more accountable agency within our democratic system of government and thank you for giving me the privilege of testifying before your committee.

May I submit a longer statement for the record plus two additional statements that explain the bills in more detail? I ask they be included in the record.

The CHAIRMAN. Without objection, so ordered. They will be included in that manner.

[The prepared statement of Mr. Hamilton and his statements before two other committees can be found in the appendix.]

It is my chance to thank you, Mr. Chairman. You certainly have been devoted to a cause even though you may not have been a member of this committee, at least for years. And we have a debt of gratitude to you actually and above all, thank you for taking time from your present pressurized position to come here this morning. If nothing is done now in what I consider to be a time of relative calm, as you have said, and this consideration, will the problems such as you have outlined, will they fade away or are there fundamental issues of accountability which really pose extremely serious problems for the Federal Reserve especially in times of national crisis?

In this sense, would you agree that the changes you and I are suggesting will help the Federal Reserve stay independent of short-term political pressures?

Mr. HAMILTON. Mr. Chairman, I do feel that way. I think you have put your finger on the right problem, the fundamental problem of accountability. Let me observe that I am coming to the view that more and more Americans are understanding the importance of the Fed. Many years ago, when interest rates were very low and didn't fluctuate, nobody really had much of a concept of the influence of the Fed.

Many economists today believe, maybe even most believe, that the most important economic policy actor is not the Congress and not the President, but the Fed. Or to put it another way, what the

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Fed does has a more profound impact on the economic lives of our citizens than what we and the President do in fiscal policy. That is a debatable point, but no one would dispute the view, I think, that the Fed is a powerful economic actor.

I notice that Americans are beginning to understand that, and they are beginning to understand that what these people do down in the temple of the Fed is beyond their reach and beyond their understanding. I don't think they like that. At some point, that is going to bubble up and become a critical problem. It may not be this year. It may not be next year, but I think it will at some point. I think the Fed has to get much, much more serious about this whole question of accountability.

I have not seen Chairman Greenspan's testimony, but I am told that he takes a strong position against every one of these proposals. That kind of a posture I think is not advisable given the underlying politics of the situation.

The CHAIRMAN. Thank you very much. I agree with you. I have sat on this committee long enough to have worked through about eight or nine different and diverse Federal Reserve Board Chairmen. We had a period of time in which you had a relatively fast turnover of Chairmen. And you are right; the people—who are the people? What were we before we had political office responsibility? Weren't we part of the people?

The fact that we are invested with this office, does that make us smarter? I never have thought so, but I do know that the people may not be sophisticated enough to understand the fine points and nuances and jargon involved, but they know who is deciding their fate as to the American standard of living, their jobs, and everything else.

Those who travel know that their dollar doesn't carry one-fourth as much as it did just 8 years ago in foreign countries. The fact is that we are the ones that are supposed to be accounting and leading and informing the people and that is why I have so much respected you and honored you, because you have sensed the grave importance of this matter, and have spoken out and have gone beyond your call of duty to record your voice.

So thank you again, Mr. Chairman.

Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. I also welcome you, Mr. Hamilton. Your thoughtfulness is widely respected in this body. I would only say that I do think now is a reasonable time to make some adjustments to the Federal Reserve System. As was mentioned at last week's hearing as well as this week's, it is better to make modest adjustments when times are good than when times are a little more tense.

I would only stress that there may be other approaches that could be laid on the table as well. For example, we have two broad approaches right now, one from the Senate that talks about taking Reserve Bank presidents off the Federal Open Market Committee, which has some advantages, also some disadvantages. And one from the House that suggests that we require Senate confirmation of Reserve bank presidents.

A third alternative would have the Federal Reserve Board in Washington appoint the presidents of the Reserve banks. I think

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that is one alternative that ought to be more seriously entertained. But I would only stress that not only when times are good is it a better time to make adjustments, but when times are bad, more mistakes are made, so one could see much more onerous change exacted upon the Fed that might be in the long term a disadvantage to the public. Therefore, it is particularly appropriate that we review some of these issues.

In political science terms you are right about some break in the system existing. On effectiveness grounds, it is a little bit ironic I think greater breaks in the system occurred a decade and a half ago than are occurring today. I think the recent record of the Fed is in policy terms more impressive than it was a decade and a half ago, in the interest rate policy as well as on regulation of banks, which is the part of the Fed that gets the least review.

But still I think when all is said and done that the Fed is best protected by making some modest adjustments today and I hope that we can look at this legislation and review it. I am not convinced of all of its parts, but I think there are some things that can be done.

I want to say your input in all this is most appreciated. Thank you.

Mr. HAMILTON. Thank you very much, Mr. Leach.

Let me observe that I appreciate your openness on these issues. The bills I spoke about this morning were introduced years ago. I wouldn't for a moment pretend they are exactly the right formula. There are plenty of variations of them. I appreciate the fact that you are open to change here.

Second, let me reiterate that my appearance is in no way dictated or governed here today by dissatisfaction with monetary policy. That is not what drives me or the reason behind these bills. It has nothing to do with that.

I separate completely the question of monetary policy, the merits or demerits of it, from the question of accountability of the Fed, and I think they are separate questions.

The CHAIRMAN. I have been informed that Chairman Greenspan has arrived and is waiting on the side here. I want to ask my colleagues, who feel impelled to ask Chairman Hamilton a question, please make it brief.

I will recognize you for a minute if that is the case. If not, I would suggest that we submit additional questions in writing to the Chairman.

Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman. I want to give our distinguished colleague a chance to rebut an argument that is going to be made. I agree with you, Chairman Hamilton, on your legislation. The arguments we will hear this morning is that the Fed is analogous almost to the Supreme Court. They should have their own autonomy. We don't want too much political influence because political influence is not good for the political or for the monetary system. They will say, for example, look at Paul Volcker. He broke the back of inflation in 1980 because he took strong stands and if you would have had all kinds of political pressures he couldn't have done that. How would you respond to arguments like that?

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Mr. HAMILTON. Mr. Roth, I appreciate that. I guess any of us who recommend any change of any kind in the Fed are immediately attacked on the basis that we are trying to undermine the independence of the Fed. I tried very hard in this legislation to not do that. I do not believe the Congress of the United States and the President of the United States should set monetary policy, and the proposals that I have made go to the question of accountability and coordination. They are so simple to me.

Take the situation of not having any formal communication between the people who make fiscal policy and the people who make monetary policy. Mr. Greenspan will tell you he and the Treasury Secretary meet regularly on an informal basis. That is marvelous and I commend him for that, but suppose you have a Fed Chairman who doesn't like the Secretary of Treasury or the President.

We ought to try to build into the structure some coordination of fiscal and monetary policy. The other proposals are so modest, the term of the Federal Reserve Chairman, I don't see that that has any impact on Fed independence. Many Chairmen have approved it.

For another example, the Federal Reserve budget being published. My goodness, how can people object to having their budget published in this day and age?

You mentioned the Supreme Court has its budget published and yet we all recognize the independence of the Supreme Court. I just don't understand why you don't publish the budget of the Fed. So it goes down the line.

I think you are right in making the objection that you do, but I want to point out that I don't think the proposals I make undermine that independence in any way.

Mr. ROTH. Thank you. I appreciate your explanation.

The CHAIRMAN. Mr. McCandless.

Mr. MCCANDLESS. Thank you, Mr. Chairman. Mr. Hamilton, there are many things that we need to correct and I appreciate your proposal. I would like to focus on one aspect of what I understood to be in your presentation, the video reporting of the Fed meetings. Did I understand correctly that is a part of your proposal?

Mr. HAMILTON. That is not a part of my proposal, Mr. McCandless. It is a part, I think, of the chairman's proposal. All I propose with respect to that is the immediate release or disclosure of monetary policy decisions, the major decisions. But the video release is a proposal in the chairman's bill, not in my bill.

Mr. MCCANDLESS. Thank you.

The CHAIRMAN. Thank you, sir, and I thank my colleagues.

Mr. BACHUS. I have one or two questions.

The CHAIRMAN. Could you submit them in writing, sir?

Mr. BACHUS. I would prefer not to. I will be very brief.

The CHAIRMAN. We will give you half a minute.

Mr. BACHUS. Representative Hamilton, whatever your purpose is, are you not putting the conduct of monetary policy more closely under the influence of politicians?

Mr. HAMILTON. In what provision?

Mr. BACHUS. With the provisions of more oversight, more control?

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Mr. HAMILTON. I don't think so, Mr. Bachus.

One provision is the coordination of monetary and fiscal policy; that doesn't bring about any more oversight. It brings about coordination. The disclosure of monetary policy decisions when they are made, that doesn't bring about more oversight. I guess you could argue that the GAO audits would provide the possibility of more oversight, but I don't see it that way.

It just seems to me that an agency that spends billions of dollars ought to have somebody other than themselves telling them that they are doing it in a proper way. By saying that I don't make any charge of fraud or waste in the Fed. I don't have any evidence of that.

Let me just say that I tried very hard to draft this bill in such a way as to avoid the charge of trying to control the Fed. I ask you to go through the provisions of it if you would and see if in fact they would bring about more control. I know that is the charge that is made against the bill again and again, but I don't see very many specifics to support it.

May I say to you that if I were persuaded that the bill would put more control by the politicians on the Fed, I wouldn't support it.

The CHAIRMAN. The time of the gentleman has expired.

Thank you again, Mr. Chairman, very much.

Mr. HAMILTON. Thank you, Mr. Chairman.

The CHAIRMAN. I want to welcome at this time our Federal Reserve Board Chairman Alan Greenspan as the next witness in the series of hearings.

Chairman Greenspan is Chairman of both the 7-member Board of Governors and the 12-member Open Market Committee. These Federal Reserve Committees have vast powers. Under the direction of the FOMC, the Fed can order unlimited amounts of U.S. dollar bills, labeled as Federal Reserve notes, from the Bureau of Engraving at the U.S. Treasury to be delivered to any of the 12 Federal Reserve Banks. Through open market operations at its New York Federal Reserve Bank, the Federal Reserve determines how much of this money is put in circulation.

The FOMC members have authorized the holding of a portfolio of over $300 billion in U.S. securities from which the Federal Reserve earned $17.3 billion in interest last year. After deducting its expenses, additions to its surplus, and interest paid to member banks for their stock, the balance at the Federal Reserve is returned to the Treasury and helps to reduce the Federal Government's deficit.

Thus, every dollar used by the Federal Reserve for its expenses increases the taxpayers' liability for financing the Federal Government.

It is important that taxpayers know exactly how their money is being spent. That is why I have proposed in H.R. 28 to require independent audits of all Federal Reserve operations and authority for the General Accounting Office to examine all Federal Reserve operations. At present, the GAO is prohibited from inspecting large parts of the Federal Reserve operations.

Under this proposed legislation, the Federal Reserve would have to provide a detailed account of its expenditures for dues for its employees' memberships in private societies and clubs during the past

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year. Those expenditures with budgeted funds are illegal for employees of the U.S. Government. Similarly, the Federal Reserve would have to account for adding a $200,000 renovation to its gun range at the Dallas Federal Reserve Bank shortly after the new building was constructed.

We would also have a detailed account of the cost of land and real estate the Federal Reserve owns all over the country. The American public has a right to know exactly how the Federal Reserve is spending every dollar of its money.

There should be no independence from accountability for expenditure of taxpayers' money. Why should the Federal Reserve spend its resources—and that means taxpayers' money—to send members of the Board of Governors, as it did in 1977, to the Federal Reserve Banks to organize a lobbying effort?

This was a proper time for the Congress to order the GAO to investigate what happened and to determine if any Federal Reserve employee had made profits on inside information with respect to the recent happening that we have anticipated because they have happened before.

The episode of 1979 illustrates the phoniness of the argument of independence when it comes to accountability. In 1979 the Federal Reserve was called before the House Banking Committee because the Federal Reserve had issued a grossly incorrect report on the money supply. The report sent bond prices down and interest rates up on the Friday after the announcement, even though at least one senior official at the New York Federal Reserve Bank was reported to have known the numbers were wrong.

This was a proper time for the Congress to order the GAO, and I recall vividly at that period of time, and mostly just to determine what happened and if any Federal Reserve employees had made profits on inside information.

As a matter of fact, I persisted and finally at that time Chairman Reuss in obedience to my repeated insistence prevailed and the chairman said that we would have an internal investigation, they would investigate themselves, and they did. The charges were then circulating around, and these were rumors that two banks in New York had profited unjustly through the leakage of this information. So this internal investigation was conducted and the lawyer, the very prominent attorney Jaworski, was hired, but he also happened to be the attorney for one of the banks.

There were two banks in New York that were pointed out as having been the recipients of unearned profits because of this premature information leakage. Anyway, finally, after 1 year's time and just after Chairman Reuss had left, we finally got a copy of that report and I placed it in the *Congressional Record* and it is in the record.

The investigation concluded that yes, somebody, some staffer, had negligently caused this information, but it wasn't anything intended or deliberate. At least that was the conclusion.

Now, our Nation's central bank proceeded to hire this private firm and it invested it with these powers of investigation. Now, in the footnote, which as I say and I repeat, to this report which I placed in the record—it is in the record if anybody wants to look it up—there was a little footnote buried in the final report that

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said that a New York Federal Reserve official may have conducted insider trading and the case was turned over to the Securities and Exchange Commission.

If you overlooked the footnote, the report was a clean bill of health for the Federal Reserve, which was billed $877,635.88 cents by the law firm. That would be about $1.7 million in 1993 dollars. Paying for a good conduct medal is not an ethical way to run a government agency. Why should taxpayers have to pay for that kind of activity?

H.R. 28 requires the Federal Reserve to resume making a record of their FOMC meetings. Official policy changes would have to be made public within a week and a videotape of the meetings would be made public in 60 days. It could even be accessible to cable and even with musical background in moments of lull.

In 1977, the former Federal Reserve officials and scholars from across the country sent their views to the House Banking Committee about the Federal Reserve's decision to stop taking minutes at FOMC meetings. The responses that year generally deplore the Federal Reserve's blatant action in dropping the curtain over their operations by refusing to take detailed minutes of the committee that manages the Nation's money supply.

How would we know what the policy of the Federal Reserve really was before the 1972 reelection of President Richard Nixon, for example, if it were not for the minutes? Federal Reserve Chairman Arthur Burns was outwardly the government's champion fighter against inflation. Yet, at two secret FOMC meetings before the Nixon election, August 15, 1972 and September 19, 1972, he argued forcefully for fast money growth.

The minutes reflect that even though Vice Chairman Robertson warned that the projected fast money growth was "cause for real concern," in his words, Burns "saw no need to be afraid of prosperity and to adopt restrictive monetary policy."

Should the public and the financial markets have access to full information and to full accountability? Do the financial markets work best with full information, as the modern theories of finance contend? Or should the Federal Reserve continue to nourish the rumor mill industry and selectively leak the results of its FOMC meetings?

H.R. 28 would require all individuals voting on the Nation's money supply to be constitutional officers. Five of the FOMC members are private citizens serving as presidents of the Federal Reserve Banks. The presidents are selected by their individual bank's board of directors who, in turn, are drawn from the banking industry.

Testifying before the House Banking Committee on April 13, 1938, the great Chairman of the Federal Reserve for 13 years until 1948, Marriner S. Eccles, repeated his strong conviction that the 1935 reorganization of the Federal Reserve was seriously incomplete.

He said, "Presidents of the Reserve banks are elected by the directors of these banks, two-thirds of whom are in turn elected by the member banks. Their viewpoint necessarily is likely to reflect that of member banks. I feel that a committee which is entrusted

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with monetary policy as important as those given to this committee should consist entirely of persons representing the public interest."

There were suits against the Federal Reserve in the 1980's to attempt to remove the votes of the presidents of the Federal Reserve Banks because the Constitution specifies that those who make major decisions in the government must be constitutional officers who have gone through the confirmation process.

Federal District Court Judge Greene in an opinion said it was all right for private citizens to vote on the money supply. It is important to note that the court of appeals in *Melcher* v. *Federal Open Market Committee* vacated Judge Greene's opinion so that it has absolutely no legal effect. This was all brought out in last week's hearing.

The court of appeals explicitly said that the matter should be settled by the legislature. Now is the time to follow the Constitution and correct an error.

Chairman Greenspan, you do head the most powerful institution in our government that directly affects the economic health of our citizens. The changes we propose in H.R. 28 are not damaging to that independence nor do they attempt to micromanage monetary policy. The Federal Reserve presidents would have increased independence since they would be constitutional officers.

This is not radical reform and there is no cause for the Federal Reserve to proceed as if barbarians are at the gate and it is the end of Western civilization. Senator Byron Dorgan told us last week, "If you talk about fixing the doorjamb at the Fed, they accuse you of being part of a building demolition crew." We should not pretend the Federal Reserve, of all institutions in government, is infallible.

We must have openness and accountability from the government bureaucracies that operate in our democracy. President Clinton wants to reinvent government to make it more efficient, less wasteful, more representative of all Americans.

The provisions of H.R. 28 I have proposed are rational and useful changes that will make the Federal Reserve a better and stronger institution that will fulfill its functions as the central bank more effectively.

Let's not wave the flag of independence when it comes to the public's right for full accountability for the operation of its central bank. The Federal Reserve is not and should not be infallible, unalterable, unapproachable, and unaccountable.

[The prepared statement of Chairman Gonzalez can be found in the appendix.]

The CHAIRMAN. Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. I have a short statement.

Mr. Chairman, it is easy to defend the Fed when times are good and/or when its policies are not perceived to be at the root of particular problems of the moment in the economy. Frankly, I think times may not be perfectly good, but the Fed is deeply respected and well led at this time. But when times are less good or mistakes are made it is important that the Fed have in place structural arrangements that are above reproach. Stability of the financial system depends on confidence, and unfortunately it is difficult to have confidence in the precept that individuals selected by private sector

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boards of directors accountable in large part to one industrial sector, banking and finance, should have a significant if not determinative role in interest rate decisions affecting the Nation's economy at large.

It is even more difficult to have confidence in a system where regulation of an industry is partly in the hands of individuals accountable to boards largely controlled by those being regulated.

Legislatively, two approaches to correcting this democratic institutional unseemliness have been presented: The House is suggesting that Federal Reserve Bank presidents be appointed by the President with the advice and consent of the Senate. The Senate, on the other hand, takes the position that Reserve bank presidents should be removed from voting in the Federal Open Market Committee. The common denominator shared by both is that only publicly appointed individuals should be permitted to directly participate in the formulation and implementation of U.S. monetary policy.

While I see certain merits and demerits to each approach, an alternative which preserves more firmly the independence of the Fed should be laid on the table. The alternative would maintain Reserve bank participation in the FOMC, but require that Reserve bank presidents be appointed for precise terms by the Federal Reserve Board of Governors. Since the Board of Governors is composed solely of publicly appointed individuals such an alternative would solve the political science dilemma of having private citizens directly participate in public decisions without direct accountability and at the same time address the concerns of those, like myself, who believe an independent Fed protects the public better than one too tied to a fiscally wanton Congress.

The issues of greater transparency of the FOMC decisionmaking as well as greater budgetary openness can no longer be ducked. A reasonable case can, of course, be made that immediate revelation of FOMC decisions could result in adverse market reactions both domestically and internationally as market speculators use information discussed at FOMC meetings to their advantage.

At last week's hearing, for instance, William Greider, a noted proponent of making the Federal Reserve System more publicly accountable expressed concern with immediate disclosure of FOMC decisions. Mr. Greider stated, "It makes no sense to compel the Fed to reveal its trading strategy in advance so that other traders can use information to adjust their portfolios." The Fed is the public's trader and thus deserves public protection. Nonetheless, more information on a more timely basis makes democratic common sense.

Mr. Chairman, in conclusion let me stress the best way to protect the independence of the Fed is to ensure that its indefensibly undemocratic elements are rooted out. The issue isn't populist, it is prudential. In a democracy arrogance always gets its comeuppance. For a citadel to maintain its holy aura it must be perceived to be a bastion of service, not privilege. A reform in time saves nine.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. I am going to ask unanimous consent that all members, both present and absent, who wish to have for the record an opening statement be allowed to do so.

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At this time, we will proceed. We are in session and we want to avoid any unnecessary interruptions with votes that we may get later and we want to hear from the Chairman in an uninterrupted manner.

Chairman Greenspan, thank you for accepting our invitation. Your written statement will be in the record exactly as you gave it to us.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN OF THE BOARD OF GOVERNORS OF FEDERAL RESERVE BOARD AND THE FEDERAL OPEN MARKET COMMITTEE

Mr. GREENSPAN. That statement is rather extended and I have excerpted relevant parts and appreciate your placing the whole testimony in the record.

I certainly appreciate this opportunity to discuss the important issues raised by recent legislative initiatives to alter the structure of the Federal Reserve System and the additional notion that Representative Leach put on the table moments ago.

The appropriate role of the central bank in a democratic society is an important and controversial issue. The performance of such an institution has profound implications for the Nation's economy and the people's standards of living. Americans have pondered the question of the appropriate role and structure of the central bank at length, beginning with the debate over the First Bank of the United States, which George Washington signed into existence in 1791.

Echoing the earlier discussions surrounding the chartering of the First and Second Banks of the United States, extended debate and compromise preceded the establishment of the Federal Reserve System. Much of the focus of the debate was on the balance that should be struck between public and private authorities in governing the central bank.

In 1908, in response to the periodic financial crises that had plagued the country in the latter part of the 19th century and in the early years of the 20th, a National Monetary Commission consisting entirely of Members of Congress was established by legislation. Four years later, the Commission, in submitting its report to Congress, called for the creation of a National Reserve Association to provide stability to our financial system. Both the Commission's plan and an alternative proposed by President Woodrow Wilson envisioned the central bank as containing public and private elements.

President Wilson's plan won the approval of Congress and established the Federal Reserve System as our Nation's central bank. Over the intervening years, Congress has initiated many reviews of the System's structure, but with rare exceptions has chosen to leave the basic structure intact.

