

ACTIVITIES AND POLICIES OF DISTRICT BANKS AND THEIR IMPLICATIONS FOR MONETARY POLICY

HEARING
BEFORE THE
SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-SEVENTH CONGRESS
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ACTIVITIES AND POLICIES OF DISTRICT BANKS AND THEIR IMPLICATIONS FOR MONETARY POLICY

THURSDAY, SEPTEMBER 23, 1982

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Walter E. Fauntroy (chairman of the subcommittee) presiding.

Present: Representatives Fauntroy, Neal, Barnard, Reuss, Patman, Hansen, Paul, McCollum, Lowery, Weber, and Coyne.

Chairman FAUNTROY. The subcommittee will come to order.

Today, we are meeting to take testimony from 5 of the 12 Federal Reserve district bank presidents in what I must characterize as a historic hearing. The Federal Reserve district banks act as intermediaries between the Board of Governors of the Federal Reserve System in Washington and the business and financial communities and general public in the various districts.

They are, on the one hand, entities which carry out the day-to-day operations of the Federal Reserve System including the distribution of currency, processing of checks, acting as the Government's banking, supervising some of the activities of financial institutions, and extending loans to depository institutions. As the premier financial institution in their communities, they are also potential leaders in the affirmative action and upward mobility programs as well as a source of significant employment and economic expertise.

On the other hand, presidents of the district banks attend meetings, and five serve on a rotating basis as voting members of the Federal Open Market Committee which is this Nation's central body for monetary policy decisions. They are supposed to assure that regional economic developments and conditions are reflected in our national monetary policy.

These hearings are intended to explore just how well the district banks are carrying out these two different functions. We ought not assume that just because we have had district banks for many decades, as both the operating arms of the Federal Reserve and participants in its policy process, that the system works perfectly or that it should not be modified to better meet today's needs.

In inviting each of you to this hearing, I posed in my letter of invitation a number of issues. Among them are the results of the explicit pricing policy for Fed services mandated by the Monetary Control Act and its effect on employment at the district banks, and the impact of the expansion of reserve requirements. I also asked about the composition of the boards of directors and possible expansion to include thrifts and other financial institutions, and the banks' involvement in community and scholarly activities, work training and upward mobility programs, affirmative action policies and the numbers of minorities employed in management and research positions.

Additionally, I want to explore with you the impact on monetary policy of regional business, financial, employment, and credit conditions, as conveyed by the district bank presidents. Finally, I would like to examine the role that the directors of the banks have in aiding you to formulate your ideas which are then translated into policy by the FOMC.

Some of this discussion will obviously touch upon the most important question of the appropriateness and viability of the monetary targets presently in use and whether we might not consider alternative targets such as credit, nominal GNP, or interest rates.

[A copy of the subcommittee notice of the hearing with the questions that were submitted to the Federal Reserve district bank presidents and a press release of the subcommittee, dated September 7, 1982, follow:]

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U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-SEVENTH CONGRESS

WASHINGTON, D.C. 20515

On Thursday, September 23, 1982, the Subcommittee on Domestic Monetary Policy will hold hearings on the Activities and Policies of the Federal Reserve District Banks and their Implications for Monetary Policy. These hearings will examine a wide range of issues, including the role and operations of the Federal Reserve District Banks in their communities and regions and their role in determining monetary policy.

I would like you as the President of a Federal Reserve District Bank to testify at these hearings on your two-fold role of translating national policies into local and regional affairs, and communicating local and regional economic concerns to the Board of Governors of the Federal Reserve System. In regards to the first role, I hope that you will address the following questions:

1. What are the results of the explicit pricing policy for Fed services mandated by the Monetary Control Act? What have been the effects on employment by the District Banks and their branches? What difficulties, if any, have been encountered by the expansion of Reserve Requirements? What degree of integration and cooperation has developed between the Reserve District Banks, the commercial banks, and the thrifts?
2. What is the composition of your Board of Directors, the number of women and minorities who serve on your Board, and the number of individuals who are associated with thrift institutions? What are your plans to expand their participation on the Board? What is your view of proposals under consideration to increase the number of Class "C" Directors or create a new class of Directors who would represent the thrifts or other financial institutions?

3. What has been your bank's involvement with community and scholarly activities? In this connection, I would be pleased to know what work-training programs, upward mobility programs, affirmative action policies, forums for small and minority businesses, and research activities your bank has been and is presently engaged in doing.

In regard to your second role as conveyors of local and regional concerns to the central bank, the Subcommittee is interested in the views and perceptions of economic conditions that you, as a Reserve Bank President, bring to the deliberations on monetary policy of the Federal Open Market Committee. Specifically, the Subcommittee would like to know your opinions of the following monetary issues:

1. The status of business and financial liquidity, in the economy as a whole and in your District, and the implications for monetary policy.
2. Employment and business conditions in the economy, as a whole and in your District, and the implications for monetary policy.
3. The relative importance of further reductions in inflation at this time compared with the state of employment and business conditions and liquidity.
4. The appropriateness and viability of the monetary targets currently used by the Federal Reserve, specifically the M-1 aggregate, and your views on alternative targets, including the monetary base, a credit target, GNP, or targetting of real or nominal interest rates.
5. The role which directors of your bank have in assisting you formulate policy or recommendations.

The hearing will take place at 10:00 a.m. on Thursday, September 23, 1982, in the Wright Patman Hearing Room, 2128 Rayburn House Office Building. The Subcommittee requires witnesses to provide 100 copies of their testimony to its Members and Professional Staff 48 hours prior to the hearing. Witnesses who wish to assure that the public and press will have adequate copies of their statement should bring additional copies with them at the time of the hearing. Copies may be delivered to the offices of the Subcommittee which are located in Room H2-109, House Office Building Annex #2, Second and D Streets S.W., Washington, D.C. 20515. Any questions which you or your staff may have concerning this invitation may be addressed to Howard Lee, Staff Director of the Subcommittee, who may be reached at 202/226-7315.

Sincerely yours,

Walter E. Fauntroy
Chairman

WALTER E. FAUNTROY, D.C. CHAIRMAN

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OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-SEVENTH CONGRESS
WASHINGTON, D.C. 20515

news release

TUESDAY, SEPTEMBER 7, 1982
FOR IMMEDIATE RELEASE

contact: Howard Lee
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FAUNTROY SUBCOMMITTEE TO HEAR FROM FEDERAL RESERVE DISTRICT BANK PRESIDENTS ON MONETARY POLICY AND BANK OPERATIONS

Hearing with District Bank Presidents is Historic First

(WASHINGTON, D.C.) Congressman Walter E. Fauntroy (D.-D.C.), Chairman of the Subcommittee on Domestic Monetary Policy of the House Banking Committee, today announced that the Subcommittee would meet on Thursday, September 23, 1982, to take testimony from selected Federal Reserve District Bank Presidents, five of whom sit as voting Members of the Federal Open Market Committee. The Hearings will be held at 10:00 AM in Room 2128 of the Rayburn House Office Building in Washington, D.C.

Mr. Fauntroy stated that the hearings would address both how well the District Banks are carrying out national policies such as financial institution deregulation and affirmative action, and how well the Presidents of these banks are conveying economic and financial conditions in the districts to the monetary-policy deliberations of the Federal Open Market Committee. "This will be the first time in modern economic history that a group of Federal Reserve District Bank Presidents have appeared before a House Committee or Subcommittee," the D.C. Congressman pointed out, although individual Presidents have testified.

The twelve Federal Reserve District Banks act as intermediaries between the Board of Governors of the Federal Reserve System in Washington, D.C., and the business and financial communities and the general public in the various Districts. "On the one hand," said Chairman Fauntroy, "the District Banks carry out the day-to-day operations of the Federal Reserve

-more-

System, including distributing currency, processing checks from where they are cashed to the banks upon which they are written, acting as the Government's banker, supervising some of the activities of financial institutions, and extending loans to member banks. The District Banks also have a substantial impact on the communities in which they are located, as a back-up for financial institutions, an employer, and a potential source of economic expertise and community leadership."

"On the other hand," noted the Congressman, "the Presidents of the District Banks attend the meetings, and five serve on a rotating basis as voting members, of the Federal Open Market Committee, which is the central body for decisions on monetary policy. The Bank Presidents are supposed to assure that regional economic developments and conditions are reflected in monetary policy."