The major piece of legislation affecting the Federal Reserve's organization since its inception in 1913 was the Banking Act of 1935, which established the Federal Open Market Committee in its current form as the central decisionmaking body for monetary policy. When it was clear by the 1930's that the buying and selling of securities by the Federal Reserve was a crucial monetary policy instrument, there was again debate in Congress over whether it

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should be carried out entirely by government appointees or whether the Reserve bank presidents who were not politically appointed should share in that policymaking role.

In the 1935 act, Congress reaffirmed that the Reserve bank presidents should have a substantive voice in policy. They were granted 5 of the 12 positions on the FOMC while the 7 members of the Board constituted the majority. The wisdom of Congress in setting up the structure of the system has stood the test of time.

In that decision which you cited, Mr. Chairman, Federal District Court Judge Harold Greene in commenting on the constitutionality of the FOMC in 1986 noted, "The current system, the product of an unusual degree of debate and reflection, represents an explicitly balanced approach to an extremely difficult problem."

It is true as you point out, Mr. Chairman, that on appeal, the actual decision of Judge Greene was vacated on the ground that the issue of the constitutionality of the FOMC was not needed or relevant to the particular decision at hand. However, at no point in that particular appeal decision was the issue of the point made by Judge Greene contested.

I really choose to use this particular quote to indicate what a distinguished jurist's view of the constitutionality issue was. The difficulty is that we have not yet, as you have pointed out, had an issue brought fully to the Supreme Court on the question of the FOMC.

The role of a central bank in a democratic society requires a very subtle balancing of priorities between the need for sound farsighted monetary policy and the imperative of effective accountability by policymakers. Accountability and control by the electorate are vital.

The Nation cannot allow any instrument of government to operate unchecked. The central bank just like other governmental institutions in a democracy must ultimately be subject to the will of the people.

In this regard, the Federal Reserve's activities are constantly scrutinized by this committee and others in Congress. The Federal Reserve Board reports semiannually both to the House of Representatives and to the Senate pursuant to the Humphrey-Hawkins Act and we regularly respond to other congressional requests for testimony.

We recognize our obligation to do so and appreciate the importance of maintaining open communication with the Nation's elected representatives. We also provide a great deal of information about our operations directly to the public, and we consult frequently with those responsible for economic and financial policy in the administration.

We have to be sensitive to the appropriate degree of accountability accorded a central bank in a democratic society. If accountability is achieved by putting the conduct of monetary policy under the close influence of politicians subject to short-term election cycle pressures, the resulting policy would likely prove disappointing over time.

That is the conclusion of financial analysts, of economists, and others who have studied the experiences of central banks around the globe and of the legislators who built the Federal Reserve. The lure of short-term gains from gunning the economy can loom large

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in the context of an election cycle, but the process of reaching for such gains can have costly consequences for the Nation's economic performance and the standards of living over the longer term.

The temptation is to step on the monetary accelerator or at least avoid the monetary brake until after the next election. Giving in to such temptations is likely to impart an inflationary bias to the economy and could lead to instability, recession, and economic stagnation. Interest rates would be higher and productivity and living standards lower than if monetary policy were freer to approach the Nation's economic goals with a longer term perspective.

Several aspects of the current setup promote the central bank's distance from the political fray. The 14-year terms of the Governors on the Federal Reserve Board are one of those elements with only 2 vacancies scheduled to occur during the 4 years of any single Presidential term. Once in office, those Governors cannot be removed by the President over a policy dispute.

In addition, regional Reserve bank presidents who are selected at some remove from political channels are included on the FOMC. To prevent political pressure from being applied on monetary policymakers via the power of the purse, the Federal Reserve is not required to depend on appropriated funds to meet its expenses.

H.R. 28, the Federal Reserve System Accountability Act of 1993, would remove some of that insulation. I would view the enactment of legislation of this type as a major mistake. Provisions that in effect increase political leverage on Federal Reserve decisionmaking amount to assaults on the defenses that Congress has consciously put in place to ensure the appropriate degree of central bank independence. Weaken those defenses and I firmly believe the economy is at risk.

The Federal Reserve must be free to focus on advancing the Nation's ultimate economic goals. In that vein, as I have indicated to this committee on previous occasions, the determination of the effectiveness of the Federal agency has to be based in the end on whether it has carried out the objectives Congress has set for it. We have not always been entirely successful, but we have learned from experience what monetary policy can do and what it cannot do.

In my view, current Federal Reserve policy is promoting conditions vital to maximizing the productive potential of the U.S. economy. Monetary policy is and will continue to be directed toward fostering sustained growth in economic output and employment. Part of our task is to minimize the risk of systemic crises while endeavoring to implement good macroeconomic policy. When, for example, threats to the Nation's financial system loomed large in the wake of the 1987 stock market crash, the Federal Reserve effectively contained the secondary consequences of the crash with prompt but prudent injections of liquidity and with constant consultations with depository institutions during the crisis.

The bulk of our efforts in this area, however, of necessity garners less publicity, as it is directed at one going to efforts to fend off financial sector problems before those problems emerge as full-blown crises that could threaten American jobs and standards of living. Much of our success over the years, therefore, reflects crises that did not happen.

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In practice, the central bank of the United States works and it works well. On paper, however, its structure can appear unwieldy, an amalgam of regional and centralized authority and of public and private interests. If we were constructing a central bank for the United States now, starting from scratch, would it be identical to the Federal Reserve System described in current law? Perhaps not, but the Federal Reserve has evolved to be well suited to today's policy tasks.

One of the reasons that the Federal Reserve is effective is that its basic structure has been in place for a long time. The institution has been able to take that framework as a given and to adapt and build on it during decades of invaluable experience in the financial and economic setting of this country. As the Federal Reserve has evolved over the years, it has been permeated by a culture of competence and dedication to public service. As a consequence, the Federal Reserve has attracted highly skilled analysts, technicians, and policymakers.

While we might imagine a different initial structure for our central bank, implementing a major change at this stage could for all intents and purposes destroy the exceptionally valuable culture that has evolved over time and that continues to serve this Nation well. And there is always the risk that changing a complex organization, even with the laudable goal of improving one or more parts of it, may well have unforeseen and unfortunate consequences elsewhere in the structure.

Nonetheless, the Federal Reserve recognizes that an organization that does not appropriately respond to changes in the environment in which it functions will soon become ineffectual. Accordingly, the Federal Reserve has suggested, initiated, and instituted a number of measured changes over the years. When confronted with a new development requiring change, we advocate it.

For example, not long ago, as you remember, Mr. Chairman, we recognized an apparent weakness in the way the discount window could be used in the case of insured, failing institutions, a condition which we had rarely before experienced. The committee was also aware that this problem existed. We saw change as a constructive response, and while we were prepared to implement it by adapting our recollections, we cooperated with this committee, which chose to amend our discount window procedures.

I hope and I expect the Federal Reserve will continue to change, but always prudently in response to clearly identified problems and only for the better. One area in which I see major need for change is the inadequate pace at which women and minorities have moved into the top echelons of the Federal Reserve.

We share your concerns in this regard and are working diligently to improve opportunities for women and minorities throughout the system.

In the remainder of my remarks this morning, I would like to address one of the specific issues; that is, the status of the Reserve bank presidents on the FOMC that has been raised under the more general topic of Federal Reserve accountability. Two other issues regarding the disclosure of FOMC deliberations and decisions and the General Accounting Office's purview in auditing the Federal

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Reserve System are covered in my written statement and will be addressed more fully in hearings scheduled for later this month.

The Federal Reserve Banks represent a unique blend of public and private sectors. I believe that those who label the Reserve bank presidents as representatives of the banking interests, as opposed to the public interest, misunderstand the position of the presidents and the Reserve banks in the Federal Reserve System.

The Reserve banks are instrumentalities of the U.S. Government, organized on a regional basis. They are in a tangible sense owned by the Federal Government. The bulk of their net income is handed over to the government each year. Their accumulated surplus, were they to be liquidated, would revert to the U.S. Treasury and while a portion of the capital of the Reserve banks represents contributions by member commercial banks, those member banks are not free to withdraw the capital, their dividends are fixed by statute, and their capital stake in no way affords them the usual attributes of control and financial interest. The member banks do select the majority of the directors of their local Reserve bank, but the Federal Reserve Board chooses the remaining directors and among those designates a Chairman and a Deputy Chairman. The directors in turn select the Reserve bank's president. Their selection is subject to Board approval.

Those Reserve bank presidents then receive top secret clearances from our government and are subject to the Federal conflict-of-interest statute. They can be removed by the Federal Reserve Board, and it is the Board that sets their pay.

Upon joining the FOMC, they take an oath of office to uphold the Constitution of the United States, and uniformly in my experience they are dedicated to the service of our country. However, regardless of whether the presidents of the Reserve banks are viewed as more public than private or more private than public, the real question remains, does their participation on the FOMC make for better monetary policy?

I can assure you that it does. The input of Reserve bank presidents who reside in and represent the various regions of the country has been an extremely crucial element in the deliberations of the Federal Open Market Committee. By virtue of their day-to-day location and their ongoing ties to regions and communities outside of the Nation's Capital, the presidents see and understand developments that we in Washington can overlook. They consult routinely with a wide variety of sources within their districts, drawing information from manufacturing concerns, retail establishments, agricultural interests, financial institutions, consumer groups, labor and community leaders, and others.

The public, private, and regional makeup of the Federal Reserve System was chosen by Congress in preference to a unitary public central bank only after long and careful debate. This blending of public and quasi-public institutions has a long history in this country and has been reaffirmed repeatedly in Congress.

Some who agree that the Federal Reserve Bank presidents provide a unique perspective would nonetheless argue that such input could still be obtained by reducing the Reserve bank presidents' role to an advisory one. I doubt that for two reasons.

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First, let us not delude ourselves. Anyone permanently denied a vote sees his or her influence diminish markedly. Not only would the presidents' varied experiences and regional perspectives likely become less well reflected in policy decisions, but their ability to solicit real-time information from their communities would be diminished as well.

Second, I believe that a fair number of my colleagues who serve as presidents of the Reserve banks would have declined that office had voting rights on the FOMC not attached to it. These are people who do not lack for opportunities. If the Reserve bank presidents were denied votes, we would not attract individuals of the same caliber to these jobs that we do today. As a result, the advice received would be adversely affected and FOMC deliberations would be less productive.

A different proposal would retain the Reserve bank presidents on the FOMC, but would have them appointed by the President of the United States. Such a proposal is, of course, not new. It was considered and rejected by this committee as recently as 1976. The clearest drawback to this suggestion is one that I have already mentioned; that is, the potential for increased partisanship that would erode the quality of policy as the central bank was drawn more closely into the ambit of daily political concerns.

In addition, however, such an arrangement would create significant managerial problems for the Federal Reserve System as an organization. Under current law, Reserve bank presidents are directly accountable to the Board of Governors for their performance in carrying out systemwide policies in such areas as bank supervision, payment systems responsibilities, and discount window administration.

The Board's ultimate defense against a bank president who is either incompetent or purposely obstructing the effect of implementation of system policy is our power to remove that person from office. If the heads of the Reserve banks are instead Presidentially appointed, we presume that they could be removed constitutionally only by the President of the United States. In that circumstance, systemwide coordination of policies and interbank cooperation could be seriously impaired.

Mr. Chairman, you have made it clear that in your view H.R. 28 does not represent an attempt to politicize the Federal Reserve or to infringe on its independence. I feel I must respond that whatever its intent, legislation of this type would have precisely that deleterious effect.

I take this legislative initiative seriously not only because it would emanate from this committee, but also because of monetary policy's key position in the Nation's overall economic policy. At the flash point of financial crisis, monetary policy, if mishandled, can pose a threat to our economic system; and in this century, we have witnessed inflation, a monetary phenomenon, turned virulent in too many nations around the world.

To a considerable degree, then, both the earnestness with which we approach our task and the unique position accorded the Federal Reserve in our governmental structure derive from the potential for such dire consequences of monetary policy mismanagement. In imposing significant change on the Federal Reserve System, we would

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run the risk of real damage to the institution's effectiveness from unintended adverse consequences.

The Federal Reserve is not a flawless institution. It is, however, a very good one. In my view, it would be a mistake to legislate structural reform when, as in this case, compelling evidence of the need for change is, in my judgment, lacking.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Chairman Greenspan. I just have one historical observation by way of correcting an impression you give in your statement, that President Woodrow Wilson favored an arrangement—actually, in reading Carter Glass's book, "Adventures in Constructive Finance," he quotes President Wilson this way in addressing a group of bankers. In fact, actually what was happening there was a compromise, as all things are here.

I am going to quote Carter Glass in his quoting of the President. He says, "Will one of you gentlemen tell me in what civilized country of the Earth there are important government boards of control on which private interests are represented? Which one of you gentlemen thinks that the railroads should select members of the Interstate Commerce Commission?"

Of course, it is very interesting when you read the legislative history as a result of the financial crisis of 1908. The Congress—in fact the House committee—formed what they call the PUJO Committee, P–U–J–O, named after the chairman.

It is interesting to read their years of endeavor which finally produced the House version of what turned out to be the Federal Reserve Board Act. There was compromise. When it got to the Senate, you had quite a bit of change and give and take.

But I think that President Wilson in other accounts—not only his own but in others at that time besides Carter Glass reflected great concern at the direction, by 1916, that this newly formed board was taking. But I will leave that to history.

I didn't want to leave an impression that President Wilson supported—the other observation has to do with your statement on page 7, which you read here, pointing out an example of the flexibility and willingness for change on the part of the Federal Reserve. It has to do with the reform as to the discount window, and I think any impression here that that initiated, or that initiative came from the Fed would be wrong historically. It resulted from our hearings that we had with respect to the use of that window, the Fed as the lender of last resort to some of the banks that were obviously giving quite a bit of problem to the insurance funds.

But the most notable thing that I recall from that was the fact that—only one instance that that discount window or that lender of last resort was used in the case of an S&L, and that happened to be Charles Keating's Lincoln Savings and Loan in which in April when it went into conservatorship. I think it was 1988—it supplied better than $100 million worth, which we have reason to believe is what Keating used to divert monies for his defense later on.

But why would the Federal Reserve Board—and in fact I don't know of any other case where it used that window for an S&L—would do this at this time, keeping Lincoln with an infusion of $100 million, which was used quite adroitly by Mr. Keating. We never did resolve that. We raised inquiries, but we were satisfied

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with having some time to include some—not really substantive, but some better definition of the use of that window.

I have other questions I will submit in writing in case we don't have time later on.

I recognize Mr. Leach.

Mr. GREENSPAN. May I respond?

The CHAIRMAN. Certainly.

Mr. GREENSPAN. First, let me go backward. My recollection of that particular episode which you refer to was when Lincoln was in—already in conservatorship, in the hands of the government; and unless my memory fails me, I think we were requested to assist in a joint Federal Reserve-Federal Home Loan Bank Program to facilitate the minimization of the losses that would be associated with that.

But more importantly, the question that you raise relevant to the discount window issue I substantially agree with, that you raised this issue with respect to the discount window. We, however, were obviously aware of it because this was something new.

We had a view that we perhaps would do it, we would make the changes that we needed to do from a regulatory perspective; you chose, as I indicated in my prepared remarks, to make it a part of FIDICIA, and we were willing to do that and cooperated as I recall with your staff to craft that legislation in the appropriate manner.

The issue of Woodrow Wilson is a fascinating one. I have also read the Carter Glass book, which was, I must say, an extraordinarily interesting vehicle to somebody like myself. It is true that the overall view, as I understood that President Wilson had was that the government should exercise the regulatory—supervisory control of the system, which the Federal Reserve Board had, but he did support, and indeed it was part of his legislation, that there would be Federal Reserve Banks out there who themselves would manage the discount window for particular actions. And in that sense, even though policy on discount rate issues was then, as now, in the hands of the Federal Reserve Board, to what extent monetary policy existed back then—and remember, it was not really an issue that was fully understood in the modern sense until the early 1920's—to the extent that such policies did exist, they were implemented by the individual Federal Reserve Banks, banks which were created in the legislation supported by President Wilson.

So I think that one cannot go back in retrospect and ask the President, what would he do in the current environment? Frankly, I couldn't answer that question. I think that it was a far more complex problem back there, and I am not sure that I would read President Wilson's conclusions the way they were stipulated in the Carter Glass memoirs and interpreted by numbers of people.

Mr. FRANK. Maybe the question is whether Carter Glass was half-empty or half-full.

Mr. GREENSPAN. I assume, Mr. Chairman, that Mr. Frank has now had his question and is no longer capable of asking another question.

Mr. FRANK. I haven't had my answer, Mr. Greenspan.

The CHAIRMAN. Well, one could assume that it is a preliminary question. Mr. Frank is very agile in being able to ask more than one question at any time.

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Mr. Leach.

Mr. LEACH. Mr. Hamilton made the point, which I think is an important one, that the motivation of his approach has nothing to do with a complaint about monetary policy today. I think monetary policy is very well led today. On the regulatory side, it is better led. I don't mean to be presumptuous. I don't think it is extremely well administered, but it is much better than it has been.

With regard to the Carter Glass circumstance we frequently forget the regulatory obligations of the Fed. This concern about having people from the railroads running the Interstate Commerce Commission, is analogous to having bankers regulating bankers—to some extent that is one of the political science unseemlinesses of the regional banks.

It also has an element of unseemliness to the degree that some of the banks have different policies than others. It has been my view over time that within the banking system, different regions have had slightly different standards, which basically has the effect, among other things, of credit allocation in the final measure.

Having said all of that, it strikes me that there is a profound case for having publicly designated people make public policy decisions both for the protection of the public and also for the protection of the Fed.

I think the Fed is in an indefensible position. When times are tough certain institutional aspects are pointed out. Therefore, it is with loving kindness that I have come to the conclusion that the Fed is in need of a dose of greater democratization.

Now we have two bills with approaches on the Federal Reserve Bank presidencies that have been noted. I am kind of impressed with an alternative of simply asking or requiring the Federal Reserve Board itself to designate the Federal Reserve Bank presidents. Of those three approaches, which seems to be the more reasonable to you, recognizing you prefer none of the above?

Mr. GREENSPAN. Before I answer that or get involved in the detail of that and it is a very interesting proposal, but let me first say that it is probably the case that there are different policies on a regulatory basis implemented by all of the 12 Federal Reserve Banks under the context of control of the Federal Reserve Board because, of necessity, there are interpretive issues which relate to different parts of the economy, because the economies are slightly different. But my impression is that, considering the diversity that we have, we have a remarkably homogeneous group of examiners and supervisors who adhere to the letter of Federal Reserve Board supervision.

But I will not deny that, obviously, as in all organizations of this size, certain differences can occur. But my impression is that they are quite small and perhaps really have not very major implications.

It is true that there is potential conflict that exists between the commercial bank members of the Federal Reserve System who vote on the directors and the examiners who work under the presidents examining those banks. It is important to emphasize that the policy questions on the question of how examinations are made and what the principles are vested in the Federal Reserve Board and not in the individual banks.

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I must say that, having observed the process for a long period of time—indeed it has been 80 years since this issue first surfaced—I know of no indication of actual conflicts which have existed in that particular concern. So while one may validly hold that concern as a possibility, I think that 80 years of experience suggests that it is not something which should very basically concern us.

With respect to your more fundamental question, you are quite correct; my view about the nature of the Federal Reserve is one which I hold with respect to all public institutions; namely, that they develop, as do private institutions, a way of functioning, and as you change them, no matter how you do that, there are always unintended consequences. That is almost a managerial law which one can postulate that would describe this among all various different forms of institutions.

I would therefore argue that unless the problems in an organization—which I guess is true whether it is public or private—move above a certain threshold, it is probably unwise to make changes.

While I don't deny much of the discussion here and throughout our history as being inappropriate, the experience that I have had—and I have been at the Fed for more than 6 years—is that the system works exceptionally well from an operational and managerial point of view; and the reason why I am reluctant to change it is not because I believe that one should not change things. On the contrary, institutions which don't adjust eventually disappear. It is that I cannot see in the current structure a particular problem which requires being addressed.

Very specifically, your proposal actually would not make a major change, because clearly we at the Federal Reserve Board already have significant control over the presidents. What does happen on the negative side is the fact that the directors of the Federal Reserve Banks have a diminished role as a consequence; and my concern, as it is with the issue of removing the Reserve bank presidents from the FOMC, is that, with that diminished role, we would cease to get the quality——

Mr. LEACH. I apologize. That isn't my proposal. My proposal is to keep the Reserve bank presidents on the FOMC.

Mr. GREENSPAN. I understand, but you have removed in your proposal the ability of the directors to effectively participate in the choice of the presidents of the Reserve banks.

What I am saying is that removing that will significantly reduce the role of those directors, which I must say I have found exceptionally useful for the System.

I just, for example, came back from a directors meeting at the Federal Reserve Bank of Atlanta, in which not only were all the directors of the main office there, but all of the branch directors were there; and I learned a great deal about what is going on in that district just listening to these individual people around the table talk.

These are people of extraordinary capabilities and leaders in their particular regions and communities; and I would be fearful that by reducing their participation in the process, we would lose what I perceive to be a significant positive element in the ability of the central bank to function in an effective way.

The CHAIRMAN. Mr. Frank.

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Mr. FRANK. Thank you, Mr. Chairman. I just want to say that I appreciate very much the tone that both you and Chairman Greenspan have set. These are very important issues, not personal; no one is accusing anyone of wrongdoing. I think it is to the credit of both of you that you have set this tone that we can discuss fundamental issues in a very civil way. I hope to be able to continue that.

Mr. Greenspan, you talk about the need for a long-range perspective. Obviously, there are technical aspects of what you do, but are there not also some value questions that have to be resolved as to how much you value unemployment over long-term inflation, or would you argue that they are all technical?

Mr. GREENSPAN. On the contrary, I would say that economics at its root is a set of principles that fundamentally rests on the values of human beings. The whole question of price is derived from relative value preferences of people, and you cannot divorce——

Mr. FRANK. In policymaking, inevitably at the level of policymaking that you are engaged in, there is a value question.

Mr. GREENSPAN. Certainly there is.

Mr. FRANK. I assume that is why you say at the top of page 2, bottom of page 3, accountability and control by the electorate, of the Federal Reserve I assume we are talking about, are vital. The Nation cannot allow any instrument of government to operate unchecked. The central bank, just like other governmental institutions in a democracy, must ultimately be subject to the will of the people. Now, that establishes a common philosophical framework.

The problem I and others have is that I don't see how that happens in your case unless you choose it to. You are not by nature an autocratic individual, but I don't understand what in the system effectuates what you are talking about.

You say the central bank just like other governmental institutions in a democracy, must ultimately be subject to the will of the people. I appreciate that phraseology. It strikes me that when you and other opponents of the legislation use the phrase "politicization," you might with no loss in logic use the word "democratization." I think they can be used interchangeably.

My question is, what makes you subject to the rule of the people? You say of the 7 members of the Board this President will get to appoint 2, under the law during his term, he will get to appoint none of the 5 FOMC people, so of the 12 votes that set monetary policy, by the end of his first term, Bill Clinton will have 2; by the end of his second term, I hope, he will have 4 if everybody serves it out. So after 8 years in office, he will have 4 out of 12.

Then you say, well, Congress can look into it. We can ask you questions. Yes, we can ask you questions much of the day, but I think you give a great refutation to that when you say on page 10 with regard to the FOMC presidents, "Let us not delude ourselves; anyone permanently denied a vote sees his or her influence diminished markedly."

I think that effectively describes where we are. We can ask questions, we can have Humphrey-Hawkins reports, but no one has influence over the decisions. So where does this popular control come in? What if a substantial percentage of the voters decided that the

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current direction of monetary policy, either now or at any other time, was incorrect? How would they subject you to their will?

Mr. GREENSPAN. This, I think, is at the root of the question of accountability and basically what a central bank should or should not do under various different circumstances.

First, I think it is important to stipulate that indeed our longer term goals are part of the statute. The Congress has created a set of goals for us which we rest upon. The important issue with respect to accountability is really a difficult one because it is not easy to make the following judgment: Do you endeavor to reflect the will of the people on what they say or what they do?

Now, the reason I raise this distinction—and it is a crucial one—is that when you are dealing in the area of economic policymaking, we are aware that if a poll is taken, we will very often find that the poll will say that people want taxes reduced and benefits raised and the budget deficit reduced. I mean, it is not inconceivable that there are contradictory indications that occur.

There are no contradictory indications, however, on what the people do in the marketplace. In other words, you either spend your income or you save it. There is no hedging in that respect; the balance sheet must balance. And what you infer from that is, in a sense, what the time preference of the populous is from that; and that is the reason why I say to you that the United States is essentially a longer time preference type of society. In other words, we produce goods which are 20 or 30 years old because that is what people actually choose in our system.

Mr. FRANK. I am struck by this as a kind of a Rousseauian element. You talk about democracy in the sense that you will know what they mean no matter what they say. When you say subject to the will of the people, you divine that will by their behavior in the marketplace, and then that informs Federal Reserve policy. That is a very different conception.

Mr. GREENSPAN. That is not the issue here. The issue basically is the reason why we set out a long-term policy; our judgment is that it is necessary for the long-term prosperity.

Mr. FRANK. I understand that and realize that is a valid, substantive justification for what you do. My point is a more procedural one.

You say on the top of page 3, the central bank just like other governmental institutions in a democracy must ultimately be subject to the will of the people. My question to you is, how does that happen? Because I don't see any mechanism. If the people decide they really don't like what you are doing, other than changing their buying habits and waiting for you to figure that out, how do they indicate to you that you are not complying with their will, that they would make the tradeoffs differently than you would?

Mr. GREENSPAN. I think that ultimately what happens is that the Congress changes the law.

Mr. FRANK. So you are subject to the rule of the people because we can change the statute, the statute which sets out your goals at a very high level of generality. Congress would say we are going to change the law to change monetary policy.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Roth.

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Mr. ROTH. Thank you, Mr. Chairman.

Mr. Greenspan, Chairman Greenspan, we had Chairman Hamilton appear before you, and I asked him a number of questions about the Federal Reserve. Basically, I guess the question I have is, why shouldn't GAO audit the Federal Reserve?

Mr. GREENSPAN. I am sorry, why should it?

Mr. ROTH. Why shouldn't it? Is there any reason why the GAO shouldn't?

Mr. GREENSPAN. There will be another hearing on this in full detail. In my prepared testimony, I point out that the key question here rests on the issue of the maintenance of independence of the Federal Reserve System. If, as the Congress indicated that the GAO, in the 1978 act, could audit all aspects of the Federal Reserve System with the exclusion of those which refer to the question of the deliberations related to monetary policy, the GAO does audit us in very great detail with that very specific carve-out, which was debated by the Congress and passed in the 1978 act. The reason essentially is that if you get the GAO involved in essentially auditing and evaluating the elements involved in the deliberations of monetary policy—in our judgment and in the judgment of the Congress and the act, is that that would impede the independent activities of the determination of monetary policy.

Mr. ROTH. Well, I wasn't in Congress in 1978, but it seems to me that we have to have public accountability, like you had mentioned before, and GAO audits would give that public accountability.

Chairman Hamilton said earlier that a Federal Reserve budget is not published. Is that true?

Mr. GREENSPAN. The Federal Reserve budget is published. It is 66 pages of data. All I can say is I have read many annual reports of individual agencies in this government and this is as complete a detailing as I know of what we do, what we spend it on, where it goes.

I might say further that the major form of auditing of monetary policy is this committee. You effectively request us to come before you and explain what we are doing and why we are doing it. I will tell you that when I come up here at the invitation of the chairman, I try to convey as best I can—sometimes it is not as good as I would like—what it is we are doing and why we are doing it. And on individual occasions when the data are not as fully detailed as the chairman or other Members of the Congress might like, requests are made of us and we make those data available. We go into the files and dig them out.

So I am not certain at this particular stage what the problem is.

Mr. ROTH. I think the problem is that we feel a lot of the things going on in the Federal Reserve should be open to public scrutiny because the Federal Reserve has such a tremendous bearing on our economy.

Mr. GREENSPAN. I, absolutely, agree with that. The only areas where I think that we require an element of delayed disclosure is in areas where our deliberations and activities affect the markets and, by so doing, affect our capability of being efficient.

I agree. I say that absolutely central banks should be disclosing everything they can up to the point where the disclosure affects their effectiveness.

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Mr. ROTH. Let me see if I understand what you are saying.

You are saying that everything that the Fed does is open to public scrutiny. It may be delayed at some point for cogent reasons, but everything is made public in the final analysis; is that what you are saying?

Mr. GREENSPAN. I would say, for example, 6 weeks after our FOMC meeting, we publish very detailed minutes of what it is that transpired, who voted for what, who voted against it, and what the reasons were, involved in the various different discussions of the particular policy. I must say, it is a fairly useful set of minutes. I find them quite informative, and I hope that more people read them.

Mr. ROTH. My time is up.

Chairman GONZALEZ. Mr. Fingerhut.

Mr. FINGERHUT. Thank you, Mr. Chairman. As a new member of this committee, part of your answer to Mr. Roth when you said what is the problem, was my reaction too when I saw all the various legislative proposals by our distinguished chairman and by others and the amount of time we have been devoting to it, because from an outsider's perspective prior to this year, it has been the Fed's conduct of monetary policy that seems to have saved us from some rather dramatic swings in fiscal policy over the last decade or so.

The area that Chairman Hamilton raised in his testimony that was also on my mind during our recent meeting over the budget was the area of consultation between the branches of government, the agencies of government that deal with fiscal and monetary policy. I am on Mr. Kanjorski's subcommittee to which you present your semiannual reports on monetary policy. You were here before that subcommittee barely days before the House voted on the President's economic proposals. I remember you dancing very carefully around the subject of what you thought would be good fiscal policy to complement the monetary policy that the Fed had engaged in.

Would you comment in general terms on what kinds of consultations go on, how you think those consultations currently serve our national interest and in what ways perhaps we could improve the coordination between fiscal and monetary policy which from this outsider's, now insider's observations do not appear to have always served our Nation as best they could?

Mr. GREENSPAN. Obviously, there is a great deal of consultation going on. I, for example, have a scheduled weekly breakfast with the Secretary of the Treasury. I see him quite often in addition and we talk about various types of issues, including monetary and fiscal policy questions. We have periodic meetings with the Council of Economic Advisors, and I have numerous conversations with the individual members from Chairperson Tyson on down several times a week, because as many people know, it is the CEA which transmits the important economic statistics to Treasury and to the Federal Reserve 2 hours in advance of their release in the event that we need to know something and they invariably get involved in considerable conversation.

I, periodically, meet with individuals in the White House, Bob Rubin, whom I have known for many years, and others in the White House on occasion, including the President. As best I can

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judge, we have a fairly good set of discussions and transmissions of various policies. They are frank with me and I am frank with them, so it is not an issue of not conveying important information. I think we do, and I think they have been quite useful both to the Fed and I hope to the administration.

Mr. FINGERHUT. Should there be, in your opinion, more direct involvement from the fiscal side than the monetary policymaking side? It is clear to me that the administration and its fiscal policymakers track very carefully what you do to try and make sure that they are responding, but should it work the other way around? For example, Chairman Hamilton and others have proposed that fiscal policymakers ought to sit in an advisory role on the Open Market Committee or other aspects of the Fed's activities.

Mr. GREENSPAN. We did have the Secretary of the Treasury and the Comptroller of the Currency as ex officio members of the Federal Reserve at the beginning. It was found to be inappropriate and indeed it was Carter Glass who, as Secretary of the Treasury at one point, considered that it was a politization of the Federal Reserve System which was inappropriate and in the 1930's they were removed from the Federal Reserve and have not had participation directly since.

My concern is basically that the issues have not fundamentally changed, and it would, I fear, create some difficulties in the deliberative process and the independence of the system. I don't see any need.

In other words, I don't see any particular area where, for example, the Secretary of the Treasury is uninformed about what is going on that he needs to know. I make certain that he knows what is relevant to his deliberations within the administration and specifically in areas of fiscal policy.

The CHAIRMAN. The time of the gentleman has expired.

Mr. McCandless.

Mr. MCCANDLESS. Thank you, Mr. Chairman.

Chairman Greenspan, in the legislation before us there are a number of issues which I have cataloged into an area which I entitle "policy determination, process and membership." I will pick some key elements of that.

For example, the public videotaping of your meetings. The Advisory Council has recommended an expansion of the Federal Reserve Board membership to include various and sundry elements of our social structure. I would appreciate it if you would comment on some of those areas which I have labeled policy determination, process, and membership.

Mr. GREENSPAN. I am not quite certain what the specific areas you wish me to focus on are. Are you talking about—could you be more specific, please?

Mr. MCCANDLESS. We have before us a three-column outline of the three, or actually two bills, and one area here is representatives from agriculture, small business, labor, and consumer community organizations: "Women and minorities shall be included when filling vacancies of boards of Reserve Banks. Each Federal Reserve Bank shall establish an Advisory Council consisting of representatives of small business, agriculture, consumer and community organizations, women's rights, and so forth.

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A videotape and the minutes of each FOMC meeting shall be made public within 60 days of the meeting, and so forth. With the time I have, that would probably be more than you could comment on, but I would appreciate it if you would.

Mr. GREENSPAN. First of all, we do have for each of the 12 Federal Reserve Banks, Advisory Councils for small business and agriculture. We have at the Federal Reserve Board innumerable advisory groups who come in and give us their particular views. In choosing the directors of the Federal Reserve Banks and the branches of the Federal Reserve Banks, we have especially in recent years given very considerable consideration to increasing the number of labor and consumer interest people on those boards and the numbers have gone up quite considerably.

We think that we should have representation of the community on our Federal Reserve Boards, and we are working diligently at the Board of Governors to make certain that that process continues, and I think we have made substantial progress not, frankly, as much as I would like to see myself, but we are getting there and I would hope that we can at some point come before this committee and say that we are satisfied that we have full representation on those boards which reflect all the crucial interests that those particular areas have.

Mr. MCCANDLESS. Another section that I wanted to cover was the financial auditing process that is proposed for members and the boards and the General Accounting Office's involvement. It would appear that there is room for some movement in view of the fact that such institutions as the Supreme Court that had been pointed out earlier today has a certain financial obligation in that the monies involved are public, realizing where you get your money, but still indirectly public.

What are your feelings on the financial review audit process that is being proposed in the legislation?

Mr. GREENSPAN. This creates a significant dilemma for a central bank. On the one hand, the chairman is quite correct—we are using public monies in the sense that to the extent that we spend $1,000, that does not get passed on to the Treasury and appear in the budget receipts. This is the reason why we have been, in my judgment, extraordinarily scrupulous in endeavoring to make certain that we keep our budgets under very considerable control, but the data will show that the growth in expenditures and costs of the Reserve banks has been a growth rate very significantly less than general government, excluding the Defense Department.

Even though we have had a major increase in the workload of the Federal Reserve Banks as a consequence of increased supervision and regulation requirements resulting from FIRREA and FIDICIA specifically, our growth in costs is very well contained. We at the Federal Reserve Board spend an inordinate amount of time auditing the individual banks and holding their cost structures at bay and I think we have been quite successful at that.

The reason we do is precisely because if we are confronted with the requirements of having congressional oversight of our budget, that inevitably affects how monetary policy is controlled. It is, therefore, incumbent upon us to make certain that we are extraordinarily responsible in the expenditure of funds, and with the ex-

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ception of the deliberations question which I was mentioning to Mr. Roth, and certain relationships with foreign central banks and governments which we are required to maintain confidentiality on, we think that as much detail and as much auditing as the Congress, the GAO, or anybody else wants to do is appropriate.

The only question I would raise is that there are cost elements involved in doing this and many of the times my concern about various different types of audits which I perceive are duplicative is not that that is a problem to be done but it is costly. I don't like to spend the money unless we think it is necessary to do so. But my view is that there are very limited carve-outs of where disclosures, financial and otherwise, should not be made wholly because such disclosures affect our ability to do the job which the Congress has required us to do.

Aside from that, we are obligated to divulge everything and if in the judgment of this committee any particular aspects of our operations should be made available to this committee, we have done it.

There have been occasions where I have commented in letters back to the chairman that certain types of things would be exceptionally difficult to do or exceptionally costly and we have succeeded in discussing with the staff a means of getting the information that this committee desired in a somewhat more cost-effective manner, but we have no interest in not making ourselves as open as possible to disclosure.

Mr. McCANDLESS. My time is up.

Thank you, Mr. Chairman.

The CHAIRMAN. Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

You mention in your testimony that you recognized the inadequate pace at which women and minorities have moved up within the Fed system. What do you believe is the cause for that?

Mr. GREENSPAN. I am sorry?

Ms. VELAZQUEZ. You mentioned that you recognized the inadequate pace with which women and minorities have been moving up within the Fed system. What is the cause for that?

Mr. GREENSPAN. I think the cause first of all is—the cause of that problem which exists throughout our society, and I think if you go back and look at the level of discrimination 20 years ago, you see a reflection of that not only in our composition of employment, but you see it throughout the society. There has been a very dramatic improvement in that direction and while, as I indicated in my prepared remarks, I am not satisfied with the progress that has been made, we have actually made quite substantial progress.

In fact, I just had somebody look up some of the data the other day and, for example, I had them put together the total employment of the officer corps of the Federal Reserve System because that is where most of the discrimination earlier, in my judgment, took place. If you look at it in 1977, of all officers in the System, 5.3 percent were female, 2.3 percent were minorities. The data for 1993 shows 22 percent female officers and 9 percent minority officers.

Now, that is still less than I would like to see, but there is very substantial progress here. I mean, for example, from 1987 to 1993

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the proportion of minority officers went up from 5.4 percent to 9 percent and women from 16.1 percent to 22.2 percent. And that trend is continuous. We are keeping the pressure on, we are making progress.

I find it frustrating in a lot of particular areas and if I were to say we are doing as well as we should I think the answer is no, we are not.

Ms. VELAZQUEZ. Can you tell me how you are going to improve that?

Mr. GREENSPAN. What we are doing at this stage is putting into place a fairly significant program which—I don't want to take the time of this committee to list, but there is a very considerable number of actions which we are taking to try to attract minorities and women to the Federal Reserve System and we are involved in a significant number of programs for sponsoring scholarships and internships which brings minorities to the Federal Reserve System.

It is a recruitment procedure which has emphasized a disproportionate number of new add-ons coming from women and minorities and that is the reason why the total numbers are going up. The only way you can do that is have a disproportionate number of your new applicants from those groups. And we are looking for ways to improve on that, and as I have said before this committee, we have got a way to go, but it is not because we are not trying in a very vigorous manner.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Will the gentlelady yield?

I think it is very important to bring out that last week I submitted for the record the announced appointments by the Board of Governors of the 12 chairmen for the Regional Federal Reserve Bank Boards where there is apparently only 1 woman in the group and as far as we could tell no minorities.

Why has the Board of Governors failed to approve more than one woman and no minorities as presidents of the Reserve banks?

Mr. GREENSPAN. My recollection is we had three women as chairmen last year, and there are a number of—in fact I have a list here of the deputy chairmen and chairmen of which there are, of course, 24, and of the 24 chairmen and deputy chairmen, 4 are women, 3 are minorities with duplication, 2 are labor, and 1 consumer.

So I would say what that is, is that that is a problem of the fact of who we have and how we are moving them. But we have moved up to a fairly high proportion of minorities and women in the deputy chairmanships and the deputies automatically become chairmen. So there are aberrations where periodically the timing means that you dip a little, but we are still moving up on the trend and the total or the combination of the two which is crucial continues to move up.

The CHAIRMAN. But the announcement last week is substantially that, it was one woman——

Mr. GREENSPAN. I think that is correct. I have it here and I can double check it.

Yes, that is correct.

The CHAIRMAN. Thank you very much for yielding to me, Ms. Velazquez.

Mr. Bachus is next.

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Mr. BACHUS. Chairman Greenspan, are you aware of the President's September 20 letter to Chairman Gonzalez when he stated that the Fed is functioning well and does not need an overhaul?

Mr. GREENSPAN. Yes, I am, Congressman.

Mr. BACHUS. He also said in that letter—and this is my concern—that we run the risk of undermining market confidence in the Fed by making major structural change in the Federal Reserve.

First of all, and let me say, I agree that the Fed is working and is working well. As you stated in your statement, basically, it has worked this way since 1935. And I think you agree with the President that we don't need any major structural changes. Has he given you any indication since September 20 that he now endorses this legislation?

Mr. GREENSPAN. I have not spoken to the President on this issue at all.

Mr. BACHUS. Would you comment on his assertion that this type of change at this time could undermine the market's confidence in the Fed?

Mr. GREENSPAN. My general concern is that change tends to create the possibility or I should say, change invariably creates unintended effects and they tend often to be adverse. That is the reason why I said earlier that I think in order to advocate change you have to reach a certain threshold of a problem before it is wise to take the risk.

In that respect, I clearly subscribe to the President's concern, because that is mine.

Mr. BACHUS. Do you agree that we are taking a risk here by this legislation of——

Mr. GREENSPAN. You mean in this discussion?

Mr. BACHUS. Not this discussion. If this legislation were to pass, do you see it as creating a risk of undermining your ability to set monetary policy at the Fed and therefore undermining the economy of this country?

Mr. GREENSPAN. I said in my prepared testimony that I am concerned that any significant change in the structure does risk problems for the economy and the management of monetary policy.

Mr. BACHUS. Thank you.

One other question. You heard Chairman Hamilton when he was here earlier state that if his legislation in any way attempted to politicize the Federal Reserve he would not—he would back off his support for that.

As I understand it from your testimony and from my understanding of the Federal Reserve, the FOMC is the major policy monetary, policymaking committee of the Federal Reserve. Is that right?

Mr. GREENSPAN. That is correct.

Mr. BACHUS. And the FOMC—at the present time, the President appoints seven members, the Governors, but not the other five?

Mr. GREENSPAN. That is correct.

Mr. BACHUS. And with the changes that this bill would make, the President would make all 12 appointments to the FOMC?

Mr. GREENSPAN. Yes.

Mr. BACHUS. How is that not making the system more political?

Mr. GREENSPAN. As I have commented in my prepared text, in my judgment it does. I know that is not the intent of the proposal

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as the chairman indicated. We have a disagreement on this question as to the effects. In my judgment I think it clearly would be a mistake to pass this legislation.

Mr. BACHUS. I agree any time you give the President the power to appoint all 12 members of the major policy committee of the Fed, I can't understand how that is not making it more political. There was something in the *New York Times* yesterday saying Mr. Gonzalez talks of the central bank as an elite, secretive club often unresponsive to the public's demand for faster growth.

Should the Federal Reserve be responsive to day-to-day public demands and political demands for changes in monetary policy?

Mr. GREENSPAN. What we do is evaluate the economy as we see it and try to make a judgment as to what the appropriate policy is in the context of the statutes which regulate the Federal Reserve generally and the Federal Open Market Committee in particular.

Mr. BACHUS. So would——

The CHAIRMAN. The time of the gentleman has expired.

Mr. Hinchey.

Mr. HINCHEY. Thank you, Mr. Chairman.

Good morning, Mr. Chairman. I was fascinated by the discussion you were having with Mr. Frank because in many ways I think that that is the central question here, that being the accountability of this agency to the public. We live in a government that is almost unique in that regard and all of our activities are directly accountable and overseen by the general public with the exception, the large exception, of the Federal Reserve, which seems to be a very anomalous situation.

That is the point that seems to be central to this discussion. Even the President's ability to remove the two appointments that he is likely to get is taken from him. He doesn't have the ability to remove those people that he appoints.

Mr. GREENSPAN. I might add, for policy reasons. Obviously, individuals can be impeached or can be removed for purpose.

Mr. HINCHEY. If they can be shown to be mentally incompetent or something of that nature, but that would be under the most extraordinary of circumstances and I don't know that that has ever occurred. However, with regard to the Reserve bank presidents and the way that they are appointed, and also removed, there is that difference there.

You make the case that the way that you hold the Reserve bank presidents accountable is by the threat of removal because the Board has the power to remove them if they operate in a way that is contrary to the will of the Board. Isn't that a glaring discrepancy there in reasoning?