"These Hearings," Mr. Fauntroy said, "are intended to explore how well the District Banks are carrying out these two different functions. We cannot assume, just because we have had District Banks for many decades as both the operating arms of the Federal Reserve and participants in its policy decisions, that this system is working perfectly or that it cannot be modified to better meet today's needs."

Among the issues before the Subcommittee at this hearing are the results of the explicit pricing policy for Fed Services mandated by the Monetary Control Act, its effect on individual bank employment and the impact of the expansion of reserve requirements. The composition of the Board of Directors, possible expansion of the boards, retirement of the Federal Reserve Stock, affirmative-action and upward-mobility programs of individual banks will also be examined.

Most importantly, the Subcommittee will also explore the impact on monetary policy of regional business, financial, employment and credit conditions, as conveyed by the District Bank Presidents. The Subcommittee will also inquire of the Presidents' views on the appropriateness and viability of the monetary targets presently in use, on the objectives and limits of monetary policy, and on related issues.

Chairman FAUNTROY. President Morris, President Solomon, President Roos, President Corrigan, and President Boykin, I extend to you a deep and sincere welcome. I understand that you have a joint statement and individual statements. Before I recognize President Solomon to present the joint statement, I would like first to recognize our distinguished colleague, the chairman of the Joint Economic Committee of the House, Congressman Henry Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

I join you in welcoming the presidents of our Reserve banks. At the witness table, I am delighted to see Boston, which has done such great work among other things in regional economic development; New York, renowned in the international field; St. Louis, whose excursions into monetary reauthorization have been welcome. Closer to my home, Minneapolis, which likewise has directed its attention to regional economic problems of agriculture and of high technology industry. And of course Dallas, which has given energy some new dimensions.

It is a rare occasion to have with us the leaders of the regional Federal Reserve banks. I have often suggested that they ought to be heard from, by Congress, and I am delighted that today we are going to be able to do so. And I hope that today's hearing will be but the first in a series, for which I commend you, Mr. Chairman.

I have a couple of observations on monetary policy. First, on the supply side, the supply of money, it is my belief that monetary policy, particularly the Fed's plans for 3 months from now, for 1983, remain too tight. Every day evidence grows that the economy is not recovering. The pace of growth hoped for by the administration is hopelessly out of sight. That sought in the congressional budget resolution is not going to be achieved, and that is going to make another mockery of the budget process.

Yesterday we got some more bad news. Economic growth in the third quarter is down to an estimated tiny 1.5 percent. Industrial production continues to fall. Just yesterday, new factory orders were reported to have dropped 3.8 percent in the month of August alone, the lowest level in 5 years.

Since this continues to happen despite falling inflation and despite the fact that the monetary aggregates are growing at or above the top of their targets, there can be only one conclusion, and that is that the monetary targets are too tight.

Despite my pleas, the Fed last July refused to raise its M_1 target from its 2.5- to 5.5-percent range. A more defensible range of say 4 to 7 percent would have validated monetary policy today, and would put to rest market expectations that the Federal Reserve will now shortly move to tighten again and send interest rates up.

My second concern is on the side of the demand for money. Need I recite again the list of companies, municipalities, and whole industrial and farm sectors of our economy which are starved for credit and in desperate need of relief. The condition of basic industry, agriculture, small business, housing, automobiles, farm implements, the public infrastructure, has now passed beyond the domain of mere concern. I believe we are in a full-scale crisis. Yet we still find, in the playground of our national capital markets, that such well-heeled operators as Bendix and Martin Marietta can tap hundreds of millions of dollars of scarce credit for a game of

corporate chicken which is completely devoid of redeeming public economic benefit.

In the international field, we look at the array of dominos teetering on the financial scene—Mexico, Brazil, Poland, Argentina, International Harvester, Massey Ferguson, Dome Petroleum, Drysdale, Penn Square, and hundreds of other less well-known countries and firms.

The question which I raise today in a friendly spirit, but with deep concern, is how long can the Federal Reserve continue to close its eyes to this grotesque misallocation of resources. Wouldn't it have been better in the last years if the Fed had slowed down bank lending for commodity speculation, for unproductive corporate takeovers, and for excessive and imprudent foreign lending.

Would not that foresighted course have spared the Fed its present position, one of self-proclaimed lender of last resort for the world, but one of in fact quaking in its boots that its hand may be called.

I am concerned, gentlemen. And I welcome this chance to explore the nature of the crisis with you and how we may safely get out of it.

Thank you, Mr. Chairman.

Chairman FAUNTROY. I thank our dean. I want to yield now to the distinguished ranking member of the subcommittee, the Honorable George Hansen, for comments as well.

Mr. HANSEN. Thank you, Mr. Chairman.

I join with you in welcoming this distinguished panel of witnesses. It is indeed a rare event to have five Federal Reserve district presidents and members of the FOMC testify on the conduct of their activities in their respective districts, as well as on the national level.

A wide range of topics which we plan to discuss will give us who serve on this subcommittee, as well as on the full Banking Committee, added insights into the workings of the Federal Reserve System. It will, so to speak, provide us with a new dimension, new background against which to appreciate the periodic testimony of your Chairman, Paul Volcker.

Chairman Fauntroy has provided you with an extensive agenda of topics, some of them of an administrative, some of them of a factual, some of them of a policy nature. Since our time with you unfortunately is limited, if I could express a preference, I would like to urge you not to pass over too lightly, in your statements, the question of the appropriateness of the monetary targets currently in use by the Federal Reserve and your views on possible alternative procedures.

We know that all of you have given the matter much thought, and some of you in your speeches and writings have put forward specific proposals. Not long ago, this subcommittee received testimony on that subject from a number of well-known academicians. My colleagues and I therefore are looking forward to your testimony with great interest in the expectation that your comments and recommendations will be valuable for the future conduct of this important aspect of public policy.

Mr. Chairman, with that, I would like to ask unanimous consent that we enter at an appropriate place in the record, a New York

Times magazine article of September 19, 1982, titled "A Talk With Paul Volcker." In his first interview since his appointment 3 years ago, the Chairman of the Fed predicts that, if current trends continue, the economy could be entering a period of sustained prosperity.

I think this would be very appropriate to enter in this record, in the context of the witnesses we have.

Chairman FAUNTROY. Without objection, so ordered. The article will be entered in the record at this point.

[The New York Times Magazine article follows:]

A TALK WITH PAUL VOLCKER

In his first interview since his appointment three years ago, the chairman of the Fed predicts that, if current trends continue, the economy could be entering a period of sustained prosperity.

By Andrew Tobias

We are hardly out of the economic woods. But last June, when Paul A. Volcker sat for the first extended on-the-record interview since he became chairman of the board of governors of the Federal Reserve System, things were worse.

Yet even then, with the stock market dismally low and headed lower, with unemployment high and headed higher, with interest rates stuck in what some considered an impossible deadly gridlock — even then, Volcker made a strong case that much of the worst was behind us. That this decade, if we keep our wits about us, could become the reverse of the last one: falling inflation, falling interest rates, rising productivity, rising real wages, falling unemployment.

Given today's improved but still precarious environment, it sounds almost too good to be true. Is it possible things could actually go right for a change?

"This is not an impossible vision," Volcker reported to Congress earlier in the year. "Much of the groundwork has been laid."

There has been the Fed's own restrictive monetary policy, a steady "leaning against the wind" of inflation, which Volcker vows to continue. There have been, too, moves toward deregulation, a moderating in the demands of labor and changes in the tax code to encourage investment (one little-noted result: some 14 million Americans set up Individual Retirement Accounts in just the first three months of this year).

"What we're aiming for," says Volcker, "is a situation in which people can proceed about their business without worrying about what prices are going to do over the next year, two years, three years, 10 years, and can take it for granted that they're going to be more or less stable. And in that kind of environment you ought to have the interest rates we had in the mid-60's, anyway."

The prime rate in 1965 averaged 4½ percent. Municipal bonds yielded 3¼ percent. Home mortgages were still under 6 percent, as they had been, with only minor exceptions, for more than a century.