Mr. GREENSPAN. No. If I understand you, Congressman, I think the question really gets down to the issue of how a central bank functions in the type of society which we have. In other words, it is not like any other institution. Of necessity, or I should say really of—essentially the practice that has occurred from all central banks in living memory is that there are certain things central banks do that no other governmental agency does.

We, obviously, have a control over the currency and that is something which is a very important and very sensitive question.

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Mr. HINCHEY. But that could be said about any of the various elements of the government.

Mr. GREENSPAN. There is one fundamental difference and the difference basically is that we have to act in the marketplace and as a result our actions have effects on how people behave in a manner which feeds back directly on the policy that we have. So that there is an important distinction here between how the Federal Reserve functions and other agencies. That is not true with the Federal Trade Commission; it is not true of the SEC. It is not true of a series of independent agencies who are involved very specifically in interfacing with the market, with market prices, and with the whole structure of the way the system functions.

So what we have had as a problem, and I mentioned this in my earlier testimony, is that this issue has basically been a dispute within this country at a fairly high level of discussion—in fact I think it may have been Judge Greene who said that the question of monetary control and the central bank has taken up more debating time within the Congress since the beginning than most any other issue. And it is a fascinating history, because I think if we took the transcript of today's hearing and matched it against the discussion as to what went on in the debate that led up to the first bank of the United States in 1791, aside from some peculiarity of language, the concepts are remarkably the same.

It is a dilemma which confronts our society which has never been unanimously resolved. The issue has come up repeatedly and there are legitimate differences of opinion on the question. Ultimately, I think the issue which must be resolved, indeed has to be, is the balance between accountability, which is essential in a democratic society, and effectiveness of monetary policy.

Anyone who thinks they have the unquestioned answer to that balance has not dealt with this subject in any very great detail. I agree, I think that the issues that Congressman Frank and yourself are raising are crucial to this particular discussion, and I have my own views, having been Chairman of the Federal Reserve for 6 years, and I hold them strongly because I have seen the way the system works, and I must say it is a really impressive institution and it is impressive because of the people who are there and it does an important job for this country and I would be very much chagrined to see much of the independence peeled away.

I grant that all of these discussions that are occurring here, whether or not it is one version of a bill or another, actually probably increases the power of the Federal Reserve Board one way or the other. I know it is inappropriate for anyone in Washington to say they don't want more turf and more power, but having looked at the system, I would say that to essentially give more control to the central authority in the system I don't think is in the Nation's interest.

Mr. HINCHEY. Thank you.

The CHAIRMAN. Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman.

Chairman Greenspan, earlier you commented what is the problem we are focusing on and trying to resolve. I have been equally concerned about that question. Perhaps it is that interest rates aren't low enough, that there isn't enough regulation in the mar-

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ketplace or perhaps there is not enough politics in our financial marketplace. That, obviously, not being the issues of concern, I think the debate has to be cast around the issue of accountability, who is doing what to whom and why, and how do we make sure that the enormous authority of the Federal Reserve policymaking is not somehow abused or perhaps worse in the eyes of some, ignoring the will of the public.

I then went to your comments and found the statement, "We publish our balance sheet every week with a 1-day lag enabling analysts to review operations in detail. Two, we publish lengthy records of the policy deliberations and decisions from each FOMC meeting shortly after the next regular meeting has taken place. Three, the vote of every FOMC member is recorded by name and the reasons for that vote are also recorded."

I found that to be of particular interest in light of the fact Conference Committees of the Banking Committee on public policy matters representing to finance are not open to the public. It is difficult to find out who offers amendments and how the members vote. I would find it refreshing to have the Federal Reserve's policies applied to the Congress.

More importantly, I think the observation of concern you made in your written remarks are that leaks of FOMC proceedings are clearly unfair to the public, potentially disruptive, and undoubtedly destructive of public confidence in the Federal Reserve. I think from the tenor of my remarks you may determine that I feel the current system to be one which has served us well, which would not be enhanced by further political involvement, and for the life of me I cannot understand why we would in the moment of this current economic circumstance be debating this issue.

Suffice it to say, there are two areas raised for public debate; one being greater participation for minorities and women, the fact that there are now 22 percent of positions held by women in the organization seems to exceed once again the performance of the Congress.

Mr. GREENSPAN. That is officers.

Mr. BAKER. There would not equally be 22 percent of House officers in leadership held by women. I would simply say that in looking at positive direction and help from your perspective, assuming there is validity in enhanced reporting and responsiveness, isn't there anything that you could suggest to us today that may or may not be contained in any legislative proposal that would enhance awareness and understanding of the role, mission, purpose, and decisionmaking of the Fed that you do not today engage in; or do you feel that any further disclosure not now already required would perhaps only enhance the potential for unauthorized release of information, which to the dismay of some may in fact hurt the consumer because volatility of the marketplace is extraordinarily high and the only thing the consumers of credit at the working man's level today know is whether they can get access to credit and what does it cost them?

They may not know what the Fed or FOMC is about, and hopefully they don't know what the Congress is about; but in any event they certainly are affected by policies at the national level, and don't we do a better service by retaining stability in the market rather than subjecting it to the volatility of political interference?

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Mr. GREENSPAN. Congressman, we spend a great deal of time trying to make judgments as to what changes, if any, we should be making in our procedures and in the various different elements involved in how we do our business. On occasion we have come before the Congress making requests for certain changes in legislation relevant to certain aspects of banking law and supervision and regulation.

We have, as I have indicated in the past, discussed questions of disclosure at great length internally within our committee, and have raised questions as to what we should or could not do without undercutting the deliberations; and it is not as though we have not discussed these questions. Indeed, basically, at the request of the chairman, I on many occasions raised questions within the FOMC with respect to a number of these issues, and we debated them at very considerable length. And the general conclusions of the committee are that the particular policy that we now have, in our judgment, is the best way to balance our capability of doing what the Congress requires that we do, with the issue of maximum disclosure of the types of things that we do in the marketplace.

I am not going to say to you, because I don't believe it, that what we have now is exactly what should exist for all time and in all places. I don't think that is correct. As the system changes as, for example, technology changes, we are consolidating a goodly part of our automation systems, and we will continue to do that. So there are going to be a lot of changes in the system, but hopefully, as I indicated in my prepared remarks, they will be for the better and not for the worse; and my main concern in changing the structure of this system is that there is no way to do it without secondary consequences, and unless I am fairly well convinced that those consequences are benign, I would be quite reluctant to recommend to this committee that we make changes of that nature.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Hinchey and Mr. Frank and you, Mr. Chairman, have raised this most important question it seems to me of accountability. I think that is quite on point. But I think the question is accountability to what? It seems to me that we have reached a point in our understanding of monetary policy—in fact, fairly recently in the overall scheme of things, I noticed Chairman Greenspan said somewhere along the line this morning that we didn't understand monetary policy in a contemporary sense until the 1920's, and it seems to me that we didn't even have a—well, I am not trying to say we have a complete understanding, I don't feel that we do, but that we have a different understanding now of the role of monetary policy in the economy than we did during the 1970's.

It seems to me, back during the 1970's, that it was generally thought that inflation was a function of budget deficits. That was the popular understanding, and it was just generally agreed, I think because of the work of a number of economists and so on, and then finally the implementation of monetary policy, even in the light of a restrictive monetary policy, even in the light of high budgetary deficits, it became clear that inflation was a monetary phenomenon, one that the Fed can control independently of other

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aspects of the economy, and a better understanding of what the right monetary policy is, that gives us whatever else it is that we want in the economy, which is maximum sustainable economic growth, maximum employment levels for our people, the lowest possible interest rates, the highest levels of savings, and therefore the highest levels of investment and productivity, leading to the best economic future for our people, the most competitiveness in the international environment, and so forth.

In other words, it seems to me—I will quit talking and ask the chairman to comment—that we have a better understanding of what the monetary policy is that will produce the best possible conditions for our constituents.

I have worked with Chairman Gonzalez for almost 20 years. I know him unfailingly to look out for the interests of the common man, for the little guy. I know that without question. I know he wants what is the right policy for the average American.

Again, I think that we know in terms of monetary policy—not everything, but generally speaking in terms of monetary policy—what that is and that the Fed should be held accountable to that policy. That is the key question. Anyway, I think that policy essentially is, the lower inflation, the better; and that even over time, though we may have to take little zigs and zags away from that—if we were driving from here to California, we might have to head north for awhile and then south—it might not be a straight line, but we head in generally one direction and that goes to our destination.

Anyway, I think that is ultimately the most important debate in that we—sort of these other questions of how we get there are interesting and, in some cases, important—especially when it comes to the question of minority opportunity, and so on, vitally important—but ultimately the most important question is the proper policy and how well the Fed is accomplishing that policy.

I just wondered if the Chairman might comment on that. And may I ask one other thing before my time runs out?

Often there has been an almost constant claim that the Reserve bank presidents represent private interests, and as I understand it, the Board of Governors can veto the appointment of Reserve bank presidents, the Board can fire Reserve bank presidents, the Board sets their salary or approves it, that they are paid out of public funds, that they have to administer their banks in accordance with the rules and policies of the Board of Governors, and that most, if not all, are professionals; that is to say, they come up through the ranks of the Fed, they are not bankers as some people claim. Is that understanding generally correct?

Mr. GREENSPAN. I think that is generally the case. These are essentially public officials dedicated to the policy of this country. Their ties to the banking community are nebulous at best. The only relationship exists indirectly through those members of the Board which are essentially elected by the commercial banks.

I would certainly agree with you in the sense that the control of the presidents is not by the commercial banks, it is by the Board of Governors. And fortunately, the issue doesn't ever really come up, because there is and has developed a collegiality within the Federal Reserve System in which what happens in Federal Open Market Committee meetings is an endeavor on the part of this

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group of 19 people, including the voting members and the nonvoting members, to try to understand what is going on in the various areas of our country, and in the country as a whole, and what alternate monetary policies are apt to do with respect to the future of the country.

I recall no single instance in which the discussions that were involved at the FOMC were other than directed at trying to find that crucial answer. Just as importantly, I have also noticed that with perhaps a few exceptions, most of the members of the FOMC come into those meetings with their minds not fully made up and that the interaction amongst the individuals on that committee clearly changes people's view as the meeting goes on, which to me is an extraordinarily important and, I must say, very impressive sight.

The presumption that what we are seeing are individuals representing bankers or anybody else other than the national interest is, in my judgment, without any basis in fact, Mr. Neal.

The CHAIRMAN. The time of the gentleman has expired. Mr. McCollum.

Mr. McCOLLUM. Thank you very much, Mr. Chairman. I come to these hearings and this bill with the adage, "If it ain't broke, don't fix it," and that the burden is on the proponents in this case particularly with the reform of the Federal Reserve and its auditing to prove there is something wrong.

I listened intently to some of my colleagues here, Mr. Chairman, who are very fine people, whose judgment I often respect and admire, explain their rationale. But while they may have academically approached this, they have not given me so far any real concrete reasons why we should be making any of these significant changes that have been proposed. I want to make sure that I am not wrong about that.

One of the question areas I have has to do with the question Mr. Neal just raised with you and you partially answered it. Does anything in your experience at any time show any sign that a vote or decision of any regional president who served on the Open Market Committee has been influenced by the self-interest of a commercial bank director of his regional bank?

Mr. GREENSPAN. No, Congressman.

Mr. McCOLLUM. I wanted that answer because that is the only rationale that I have heard anyone say that would be plausible for saying we should tinker with the system as it presently exists of choosing presidents to put on the Open Market Committee.

The second question has to do with the independence of the Federal Reserve as our central bank compared to the lack of independence of the central banks of other countries. You mentioned this in your testimony, but I would like to comment that I have seen in my observations serving on this Banking Committee that there are a number of central banks in the world, in countries where inflation has been running rampant over the years, that don't have anywhere near the independence that we have.

You commented that some movement is being made that you have observed toward a stronger, more independent central bank in some locations. Could you give us one or two examples of cases where you think—in countries—that the absence of an independent bank has led to greater economic problems and inflation, and so

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forth, than otherwise would be the case if they had an independent bank; and could you give us an example of cases where there is a movement toward a more independent bank?

Mr. GREENSPAN. Well, I hesitate to give you explicit examples, but there is a relatively well-documented case that was analyzed and evaluated by the current Under Secretary of the Treasury for International Affairs; and what I would suggest is what the basic study by Summers and Alcina shows is a very interesting correlation between measures of the degree of independence of various central banks and the rates of inflation over the post-World War II period.

As we point out, Mr. McCollum, the correlation is surprisingly tight. To my knowledge, there has not been any significant challenge to that conclusion. There have been a number of papers written relevant to it, but the conclusion turns out to be, as statisticians like to say, "relatively robust."

Mr. MCCOLLUM. At one time, we were the most independent central bank in the world. There is a movement to make more central banks independent, is there not, in many parts of Europe, and in South America in particular? Is there not movement to make central banks in Europe and South America more independent today?

We were once standing almost alone with the degree of independence that you have.

Mr. GREENSPAN. I think that is a very important point, Mr. McCollum, that the change in central banks, to whatever extent it is occurring, is all toward the direction of more independence rather than less. In other words, that is true in France; it is true in a number of Latin American countries. There is even a discussion about making the Bank of England independent.

That has become a fairly significant trend of recent years, and I believe it results from the destabilizing inflation that struck the world, the industrial world especially, in the latter part of the 1970's and the early part of the 1980's; and the consequence of this has been an acute awareness that doesn't come from statistical analysis, but experience, which has led to an awareness that independence of the central bank is an element in keeping inflation down, but just as importantly, increasing evidence that the lower the rate of inflation, the higher the growth rate in productivity. And putting those together—and there are some disputes in the economics profession about whether it is true—below a 5-percent inflation rate, as well as above.

Everyone agrees that this relationship is a very important one. Our evidence suggests that the lower the inflation rate, even under 5 percent, is consistent with higher growth rates and productivity. Since it is productivity growth which ultimately determines standards of living, the issue of maintaining independent central banks as a goal toward the highest standard of living for the society is, in my judgment, becoming increasingly evident in the data, and increasingly the conviction of economists in the profession pretty much around the world.

Mr. MCCOLLUM. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Flake.

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Mr. FLAKE. Thank you, Mr. Chairman. Mr. Greenspan, thank you for your candor, your sincerity, as it relates to our discussions relative to the improvement of the diversity in the Fed overall and your desire to try to assure that there are levels of participation for women and minorities throughout the Fed.

My question has more to do with monetary policy, particularly as it relates to what I consider to be the third world nation that has emerged within our borders represented by the conglomerate communities, particularly urban communities, within this Nation.

On the FOMC, you have bank presidents that represent various regions of the country. Many of those regions have within them these urban communities that, in my opinion, represent in many instances exorbitant costs of trying to solve many social problems which, in fact, can be solved by an approach—I think from a monetary policy perspective—that gives some attention to the needs of those particular communities.

Obviously, in the banking world much of that has been assumed to be able to be addressed by CRA. Obviously, that approach alone has not been totally capable of resolving many of those problems, which gives us a major cost in terms of social impact costs, hospitals, jails, other kinds of social legislation that is necessary to try to solve them.

My question has to do with whether or not it is within the purview of the Fed to focus some attention on how monetary policy might affect not only the creation, the development of those communities, but in fact with an understanding that if we can find ways to involve, build up, somehow create the economic vehicles that lift those communities, we have in fact strengthened this Nation. Because the cost of trying to solve those problems after the fact has become so great.

I would want to think that a part of what the FOMC does is look at monetary policy in an inclusive perspective that can speak to those particular issues, understanding the devastating negative impact it has if we don't do something to really turn those communities around. I would like your comments in terms of how the Fed might be involved in bringing attention, lifting to the concern of this Nation, how we might be better able to impact—Governor Lindsey has been at meetings I have been at, and I know there is a concern.

I would hope that we can bring this to the forefront even as we address community development legislation in the future.

Mr. GREENSPAN. I think you are raising a terribly important concern that we all have. I think the way you put it, that there is a third world economy problem within our cities, I think is regrettably too apt.

Monetary policy, as such, by its nature in an economy such as the United States, can only be uniform; there is only one policy. Leaving aside the issue of the fact that there are problems within individual cities—for example, when you get differences in the regional area; for example, when California was extraordinarily weak, and still is; or when New England was in very bad shape economically—if they were separate countries, they would have had different monetary policies than the Nation as a whole. But we don't have that capability.

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In other words, if you have a single currency and it is a dollar, you cannot have different monetary policies; only a single policy.

So even though I fully agree with you that the problems within the urban areas are really sapping the strength of the system, monetary policy as such is not and cannot be the vehicle which addresses that problem.

Mr. FLAKE. I agree with that. The underlying question becomes, does the Chairman of the Federal Reserve from standing on a platform that the whole world recognizes, making certain statements in recognition of the fact that there exists such a problem, stand in a position to be able to influence a change in attitude that gives some focus to those particular areas, realizing that it is more costly not to do it than it is to do it?

Mr. GREENSPAN. In fact, that is what I am doing right now.

Let me say very quickly, though, if monetary policy as such cannot address that, that does not mean that the Federal Reserve System as such is wholly impotent in this area—or for that matter, my colleagues at the Comptroller of the Currency, or FDIC and the like.

For example, we do have, at all 12 of our Reserve banks, we have community affairs officers, and also we have a significant division within the Federal Reserve Board which is looking and trying to address precisely this issue. It is our means of administering the CRA. And it is in that area where we absorb what the nature of the problems are; and you are quite correct that Governor Lindsey, who was chairman of the Board subcommittee which is involved in community affairs, is our lead vehicle for evaluating these processes. And I would agree with you that to say that this is an issue independent of monetary policy is false.

I mean, it is not that monetary policy itself can change it, but unless this other set of problems is changed, it affects the economy overall and what it is that we have to do. And if you are saying to me that we must basically resolve this corrosive force which is involved in the urban areas if our economy is to function in an effective manner, absolutely.

I mean, it is potentially a very disturbing and dangerous trend unless we can make certain that all of our citizens have access to the economic expansion, the opportunities which exist within this very broad economic system.

The CHAIRMAN. The time of the gentleman has expired.

We have notice of a required vote. We have three members who still remain to be recognized. I am willing, if there is no objection, to recognize Mrs. Roukema. We still have about 8 minutes.

Mrs. ROUKEMA. Mr. Chairman, I will be brief because I am simply going to associate myself with the remarks of my colleagues who strongly oppose any reforms that might potentially lead to politicalization of the Fed. I think, Mr. Chairman, that you have spoken very eloquently and precisely to that point, specifically in your definition of the accountability of the Fed and alerting us to the problems that could ensue if that accountability led to compromising the financial markets.

I might also say that I appreciate your response to Mr. McCollum's question, because it was my question, as well; that is, the precision with which you answered the allegations of conflicts of in-

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terest with regard to the Fed Board presidents. Also the fact that those countries that have the most stable economies and the most stable monetary policies, as well as lower inflation rates and higher productivity rates, are those that have clear separations between the central banks and the political establishment; specifically the European Community in the Maastricht Treaty is moving in that direction because it is important for their economic viability.

So those countries that have had that overlap are now moving away from it, recognizing that in a world economy it will not serve their purposes. I appreciate greatly your responses to the questions.

The CHAIRMAN. Mr. Schumer.

Mr. SCHUMER. Thank you. I appreciate your indulgence, Mr. Chairman, as well as your efforts and sincerity on this bill. Before, Mr. McCollum said he has a great deal of respect for you, but he didn't say he agrees with you most of the time. I so agree with you most of the time and I share in his respect for you, but this is not one of them.

Let me ask you to comment on this, Chairman Greenspan. I come from two places on this that lead in the same direction. First, basically, we do not—we have levels of democracy so to speak within our government. Not everything—the most democratic, if you will, would be the House of Representatives; we are elected every 2 years and are supposed to be very close to the people. On the other hand, the Supreme Court has lifetime appointments and that makes sense from a structural point of view because the Supreme Court is supposed to guard the Bill of Rights which protect one person speaking of something unpopular that 99 percent would disagree with.

It seems to me that in monetary policy, where you really have to escape the short-term vicissitudes of politics, the winds blowing, and the whims, that it is a correct place to have some insulation. There should be public pressure. Indeed, there is. We know and we see before election time Presidents jawbone the Fed. But at the same time, if a message were sent to the Fed that they ought to respond to the short-term political and, often, electoral needs of the Congress or the President, I think we could mess up monetary policy royally. Not so much that the changes would be that great, but then the theory of the independence of the Fed would wash away.

So my view is—I know many have talked about accountability—my view is, there is accountability but that ought not be the only standard by which we judge the Fed; that second, there is a need for some public-private interaction in a monetary policy area; and third, that quite frankly, when you look at it, it could well be argued that the Fed has done a better job in monetary policy than Congress has in fiscal policy. Look at our deficit.

So "If it ain't broke, don't fix it," it is like saying from the folks that brought you the budget deficit, let us deal with monetary policy or let us have the appearance that we are dealing with monetary policy; and I am worried about that. So I guess what I would have to be shown is a practical conclusion that, not abstract opinion that, we need more accountability—as I said, you could argue the Supreme Court should be more accountable if the theory were just accountability. It is less accountable than the Fed is structured

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now. Many of my colleagues decry the Fed accountability would die for the Supreme Court's independence. I guess independence and accountability are opposite sides of the same coin.

So the question to me is, if you are going to tamper, there ought to be a good, practical reason that the lack of accountability or less accountability that is in the Fed has resulted in some real problems in terms of monetary policy. As I say, in my view, it has served pretty well as an insulation from the political vicissitudes.

I realize this is one of the few times I am just pitching a softball at you. Can you give some—are there times when you think that greater accountability in the history of the Fed which you are a much greater expert at than I am—when greater accountability would have made better monetary policy?

The CHAIRMAN. If the gentleman would yield, we have 2 minutes. Why don't we accept Chairman Greenspan's answering that in writing for the record?

Mr. SCHUMER. That is fair. I have no objection.

[The information referred to can be found in the appendix.]