"Today," he says, "we are acutely aware of disturbed capital markets, high interest rates, economic slack and poor productivity. But when the economy begins to expand, productivity should rise. That will permit prices to rise more slowly than wages, encouraging further moderation in wage demands." And further disinflation. "As confidence returns to securities markets, prices of bonds and stocks should rise. Lower interest rates will, in turn, support the continuing growth in investment and productivity." Things could grad- (Continued on Page 38)

Andrew Tobias's most recent book is *"The Invisible Bankers: Everything the Insurance Industry Never Wanted You to Know."*

ually get better and better. "With appropriate budgetary and monetary discipline, the process could be sustained for years."

□

In the broadest sense, the principal responsibility of the nation's central bank is to see to the health of the national currency: the dollar. Inflation wrecks a nation's currency, and the inflation Volcker inherited on Aug. 6, 1979, was of a type so prolonged and virulent that many young Americans — as he frequently points out — have never not known it.

In theory, faced with economic and social chaos — for this is what prolonged, accelerating inflation inevitably brings — the Fed would get tough, which it has; and so would Congress — which it hasn't. ("The trouble is Congress," opined Business Week on its Aug. 16 cover.)

Notwithstanding the \$98.3 billion tax package the President managed to ram through recently, Congress has given us a 1983 budget deficit projected to approach \$150 billion. In a recession, such a deficit, given the size of our economy, should be tolerable. Far worse, however, is this: The deficit is projected at similar or higher levels in 1984 and 1985. Even with an economic recovery. (It's one thing for a family to spend more than it earns for a while, after one spouse has been laid off; quite another to overspend all the time.)

One best-selling doomsayer thus describes the Fed's efforts, which he lauds, as "one hand clapping." Buy gold, he says, the next round of inflation will be much worse. ("Is he still saying that?" Volcker asks.)

There are lots of complicated technical things the Fed can do to "administer monetary policy," but really they boil down to two: The Fed can ease up, by expanding the money supply, which it does by buying Treasury securities, thereby putting more money in the banking network; or tighten up, by restricting it (selling those securities).

Here's the way it's supposed to work: If the Fed pumps money into the system, interest rates — the price of money — fall. (Money is like anything else: When you increase its supply, its price falls.) Lower interest rates allow more people to

buy cars and houses; business booms; unemployment falls; tax receipts rise; everything is wonderful.

Except that if you pump money into the economy faster than is needed to keep up with real growth, you fuel inflation. Pumping new dollars into the system cheapens those already in existence.

So what's been happening — at least until recently — is that when the financial markets (which include anyone with a few dollars to invest) perceive an easing in money, they fear a new round of inflation — and so they demand higher interest rates.

Great! Tighten up and interest rates rise; ease up — and they also rise. This does not leave a lot of room to maneuver.

The trick is for the Fed to be able to ease up a bit, occasionally, as conditions warrant, while persuading the financial markets that the fundamental anti-inflationary policy has not been abandoned.

It's not enough simply to say the policy has not been abandoned. We've been through too much to believe all the pronouncements of our elected and appointed officials. That only worked in a simpler, more innocent time. Anyone who bought 8½ percent 30-year bonds in 1976, when inflation had been damped down from double digits to a mere 5 percent, trusting promises of a sound dollar ever after, carries a deep scar. Volcker appreciates the problem. Credibility must be earned, he constantly reasserts, by persistence and performance.

Affirms Ashby Bladen, author of "How to Cope With the Developing Financial Crisis," as skeptical of government pronouncements as anyone: "The only way that confidence and, therefore, moderate and stable interest rates can be restored is through a long period of responsible and noninflationary policies."

"Recently," he adds, "Fed policy has been rather reassuring."

You've seen the "Peanuts" classic. Lucy's index finger is on a football awaiting Charlie Brown's big toe. "Come on, Charlie Brown — kick it!" she says. Charlie Brown says no. "Come on, Charlie Brown," she says, "kick it!" Every year Lucy plays this dumb trick on him. Just as he

(Continued on Page 66)

runs to the ball and begins to kick she whisks the ball away, and he lands *boink!* on his head. This year, he tells her, he's not going to fall for it. Lucy swears up and down that this year she'll really hold the ball — ascribes past behavior to immaturity, since outgrown — but Charlie Brown shakes his head. "I swear I won't pull the ball away," she says. "I swear!" This year, she means it. She really, really means it. So, trusting soul, Charlie Brown runs up to the ball, kicks his little heart out — and lands *boink* on his head. Lucy laughs hysterically.

"Is it fair to say," Volcker is asked, "that this is the nub of the whole thing? That your very biggest problem, in a way, is somehow convincing the financial markets that you really, really mean it?" "Yes. Without killing the economy in the process."

□

The Fed is charged with managing the money supply. O.K. — what's money? Cash, of course, and checking-account balances. But do you include money-market funds? Savings accounts? Saving certificates? Savings bonds? (Corporate bonds? Stocks? Options? Diamonds? Baseball cards?) How about borrowing power?

It used to be that the only way to buy something was to have coins in your pocket. Someone with no coins had no money. Today, someone with no coins but \$2,000 of unused credit on his MasterCard can buy \$2,000 worth of goods. Is that credit line "money"?

Ultimately, says Volcker, you could technically get to the point where nobody keeps any cash or checking-account balance at all. Everybody runs an overdraft all the time. "Then what do you call the money supply? The total of their overdraft limits?"

"Basically, we've got a problem of interpreting what is going on ourselves," Nancy Hays Teeters, a Fed governor, told *The New York Times* recently. Echoed Frank E. Morris, the president of Federal Reserve Bank of Boston: "I have ... concluded, most reluctantly, that we can no longer measure the money supply with any kind of precision...."

If you can't define it or measure it, how do you control it? "Obviously," Volcker responds, "our presumption is that you can do it within a

narrow enough band — which is not as narrow as some people think it is — in a way that's meaningful in today's conditions. But I don't think you can just write a rule that's supposed to last for 10 years or something" (as it was recently proposed).

What many laymen, and some congressmen, fail to grasp, is that economics may be a "science," but it works less neatly in the real world than in textbooks. It's one thing to get a couple of chemicals to react the way they should; people are less predictable. You can feed new dollars into the system, for example, but how do you feed people the confidence to borrow and invest them?

Consider: If the projected budget deficits were smaller, interest rates would be lower (because Treasury borrowing and inflationary expectations would ease). Yet if only interest rates were lower, the budget deficit would be smaller (because tax receipts would be higher, expenditures lower).

It is one of those circular problems very much on the order of "The only thing we have to fear is fear itself." Today's version: "If we had confidence inflation were ending" — and consequently moderated our wage demands, committing our money to productive long-term investments, and so forth — "inflation would end."

And yet, one Fed governor acknowledged, "you can push the economy so hard to kill inflation that you discourage the investment that killing inflation was meant to stimulate."

As the economists at the Aetna Life and Casualty Company put it this summer: "Our central bankers have so far engineered the economy along the razor's edge between reflation and financial chaos. The more doctrinaire monetarists" — Treasury Under Secretary Beryl Sprinkel's crowd — "may call this irresponsible. We prefer to call it the application of reasoned human judgment."

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Given the extraordinary difficulties Volcker has faced, and still faces, as chairman of the nation's central bank, it is hard not to wonder whether he actually likes his job. "Do you like this job?" he is asked as he settles his 6-foot-7-inch frame onto

the couch under one of two large paintings in his office (a garden scene, by the wife of the staff director for monetary and financial policy). He is wearing a banker's pin-striped suit and has a sharp pencil sticking out of the pocket a dandyier soul might use to display a handkerchief.

The question makes him laugh. Volcker has a voice like the largest drum in the band, tapped gently, for the most part, and an almost Santa-like laugh. He is entirely forthcoming.

"I don't think of it in those terms," he says. "I really don't. I know some people say, 'Gee, is it exciting?' or, 'Are you having fun?' That's a favorite question — and I suppose in some deeper sense I am, but ..." (his voice rises to a low boom as he laughs) "... I don't think of it as fun on a day-to-day BA-sis! There's a satisfaction, I guess, but it seems to me you do it because it's here, and you got picked."

Volcker got picked by Jimmy Carter to succeed the undistinguished chairmanship of G. William Miller (1978-79), who had succeeded Arthur F. Burns (1970-78), who had succeeded William McChesney Martin Jr. (1961-70). There were Fed chairmen before Bill Martin — Charles Hamlin, in 1914, was the first — but that's not important. Not important, either, but the principal way the public has perceived these men: Burns smoked a pipe, Miller smoked nothing and posted a sign requesting the same of his colleagues (with mixed results), and Volcker smokes Antonio y Cleopatra Grenadiers, \$1.45 the half dozen.