The CHAIRMAN. I want to thank you, Mr. Chairman, and there is no use holding you over.

Mr. SCHUMER. I would like him to think long and hard about those examples, so in writing would be just fine.

The CHAIRMAN. You yourself said you were throwing him a softball. The committee stands adjourned until further call of the Chair.

[Whereupon, at 12:30 p.m., the hearing was adjourned, subject to the call of the Chair.]

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APPENDIX

October 13, 1993

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Opening Statement
by
Henry B. Gonzalez
Chairman
Committee on Banking, Finance and Urban Affairs
Second Day of Hearings
on the Issues Involved in
the "Federal Reserve System Accountability Act of 1993," HR 28

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I welcome Federal Reserve Chairman Alan Greenspan as the next witness in this series of hearings on the issues involved in the Federal Reserve System Accountability Act of 1993 -- HR 28.

Chairman Greenspan is Chairman of both the seven-member Board of Governors and the 12-member Federal Open Market Committee (FOMC). These Federal Reserve committees have vast powers. Under the direction of the FOMC, the Federal Reserve can order unlimited amounts of U.S. dollar bills, labelled as Federal Reserve notes, from the Bureau of Engraving at the U.S. Treasury to be delivered to any of the 12 Federal Reserve Banks. Through open market operations at its New York Federal Reserve Bank, the Federal Reserve determines how much of this money is put in circulation.

The FOMC members have authorized the holding of a portfolio of over $300 billion in U.S. securities from which the Federal Reserve earned $17.3 billion in interest last year. After deducting its expenses, additions to its surplus, and interest paid to member banks for their stock, the balance at the Federal Reserve is returned to the Treasury and helps to reduce the Federal government deficit.

Thus, every dollar used by the Federal Reserve for its expenses increases the taxpayers' liability for financing the Federal government.

It is important that taxpayers know exactly how their money is being spent. That is why I have proposed in H.R. 28 to require independent audits of all Federal Reserve operations and authority for the General Accounting Office (GAO) to examine all Federal Reserve operations. At present, the GAO is prohibited from inspecting large parts of the Federal Reserve operations.

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Under my legislation, the Federal Reserve would have to provide a detailed account of its expenditures for dues for its employees' memberships in private societies and clubs during the past year. Those expenditures with budgeted funds are illegal for employees of the United States government. Similarly, the Federal Reserve would have to account for adding a $200,000 renovation to its gun range at the Dallas Federal Reserve Bank shortly after the new building was constructed. We would also have a detailed account of the cost of land and real estate the Federal Reserve owns all over the country. The American public has the right to know exactly how the Federal Reserve is spending every dollar of its money.

There should be no independence from accountability for expenditures of taxpayers' money. Why should the Federal Reserve spend its resources -- and that means taxpayers' money -- to send members of the Board of Governors, as it did in 1977, to the Federal Reserve Banks to organize a lobbying effort? The Federal Reserve organized bankers that it regulates to prevent the House Banking Committee from including a GAO audit requirement in the Federal Reserve Reform Act of 1977.

Attempts by regulatory agencies to orchestrate lobbying campaigns against bills affecting their agencies are illegal when Congressionally appropriated funds are used. Does the Federal Reserve really want the Banking Committee to maintain its exemption and will it stretch the meaning of independence to rationalize this exemption?

An episode in 1979 illuminates how phony the argument of independence really is when it comes to accountability. In 1979 the Federal Reserve was called before the House Banking Committee because the Federal Reserve had issued a grossly incorrect report on the money supply. The report sent bond prices down and interest rates up on the Friday after the announcement, even though at least one senior official at the New York Federal Reserve Bank was reported to have known the numbers were wrong.

This was a proper time for the Congress to order the GAO to investigate what had happened and to determine if any Federal Reserve employees had made profits on inside information. The Federal Reserve lobbying efforts had helped close down that kind of rational inquiry. The Federal Reserve told the Banking Committee it would investigate itself.

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Our nation's central bank proceeded to hire a private law firm with no official powers of investigation. There was a footnote buried in the final report that a New York Federal Reserve official may have conducted insider trading and the case was turned over to the Securities and Exchange Commission. If you overlooked the footnote, the report was a clean bill of health for the Federal Reserve, which was billed $877,675.88 by the law firm, $1.7 million in 1993 dollars. Paying for a good conduct medal is not an ethical way to run a government agency. Why should taxpayers pay for those actions?

H.R. 28 requires the Federal Reserve to resume making a record of their FOMC meetings. Official policy changes would have to be made public within a week and a videotape of the meeting would be made public in 60 days.

In 1977, former Federal Reserve officials and scholars from across the country sent their views to the House Banking Committee about the Federal Reserve's decision to stop taking minutes at FOMC meetings. The responses that year generally deplore the Federal Reserve's blatant action in dropping the curtain over their operations by refusing to take detailed minutes of the committee that manages the nation's money supply.

How would we know what the policy of the Federal Reserve really was before the 1972 reelection of President Richard Nixon if it were not for the minutes? Federal Reserve Chairman Arthur Burns was outwardly the government's champion fighter against inflation. Yet, at two secret FOMC meetings before the Nixon election (August 15, 1972 and September 19, 1972) he argued forcefully for fast money growth. The minutes reflect that even though Vice Chairman Robertson warned that the projected fast money growth was "cause for real concern" Burns "saw no need to be afraid of prosperity and to adopt restrictive monetary policy."

Should the public and the financial markets have access to full information and to full accountability? Do the financial markets work best with full information, as the modern theories of finance contend? Or should the Federal Reserve continue to nourish the rumor mill industry and selectively leak the results of its FOMC meetings?

H.R. 28 would require all individuals voting on the nation's money supply to be constitutional officers. Five of the FOMC members are private citizens

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serving as presidents of the Federal Reserve Banks. The Presidents are selected by their individual Bank's board of directors who in turn are drawn from the banking industry. Testifying before the House Banking Committee on April 13, 1938, the great chairman of the Federal Reserve for 13 years until 1948, Marriner S. Eccles, repeated his strong conviction that the 1935 reorganization of the Federal Reserve was seriously incomplete. He said:

> "presidents of the Reserve banks are elected by the directors of those banks, two-thirds of whom are in turn elected by the member banks, their viewpoint necessarily is likely to reflect that of member banks. I feel that a committee which is entrusted with monetary policies as important as those given to this committee should consist entirely of persons representing the public interest."

There were suits against the Federal Reserve in the 1980's to attempt to remove the votes of the presidents of the Federal Reserve Banks because the Constitution specifies that those who make major decisions in the government must be Constitutional officers who have gone through the confirmation process. Federal District Court Judge Harold Greene did give an opinion in 1986 that it was all right for private citizens to vote on the money supply. It is important to note that the Court of Appeals in Melcher v. Federal Open Market Committee, 836 F 2d 561 (D.C. Cir. 1987) vacated Judge Green's opinion so that it has absolutely no legal effect. The Court of Appeals explicitly said that the matter should be settled by the legislature. Now is the time to follow the Constitution and correct an error.

Chairman Greenspan, you head the most powerful institution in our government that directly affects the economic health of our citizens. The changes we propose in H.R. 28 are not damaging to the independence of the Federal Reserve nor do they attempt to micro-manage monetary policy. The Federal Reserve presidents would have increased independence since they would be constitutional officers. This is not radical reform and there is no cause for the Federal Reserve to proceed as if barbarians are at the gate and it is the end of western civilization. Senator Byron Dorgan told us last week that "If you talk about fixing the doorjamb at the Fed, they accuse you of being part of a building demolition crew." We should not pretend the Federal Reserve, of all institutions in government, is infallible.

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We must have openness and accountability from the government bureaucracies that operate in our democracy. President Clinton wants to reinvent government, to make it more efficient, less wasteful, and more representative of all Americans. The provisions of H.R. 28 I have proposed, are rational and useful changes that will make the Federal Reserve a better and stronger institution that will fulfill its functions as a central bank more effectively. Let us not wave the flag of independence when it comes to the public's right for full accountability for the operations of its central bank. The Federal Reserve is not and should not be infallible, unalterable, unapproachable, and unaccountable.

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STATEMENT BY
REPRESENTATIVE JAMES A. LEACH
Before the Committee on Banking, Finance and Urban Affairs
Hearing on Reforming the Federal Reserve System
October 13, 1993

It is easy to defend the Federal Reserve System when times are good and/or when its policies are not perceived to be at the root of particular problems of the moment in the economy. But when times are less good or mistakes are made (a la the roller coaster effect of loosening and then tightening money supply at the end of the seventies and beginning of the eighties and the regulatory inattention given to capital ratios and prudential risk implicit in LDC lending) it is important the Fed have in place structural arrangements that are above reproach.

Stability of the financial system depends on confidence and unfortunately it is difficult to have confidence in the precept that individuals selected by private sector boards of directors accountable in large part to one industrial sector -- banking and finance -- should have a significant if not determinative role in interest rate decisions affecting the Nation's economy at large. It is even more difficult to have confidence in a system where regulation of an industry is partly in the hands of individuals accountable to boards largely controlled by those being regulated.

Legislatively, two approaches to correcting this democratic unseemliness have been presented: the House is suggesting that Federal Reserve Bank presidents be appointed by the President with the advice and consent of the Senate. The Senate, on the other hand, takes the position that Reserve Bank presidents be removed from voting on the Federal Open Market Committee (FOMC). The common denominator shared by both is that only publicly appointed individuals should be permitted to participate directly in the formulation and implementation of monetary policy.

While I see certain merits and demerits to each approach, an alternative which preserves more firmly the independence of the Fed should be laid on the table. The alternative would maintain Reserve Bank president participation on the FOMC but require that the Reserve Bank presidents be appointed for precise terms by the Federal Reserve Board of Governors. Since the Board of Governors is composed solely of publicly appointed individuals, such an alternative would solve the political science dilemma of having private citizens directly participate in public decisions without direct accountability and, at the same time, address the concerns of those, like myself, who believe an independent Fed protects the public better than one too connected to a fiscally wanton Congress.

The issues of greater transparency of FOMC decision making as well as greater budgetary openness can no longer be ducked. A reasonable case, of course, can be made that immediate revelation of FOMC decisions could result in adverse market reactions, both domestically and internationally, as market speculators use information discussed at FOMC meetings to their advantage. At last week's hearing, for instance, William Greider, a noted proponent of making the Federal Reserve System more publicly accountable, expressed concern with immediate disclosure of FOMC decisions. Mr. Greider stated: "It makes no sense to compel the Fed to reveal its trading strategy in advance so that other traders can use the information to adjust their portfolios." The Fed is the public's trader and thus deserves public protection. Nonetheless, more information on a more timely basis makes democratic common sense.

In conclusion, let me stress that the best way to protect the independence of the Fed is to insure that its indefensibly undemocratic elements are rooted out. The issue isn't populist; it's prudential. In a democracy, arrogance always gets its comeuppance. For a citadel to maintain its holy aura, it must be perceived to be a bastion of service, not privilege. A reform in time saves nine.

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STATEMENT
of
CONGRESSMAN LEE H. HAMILTON
before the
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
of the
U.S. HOUSE OF REPRESENTATIVES
on
October 13, 1993

Mr. Chairman, I very much appreciate the opportunity to appear before the Committee on Banking, Finance and Urban Affairs this morning to testify on the topic of Federal Reserve accountability and Federal Reserve reform.

Mr. Chairman, this is a very important series of hearings on a very important topic and I commend you for your efforts to make the Federal Reserve more accountable and more open within the framework of our democratic system of government. I have tried to contribute to this goal over the years and I hope these hearings will mark the start of some tangible progress.

I want to begin with what I consider to be one of the most important points that can be made about Federal Reserve reform. The bills being considered during this hearing -- H.R. 28, which you introduced earlier this year; the two bills (H.R. 586 and 587) that Rep. David Obey and I introduced; and similar bills (S. 212 and 219) introduced by Senators Paul Sarbanes and Byron Dorgan -- would go a long way toward addressing the accountability issues that concern us in this hearing without impairing, or interfering with, the independence of the Fed to conduct monetary policy.

I emphasize that point, because I have often been accused of trying to do just that. Eight years ago, when I introduced my first bill to bring the Federal Reserve's budget into the sunlight, and four years ago, when I first introduced broader legislation with Congressman Byron Dorgan to reform a number of the practices and procedures of the Federal Reserve, these bills were frequently characterized as efforts by Congress to take over control of monetary policy from the Fed and pressure the Fed to reduce interest rates.

If that were true, then today's lower interest rates would give me little reason to be here this morning or to continue my efforts to reform the practices and procedures of the Federal Reserve.

Eight years ago, when I introduced my bill on the Federal Reserve's budget, interest rates were in the range of 8.5 to 10.5 percent. Four years ago, when I introduced the broader Federal Reserve Reform bill, interest rates were in the range of

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8.5 to 9.5 percent. Today, the Federal Funds rate is 3.0 percent, the lowest level in 30 years, and long-term rates are just over 6 percent, the lowest level in 20 years. The problem of high interest rates is largely behind us. If this were the motive for my bills, there would be no reason for me to be here today.

But there is, and the reason is that what is appropriate in terms of Federal Reserve openness and accountability is completely independent of what is appropriate in terms of interest rates and monetary policy. Interest rates may be down, but the need for reform of the Federal Reserve System is just as imperative today as it was when I first addressed this subject.

The Federal Reserve occupies an anomalous position within the government of the United States. It is an enormously powerful institution, but it does not conform to the normal standards of government accountability. Power without accountability simply does not fit into the American system of democracy.

Through its control over monetary policy the Federal Reserve affects the lives and wellbeing of all Americans. The path that the Federal Reserve sets for monetary policy and interest rates affects every businessperson, worker, consumer, borrower and lender in the United States. With fiscal policy constrained by the continuing need to reduce the Federal deficit, the Federal Reserve by default must make the decisions by which the government exercises its responsibility for the overall performance of the economy.

The dilemma created by this concentration of power is that the independence which the Federal Reserve must have in order to insulate monetary policy from political pressures also serves to remove the Fed from the normal processes of accountability that apply to every other agency of the federal government. Let me list some of the ways in which the Federal Reserve fails to conform to the normal standards of accountability in a democracy:

o Monetary policy is decided in secret, behind closed doors.

o The Federal Reserve is not required to consult with Congress or the Administration before setting money or interest rate targets, even though its power affects the financial well-being of every American.

o It waits six weeks before releasing policy decisions.

o It keeps no transcript or minutes of any of the meetings at which the Federal Open Market Committee makes important monetary policy decisions.

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- The President, who is held responsible for the performance of the economy and is blamed if things go wrong, often must wait until late in his term to appoint a new Chairman of the Federal Reserve Board.

- The Fed's budget is not published in the U.S. Government Budget, even though it spends over $1.7 billion per year.

- The Federal Reserve engages in trillions of dollars in transactions in the money markets each year, but most of these activities are exempt from audit by the GAO or any other outside agency.

- Of the twelve voting members of the FOMC, which makes among the most important decisions of any government agency, only seven are public officials who are appointed by the President and confirmed by the Senate. The rest are appointed primarily by the commercial banking industry.

FEDERAL RESERVE REFORM ACT

I have introduced two bills that would address many of these problems by making a number of modest changes in the practices and procedures of the Federal Reserve. The first bill, the Federal Reserve Reform Act, has five major provisions. Federal Reserve Chairman Alan Greenspan has made his views known on this bill and I will address his objections where appropriate in my testimony.

I. Consultation with the Administration

The Federal Reserve Reform Act would require the Secretary of the Treasury, the Chair of the Council of Economic Advisers, and the Director of the Office of Management and Budget to meet three times a year on a non-voting basis with the Federal Open Market Committee (FOMC), to consult on monetary and fiscal policy.

The purpose of the meetings is to improve the flow of information between the Administration and the Federal Reserve. Currently, there is no formal channel of communication. At times in the past, Administration officials have been reduced to conveying their views on monetary policy by publicly sniping at the Fed through the press. Under our bill, the Administration will have a formal avenue to convey its policies to the FOMC and lay out its goals for monetary policy. The Members of the FOMC will also have an avenue to express their concerns about policy to the Administration. Communication will flow both ways.

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Chairman Greenspan opposes this provision on the grounds that the Federal Reserve and the Administration already communicate through informal channels and that the more formal arrangement proposed by my bill would result in political manipulation of monetary policy.

Informal channels of communication do exist; for example, Chairman Greenspan and Treasury Secretary Bentsen meet about once a week. Over the years, however, the success of such informal meetings has varied, depending on the personalities involved. This ad hoc approach to making decisions which affect the economic well-being of all Americans is not the best way for a great economic power to conduct its business. It is astonishing that the world's greatest economic power does not have a formal channel of communication between the key makers of economic policy. My bill would establish a channel of communication that would not depend on personalities for success.

II. Term of the Federal Reserve Chairman

The bill would allow the President to appoint a Chairman of the Federal Reserve Board (with the advice and consent of the Senate) one year after taking office, which is the time when the first regular opening would occur on the Federal Reserve Board. This would make the Fed Chairman's term roughly coterminous with the term of office of the President of the United States.

The Chairman of the Board of Governors, Alan Greenspan, was appointed to his current term by President Bush and will hold that office until March 2, 1996, more than three years into President Clinton's term. Fortunately, Chairman Greenspan and President Clinton have a cordial relationship. The fact that Mr. Greenspan was not appointed by President Clinton has not caused any significant problems with monetary policy. But if they were unable to work together, the result could be serious damage to the American economy and a paralysis of economic policy. Why take that risk?

My bill would address this by having the President appoint the Fed Chairman to a four-year term beginning one year after taking office, when there would be a new vacancy on the Board in any event. The Chairman would still be subject to Senate confirmation, as under current law. Giving the President three years of a term with a Federal Reserve Chairman of his own choosing is surely preferable to the possibility under current law of a lengthy period where the President and Chairman cannot work together.

The Federal Reserve's position on this issue has varied over the years. Chairman Greenspan opposes it, but former Chairmen William McChesney Martin and Paul Volcker supported it, while Arthur Burns was on both sides at different times during his chairmanship.

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In 1966, Federal Reserve Chairman William McChesney Martin said the Board believed that the terms of the Chairman and Vice Chairman should be related to the President's term of office and that a new President should be able to appoint a Chairman of his own choice. In a 1977 hearing before the House Banking Committee, Chairman Arthur Burns said he was still making up his mind.

> Last year in connection with a bill that the Congress was then considering, I reported to the Congress that the Board had no objection to a roughly coterminous term. Since then we have considered this issue again within the Board. I have given it a good deal of thought, and I do not find it an easy question. At present a clear majority of the Board favors the position that I have taken.

Chairman Paul Volcker also supported the change in the Chairman's term this bill would make. In testimony before the Domestic Monetary Policy Subcommittee on October 18, 1983, he said:

> The Board believes there is merit in providing for a consistent relationship between the term of the Chairman of the Federal Reserve with the term of the President.... there is a sound basis for making the four-year term of the Chairman begin on February 1 of the year after the President's term of office commences. Such an alignment would permit a President to nominate a Chairman relatively early in his term, but at a point in time somewhat removed from the series of political appointments required at the very start of a new Administration. Continuity at the central bank in the midst of a transition of administrations would be especially desirable.

This is almost precisely what my bill would do.

III. Disclosure of Monetary Policy Decisions

The bill would require the Federal Open Market Committee to disclose immediately any changes in the targets of monetary policy, including its targets for monetary aggregates, credit aggregates, prices, interest rates, or bank reserves.

The FOMC currently keeps major policy decisions secret for six weeks after they are made and carried out. Most other government agencies must not only publish decisions in the Federal Register before they can take effect, most in fact must publish <u>proposed</u> decisions for public comment before they can even be issued in final form.

Such secrecy has two economic costs. First, secrecy makes capital markets operate less efficiently because investors do not have the information they need to make wise and informed decisions. Second, secrecy is unfair to small investors since they do

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not have the money that large Wall Street firms have to hire full-time professional Fed-watchers. The solution -- immediate release of Federal Reserve policy decisions -- is widely supported by economists and participants in financial markets.

Chairman Greenspan argues that immediate release would impair the Federal Reserve's flexibility and could result in increased instability in financial markets. Our bill does not require the Federal Reserve to announce every day-to-day move it makes in conducting monetary policy. In practice, it would only require immediate release of the general instructions which the FOMC issues at the end of each meeting to the New York Federal Reserve Bank -- the "directive" -- plus any other major policy changes that the FOMC makes between formal meetings. The Fed would still be able to operate under the same day-to-day rules it currently follows.

Mr. Chairman, your bill, H.R. 28, would supplement this by requiring the FOMC to make a video transcript of each meeting and air it after 60 days. Years ago, the Fed published minutes of its meetings, a practice that was discontinued during the 1970s. Both Houses of Congress publish a full verbatim transcript of our deliberations, on the floor and in committees, and there is no reason why the Fed should not do the same thing.

IV. GAO Audits

The Federal Reserve Reform Act would permit the Comptroller General to conduct more thorough reviews and studies of Federal Reserve operations, by removing selected current restrictions on GAO audits.

The General Accounting Office is the watchdog of Congress. Its audits are of tremendous value. Not only do they ferret out waste, fraud and abuse, they perform the even more important function of telling Congress when programs are not working and where programs can be improved.

Although the GAO is currently permitted to audit the Fed's regulatory activities, it is prohibited access to any Federal Reserve function involving (1) transactions with a foreign central bank or foreign government, (2) any deliberations or actions on monetary policy matters or (3) any transactions made under the direction of the FOMC. My bill would remove the last two restrictions while retaining the first.

Chairman Greenspan opposes GAO audits on the grounds that they will duplicate the Fed's own efforts. But every government agency that takes in and spends billions of dollars each year ought to be subject periodically to outside review. I am not accusing the Federal Reserve of dishonesty, I just believe the GAO should have more complete access to the Federal Reserve's financial statements. Your bill would complement this by requiring an annual GAO audit of the Fed's open market operations.

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V. Federal Reserve Budget

The bill would require that the Federal Reserve's annual $1.7 billion budget be published in the Budget of the U.S. Government. The Fed would submit its budget for the current year and the two following years to the President by October 16 of each year, and the President would be required to print the Fed's budget in the Government Budget without change.