Periodically as he speaks, legs outstretched on the sofa, he absent-mindedly waves a match in the air to extinguish it, then tosses it into a large pewter ashtray (that reads: "When You Leave New York, You Ain't Going Nowhere"). Still smoldering, the match bounces out onto the hardwood coffee table. Again and again, the interviewer reaches over to make the save. Volcker played basketball for Princeton, but only second string. Now his sport is fishing. This is important, since it reflects one of his principal attributes: patience. Two others: consistency, and as one senator put it near the end of a 190-minute subcommittee grilling session, "coolness under fire."

Volcker did not succeed Bill Miller thinking he had all the answers. "In a very general way, I thought I had some sense of what the problems were," he says. "It's a field

I've been in virtually all my life. But I did not have the sense that this was an ideal time — and certainly not an easy time — to become chairman of the board."

Prior to assuming the chairmanship, he had presided over the Federal Reserve Bank of New York. There he earned \$116,000. As chairman of the entire 12-bank system, he earns \$60,663. For this princely stipend, some would say, he bears the weight of the Western world on his shoulders. But Paul Volcker, 55, does not appear to be a man raw from criticism or awesomely burdened. He has no great difficulty sleeping.

"I see myself to a considerable extent as part of an institution," he says. "And not just the institution of the Federal Reserve, but in a broader sense as part of a bigger governmental apparatus. I don't personalize it as much as people outside do." Like the 2,000 construction-industry folk, a couple of years ago, who slapped \$1.81 in postage on blocks of 2-by-4's, addressed them to Paul A. Volcker, ink on wood, and dropped them in the mail. "I've become the symbol for monetary policy. Maybe I don't feel quite as burdened as I might if I really had all the power people think I have."

(When "leaders in 30 fields" were asked by U.S. News & World Report to rank the most influential men and women in America, Ronald Reagan ranked first; Paul Volcker, second.)

Born in Cape May, N.J., Volcker went to Princeton, to Harvard and to the London School of Economics. From there he went to work for the Fed, for Chase Manhattan, for the Treasury, for Chase Manhattan again, for the Treasury again (Under Secretary for Monetary Affairs) and then spent a year as a senior fellow at Princeton's Woodrow Wilson School. In August 1975 he was tapped to run the Federal Reserve Bank of New York.

The situation he inherited four years later as chairman of the Fed was alarming. "You had a sense in the summer of '79 that psychologically and otherwise inflation was getting ahead of us. I suppose we're interested in inflation in the end because the economy over a long period of time can't operate very well without a stable currency."

"So more forceful action probably had to be taken, and it was only a couple of months after I was here that we adopted this new operating technique — I'm not sure we

understood all the implications. You never do. But we understood some of them, certainly."

The new technique, which remains in effect, was a major refocusing. Rather than concentrate on managing the level of interest rates in its fight against inflation, as it had done in the past, the Fed announced in October 1979 that it would, from then on, concentrate on controlling the money supply directly, letting interest rates fall — or rise — where they may.

"What we did was not basically a new idea. I'd thought about it some, but I can't say I'd been an advocate of it. It had some problems. What persuaded me was the need to somehow get a grip on the situation, and on psychology, and this seemed to me a way to do it."

"We had taken some tightening moves in August-September that didn't seem to make much of an impact. So I thought, how can we change the approach a little bit here to get people's attention?" Mr. Volcker's laughter erupts through his words in capital letters.

"One of the things we did anticipate — that it would inject more instability into the market in the short run — was not considered altogether undesirable at that point. A little more uncertainty, we thought, might have favorable effects on psychology and behavior, speculative behavior in particular."

Gold had nearly doubled in the previous year and its rise was accelerating. In California, people were buying extra houses to capitalize on inflation. From going largely unnoticed a decade earlier, inflation had become so entrenched that middle America was devising schemes to exploit it.

The Fed's refocusing, which 31 Democratic senators are attempting to undo, was initially well received. But interest rates proved even more volatile than the Fed had anticipated and rose higher.

The Fed's second big move came in March 1980: the imposition of controls on consumer credit. In hindsight, not such a great idea.

"I think certainly, with the benefit of hindsight, we would have done a few things differently during this period," booms Volcker. At the time, though, something had to be done. Inflation was raging along at an 18 percent annual rate. "Despite what we had done up to that point, people had gotten more scared than they were before, I think."

"And you kept getting reports from the market that in-

terest rates may be high, but everybody wants to lend like crazy. Nobody wants to restrain anything — they're all looking to more inflation. So the general idea of maybe having to do something more forceful was not foreign to me."

"The President wanted to put together a big program, which I was encouraging him to do."

But what Carter came up with was a plan to limit the growth of consumer credit.

"I did not want to invoke the Credit Control Act. I thought it was very much a two-edged sword. You never know what the results of these sorts of things are going to be. We were talking about some narrow sector of consumer credit, but what specter is that going to raise in everybody's mind?" Federally mandated credit allocation? Interest-rate controls?

"But we finally went along with it. The President wanted to invoke the act, and we would have had a confrontation if we refused to administer it. So we agreed to do something in the consumer-credit area, and we found out that it had a lot bigger psychological repercussions than we or the Administration had assumed."

Purveyors of consumer credit were told that to the extent they allowed their loans to increase, they would have to pay a small penalty, which they could pass on to their customers or not as they saw fit. Secured loans, for cars and houses, were not included.

"The action that was taken was frankly the mildest we could think of. In economic terms it was a small action. But when the President of the United States announces that we don't want people using their credit cards, and that measures would be taken, the message that came through was: 'Don't use consumer credit!' Including automobile credit and that kind of stuff, which we'd exempted. And you got a very sharp reaction in the economy."

The economy plunged.

"It looked like a recession, and it went down in the history books as a recession, but I guess in retrospect it was an odd kind of contrived affair. We lifted those controls as soon as it looked reasonable to do so, because we didn't want them on any longer than we had to. It was always in my mind that it would be temporary."

Imposed March 14, 1980, the controls were partially dismantled 10 weeks later and removed entirely by July 4. But if Chairman Volcker and his six fellow Fed governors knew the controls would be fleeting, the public was less certain.

"The people who were really worried were the retailers — and it became quite clear why. They were worried about the Christmas season, when you get a big seasonal increase in consumer credit."

"Well, I must confess it was a problem we had not thought about, because I know in all my thinking I did not imagine that the thing was still going to be on nine months later during the Christmas season! But, from their standpoint, they had to begin planning, and it was a perfectly natural concern."

"Anyhow, the economy had this abrupt fall, and the money supply fell very rapidly with it. It was an artificial reaction precisely to the consumer-credit controls. Consumers suddenly thought they'd better not use their credit cards, or consumer credit at all. But they had bills to pay, and so they drew down their cash balances. So you had this wild decline in the money supply for six weeks or so. Interest rates fell like a stone, too."

And why not? The demand for credit had been suddenly stifled. But the action backfired.

"In a sense you had the psychological result that everybody says, 'The problem's over with.' The basic problem of inflation was not over with." But once the credit restrictions were lifted, says Volcker, "it seemed as if everything was easy again — business as usual. We lost some psychological ground."

The money supply began rising again. "It began bouncing back, which we didn't mind for a month or two because it was just offsetting the decline. What we did not judge, we nor anybody else, was that the economic decline itself was going to be so short-lived."

The Fed kept expecting growth in the money supply to slow down, but it didn't.

"And part of the reason it didn't," says Volcker, "was that the economy was picking up much faster than people realized. If it hadn't been the focus of so much attention, I don't think it would have made much difference, but everybody had come to look at the money-supply figures as the symbol of policy. And we were in the midst of an election campaign, so everybody could attribute political interpretations to everything that happened. That didn't help any."

Down from nearly 20 percent in April 1980 to 11 percent by August, the prime hit 21.5 percent in December.

"The net of that long story is that the kind of discontinuity introduced by the credit controls in hindsight was harmful rather than helpful."

The net of that long story may also be that running the Fed and charting appropriate monetary policy have as much to do with psychology as with finance.