Despite the fact that the Federal Reserve takes in and spends billions of dollars each year, the Federal Reserve's budget is not conveniently available to Congress or the public. Only a small fraction of the Fed's $1.7 billion of operating expenses is included in the U.S. Government Budget -- just the $133 million of expenses incurred by the Board of Governors in Washington. The details on this part of the Fed's budget, less than 8 percent of the Federal Reserve's total spending, appear on the next-to-last page of the Budget, in a section entitled "Government-Sponsored Enterprises."

Chairman Greenspan opposes this provision on the grounds that the Federal Reserve's functional independence is inseparable from its budgetary independence. My bill will not reduce the Federal Reserve's control over its own budget. All it does is require that the data be published conveniently in the U.S. Government Budget, where spending by every other government agency is already listed. This includes the Supreme Court, which has its budget published in the Government Budget without any loss of independence.

MONETARY POLICY REFORM ACT

The second bill -- the Monetary Policy Reform Act -- would make two changes in the structure of the Federal Reserve. First, it would dissolve the Federal Open Market Committee and assign sole responsibility for open market operations to the Board of Governors. Second, it would establish a Federal Open Market Advisory Committee through which the presidents of the 12 regional Federal Reserve Banks could advise the Board of Governors on open market operations and monetary policy.

Currently, decisions on monetary policy are made by the Federal Open Market Committee, which consists of the seven members of the Board of Governors plus five of the twelve presidents of the regional Federal Reserve Banks, who serve on a rotating basis. The Governors are appointed by the President and confirmed by the Senate to 14-year terms and are thus duly-appointed government officials who are accountable to the President and Congress, and through them to the American people, for their conduct in office.

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By contrast, the Federal Reserve Bank presidents owe their jobs to the Boards of Directors of the regional Banks, subject to the approval of the Board of Governors. These regional Boards are dominated by local commercial banks, who appoint six of the nine directors. Neither the President nor Congress has any role in selecting either the directors or the presidents of the Federal Reserve Banks. Some of the Bank presidents are career employees, others have backgrounds in banking, business and academics; they are talented and respected individuals. But they are not properly-appointed government officials, and they are not accountable to the American people for their performance in office. Nonetheless, they participate in monetary policy decisions through their membership on the FOMC, where they cast five of the twelve votes that determine monetary policy and interest rates.

This situation, in which private individuals participate in monetary policy decisions, is an anomaly in our system of democratic government.

The Monetary Policy Reform Act would address this concern by assigning the conduct of monetary policy and open market operations to the seven-member Board of Governors of the Federal Reserve System, thus lodging this responsibility with properly-appointed public officials. It would also create a special new Federal Open Market Advisory Committee through which the presidents of the regional Federal Reserve Banks could continue to advise the Board on monetary policy. The Bank presidents would no longer have a vote on monetary policy, but the Board of Governors would still have the benefit of their advice.

Mr. Chairman, your bill would address this problem by having the President appoint and the Senate confirm the Federal Reserve Bank presidents, thus making them government officials. Either way would put important monetary policy decisions solely in the hands of responsible public officials, where they belong, rather than the hands of individuals representing private interests.

Before concluding, Mr. Chairman, I would like to address a more general argument that is frequently used to oppose efforts to reform the Federal Reserve.

The argument is that "If it ain't broke, don't fix it."

People who raise this objection completely miss the point of my proposals. They assume the purpose of my bills is to pressure the Federal Reserve to alter its conduct of monetary policy, which could harm the economy of the United States. When people say "If it ain't broke, don't fix it," they mean monetary policy.

But such an objection is based on a misreading of my bills. These bills are not directed at the Federal Reserve's conduct of monetary policy. There is no provision in either one that would give Congress or the President any more influence over monetary policy than they have at this very moment. If someone wanted to politicize monetary

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policy, these bills would not be the way to do it.

Nonetheless, the system is broken in a different way, because many of the Federal Reserve's practices and procedures violate the normal standards of accountability in a democratic society. These are just not widely recognized because they are not widely publicized:

- How can someone argue that the system is not broken when the Fed conducts its business in secret, refuses to keep minutes, and fails to inform Congress and the public of its decisions until weeks after they are carried out?

- How can someone argue that the system is not broken when no formal channel of communication exists between decisionmakers at the Federal Reserve and the top economic policymakers in the Administration?

- How can someone argue that the system is not broken when trillions of dollars of transactions by the Fed are barred from outside review and most of the Federal Reserve's $1.7 billion budget does not even show up in the official budget documents of the U.S. government?

- How can someone argue that the system is not broken when private interests have a direct vote on monetary policy, in violation of the most basic democratic principle that public decisions should be made solely by properly-appointed or elected public officials?

The system is broken in these ways, and it needs to be fixed. My bills would do that without jeopardizing the Federal Reserve's independence or injecting politics into monetary policy. Congress should not wait until a monetary crisis to reform the Federal Reserve. These bills take advantage of a period of high regard for the Fed, and a moment of economic calm, to bring Fed procedures up to date. If we wait to make the necessary adjustments until a time of economic turbulence and controversy, the results may be far less measured.

Again, Mr. Chairman, I want to commend you for your efforts to make the Federal Reserve a more accountable agency within our democratic system of government and thank you for inviting me to testify during these important hearings. I would also like to submit two additional statements for the record that explain the bills in more detail.

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Testimony by

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 13, 1993

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I appreciate this opportunity to discuss the important issues raised by recent legislative initiatives to alter the structure of the Federal Reserve System. I will begin my remarks this morning by placing these issues in some historical perspective, before commenting specifically on provisions that would change the status of Reserve Bank presidents, broaden the authority of the General Accounting Office to audit the Federal Reserve, and mandate additional disclosure of monetary policy decisions and discussions.

The appropriate role of a central bank in a democratic society is an important and controversial issue. The performance of such an institution has profound implications for the nation's economy and the people's standard of living. Americans have pondered the question of the appropriate role and structure for the central bank at length, beginning with the debate over the First Bank of the United States, which George Washington signed into existence in 1791.

Echoing the earlier discussions surrounding the chartering of the First and Second Banks of the United States, extended debate and compromise preceded the establishment of the Federal Reserve System. Much of the focus of the debate was on the balance that should be struck between public and private authorities in governing the central bank.

In 1908, in response to the periodic financial crises that had plagued the country in the latter part of the nineteenth century and in the early years of the twentieth, a National Monetary Commission, consisting entirely of members of Congress, was established by legislation. Four years later, the Commission, in submitting its report to Congress, called for the creation of a National Reserve Association to provide stability to our financial system. Both the Commission's plan and an alternative, proposed by President Woodrow Wilson,

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envisioned the central bank as containing public and private elements. President Wilson's plan won the approval of Congress and established the Federal Reserve System as our nation's central bank. Over the intervening years, Congress has initiated many reviews of the System's structure, but with rare exceptions has chosen to leave the basic structure intact.

The major piece of legislation affecting the Federal Reserve's organization since its inception in 1913 was the Banking Act of 1935, which established the Federal Open Market Committee (FOMC) in its current form as the central decisionmaking body for monetary policy. When it was clear by the 1930s that the buying and selling of securities by the Federal Reserve was a crucial monetary policy instrument, there was again debate in Congress over whether it should be carried out entirely by government appointees or whether the Reserve Bank presidents, who were not politically appointed, should share in that policymaking role. In the 1935 act, Congress reaffirmed that the Reserve Bank presidents should have a substantive voice in policy. They were granted five of the twelve positions on the FOMC, while the seven members of the Board constituted the majority.

The wisdom of Congress in setting up the structure of the System has stood the test of time. Federal District Court Judge Harold Greene, in commenting in 1986 on the constitutionality of the FOMC, noted that, "The current system[,]... the product of an unusual degree of debate and reflection[,]... represents an exquisitely balanced approach to an extremely difficult problem."

The role of a central bank in a democratic society requires a very subtle balancing of priorities between the need for sound, far-sighted monetary policy and the imperative of effective accountability by policymakers. Accountability and control by the electorate are vital; the

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nation cannot allow any instrument of government to operate unchecked. The central bank, just like other governmental institutions in a democracy, must ultimately be subject to the will of the people.

In this regard, the Federal Reserve's activities are constantly scrutinized by this Committee and others in Congress. The Federal Reserve Board reports semiannually both to the House of Representatives and to the Senate pursuant to the Humphrey-Hawkins Act, and we regularly respond to other congressional requests for testimony. We recognize our obligation to do so and appreciate the importance of maintaining open communication with the nation's elected representatives. We also provide a great deal of information about our operations directly to the public. And we consult frequently with those responsible for economic and financial policy in the Administration.

We have to be sensitive to the appropriate degree of accountability accorded a central bank in a democratic society. If accountability is achieved by putting the conduct of monetary policy under the close influence of politicians subject to short-term election-cycle pressures, the resulting policy would likely prove disappointing over time. That is the conclusion of financial analysts, of economists and others who have studied the experiences of central banks around the globe, and of the legislators who built the Federal Reserve.

The lure of short-run gains from gunning the economy can loom large in the context of an election cycle, but the process of reaching for such gains can have costly consequences for the nation's economic performance and standards of living over the longer term. The temptation is to step on the monetary accelerator, or at least to avoid the monetary brake, until after the next election. Giving in to such temptations is likely to impart an inflationary bias to the economy and could lead to instability.

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recession, and economic stagnation. Interest rates would be higher, and productivity and living standards lower, than if monetary policy were freer to approach the nation's economic goals with a longer-term perspective.

The recognition that monetary policies that are in the best long-run interest of the nation may not always be popular in the short run has led not only the United States but also most other developed nations to limit the degree of immediate control that legislatures and administrations have over their central banks. More and more countries have been taking actions to increase the amount of separation between monetary policy and the political sphere.

In this nation, several aspects of the current set-up promote the central bank's distance from the political fray. The fourteen-year terms of the governors on the Federal Reserve Board are one of those elements, with only two vacancies scheduled to occur during the four years of any single Presidential term. Once in office, those governors cannot be removed by the President over a policy dispute. In addition, regional Reserve Bank presidents -- who are selected at some remove from political channels -- are included on the FOMC. To prevent political pressure from being applied on monetary policymakers via the power of the purse, the Federal Reserve is not required to depend upon appropriated funds to meet its expenses.

H.R. 28, The Federal Reserve System Accountability Act of 1993, would remove some of that insulation. I would view the enactment of legislation of this type as a major mistake. Provisions that, in effect, increase political leverage on Federal Reserve decisionmaking amount to assaults on the defenses that Congress has consciously put in place to ensure the appropriate degree of central bank independence. Weaken those defenses and, I firmly believe, the economy is at risk. The Federal Reserve must be free to focus on advancing the nation's ultimate economic goals.

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In an amendment to the Federal Reserve Act, Congress has charged the central bank with furthering the goals of "maximum employment, stable prices, and moderate long-term interest rates." To promote those objectives, the Federal Reserve must take a long-run perspective.

In that vein, as I have indicated to this Committee on previous occasions, the determination of the effectiveness of a federal agency has to be based, in the end, on whether it has carried out the objectives Congress has set for it. In discharging its tasks over the years, the Federal Reserve has faced a variety of challenges; our economy has been buffeted by swings in fiscal policy and by strong external forces, including oil price shocks and wars. In often difficult economic circumstances, the Federal Reserve has implemented policies aimed at promoting the nation's economic health. We have not always been entirely successful, but we have learned from experience what monetary policy can do and what it cannot do.

In my view, current Federal Reserve policy is promoting conditions vital to maximizing the productive potential of the U.S. economy. Monetary policy is, and will continue to be, directed toward fostering sustained growth in economic output and employment.

As the nation's central bank, the Federal Reserve stands at the nexus of monetary policy, supervisory policy, and the payments system. Part of our task is to minimize the risk of systemic crises while endeavoring to implement a macroeconomic policy that supports maximum sustainable economic growth. When, for example, threats to the nation's financial system loomed large in the wake of the 1987 stock market crash, the Federal Reserve effectively contained the secondary consequences of the crash with prompt but prudent injections of liquidity and with constant consultations with depository institutions during the crisis. The bulk of our efforts in this area, however, of necessity garners

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considerably less publicity, as it is directed at ongoing efforts to fend off financial-sector problems before those problems emerge as full-blown crises that could threaten American jobs and living standards. Much of our success over the years, therefore, reflects crises that did not happen. In working with other regulatory agencies, the Federal Reserve also has brought its broad perspective to bear on supervisory actions that could have had macroeconomic or monetary policy implications.

In practice, the central bank of the United States works, and it works well. On paper, however, its structure can appear unwieldy -- an amalgam of regional and centralized authority, and of public and private interests. If we were constructing a central bank for the United States now, starting from scratch, would it be identical to the Federal Reserve System described in current law? Perhaps not. But the Federal Reserve has evolved to be well suited to today's policy tasks.

One of the reasons that the Federal Reserve is effective is that its basic structure has been in place for a long time. The institution has been able to take that framework as a given and to adapt and build on it during decades of invaluable experience in the financial and economic setting of this country.

As the Federal Reserve has evolved over the years it has been permeated by a culture of competence and dedication to public service. As a consequence, the Federal Reserve has attracted highly skilled analysts, technicians and policymakers. While we might imagine a different initial structure for our central bank, implementing a major change at this stage could, for all intents and purposes, destroy the exceptionally valuable culture that has evolved over time and that continues to serve this nation well. And there is always the risk that changing a complex organization, even with the laudable goal of improving one

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or more parts of it, may well have unforeseen and unfortunate consequences elsewhere in the structure.

Nonetheless, the Federal Reserve recognizes that an organization that does not appropriately respond to changes in the environment in which it functions will soon become ineffectual. Accordingly, the Federal Reserve has suggested, initiated, and instituted a number of measured changes over the years. When confronted with a new development requiring change, we advocate change. For example, not long ago we recognized, as did this Committee, an apparent weakness in the way the discount window could be used in the case of insured failing institutions, a condition which we had rarely before experienced. We saw change as a constructive response, and, while we were prepared to implement the change by adapting our regulations, we cooperated with this Committee which chose to amend our discount window procedures as part of FDICIA.

I hope, and I expect, the Federal Reserve will continue to change, but always prudently -- in response to clearly identified problems -- and only for the better. One area in which I see major need for change is the inadequate pace at which women and minorities have moved into the top echelons of the Federal Reserve. We share your concerns in this regard and are working diligently to improve opportunities for women and minorities throughout the System.

In the remainder of my remarks this morning, I would like to address three specific issues, under the more general topic of Federal Reserve accountability. These are, first, the status of the Reserve Bank presidents on the FOMC, then the General Accounting Office's purview in auditing the Federal Reserve System, and finally the disclosure of FOMC deliberations and decisions.

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The Status of Reserve Bank Presidents

The Federal Reserve Banks represent a unique blend of the public and private sectors. I believe that those who label the Reserve Bank presidents as representatives of the banking interests, as opposed to the public interest, misunderstand the position of the presidents -- and the Reserve Banks -- in the Federal Reserve System.

The Federal Reserve Banks are instrumentalities of the United States government organized on a regional basis. They are in a tangible sense "owned" by the federal government. The bulk of their net income is handed over to the government each year. Their accumulated surplus, were they to be liquidated, would revert to the U.S. Treasury. And while a portion of the capital of the Reserve Banks represents contributions by member commercial banks, those member banks are not free to withdraw the capital, their dividends are fixed by statute, and their capital stake in no way affords them the usual attributes of control and financial interest.

The member commercial banks do select the majority of the directors of their local Reserve Bank. But the Federal Reserve Board chooses the remaining directors, and, among those, designates a chairman and a deputy chairman. The directors, in turn, select the Reserve Bank's president, but their selection is subject to the Board's approval.

Those Reserve Bank presidents then receive top-secret clearances from our government and are subject to the federal conflict-of-interest statute. They can be removed by the Federal Reserve Board, and it is the Board that sets their pay. Upon joining the FOMC, they take an oath of office to uphold the Constitution of the United States, and -- uniformly in my experience -- they are dedicated to the service of our country.

However, regardless of whether the presidents of the Reserve Banks are viewed as more public than private or

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more private than public, the real question remains, does their participation on the FOMC make for better monetary policy? I can assure you that it does.

The input of Reserve Bank presidents who reside in and represent the various regions of the country has been an extremely useful element in the deliberations of the FOMC. By virtue of their day-to-day location and their ongoing ties to regions and communities outside of the nation's capital, the presidents see and understand developments that we in Washington can overlook. They consult routinely with a wide variety of sources within their districts, drawing information from manufacturing concerns, retail establishments, agricultural interests, financial institutions, consumer groups, labor and community leaders, and others. Moreover, because their selection is apolitical, they tend to bring different skills and perspectives to the policymaking process.

The public-private and regional makeup of the Federal Reserve System was chosen by Congress, in preference to a unitary public central bank, only after long and careful debate. The system was designed to avoid an excessive concentration of authority in federal hands and to ensure responsiveness to local needs. Nonetheless, then as now, the operations of the Reserve Banks were placed under the general supervision of the Board of Governors. When the FOMC was given its current form in 1935, five Reserve Bank presidents were placed on that Committee, but their presence was outweighed by the seven Presidentially appointed members of the Board.

This blending of public and quasi-public institutions has a long history in this country and has been reaffirmed repeatedly in Congress. Nonetheless, the presence of Reserve Bank presidents on the FOMC periodically resurfaces as an issue. This occurs despite the long and successful history of the presidents' membership on the

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FOMC, which counters a similarly lengthy history of claims that their participation would be detrimental to our nation. The involvement of quasi-government officials in monetary policymaking has survived a series of challenges over the years. It has survived the test of time. One must wonder why we would wish to tinker with a unique partnership of the public and the private that has worked well for more than half a century.

Some who agree that the Reserve Bank presidents provide a unique perspective would nonetheless argue that such input could still be obtained by reducing the Reserve Bank presidents' role to an advisory one. I doubt that, for two reasons. First, let us not delude ourselves: Anyone permanently denied a vote sees his or her influence diminish markedly. Not only would the presidents' varied experiences and regional perspectives likely become less well reflected in policy decisions, but their ability to solicit real-time information from their communities would be diminished as well. Second, I believe that a fair number of my colleagues who serve as presidents of the Reserve Banks would have declined that office had voting rights on the FOMC not attached to it. These are people who do not lack for opportunities. If the Reserve Bank presidents were denied votes, we could not attract individuals of the same caliber to these jobs that we do today. As a result, the advice received would be adversely affected, and FOMC deliberations would be less productive.

A different proposal would retain the Reserve Bank presidents on the FOMC, but would have them appointed by the President of the United States. Such a proposal is not new: It was considered and rejected by this Committee as recently as 1976. The clearest drawback to this suggestion is one that I have already mentioned, that is, the potential for increased partisanship that would erode the quality of policy, as the central bank was drawn more closely into the

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ambit of daily political concerns. In addition, however, such an arrangement would create significant managerial problems for the Federal Reserve System as an organization.

Under current law, Reserve Bank presidents are directly accountable to the Board for their performance in carrying out Systemwide policies in such areas as bank supervision, payments systems responsibilities, and discount window administration. The Board's ultimate defense against a Bank president who is either incompetent or purposely obstructing the effective implementation of System policy is our power to remove that person from office.

If the heads of the Reserve Banks were instead Presidentially appointed, we presume that they could be removed constitutionally only by the President. In that circumstance, Systemwide coordination of policies and inter-bank cooperation could be seriously impaired.

In sum, if the sole duty of Reserve Bank presidents were to vote on the FOMC, granting the President of the United States the power to appoint and remove them would be unwise on only one count -- that of adversely affecting the conduct of the nation's monetary policy. However, Reserve Bank presidents also run large organizations charged with such tasks as collecting data, processing currency, operating the book-entry system, and auctioning Treasury bills. The twelve Banks must operate as one in these various areas, and Congress has given the Board general oversight of the Banks to ensure that they do. A proposal that divested the Board of the power to remove a Reserve Bank president from office would subtly but significantly undermine the ability of the Board to manage the Federal Reserve System.

Scope of GAO Audits

As you know, the passage in 1978 of the Federal Banking Agency Audit Act made most of the operations of both

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the Federal Reserve Board and the Federal Reserve Banks subject to review by the General Accounting Office. Since then, the GAO has completed more than 100 reports on various aspects of System operations, as well as numerous others that involved us less directly. At present, the GAO has roughly 25 audits of the Federal Reserve under way and maintains several of its staff in residence at the Board and at selected Reserve Banks.

The GAO has free rein to audit the System, with the explicit exemption of only three functions: Those are deliberations, decisions, or actions on monetary policy matters; transactions made under the direction of the FOMC; and transactions with, or for, foreign official entities. By excluding these areas, the 1978 Act represented another effort to balance, on the one hand, the public accountability of the Federal Reserve with, on the other, its ability to perform its policy functions most effectively.

The benefits, if any, of broadening the GAO's authority into the monetary policy and FOMC areas would be small, in part because a GAO audit would tend to duplicate functions that are already performed. With regard to purely financial audits, the Federal Reserve Act already requires that the Board conduct an annual financial examination of each Reserve Bank, including open market and international operations. And these exams are complemented by other Board reviews of Reserve Bank effectiveness and efficiency, as well as by comprehensive audits conducted by each Reserve Bank's independent internal audit function. In order to provide the Board with additional assurance of the quality and comprehensiveness of the Board's audit process, complete financial audits are currently being conducted by nationally recognized independent accounting firms at Reserve Banks. Two such audits were conducted this year. The results of these audits to date have confirmed the integrity and

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quality of the System's audit process. In addition, the Board itself is audited annually by an independent public accounting firm, and the results of those audits are furnished regularly to Congress.

More broadly, Congress has, in effect, mandated its own review of monetary policy by requiring semiannual monetary policy reports and by holding hearings. In addition, a vast and continuously updated literature of expert evaluations of U.S. monetary policy exists. In this environment, the contribution that a GAO audit would make to the active public discussion of the conduct of monetary policy is not likely to outweigh the negatives.