"You do get in that dilemma," Volcker acknowledges. "Sometimes, the technical analysis runs in the same direction as the psychology, so making policy is easy. But sometimes they run in opposite directions. Then they do create a dilemma. And the psychology often runs to extremes. You go back to early '80 — I mean, people were really scared! The Federal Reserve isn't restrictive at all; this thing is never going to stop, credit expansion is going to go on forever — and of course within three weeks the view was all changed, but that was the psychology that existed. And you're tempted to respond to the psychology. Sometimes I think you have to. But on purely technical grounds it can be a mistake.

"Sometimes it means there is no right policy, I think. You know, what seems technically right isn't right if the psychology is running in the other direction and it makes no impact. It can be very hard to deal with in the short run."

You can do all the sensible technical things, but if you can't persuade the marketplace of your long-term intentions and resolve, you've failed. But how do you persuade the marketplace without killing the economy in the process?

"That's the basic dilemma. You've got so much underlying inflationary momentum, exaggerated at times, but it's clearly there — really I'm talking about now." Wages really have been going up faster than is consistent with price stability. Productivity really has stagnated. We really have suffered from a degree of managerial complacency born of decades of world economic superiority. People really have bet on the future of inflation. "All this comes along and collides with a restrictive monetary posture, sooner or later, and there is a real collision if there isn't enough money to permit this momentum to continue. There's a kind of psychological collision, too, because behavior doesn't change very readily. And if people don't believe that you're going to carry through, it'll change all the more slowly!

"But if it changes too slowly," says Volcker quietly, "then you got an impossible problem."

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To get people to believe the Fed is really going to carry through this time, what would he think — just for example — of Reagan's announcing,

now, that when Volcker's term expires next August he will be reappointed for another four years. The chairman snorts in amusement. He relights his cigar, bouncing a smoldering match out of the ashtray onto the table.

"People reach out and try to think of something that's going to symbolize what you're after here," he says. "I think that's the root of the interest in the gold standard. You're saying, in effect, how about a 'Volcker standard.' Or other people would say, write in a monetary rule" — by which Congress would set the rate, now, at which the money supply would be allowed to grow ever after.

"I wish it were that SIMPLE," he laughs, "but I don't think we're going to win it just by hanging out some dramatic symbolic action, whatever that action is. That's the basic trouble with the gold-standard thing — there are lots of technical troubles, but the trouble with that argument is: Great, we're going on the gold standard, so 30-year bond rates are going to go down to 5 percent because investors know we're on the gold standard. But they know much more than that! We went off the gold standard 10 years ago, and when you're looking at a 30-year bond... You know once you've bit the apple, you can't say you haven't left the Garden of Eden.

"I'm not a disbeliever in all symbolism; in fact, the older I get the more importance I think there is in just conveying a message to the public. You've got to keep things simple in order to affect behavior, without getting caught by the simplicity of what you're SAY-AYING, and having the real world jump up and bite you."

□

You've also got to take account of political realities.

"I think these criticisms that the Federal Reserve was a great engine of inflation are really unfair," Volcker says. "An institution does what it can within the framework of a big environment."

Volcker hasn't met with the President since February, but he does meet frequently with Treasury Secretary Donald T. Regan, and he makes frequent trips to the Hill. The Fed is independent by law, but laws can be changed.

"Well, I suppose it's that concern put in its crudest form, but you don't even have to put it that way. It's not that Congress goes and legislates a different policy, which is the ultimate possibility. Your policy itself is not going to be successful if you haven't got a reasonable degree of understanding around the country of what you're trying to do

and a kind of willingness to support it. I'm not saying you have to have a majority vote. You can have a lot of opposition. But I don't think you can sustain a policy whose purpose nobody understands. So you've got to operate under that general constraint, if for no other reason than if they don't understand it, they don't think it's going to last. Which is where you come back to your psychological point — getting people to believe."

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With everyone in "the big environment" screaming about interest rates, the effort now is to ease up, insofar as may be justified, without reigniting inflation. That is a two-part effort. First you have to figure out how much easing is justified; then you have to get the financial markets to "agree."

One might imagine, for example, that when the stock market takes a frightening plunge, the money supply has in a sense plunged, too. Stockholders feel poorer, can borrow less, spend less freely.

"I wouldn't call it the money supply or even the credit supply, but I agree that it's a factor," says Volcker. "The big engine for this kind of stuff has not been stocks recently, but houses. Everybody began taking out their equity with second mortgages, convinced that that equity was going to increase forever and ever."

So doesn't the drop in real-estate values give the Fed a legitimate rationale to pump up the money supply, just by way of compensation?

"Yeah, if we just looked at that I think it is accurate. But here's precisely where we get into the problem. Suppose your analysis is exactly right. We could say, 'Look, people are going to spend less money, and they're going to want higher cash balances because the value of their houses has gone down. So we think precisely the right thing to do is to increase the money supply by 7½ percent where previously we had said we were going to increase it by 5 percent.' How do you explain that?

"Hey," Volcker goes on, "we've got that problem right now! It's a more general phenomenon, but it's not unrelated: People want to be more liquid. And part of being more liquid is holding more money in the bank. It's very easy to relate it to fear about the recession, fear about the financial system."

"Now if that phenomenon is going on, I think it's true to say you would not want the money supply to be as low as it otherwise would have been, because in economic terms you're tighter than you intended. But try to quantify

that and try to explain it!"

(The more work any given dollar bill can do in a year — the more hands it can pass through — the greater its "velocity." And the fewer of them the economy needs to function. So when velocity increases, the money supply in a sense increases, even though the actual number of dollars in circulation may have remained constant. By moving around faster, they can handle an expanded level of transactions. To conduct monetary policy, therefore, you must not only "count" the number of dollars in the money supply, you've got to figure out how fast they're moving.)

It is doubtless a sound economic notion: Dollars frozen in the checking accounts of people who scared to spend or invest them support less economic activity than dollars that move around faster. But can the Fed announce an easing in monetary policy based on such a thing?

Every Friday just past 4 P.M., East Coast time, men and women throughout the nation and much of the world stop what they're doing to await the weekly money-supply figures (much to the annoyance of the Fed, which wishes less attention were paid to the weekly fluctuations). And you expect them to believe that a huge jump is O.K. because of some behavioral "phenomenon"?

"Try to explain it to someone who thinks that the perpetual mistake of the Federal Reserve has been being too easy all the time," Volcker says. "All he'll say is, well, this is just another rationale for being too easy. And there's always the danger that he's right. So you've got to be a little cautious about it."

"I suppose we've compromised. We've been restrictive, but not nearly as restrictive as we would have been if we didn't think that this phenomenon was going on."

□

Volcker is not one who abhors any deficit (particularly in a recession) or who dreams of paying off the national debt. There may be times, he says — this is not one of them — when it would be appropriate public policy to pay off some of the debt, to make room for more private borrowing. But, he says, "a substantial national debt is not a problem. In the context of a huge economy, it's supportable. It's a question of the speed at which it grows — that's the risk now."

Part of the problem is an Administration not entirely of one mind. It demands lower spending to finance tax cuts it insists can't be delayed, but insists, too, on much larger defense expenditures and then tax increases to protect its tax cuts. A larger part of the problem is a Congress

that passed the initial tax cuts only after tacking on many billions in extra cuts of its own, and that simply cannot summon the nerve to cut the growth in spending in politically sensitive areas.

"I remain convinced," Senate Banking Committee chairman Jake Garn has said, "that it is the Congress that is primarily to blame for the failure of interest rates to decline as quickly as inflation."

"There is a great effort by Congress," he told Volcker at the committee's semiannual hearing on monetary policy last July 20, "to pass the buck to you. You are one of the favorite topics of speeches by congressmen and senators of both parties: 'If only we could get that damn Paul Volcker to do something, all this would go away.' There's never much talk about fiscal policy; never much talk about our role in it."

"If we really don't like these budget deficits, why don't we just shut up and do something about it?"

Quite a number of congressmen are incensed at the Fed's intransigence. They are priming the Treasury to borrow half a trillion or so to finance the deficit of the coming three years, and they just don't understand why the average investor, in the face of this, is not willing to accept 4 percent or 6 percent or 8 percent on a long-term bond, the way he always used to.

In June, Senator Edward M. Kennedy walked in near the end of a session at which Volcker was present and began decrying the Fed's independence. "If you were up here as a member of the Treasury," he glowered, "our relationship would be different." Responded Volcker calmly: "That's probably true, but I believe that it was intentionally designed this way."

Does Volcker ever feel incredibly frustrated that congressmen and senators, for selfish political reasons, are letting the country go down the tubes?

The chairman's eyes widen at the notion that he would even consider answering a question like that. "You're leaving on the microphone?" he asks; then answers only: "Elections obviously don't make things any easier."

His view of the budget compromise then sorting their way through Congress is hopeful but realistic: "If they follow through, it would be a very considerable step in the right direction. But the time has probably passed when you could have had a sharp impact on psychology. It's too late for a bipartisan, everybody-go-out-of-the-room-together sort of thing."

Instead, you get this sort of

thing (from The Wall Street Journal, Aug. 4): "In a partisan showdown vote, the House refused to limit to 4 percent the annual cost-of-living increase in Civil Service retirees' pay, as called for in the fiscal 1983 budget. The Democrat-led House, which had balked at placing the unpopular ceiling on Federal pensions in this election year, managed to put Republicans into the uncomfortable position of having to propose the limit without Democratic support if they wanted it passed. The Republicans refused."

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The doomayers know exactly how this goes. Inflation heats up, so monetary policy tightens. But that becomes painful, so political pressure is brought to bear. Then, rather than follow through, the Fed steps on the gas. That brings on worse inflation, followed by even more painful tightening, followed by hyperinflation, followed by complete collapse. It's not certain how many cycles this takes, or which one we're in, but the doomayers are convinced that in the midst of the current misery, the public will forget how much they hated inflation. After all, what's really so terrible about a little inflation?

"More and more people will probably be saying that at this point," Volcker agrees. But inflation, at this stage, is not the harmless little phenomenon it once was. It goes to the very roots of trust in government and society.

"You know," he says, "I grew up and was educated in the period when advanced thinkers said a little bit of inflation was a good thing. People thought they were a little richer each year, the profits were always a little higher than expected, it's also to have the price of your house going up — and, the argument ran, all that will lead to a good economy."

"In fact, I think there is some truth to that, but it's got a big catch: There's only some truth to it so long as people are 'surprised,' implicitly or explicitly, by the inflation. Once they begin getting the sense that it's a game, and they're just trying to keep ahead of it but can't, then you've got an entirely different set of circumstances."

"I think that is the watershed we passed in the 70's."

□

"I believe we have a desperate situation on our hands," an agitated Senator Donald W. Riegle Jr. told Volcker repeatedly at the July 20 hearing.

The situation seems a little

less desperate now. But through most of the summer, at least, much of the nation was having a severe — well-founded — anxiety attack.

It is in that context that Volcker is asked: Can we get out of this economic box? He answers in a way that suggests he knows this box very, very well. (A final match bounces out of the ashtray. As an experiment, the interviewer decides to sit pat. Is this man oblivious to the real world as some of his critics charge? Slowly, the chairman leans forward, reaches out a long arm and retrieves the match.)

"Well," he says, "you're asking the question, I guess, how big the box is. The box is certainly tougher, or pieces of the box are stronger, than you would hope. I think we're about to get out of the box, in some sense — but that's a projection."

(And, as it turned out, not a bad one.)

"I don't expect anything very exuberant — and I wouldn't want anything too exuberant, because sustainability is very important — but you get some recovery going for a while, and at the same time you get interest rates going down, and you get the inflation rate continuing to go down. I think then things begin interacting in a nice way."

"And if you could restrain a recovery and have the inflation rate continue to fall — inflation did fall in the last recovery for a year or so — then you have a quite different setting. Suppose the inflation rate is falling for two or three years and suppose by that time you're back to something that people are willing to live with. Then you've won the game in some sense."

"That's all I'm saying: that some day the good scenario ought to feed upon itself. So the question you're raising, I think, is: How long does the bad scenario feed upon itself before it gets overtaken by the good one? I hope we're pretty close to that point. And I think we are. But of course I can't prove it."

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One night, a few months before he made these rather prescient comments, the chairman was going to dinner with his wife. (Barbara Volcker is a bookkeeper at a New York architectural firm. He usually flies up on week-

ends to the Manhattan co-op they bought in 1975, "when everybody thought New York was going to go bust." Sometimes she comes to stay in the modest one-bedroom apartment he rents within walking distance of the Fed.) He went out and got in the car, behind the Federal Reserve driver.

"I look over his shoulder" — Volcker enjoys telling this story — "and he's reading a book. The name of the book was: 'How to Make Inflation Pay.' I don't know who it was written by, but it was one of those books. Two or three months ago, you know, we'd had a string of good price statistics, and I keep making speeches about how things are going to get better. And there he is reading this book!"

"I said, 'Mr. Pena, how can you be reading that book?' He says, 'I was in a bookstore the other day and I saw it marked down from \$10.95 to \$1.95.'"

A small sign, but a sign.

More recently, at the July 20 hearing, Volcker told Congress: "The evidence now seems to me strong that the inflation tide has turned in a fundamental way." Business borrowing, he believes, is no longer premised on expectations of ever-higher inflation.

The Fed has lowered the discount rate (the rate it charges depository institutions) from 12 percent to 10 percent. And there's been a widely perceived easing in its day-to-day market operations.

Does this mean the Fed is quietly caving in again? Is it the old election-year pump priming, and just in the nick of time? Volcker says no, of course. But does he mean it? Does he really, really mean it?

To give in now, he tells audiences wherever he speaks, when so much headway has been made in the fight against inflation, could only greatly complicate matters over the long run. Too much has been accomplished not to move ahead and complete the job. "It would strike me as the cruelest blow of all," he says, "to the millions who have felt the pain of the recession directly to suggest, in effect, it was all in vain."

Listening to him, it's hard to resist the temptation to put at least some of one's money, should one be so lucky as to have some money (the chairman's own net worth, exclusive of his co-op, is listed at \$26,000), into long-term bonds. ■

Chairman FAUNTROY. We now call upon our first witness, the Honorable Anthony M. Solomon, president of the Federal Reserve Bank of New York, who will present the joint statement.

Mr. Solomon, thank you so much for your presence here today.

PANEL OF ANTHONY M. SOLOMON, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK, NEW YORK N.Y.; FRANK E. MORRIS, PRESIDENT, FEDERAL RESERVE BANK OF BOSTON, BOSTON, MASS.; LAWRENCE K. ROOS, PRESIDENT, FEDERAL RESERVE BANK OF ST. LOUIS, ST. LOUIS, MO.; E. GERALD CORRIGAN, PRESIDENT, FEDERAL RESERVE BANK OF MINNEAPOLIS, MINNEAPOLIS, MINN.; AND ROBERT H. BOYKIN, PRESIDENT, FEDERAL RESERVE BANK OF DALLAS, DALLAS, TEX.

STATEMENT OF ANTHONY M. SOLOMON

Mr. SOLOMON. Thank you, Mr. Chairman.

I am delighted to be here. And my colleagues and I have presented a joint statement on certain areas, in agreement with the subcommittee.

The areas that we thought we would cover with the joint statement are pricing of Federal Reserve services, difficulties related to the expansion of reserve requirements, cooperation between the Federal Reserve banks and the commercial banks and thrift institutions, and the composition of the Federal Reserve bank boards of directors and their role in the formulation of policy.

In addition to our joint statement, we have each submitted an individual statement covering your remaining questions, which relate more to the individual activities of our respective reserve banks and our own views on monetary policy matters.

For convenience, and with your permission, we will present our summary remarks today on these issues in the same order they are presented in the written statements. Accordingly, President Corrigan will begin our joint presentation with an overview of the status of the pricing of Federal Reserve bank services and related matters.

STATEMENT OF E. GERALD CORRIGAN

Mr. CORRIGAN. Thank you, Tony. Thank you, Mr. Chairman.

For convenience of the committee, I will be briefly summarizing the material that essentially is on pages 2 through about 7 or 8 in the joint statement. I will not attempt to read it, but just touch on some of the highlights, if I may, Mr. Chairman.

The Monetary Control Act, as I think we all know, contains a number of specific provisions designed to guide the Federal Reserve in the provision of priced services to all depository institutions. While important, I think those provisions also have to be looked at in the broader light of the Federal Reserve's historical responsibilities: To encourage efficiency in the payments mechanism and to insure its safety and integrity.