Those negatives would include a potential compromising of Federal Reserve effectiveness, in part because the change could peel away a layer of the central bank's insulation from day-to-day political pressures. Even what appears to be a very limited audit of the efficiency of our operations could in fact turn into pressure for a change in monetary policy itself as the 1978 Act understood. For example, the question being posed to Comptroller Bowsher in these hearings of whether the magnitude of our open market operations reflects unnecessary buying and selling of government securities is a monetary policy question, not an efficiency question. The volume of transactions that the Open Market Desk completes in carrying out the FOMC's directive correlates directly with the substance of the policy in place.

GAO scrutiny of policy deliberations, discussions, and actions also could impede the process of formulating policy. A free discussion of alternative policies and possible outcomes is essential to minimize the chance of policy errors. The prospect of GAO review of formative discussions, background documents, and preliminary conclusions could have an adverse effect on the free

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interchange and consensus-building that leads to good policy.

Transactions made under the direction of the FOMC primarily involve domestic monetary policy operations, but also include foreign exchange operations. Expanding GAO audit authority into this latter area would risk impairing our sensitive working relations with foreign central banks and governments. Important daily contacts and exchanges of information with foreign monetary authorities now take place in a candid and constructive atmosphere. The possibility of a GAO audit of our foreign exchange operations would reduce the willingness of foreign authorities to share information with us and thereby would reduce the effectiveness and efficiency of our operations. This caution also applies to the third exempted area -- transactions with or for foreign entities; however, there the principal issue is one of sensitive proprietary information about foreign governments, foreign central banks, and international organizations.

In sum, I believe that the current structure of internal controls and audits, and congressional review strikes the right balance between public accountability and policy effectiveness.

FOMC Disclosure

The issue of fuller or more immediate disclosure of FOMC discussions and decisions has been a controversial one historically. In Congress, the financial markets, and academia, this topic has been debated repeatedly over the years. The FOMC itself has reviewed policies and procedures in this area frequently and has revised its practices several times. At the heart of this issue is, again, balance. The appropriate degree of openness comes from striking the right balance between the public's right to know and the need for effective policymaking and implementation.

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In a democratic society, all public policymaking should be in the open, except where such a forum impedes the primary function assigned to an institution by law. Accordingly, the Federal Reserve makes its decisions public immediately, except when doing so could undercut the efficacy of policy or compromise the integrity of the policy process. When we change the discount rate or reserve requirements, those decisions are announced at once. When we establish new ranges for money and credit growth, those ranges are set forth promptly in our reports to Congress. And when Congress requests our views, we come before this Committee and others to testify. Moreover, we publish our balance sheet every week with just a one-day lag, enabling analysts to review our operations in considerable detail.

What we do not disclose immediately are the implementing decisions with respect to our open market operations. However, any changes in our objectives in reserve markets are quickly and publicly signalled by our open market operations. We publish a lengthy record of the policy deliberations and decisions from each FOMC meeting shortly after the next regular meeting has taken place.

Nevertheless, the Federal Reserve has a reputation, along with other central banks, of being secretive. I suspect this is largely a result of the nature of a central bank's mission. The operations of central banks have a direct impact on financial and exchange markets; therefore, these institutions often find themselves in the position where premature openness and disclosure could inhibit or even thwart the implementation of their public purpose.

Suppose, for example, a central bank that operated by targeting the foreign exchange rate decided that it might be appropriate to change the target rate at a given point in the future. Or, to bring the discussion closer to home, say that the central bank phrased its policies in terms of contingency plans -- that is, if a given economic or

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financial event occurs, a particular policy action would ensue. If those decisions were made public, markets would tend to incorporate the changes immediately, preventing the policies from being effectively carried out as planned.

More broadly, immediate disclosure of these types of contingencies would tend to produce increased volatility in financial markets, as market participants reacted not only to actual Federal Reserve actions but also to possible Federal Reserve actions. It is often the case that the FOMC places a bias toward change into its directive to the Open Market Desk, without any change in instrument settings in fact resulting. In such circumstances, the release of those directives during the period they are in force would only add to fluctuations in financial markets, moving rates when no immediate change was intended.

As a consequence, a disclosure requirement would impair the usefulness of the directives, as Committee members, concerned about the announcement effect of a directive biased either toward ease or tightening, would tend to shy away from anything but a vote of immediate change or of no change at the meeting. An important element of flexibility in the current procedures would be lost, which can scarcely serve the public interest. Immediate disclosure of the directive would change the nature of monetary policymaking, and it would not be a change for the better.

Of course, our current policies on information release are grounded on an assumption of confidentiality. Any unauthorized, premature release of FOMC decisions is a very serious matter, and it undermines our policies. Such leaks are abhorrent. As I noted in my recent letter to you, Mr. Chairman, leaks of FOMC proceedings are clearly unfair to the public, potentially disruptive of the policymaking process, and undoubtedly destructive of public confidence in the Federal Reserve. We have taken steps that we believe

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will be effective to curb any further unauthorized release of information.

To repeat, as a general matter, public institutions are obliged to conduct their business in open forums. The Federal Reserve endorses this principle and adheres to it, except when doing so would prevent us from fulfilling our fundamental mission of producing sound public policy.

Holding open meetings of the FOMC or releasing a video tape, audio tape, or transcript of them would so seriously constrain the process of formulating policy as to render those meetings nearly unproductive. The candid airing of views, the forthright give and take, and the tentative posing of new ideas likely would disappear. Monetary policy would suffer, and the economy with it.

In open forum, a number of important items currently discussed at FOMC meetings simply could not be mentioned. We would no longer have the benefit of sensitive information from foreign central banks and other official institutions or of proprietary information from private-sector sources, as we could not risk the publication of information given us in confidence.

Moreover, to avoid creating unnecessary volatility in financial and exchange markets, the FOMC might have to forgo explorations of the full range of policy options. Our discussions would, in effect, become self-censored to prevent the voicing of any views that might prove unsettling to the markets. Even a lag in releasing a verbatim record of the meetings would not eliminate this problem, but only attenuate it. Unconventional policy prescriptions and ruminations about the longer-term outlook for economic and financial market developments might never be surfaced at meetings, for fear of igniting a speculative reaction when the discussion was disclosed.

It has been averred that, since the minutes we release do not indicate which individuals voiced which views

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at the meetings, the FOMC members themselves escape accountability for their actions. This is contrary to fact. The vote of each FOMC member is recorded, by name, and the reasons for that vote are also recorded. In the case of a dissent from the majority, the reasoning behind the vote is generally explained separately. In the case of a vote cast with the majority, the members assure themselves that the minutes accurately reflect their views and the reasons for voting as they did.

In both the Freedom of Information Act (FOIA) and the Government in the Sunshine Act, Congress explicitly recognized that there were types of information and kinds of meetings that should be protected from dissemination to the public. Certain exemptions have been provided in FOIA for information that, for example, is of a confidential financial nature and in the Sunshine Act for meetings that would prompt speculation in financial markets. In the exempted areas, it was determined that information release would not be in the public interest. As I have indicated, I believe that the consequences of requiring the prompt release of a verbatim record of FOMC meetings would most certainly not be in the nation's best interest.

Conclusion

Mr. Chairman, you have made it clear that, in your view, this legislation does not represent an attempt to politicize the Federal Reserve or to infringe on its independence. I feel I must respond that, whatever its intent, legislation of this type would have precisely that deleterious effect.

I take this legislative initiative seriously not only because it would emanate from this Committee, but also because of monetary policy's key position in the nation's overall economic policy. At the flashpoint of financial crisis, monetary policy, if mishandled, can pose a threat to

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our economic system. And in this century we have witnessed inflation -- a monetary phenomenon -- turn virulent in too many nations around the world. To a considerable degree, then, both the earnestness with which we approach our task and the unique position accorded the Federal Reserve in our governmental structure derive from the potential for just such dire consequences of monetary policy mismanagement.

In imposing significant change on the Federal Reserve System, we would run the risk of real damage to the institution's effectiveness from unintended, adverse consequences. The Federal Reserve is not a flawless institution. It is, however, a very good one. In my view, it would be a mistake to legislate structural reform when, as in this case, compelling evidence of the need for change is lacking.

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STATEMENT OF
REP. LEE H. HAMILTON
before the
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
on
THE FEDERAL RESERVE REFORM ACT OF 1989
November 9, 1989

Mr. Chairman and Members of the Subcommittee, I am very pleased to have this opportunity to testify on H.R. 3512, the Federal Reserve Reform Act of 1989.

Since Congressman Dorgan and I originally introduced this legislation in June, our bill has stimulated a thoughtful discussion among the American people about the Federal Reserve and its proper role in American society. In response to the many very helpful comments we received, Congressman Dorgan and I recently revised the bill and reintroduced it.

The Federal Reserve occupies an anomalous position within the government of the United States. It is an enormously powerful institution, but it does not conform to the normal standards of government accountability. Power without accountability simply does not fit into the American system of democracy.

Through its control over monetary policy the Federal Reserve affects the lives of all Americans. It has the power to decide who prospers and who fails. The path that the Federal Reserve sets for monetary policy and interest rates affects every businessperson, worker, consumer, borrower and lender in the United States. With fiscal policy paralyzed by the inability of the Congress and the Administration to agree on ways to reduce the Federal deficit, the Federal Reserve by default must make the decisions by which the government exercises its responsibility for the overall performance of the economy.

The dilemma created by this concentration of power is that the independence which the Federal Reserve must have in order to insulate monetary policy from political pressures also removes the Fed from the normal processes of accountability that apply to every other agency of the federal government. Our bill, H.R. 3512, addresses a very difficult and perplexing problem -- how to make the Federal Reserve more accountable to the American people without jeopardizing its independence and its ability to conduct monetary policy free of political pressure.

When Congress and the President make policy, we do it in the open. The debates in both the House of Representatives and the Senate are televised live throughout the country. The decisions we make are immediately reported to the American people; every penny the government spends shows up in the Budget documents of the U.S. Government and this information is readily available to any interested Member of Congress or the public; and the books and programs of every government agency are subject to audit and review by the General Accounting Office. These are the accepted rules of accountability in a democracy. If the citizens of the country are dissatisfied with the results, either with the policies themselves or the way they are carried out by government agencies, they know to whom to complain and how to register their preferences.

But these rules do not apply to the Federal Reserve. The Fed is independent of the rest of the government. It was purposely created that way to insulate monetary policy from political pressures. No other government agency enjoys the Fed's prerogatives. Monetary policy is conducted in secret, behind closed doors. The Federal Reserve is not required to consult with Congress or the Administration before setting money or interest rate targets, even though its power affects every American. It waits six weeks before releasing policy decisions. The President, who is responsible for the performance of the economy and is blamed if things go wrong, often must wait until late in

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his term to appoint a new Chairman of the Federal Reserve Board, raising the risk that the President and the Federal Reserve Board Chairman might be at odds. President Bush, for example, will not be able to appoint a Fed Chairman until August 1991. The Fed's budget is not published in the U.S. Government Budget, even though it spends over $1.5 billion per year. Only 6 percent of Federal Reserve expenditures are detailed in the U.S. Government Budget -- the $90 million spent by the Board of Governors -- and this appears only in the appendix and not in standard government format. The Presidents of the 12 Federal Reserve Banks, who participate in monetary policy decisions on the FOMC, are neither appointed by the President nor confirmed by the Senate. Even though the Federal Reserve engages in more than $1 trillion in transactions in the money markets each year, most of these activities are exempt from audit by the GAO or any other outside agency.

My constituents in the Indiana district I represent in Congress understand that the Federal Reserve has a powerful impact on their lives. But they express frustration over how the Fed operates and how they can communicate with it. I would like to quote from one letter I recently received, which summarizes the concern of many Americans:

> As an ordinary citizen, I find it outrageous that Volcker and now Greenspan have such dictatorial power over my life and those of other hard working citizens. Where are the checks and balances intended by our Constitution?

As applied to the Fed, this is not an easy question to answer. The bill that Congressman Dorgan and I have introduced is an attempt to address this very complex issue of Federal Reserve accountability. Before describing what the bill will do, let me briefly tell what it will not do.

First, it will not cause revolutionary changes at the Federal Reserve. It is a very modest bill designed to improve some of the Federal Reserve's practices and procedures. In the 75 years since Congress created the Federal Reserve System, we have made a number of changes in its structure and procedures, adding responsibilities and powers from time to time and periodically revising its relationship with Congress and the Administration. Our bill continues this process by proposing a handful of evolutionary changes in the practices and structure of the Federal Reserve.

Second, our bill will not reduce the policy-making independence of the Fed or inject politics into monetary policy. The bill does <u>not</u> impose Presidential or Congressional or other outside controls on Fed policy.

Our bill, instead, aims to make the Federal Reserve more accountable to the American people, not by giving politicians control but by creating a formal channel of communication between the President and the Federal Reserve, and by providing Congress and the American people with more and better information on the Federal Reserve's policies and procedures.

The bill has five major provisions.

I. Consultation with the Administration

First, it would require the Secretary of the Treasury, the Chairman of the Council of Economic Advisers, and the Director of the Office of Management and Budget to meet three times a year on a non-voting basis with the Federal Open Market Committee, to consult on monetary and fiscal policy.

Two of the required meetings would take place just before the FOMC sets its annual money growth targets in February and July and reports to Congress, as required by the Full Employment and Balanced Growth Act of 1978. The third meeting would occur in the fall at the start of the Administration's annual budget cycle. These meetings will bring together the key members of the fiscal and monetary policymaking teams.

The purpose of the meetings is to improve the flow of information between the Administration and the Federal Reserve. Currently, there is no formal channel of

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communication between the President and the Fed. At times, the Administration is reduced to carrying on policy disputes by publicly sniping at the Fed through the press. Under our bill, the Administration will have a formal avenue to present its program for the economy to the FOMC and lay out its goals and targets for monetary policy. The Members of the FOMC will also have an avenue to convey their concerns about fiscal policy to the Administration. Communication will flow both ways.

In his testimony before this Subcommittee on October 25, Federal Reserve Board Chairman Alan Greenspan opposed this provision on the grounds that the Federal Reserve and the Administration already communicate through informal channels and that the more formal arrangement proposed by our bill would result in political manipulation of monetary policy.

Informal channels of communication do exist; for example, the current Fed Chairman and Treasury Secretary are reported to meet about once a week. Over the years, however, the success of informal methods has varied, depending on the personalities involved. In addition, the discussions are off the record and views are conveyed second-hand to other members of the FOMC. This ad hoc approach to making decisions which affect the economic well-being of all Americans is not the best way for a great economic power to conduct its business. It is astonishing that the world's greatest economic power does not have a formal channel of communication between the key makers of economic policy. Our bill would establish a channel of communication that would not depend on personalities for success.

It is interesting to note that the Fed is already required to conduct formal advisory meetings of the kind we propose with a number of outside groups. One is the Federal Advisory Council, which is composed of 12 major private-sector bank presidents (one from each Federal Reserve district) and which meets four times a year with the Board of Governors. At the latest meeting, on September 8, 1989, the private bank presidents presented their complaints against current tax treatment of credit unions and discussed the impact of current economic policies on the U.S. trade balance.

Meetings also occur three times a year with the Consumer Advisory Council, which focuses on financial matters of importance to consumers, and the Thrift Institutions Advisory Council, which focuses on matters of interest to thrifts. The Consumer Advisory Council, and the requirement for periodic meetings with the Federal Reserve, was established in 1976 by an amendment to the Equal Credit Opportunity Act, in the same kind of modest change in Federal Reserve practices that would be made in our bill.

The Fed does not object to meeting regularly with bank presidents, consumer representatives and the thrift industry to discuss issues of importance to these groups. Why not accord representatives of the President of the United States the same privilege to discuss issues of importance to the whole nation?

Contrary to Chairman Greenspan's fears, three FOMC meetings a year with the Administration's top economic advisers will not empower the President to meddle with monetary policy. The required meetings would occur before actual FOMC meetings. No Member of the Administration would be present when the FOMC makes monetary policy decisions and none would have a vote on the FOMC. The format of the meetings would be solely under the control of the participants. Furthermore, given the Federal Reserve's current concern for its independence, any attempt by the Administration to meddle in monetary policy would and should evoke a strong reaction from the Members of the FOMC. If Chairman Greenspan raised this issue because he fears that the President, through his three representatives, could successfully dictate monetary policy, his words cast a dark cloud over the independence of the members of the FOMC.

The bill that Rep. Dorgan and I introduced will not eliminate policy mistakes at the Federal Reserve, or mistakes in fiscal policy. There will invariably be successes and failures under any set of structures or procedures. What it will do

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is reduce the risk of miscommunication and public sniping by establishing a formal channel by which the FOMC and the Administration can discuss the needs of the economy and the appropriate combination of monetary and fiscal policy.

II. Term of the Federal Reserve Chairman

Second, our bill would allow the President to appoint a Chairman of the Federal Reserve Board (with the advice and consent of the Senate) one year after taking office, at the time when the first regular opening would occur on the Federal Reserve Board. This would make the Fed Chairman's term basically coterminous with the term of office of the President of the United States.

The current Chairman of the Board of Governors, Alan Greenspan, was appointed by President Bush's predecessor and will hold that office until August 10, 1991, almost three years into President Bush's term. Fortunately, Chairman Greenspan and President Bush have a cordial relationship. The fact that Mr. Greenspan was not appointed by President Bush has not caused any significant problems with monetary policy. But if they were unable to work together, the result could be serious damage to the American economy and a paralysis of economic policy. Why take that risk?

Our bill would address this by having the President appoint the Fed Chairman to a four-year term beginning one year after taking office, when there will be a new vacancy on the Board in any event. Each appointee will still be subject to Senate confirmation, as under current law. Giving the President three years of a term with a Federal Reserve Chairman of his own choosing is surely preferable to the possibility under current law of a lengthy period where the President and Chairman cannot work together.

Chairman Greenspan testified that linking the Chairman's term to the President's could result in less independence from the White House than currently exists. To the contrary, the provision in our bill would not increase the President's influence over the Federal Reserve. A Fed Chairman who was appointed a year after the President took office and knew he would not come up for reappointment during the President's term would have much more independence than one, such as Chairman Greenspan, who must conduct policy to please President Bush if he wants to be reappointed Chairman when his term expires in 1991. In addition, over the years, some Chairmen have been appointed soon after the President took office with no detrimental effects.

Chairman Greenspan's further objection that it would be difficult to find a qualified person to fill out the remaining term of a Chairman who leaves office ignores that fact that the Chairman of the Board of Governors is a highly visible post with great power and prestige. There would be no shortage of qualified applicants. In addition, a "temporary" Chairman would still have the rest of a 14-year term to serve on the Board of Governors even if he were not reappointed to the next full Chairman's term.

As Chairman Greenspan testified, the Federal Reserve's position on this issue has varied over the years. In a letter dated October 6, 1966 to Congressman Abraham Multer, who was then Chairman of the Banking Committee's Subcommittee on Bank Supervision and Insurance, Federal Reserve Board Chairman William McChesney Martin said the Board believed that the terms of the Chairman and Vice Chairman should be related to the President's term of office and that a new President should be able to appoint a Chairman of his own choice. In response to a 1968 question from Banking Committee Chairman Wright Patman, Chairman Martin reaffirmed the Board's position. Chairman Arthur Burns was of two minds on the question of coterminous terms. In a 1977 hearing before the House Banking Committee, Chairman Burns opposed legislation tying the Federal Reserve Board Chairman's term to the President's. During the hearing, however, he gave the following response to a question from Congressman Parren Mitchell:

I do not mind reporting to you that I

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have changed my mind. Last year in connection with a bill that the Congress was then considering, I reported to the Congress that the Board had no objection to a roughly coterminous term. Since then we have considered this issue again within the Board. I have given it a good deal of thought, and I do not find it an easy question. At present a clear majority of the Board favors the position that I have taken.

Former Federal Reserve Board Chairman Paul Volcker also supported the change in the Chairman's term that our bill would make, in testimony before the Domestic Monetary Policy Subcommittee on October 18, 1983. In his prepared statement, Chairman Volcker said:

> The Board believes there is merit in providing for a consistent relationship between the term of the Chairman of the Federal Reserve with the term of the President. At present, the beginning of a Chairman's term is an accident of history -- a product of the timing of previous appointments, resignations, and expirations of the term of a Chairman as a Member of the Board of Governors. The principal problem with the present arrangement is that a new four-year appointment might be required late in a Presidential term or in the midst of, or shortly after, a contentious political campaign, tending to bring the choice into the heat of a political contest.
>
> It is difficult to argue that there is a single optimal alignment of the two terms, but among the possibilities there is a sound basis for making the four-year term of the Chairman begin on February 1 of the year after the President's term of office commences. Such an alignment would permit a President to nominate a Chairman relatively early in his term, but at a point in time somewhat removed from the series of political appointments required at the very start of a new Administration. Continuity at the central bank in the midst of a transition of administrations would be especially desirable.

III. Disclosure of Monetary Policy Decisions

Third, our bill would require the FOMC to disclose immediately any changes in the targets of monetary policy, including its targets for monetary aggregates, credit aggregates, prices, interest rates, or bank reserves.

The FOMC currently keeps major policy decisions secret for six weeks after they are made and carried out. Most other government agencies must not only publish decisions in the Federal Register before they can take effect, most in fact must publish <u>proposed</u> decisions for public comment before they can even be issued in final form.

While secrecy may help insulate the Federal Reserve from criticism, secrecy has two economic costs.

First, secrecy makes capital markets operate less efficiently. The Federal Reserve's position on this can be defended only if you believe that ignorance is better than knowledge. But one of the major conclusions of microeconomic theory is that thorough and complete information is a requirement for markets to work efficiently. This applies to financial markets as well as to markets for goods and services.

Second, secrecy is unfair to small investors. When the Federal Reserve makes a policy change, large investors and Wall Street market experts generally find out easily enough through experts who monitor the Federal Reserve. This gives them an advantage over small investors, borrowers, and others who don't have resources to employ "Fed-watchers" to interpret and anticipate Fed policy changes.