As you know, Mr. Chairman, the pricing of Federal Reserve services was phased in over a 12-month period that ended in January of 1982. Five months after the legislation said we should begin pricing, we had in fact fully priced all Federal Reserve bank services. I think it is also worth noting that in the interval between the sign-

ing of the law and the second quarter of 1982, float—Federal Reserve float, which we were supposed to either price or eliminate and which has an effect on Treasury revenues—has been reduced from approximately \$5 billion to something in the order of magnitude of \$1.2 billion. The pricing transition provided a number of challenges to us, to put it mildly. In some ways I think those challenges can best be visualized by the uncertainties we faced in terms of what would happen to the volume of the work that went through Federal Reserve banks when you went from a situation in which services were in a sense, free—at least free of an explicit price—to one in which services have an explicit price.

We recognized from the outset that shifting patterns of volume and the speed with which volume might adjust to the pricing environment, would, of course, have important implications for a variety of things—not the least of which was patterns of resource utilization within the Federal Reserve banks. In fact, the aggregate volume loss experienced by the Federal Reserve banks since the advent of pricing has been relatively modest, although there have been some fairly sharp differences from one office to the next. If you look at all services, at all 12 banks and their branches and field offices, the volume drop since the advent of pricing has been about 20 percent. But if you adjust that to take account of changes in the mix of particular types of work, 15 percent is probably a better working number.

I would comment on the check area in particular. It is the biggest area by far, and the general patterns there have been similar to the overall statistics I mentioned a moment ago. Apart from looking at what has happened to volume, we think, and I think most others would agree, that another convenient way of seeing where we are is looking at the situation in terms of what our revenues are vis a vis our costs. As you know, the law specifically says that we have to conduct this endeavor in a way that, over the long run, our revenues match our costs—including the so-called private sector adjustment factor designed to take account of capital costs, profits and taxes on the private sector firms.

In the early months of pricing, the Reserve banks as a group encountered a fairly sizable gap between total revenues and total costs which, for a short time, was on the order of 30 percent. That gap, of course, reflected a combination of factors, including volume losses, the inherent difficulties in making resource adjustments in the short run, and some of the inherent difficulties in trying to establish prices for the first time. Those considerations notwithstanding, in recent months that revenue gap has narrowed appreciably. For example, based on preliminary data, for the 3-month period ending in August of this year, the revenue gap was on the order of 15 percent. That means in a practical, business sense that the Reserve banks as a group were recovering all of the direct costs of providing these services but had not yet gotten to the point where they were recovering the private sector adjustment factor.

We fully anticipate that even over the balance of the year, further progress will be made in narrowing that gap and that in fact it will be eliminated sometime next year. At that point we expect to be covering all costs, including the private sector markup.

You asked a specific question, Mr. Chairman, about the effects of pricing on Federal Reserve bank employment. Again, I will not go into that in any great detail, except to make two points. I think this committee recognizes that for a long period of time, indeed going back to roughly 1964, there had been significant reductions in employment in the back office operations of the Federal Reserve banks, aggregating to something on the order of 17 percent over the period 1974 to 1980. Since the advent of pricing in 1981, employment in our check processing operations—which are by far our most labor-intensive activity—has declined by something on the order of 13 percent, which is roughly in line with the volume loss that we have experienced over that period of time. And I would expect that we will see further, but more modest, reductions in the months ahead.

I would emphasize, Mr. Chairman, that these employment reductions at all of the Reserve banks have been achieved in a manner that has sought to, and we believe has minimized the impact of these dislocations on our employees. This objective has been accomplished through a combination of things, including attrition, in the normal turnover sense of the word; retaining and retraining people and assigning them to other areas of the bank; and in some cases through voluntary separations supported by early retirement provisions, severance pay, and programs designed to assist affected employees in finding other employment. While it is difficult to be precise, I do believe that it is fair to say that the vast majority of the work force reduction that we have experienced, not just in the post-pricing period, but in the post-1974 period as a whole, has basically been accommodated through what I would call normal employee turnover and attrition.

That is admittedly a rather broad brushed summary of how things have happened. I cannot begin, however, to capture in a summary the full scope of the challenge this has represented to the Reserve banks. We think the initial transition to the priced service environment has been completed in a timely manner, but much remains to be done. For example, right now there are important and controversial changes in check collection procedures that have been proposed by the Federal Reserve that will significantly accelerate the collection of checks.

Similarly, in the very near term, we will be announcing the details of the next, and what I hope will be the last, phase of our float reduction and pricing efforts. In these and other efforts, we will remain sensitive to the variety of institutions that are affected by our service policies, the requirements of the Monetary Control Act, and our broader responsibilities to the payments mechanism that I mentioned earlier.

I think good progress has been made in a relatively short time. We are well down the road to fulfilling the objectives and expectations of the Monetary Control Act in this area, Mr. Chairman.

Thank you.

Chairman FAUNTROY. Thank you, Mr. Corrigan.

Mr. SOLOMON. Mr. Chairman, you asked for our views in regard to the burden on extending the reserve requirements provisions of the Monetary Control Act to more than 40,000 depository institutions. Since the House has already acted on the committee's bill,

which we think is a fine approach, I really won't say very much about it. It provides for a \$2 million reservable liability exemption, and that reduces very substantially to approximately 20,000 the number of depository institutions that would have to keep reserves with us, and yet it permits us to maintain effective monetary policy control.

If you have any specific questions, I have given some more detailed information in my statement, but I think that the House action on this and the expectation that the Senate will also act with respect to the provision in the Garn bill which is roughly analogous, and we would hope that this legislation will go forward.

Chairman FAUNTROY. We are confident it will.

Mr. SOLOMON. President Morris from Boston will comment on the remaining part of the joint statement, Mr. Chairman.

STATEMENT OF FRANK E. MORRIS

Mr. MORRIS. Mr. Chairman, your questions referred to the makeup of our directors, to the representation of women and minorities on our boards, and to the issue of representation of the thrift industry on Federal Reserve bank and branch boards. Our statement indicates that we have made considerable progress in recent years in increasing the number of minorities on our board. We have done extremely well as far as women are concerned. We now have two Reserve banks whose boards are chaired by women. We have done less well in recruiting minorities to our boards, and I think we ought to strive to do a better job in the future in this respect. We are limited of course by the nature of the act in that the Federal Reserve Board appoints only three members of the Board. The other six Board members are elected by the bankers.

Under present law, the issue of thrift representation can probably best be resolved by having the Board of Governors begin the process of electing representatives of the thrift industry to our boards through the vehicle of the class C directorship, which is appointed by the Board. Our statement did not get into the issue of broadening the size of the boards, but as you know, the Federal Reserve Board has in the past been supportive of the idea of expanding the class C directorship to five from three, which would give us room to add thrift representatives to our board. In the meantime, most of the Reserve banks have set up thrift advisory groups. We meet in Boston fairly regularly with a group composed of representatives from the mutual savings banks, S. & L.'s, credit unions. This gives them a vehicle for communicating to us their problems, the kind of changes that they would like to see in Federal Reserve services and so on. I think this is serving as a bridge until the broadening of the numbers on the board can give us a little more leeway for increasing representation from the thrifts. Your questions also asked about the participation of our directors in the formulation of monetary policy. The directors have an influence in several ways. The only direct input they have is that they vote at every meeting on the discount rate. They are encouraged by the board, when they vote on a discount rate change, to inform the Board of Governors of their reasons for the change. Thus we have a continual flow of information into Washington from these very rep-

representative groups of people in the regions as to how they view the economy and how that ought to be reflected in monetary policy, with particular respect to the discount rate. I can assure you that our directors feel themselves quite capable of communicating their views to the Board, and they do it quite vigorously. In addition to that, our directors provide the bank presidents with a very valuable source of intelligence as to what is going on in the community, in the local businesses, which gives us a jump on the economic statistics.

As you know, many statistics can come in 4 to 6 weeks behind the events. The stream of intelligence that we get from the directors brings us, a little ahead of the actual data, a better feel for what is going on in the economy. Each of the Reserve banks reports to the FOMC—in what we call the “Red Book”—the views of the directors on the state of the economy in their region, and what sorts of changes they are seeing. I think the board members and the rest of us find it a very valuable source of input when it comes to FOMC deliberations.