The solution is immediate release of Federal Reserve policy decisions, as our bill would require. This is a change that is widely supported by economists and participants in

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financial markets.

In his testimony, Chairman Greenspan argued that immediate release would impair the Federal Reserve's flexibility to react quickly in times of acute financial unrest and could result in increased instability in financial markets if investors overreact to particular announcements.

Our bill does not require the Federal Reserve to announce every day-to-day move it makes in conducting monetary policy. It requires only that the Federal Reserve release changes in intermediate targets -- that is, the targets set during the periodic meetings of the FOMC. In practice, this would require immediate release of the FOMC's directive to the open market desk of the New York Federal Reserve Bank, plus any other major policy changes that the FOMC agrees to between formal meetings. The Fed would still be able to operate day-to-day under the same rules it currently follows and would still be able to react quickly to market crises.

The possibility raised by Chairman Greenspan that immediate disclosure would cause financial market instability ignores the fact that it is ignorance, and not knowledge, about Federal Reserve decisions which creates the kinds of rumors that are unsettling to the financial markets and cause wide gyrations in bond and stock prices.

Rather than waiting six weeks before disclosing its intermediate targets, as the Fed now does, its decisions should be released immediately. This would improve the efficiency of financial markets, reduce instability, and provide all investors, large and small, with equal and timely information about monetary policy decisions.

IV. GAO Audits

Fourth, our bill would permit the Comptroller General to conduct more thorough audits of Federal Reserve operations, by removing selected current restrictions on GAO access to the Federal Reserve.

The General Accounting Office is the watchdog of Congress. It carries out that responsibility through financial and program audits of government agencies. These audits are of tremendous value to Congress. Not only do they ferret out waste, fraud and abuse, they perform the even more important function of telling Congress when programs are not working and where programs can be improved.

For many years, from the mid-1930's to the late 1970's, the Federal Reserve was exempt from GAO audits, along with the other bank regulatory agencies, on the grounds that its funds were not appropriated by Congress. In 1978, the Federal Banking Agency Audit Act authorized the GAO to audit the bank regulatory agencies, allowing full audits of the Comptroller of the Currency and the Federal Deposit Insurance Corporation and limited audits of the Federal Reserve. Since then, the GAO has conducted numerous audits of the Fed's regulatory activities, with no noticeable harm to the Federal Reserve or its effectiveness in regulating member banks.

Currently, the GAO is prohibited access to any Federal Reserve function involving (1) transactions with a foreign central bank or foreign government, (2) any deliberations or actions on monetary policy matters or (3) any transactions made under the direction of the FOMC. H.R. 3512 would remove the last two restrictions while retaining the restriction against GAO access to transactions with foreign central banks or foreign governments.

In his October 25 testimony, Chairman Greenspan protested that GAO audits would duplicate functions that are already performed, including financial audits by the Federal Reserve itself and Congressional oversight of monetary policy, and would stifle free discussion of policy alternatives by the members of the FOMC.

Although the Board of Governors does currently conduct a thorough financial examination of each of the Federal Reserve Banks through its operations review program, and the Board of Governors is audited by Price-Waterhouse, these examinations do not result in certified financial statements of the kind

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auditors would prepare for a private bank or corporation. While GAO audits of the Federal Reserve's financial condition might overlap the Federal Reserve's own efforts, every government agency that takes in and spends billions of dollars each year ought to be subject periodically to outside review. We are not accusing the Federal Reserve of dishonesty, we just believe the GAO should have more complete access to the Federal Reserve's financial statements.

What the Federal Reserve does not do under current practice is subject its practices and procedures to outside review, and this is where GAO audits could be even more valuable. Congressional oversight of complex issues benefits greatly from the kind of in-depth examination that can be conducted only by the GAO. It is true that Congress holds frequent hearings on monetary policy, and this subcommittee holds valuable annual hearings on the Federal Reserve's budget. But complex issues should not be left solely to hearings. The Congressional oversight responsibility is better carried out if it is better informed through studies that are analytic, independent, and based on full information.

By way of example, questions GAO could address that would not be possible under current restrictions include:

A. What economic information do the members of the FOMC have available during FOMC meetings? Is it presented in the most useful format? What other kinds of information should be available?

B. What are the costs associated with the Federal Reserve's purchases and sales of securities for open market operations? Is the Fed doing this efficiently?

C. What are the details of Federal Reserve operations through the discount window to assist failing banks and thrifts? What kind of collateral is being required, what are the terms and agreements?

Chairman Greenspan's concern that GAO audits would inhibit FOMC deliberations confuses access to information with disclosure. There are many instances where GAO has access to information that it cannot publicly disclose. For example, in its audits of banks and other financial institutions, the GAO is prohibited from disclosing "information identifying an open bank, an open bank holding company, or a customer of an open or closed bank or bank holding company." In carrying out these audits, however, the GAO has access to "all records and property of or used by an appropriate Federal banking agency, including samples of reports of examinations... and workpapers and correspondence related to the reports." The GAO also has access to the finances of the President and Vice President of the United States. When it audits any part of these records, however, it is prohibited from disclosing its findings, unless they involve criminal activity. If needed, our bill could be adjusted to include similar provisions.

V. Federal Reserve Budget

The final provision of our bill would require that the Federal Reserve's annual budget be published in the Budget of the U.S. Government. The Fed would submit its budget for the current year and the two following years to the President by October 16 of each year, and the President would be required to print the Fed's budget in the Government Budget without change.

The Federal Reserve's expenditures are not subject to approval by either the President or Congress, unlike the budgets of other government agencies. While the Board of Governors reviews and approves the annual budgets of the 12 Federal Reserve Banks, the Board determines its own budget.

During 1989, the revenues of the Federal Reserve System will be about $20 billion. A small fraction of these revenues will consist of payments by banks for services provided by the Fed. Most will consist of interest received from the Treasury on the Fed's holding of U.S. Government securities, which the Fed acquired during open market operations conducted for monetary policy purposes. Out of this $20 billion, paid mostly by taxpayers, the Federal

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Reserve will incur approximately $1.6 billion in operating expenses. Almost $1 billion of this will be for personnel costs. The rest will be for supplies, travel expenses, telephone and postage, printing money, maintenance of equipment, amortization of buildings, etc. The remainder will be returned to the Treasury, where it is listed in the Budget as an offsetting receipt.

Despite the fact that the Federal Reserve takes in and spends billions of dollars each year, the Federal Reserve's budget is not conveniently available to Congress or the public. Only a small fraction of the Fed's $1.6 billion of operating expenses is included in the U.S. Government Budget -- just the $90 million of expenses incurred by the Board of Governors in Washington. The details on this part of the Fed's budget, only 6 percent of the Federal Reserve's total spending, appear in Part IV of the Budget Appendix, in a section entitled "Government-Sponsored Enterprises."

Under pressure from Congress, the Federal Reserve began publishing budget data for the entire System in 1986 in an annual document entitled Annual Report: Budget Review. While this report represented an improvement over prior practice, the Federal Reserve's annual Budget Review still has three shortcomings:

-- It is not printed together with the rest of the data on how the government takes in and spends money and thus it does not get the public scrutiny accorded other government agencies.

-- There are no estimates or projections of future expenditures. The Budget Review only presents actual or estimated expenditures for the previous two calendar years and the budget for the current calendar year. By contrast, the Government budget presents estimated expenditures for government agencies not only for the current fiscal year, but for the next two fiscal years in the future.

-- Data on Federal Reserve receipts are presented only for prior years. There is no estimate of receipts either for the current year or for future years.

In his testimony, Chairman Greenspan argued that the Federal Reserve's functional independence is inseparable from its budgetary independence and that publishing its budget in the Government budget would require the Fed to keep two sets of books at the cost of millions of dollars.

H.R. 3512 will not reduce the Federal Reserve's control over its own budget. The bill would not subject the Federal Reserve to the Congressional appropriations process, nor would it give either Congress or the Administration any control over the Federal Reserve's spending. All it does is require that the data be published conveniently in the U.S. Government Budget, where spending by every other government agency is already listed. This includes the Supreme Court, which has its budget published in the Government Budget without any loss of independence.

The bill will not require the Federal Reserve to maintain two sets of books. Although the Fed does not use the Federal fiscal year or government accounting principles for its accounts, the Fed would not be required to adopt them by our bill. It would be useful, but not required. We just want the Fed's data on its budget to be published along with the rest of government spending in the Budget of the U.S. Government.

Adopting the bill would thus implement a basic principle of democracy that no government agency should take in and spend billions of dollars without having its budget readily accessible to the public.

These are the specific provisions of H.R. 3512.

Before concluding, I would like to address two more general arguments used by the Federal Reserve and others to oppose our bill.

One is, "If it ain't broke, don't fix it." This objection assumes that the effect of H.R. 3512 will be to force the Federal Reserve to alter its conduct of monetary policy, which would harm

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the economy of the United States.

This fear is based on a misreading of H.R. 3512. Nothing in our bill would affect the conduct of monetary policy. In fact, we revised the original version of the bill to eliminate a provision that many observers thought could have forced a change in monetary policy.

Nonetheless, H.R. 3512 does address a problem that does need to be fixed, the complex problem of Federal Reserve accountability in a democratic society. Congressman Dorgan and I believe the five provisions of our bill would do that in the most responsible way possible, without jeopardizing the Federal Reserve's independence or injecting politics into monetary policy. We do not think Congress should wait until a monetary crisis to reform the Federal Reserve. Our bill takes advantage of a period of high regard for the Fed, and a moment of economic calm, to bring Fed procedures up to date. If we wait to make the necessary adjustments until a time of economic turbulence and controversy, the results may be far less measured.

The second objection is that Congress and the President are not responsible enough to have control over monetary policy, given the mess we have made of the budget.

This objection also completely misreads H.R. 3512. There is no provision in the bill that would give Congress or the President any control over monetary policy. If someone wanted to politicize monetary policy, our bill would not be the way to do it. This bill does only two things: it removes some of the veil of secrecy that surrounds the Federal Reserve by shedding some light on its policies and practices; and it establishes a formal channel of communication between the President and the FOMC.

Our bill, of course, is not the only way to accomplish these goals, although we have taken care to include only provisions that would not interfere with the Fed's independence. We would be happy to have the Subcommittee's suggestions for improvements in our bill.

In our nation, the government must be accountable to the people. The Federal Reserve, with its enormous power over the economy and the well-being of the American people, does not meet the normal standards of accountability in a democracy. The bill that Rep. Dorgan and I introduced will make the Fed more accountable without impairing its ability to conduct monetary policy, by establishing a formal channel of communication between the FOMC and the Administration and by shedding more light on its practices and procedures.

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MONETARY POLICY REFORM ACT OF 1991
TESTIMONY OF REP. LEE H. HAMILTON
Before the
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
on
Wednesday, November 13, 1991

Mr. Chairman, I am very pleased to be here this morning to testify on the Monetary Policy Reform Act of 1991. Rep. Dorgan and I introduced this measure in the House of Representatives on August 1, 1991, where it has been assigned the bill number H.R. 3176. Simultaneously, Senator Sarbanes and Senator Sasser -- both Members of this Committee -- introduced it in the Senate, where it has been assigned the number S. 1611.

The Monetary Policy Reform Act would make two changes in the structure of the Federal Reserve. First, it would dissolve the Federal Open Market Committee and assign sole responsibility for open market operations to the Board of Governors of the Federal Reserve System. Second, it would establish a new Federal Open Market Advisory Committee through which the presidents of the 12 regional Federal Reserve Banks could advise the Board of Governors on open market operations and monetary policy. Together, these changes would make the Federal Reserve properly accountable to the American people.

While the need for change has long been recognized, the impetus for this legislation grew out of reports earlier this year that proposals by Federal Reserve Board Chairman Alan Greenspan to lower interest rates were being resisted by some of the regional Federal Reserve Bank presidents serving on the Federal Open Market Committee.

These were disturbing reports. The nation's economy was in a recession. Output was falling and unemployment was rising. There was widespread agreement that the economy could be helped by lower interest rates and that the Fed should reduce interest rates. Yet, as a consequence of this split among the policy-makers on the Federal Open Market Committee, the Fed moved slowly -- some think too slowly -- to take the necessary steps to lower interest rates and stimulate the economy.

In a democratic government, it is not unusual for policy-makers to disagree. But this was not simply a split among public officials. Instead, a small handful of individuals -- presidents of the Federal Reserve Banks -- who essentially represent private interests was impeding efforts by public officials to conduct monetary policy in the way they thought was best for the nation's economy.

The status of the Federal Reserve Bank presidents in the Federal Reserve System is an anomaly in our system of government. It requires some explanation. The Federal Reserve System was created by Congress in 1913 to manage the nation's financial affairs. It consists of the Board of Governors in Washington, which oversees the system and sets most of the policies, and the twelve regional Federal Reserve Banks, which carry out the day-by-day functions of the system. The Board of Governors has seven members, who are appointed by the President and confirmed by the Senate to 14-year terms. The Governors of the Federal Reserve are thus duly-appointed government officials who are accountable to the President and Congress, and through them to the American people, for their conduct in office.

At the Federal Reserve Banks, the top officials, in contrast, do not go through the normal appointment process. The Federal Reserve Bank presidents owe their jobs to the Boards of Directors of the regional Banks, subject to the approval of the Board of Governors. These regional Boards of Directors are dominated by local commercial banks, who appoint six of the nine directors. Neither the President nor Congress has any role in selecting either the directors or the presidents of the Federal Reserve Banks. Some of the Bank

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presidents are career employees, others have backgrounds in banking, business and academics; they are talented and respected individuals. But none are properly-appointed government officials, and they are not accountable to the American people for their performance in office. Nonetheless, they participate in monetary policy decisions through their membership on the FOMC, where they cast five of the twelve votes that determine monetary policy and interest rates.

This situation, in which private individuals participate in monetary policy decisions, is an anomaly in our system of democratic government. Nowhere else in the government are private individuals similarly permitted to participate in decisions which have such an enormous influence over the prosperity and well-being of millions of Americans.

Almost all government agencies make extensive use of private citizens in an advisory status. The Federal Reserve, itself, has three major advisory panels which meet with the Board of Governors three to four times a year -- the Federal Advisory Council, a panel of 12 bankers which advises the Board of Governors "on all matters within the jurisdiction of the Board;" the Consumer Advisory Council, which advises the Board on consumer financial services; and the Thrift Institutions Advisory Council, which advises the Board on issues pertaining to the thrift industry. Other government agencies have similar advisory panels. Private citizens serve on all these panels, but all they do is advise. Nowhere other than the Federal Reserve are representatives of private interests permitted to have a vote on government policy.

Among legal scholars, the present composition of the FOMC raises grave constitutional concerns. Those who have examined the conditions under which Congress has delegated powers to other branches and agencies of government and to independent commissions suggest that giving private individuals on the FOMC the right to vote on monetary policy is constitutionally flawed, if not unconstitutional. I would like to quote from a letter from Professor Harold Krent of Case Western Reserve's Law School:

> As currently constituted, the participation of private members on the FOMC raises fundamental constitutional concerns because the private individuals are not accountable to the public for their exercise of governmental authority.... The participation of private members on the FOMC cannot be easily reconciled with the focus on accountability underlying our system of separated powers.... The proposed bills would rectify that consitutional flaw by limiting the role of the private bank presidents to advice, a function fully compatible with the private status of the bank presidents.

The current structure of the Federal Reserve, and the Federal Open Market Committee in particular, is not locked in stone. Over the years, there have been many changes. In fact, between the founding of the Federal Reserve System in 1913 and the enactment of the major banking laws in 1935 and 1936, there was no Federal Open Market Committee to guide open market operations. The regional Federal Reserve Banks bought and sold Treasury securities on their own initiative, and the process frequently proved disruptive to Treasury financing plans and to the economy. When Marriner Eccles became Chairman of the Federal Reserve Board under President Roosevelt, his list of proposals to make the Federal Reserve more accountable included giving the Board of Governors full authority over open market operations. The current structure is the result of a compromise. In order to consolidate open market operations under the newly-created Federal Open Market Committee, Eccles and Roosevelt had to compromise with supporters of the Banks by giving the regional Federal Reserve Banks five of the 12 votes on the FOMC. It is now time to move further and take the next step to make the Federal Reserve more accountable.

During the early decades of the Federal Reserve, anomalies such as the role of the Bank presidents on the FOMC did not cause the concern they do today because the Federal Reserve did not exercise the influence over our

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economy that it does today. Not much was known about the Fed years ago and people didn't feel it had much impact on their lives.

But times have changed. Today, it is well known that the Federal Reserve is the chief way the government influences the economy. When I am in Indiana, people spontaneously ask me about the Federal Reserve and Federal Reserve policies. They recognize the power of the Fed and the way it affects their own personal well-being. It makes a lot of difference today how the Federal Reserve is structured. Policy-making is the proper function of public officials who have either been elected by the people or appointed in the appropriate manner, and that is the way it should be at the Federal Reserve.

The Monetary Policy Reform Act would address this concern by assigning the conduct of monetary policy and open market operations to the seven-member Board of Governors of the Federal Reserve System, thus lodging this responsibility with properly-appointed public officials. It would also create a special new Federal Open Market Advisory Council through which the presidents of the regional Federal Reserve Banks could advise the Board on monetary policy. The Bank presidents would no longer have a vote on monetary policy, but the Board of Governors would still have the benefit of their advice.

Before closing, I would like to point out, Mr. Chairman, that the Monetary Policy Reform Act is a companion measure to H.R. 1130, the Federal Reserve Reform Act of 1991, which Rep. Dorgan and I introduced earlier this year.

The Federal Reserve Reform Act would address other anomalies by which the Federal Reserve fails to conform to the normal standards of accountability in a democracy:

o Monetary policy is decided in secret, behind closed doors.

o The Federal Reserve is not required to consult with Congress or the Administration before setting money or interest rate targets, even though its power affects the financial well-being of every American.

o It waits six weeks before releasing policy decisions.

o The President, who is responsible for the performance of the economy and is blamed if things go wrong, often must wait until late in his term to appoint a new Chairman of the Federal Reserve Board.

o The Fed's budget is not published in the U.S. Government Budget, even though it spends over $1.5 billion per year.

o And, even though the Federal Reserve engages in more than $1 trillion in transactions in the money markets each year, most of these activities are exempt from audit by the GAO or any other outside agency.

The Federal Reserve Reform Act would address these problems by making the following modest changes in the practices and procedures of the Federal Reserve:

(1) It would require the Secretary of the Treasury, the Chairman of the Council of Economic Advisers, and the Director of the Office of Management and Budget to meet three times a year on a non-voting basis with the Federal Open Market Committee, to consult on monetary and fiscal policy. This would open a formal channel of communication between the policy-makers in the White House and the policy-makers at the Federal Reserve.

(2) It would allow the President to appoint a Chairman of the Federal Reserve Board (with the advice and consent of the Senate) one year after taking office, at the time when the first regular opening would occur on the Federal Reserve Board. This would make the Fed Chairman's term basically coterminous with the term of office of the President of the United States.

(3) It would require the FOMC to disclose imm
ediately any changes in the targets of monetary policy, including its targets for monetary aggregates, credit aggregates, prices, interest rates, or bank reserves.

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(4) It would permit the Comptroller General to conduct more thorough reviews and studies of Federal Reserve operations, by removing selected current restrictions on GAO audits.

(5) It would require that the Federal Reserve's annual $1.5 billion budget be published in the Budget of the U.S. Government. The Fed would submit its budget for the current year and the two following years to the President by October 16 of each year, and the President would be required to print the Fed's budget in the Government Budget without change.

The Monetary Policy Reform Act would add a sixth change to this list, by making the duly-appointed public officials on the Board of Governors of the Federal Reserve solely responsible for the conduct of monetary policy.

During the last Congress, the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs conducted a hearing on the Federal Reserve Reform Act, and I would like to submit my statement from that hearing for the hearing record.

In summary, the status of the Federal Reserve Bank presidents is an anomaly in our system of government. They do not go through the normal appointment process but, nonetheless, they participate in monetary policy decisions through their membership on the FOMC, where they cast five of the twelve votes that determine monetary policy and interest rates. In earlier times, when the Fed was less powerful, this was not a major concern. But today, it is widely recognized that the Federal Reserve is the chief way the government influences the economy. Decisions made by policy-makers at the Federal Reserve affect the lives and well-being of all Americans. Power without accountability does not fit the American system of democracy. We have changed the Federal Reserve in the past. It is now time to move further and take the next step to make the Federal Reserve more accountable. Monetary policy today must be the responsibility of properly-appointed public officials, who are accountable to the American people for their performance in office. The Monetary Policy Reform Act of 1991 would apply this principle of democracy to the Federal Reserve.

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Congressman Schumer's question to Chairman Alan Greenspan at the House Banking Committee's second hearing on the Federal Reserve System on October 13, 1993:

> Are there times when you think that greater accountability in the history of the FED -- which you are a much greater expert at than I am -- would have made better monetary policy?

Chairman Greenspan subsequently submitted the following response for the record:

Looking back over the period after the Treasury-Federal Reserve Accord in 1951, when the Federal Reserve regained the discretion to conduct an independent monetary policy, does not reveal instances when greater accountability and less independence would have resulted in better economic outcomes. Monetary policy has by no means been perfect over this period, with the most significant mistake being its unwillingness to resist adequately the pickup of inflation to the double-digit area by the late 1970s. However, political pressures mostly were for still more monetary accommodation, in hopes of propping up economic activity, although Congressional initiatives dating from 1975 encouraging the use of announced ranges for money and credit growth are perhaps a counter-example. But even the Full Employment and Balanced Growth Act of 1978, which codified into law the setting of annual ranges for money and credit growth, thereby strengthening the anti-inflationary discipline of Federal Reserve practice, at the same time incorporated unrealistically optimistic goals for employment and economic activity.

On balance, then, I would judge historical experience with Federal Reserve independence as indicating a significant advantage on balance in shielding monetary policy from the vicissitudes of short-term political pressures that would add an inflationary bias to our economic system. In particular, the reform proposals currently under consideration, which are claimed to provide greater accountability, would weaken the Federal Reserve's independence and hence tend to undercut sound monetary policy over time.

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