Finally, of course, not relating to monetary policy, but very important to all of us, our board of directors provides us with a source of management expertise which we tap very vigorously in helping us run our banks more effectively.

I think that concludes my summary, Mr. Chairman.

Chairman FAUNTROY. I thank you.

Mr. Solomon.

Mr. SOLOMON. That concludes a quick summary of the joint statement areas. What I understand the subcommittee would like is for us to give our individual statements, which summarize research, affirmative action, and our individual views on monetary policy. I would suggest that we start with President Boykin, to give his individual statement, if that is agreeable with you.

Chairman FAUNTROY. That is fine.

We will enter into the record your joint statement in its entirety at this point.

[The joint prepared statement of the Federal Reserve bank presidents testifying follows:]

Joint Statement
before the
Subcommittee on Domestic Monetary Policy
of the
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
Washington, D. C.

September 23, 1982

by

Robert H. Boykin, President
Federal Reserve Bank of Dallas

E. Gerald Corrigan, President
Federal Reserve Bank of Minneapolis

Frank E. Morris, President
Federal Reserve Bank of Boston

Lawrence K. Roos, President
Federal Reserve Bank of St. Louis

Anthony M. Solomon, President
Federal Reserve Bank of New York

Introduction

We are pleased to have this opportunity to contribute to your examination of the activities and policies of the Federal Reserve district banks and their implications for monetary policy. After consulting with the Subcommittee, we are presenting the views of all five of us in a joint statement on the following issues:

- (1) pricing of Federal Reserve services and related matters;
- (2) difficulties related to the expansion of reserve requirements;
- (3) cooperation between the Reserve Banks on the one hand and the commercial banks and thrifts on the other hand; and,
- (4) matters related to the Reserve Bank boards of directors, including the representation of women, minorities, and representatives of thrift institutions on the boards, and their role in the formulation of policy.

The other areas of questioning relate more to individual Reserve Bank activities and our own opinions on various issues related to monetary policy. Accordingly, in addition to this joint statement we are each prepared to testify separately regarding these latter issues.

Pricing of Federal Reserve Services

As the Subcommittee knows, the Monetary Control Act of 1980 (MCA) mandated among other things that all depository institutions have access to Federal Reserve Bank payment

services, and that the Federal Reserve Banks charge explicit fees for such services. The MCA further requires that, over the long run, such fees be set in such a way as to recover the full costs incurred by the Reserve Banks in providing these services--including the so-called "private sector adjustment factor" (PSAF). The MCA specifies that the Federal Reserve should set its fees giving due regard to "competitive factors and the provision of an adequate level of such services nationwide." Finally, the MCA requires that the Fed price (or eliminate) Federal Reserve float.

The legislative history of the MCA suggests that our services should be priced in such a way as to encourage competition and to enhance the overall efficiency of the payments mechanism. In this context, we believe that it is important that these specific mandates of the MCA also be viewed in the larger context of the Federal Reserve's traditional and historical public responsibilities relating to the safety and integrity of the payments mechanism.

Explicit pricing of Federal Reserve payments services was phased in on a service-by-service basis over the 12-month period ending January 1982. Thus, all payments services were explicitly priced within five months of the date specified for beginning the implementation of pricing. Similarly, since the MCA was signed into law, Federal Reserve

float has been reduced from about \$4.9 billion to \$1.8 billion. This reduction has increased our payments to the U.S. Treasury by about \$350 million.

The initial pricing of Federal Reserve services posed a host of difficult questions and issues for the Federal Reserve Banks. Not the least of these was the impossibility of our prejudging, with any degree of precision, the timing and magnitude of volume adjustments that would accompany the introduction of explicit prices for Fed services. Obviously, shifting patterns of volume would have important implications for the nature and speed of resource adjustments made by the Reserve Banks, in the wake of pricing, as well as for our ability to meet certain of the specific mandates of the MCA.

In fact, the aggregate volume loss incurred by the Reserve Banks since the advent of pricing has been relatively modest, although there have been fairly pronounced differences from one Fed office to the next. For all services at all Federal Reserve offices, the overall drop in volume has been close to 20 percent. However, when allowance is made for volume shifts among the different Reserve Bank "products," as well as differing patterns of resource utilization at the Reserve Banks, the volume decline is more modest, on the order of 15 percent.

In the check processing area, which accounts for about three-fourths of the total cost of all priced services, we have seen check processing volume decline by a similar amount, although about half of the decline in processed check volume was offset by a rise in "fine sort" or packages of sorted checks handled by the Reserve Banks. In addition, the rapidity with which check volume has fallen off, and the unevenness in this trend among the Federal Reserve offices, suggests to us that much of the decline has resulted from the establishment by the commercial banks of local clearing arrangements. This development, which contributes to the overall efficiency of the payments mechanism, has long been favored by the Reserve Banks.

Looking at the overall cost-revenue picture, the results to date are mildly encouraging. In the early months of pricing, the Reserve Banks as a group encountered a fairly sizable gap (reaching almost 30 percent) between total costs (including PSAF) and revenues. That gap reflected a combination of factors including volume losses, shifts in the composition of processed volume, the problems inherent in making resource adjustments in the short run and some of the inherent difficulties in the initial setting of prices. More recently, the revenue gap has narrowed appreciably. For example, we tentatively estimate the

revenue gap for the three months ending in August to average about 15 percent. Thus, based on these preliminary data, the Banks as a group are covering all of their actual costs, but are not yet recouping the 16 percent private sector adjustment factor. We anticipate a further narrowing of the remaining gap over the closing months of this year and the elimination of the gap during 1983.

The progress that has been made to date in narrowing the cost/revenue gap reflects a three-pronged program aimed at cost containment, the repricing of our services, and efforts to better adapt our services to the needs of depository institutions. In all of this, the Federal Reserve remains sensitive to its underlying obligation to work toward fostering greater efficiency in the payments mechanism and to its ongoing public responsibilities regarding the payments system.

In this connection, we would now like to address one specific matter related to pricing in which this Subcommittee has expressed a particular interest, namely the effects of pricing on Reserve Bank employment.

Effect of Pricing on Reserve Bank Employment

At the outset, we should note that long before passage of the MCA and the implementation of pricing for Reserve Bank services, the Federal Reserve Banks had undertaken major cost containment efforts. To a considerable extent, these efforts were spurred by technological advances

that laid the groundwork for significant improvements in "back office" operations. At the Reserve Banks, the emphasis has been on high-speed equipment for processing checks and currency and the adaptation of state-of-the-art telecommunications technology to our funds and securities transfer services. Through these efforts, the Reserve Banks have been able to achieve major reductions in the real unit costs of providing services between 1974 and 1980.

These developments have served to enhance the efficiency of the payments mechanism. The associated containment of operating costs has also worked to increase the payments made annually to the United States Treasury.

The emphasis the Reserve Banks have placed on improving the efficiency of our back office operations has, of course, resulted in substantial reductions in employment. For example, between 1974 and 1980, total Federal Reserve employment in these areas fell by more than 17 percent. Since the onset of pricing in 1981, employment in check processing alone has been reduced by nearly 13 percent, or 720 people on a Systemwide basis, and we would expect further, although more modest, reductions in the months ahead. These employment reductions have been achieved in a manner that sought--and we believe successfully--to minimize the impact of these dislocations on our employees. This objective has been accomplished through a combination of

attrition, retraining and reassignment of employees in the affected departments to other areas of our operations and voluntary separations supported by early retirement provisions, severance pay, and assistance in finding other employment. While it is difficult to be precise, we believe it is fair to state that normal employee turnover and attrition have accommodated the vast majority of the workforce reductions that have occurred in the Reserve Banks, not just in the post-pricing periods, but for the post-1974 period as a whole.

In the foregoing remarks, we have outlined with a necessarily broad brush the initial experience of the Federal Reserve Banks in operating in a priced service environment. What is not and cannot be captured in such a summary is the scope of the challenges this transition has represented to the Reserve Banks. Indeed, while the initial transition to a priced service environment has been completed in a timely manner, much remains to be done.

For example, important (and controversial) changes in check collection procedures that will significantly accelerate the collection of checks have recently been proposed by the Federal Reserve Banks. Similarly, in the near term, we will be announcing the details of the next (and, we hope, the last) phase of our float reduction and pricing efforts. In these and other efforts, we will remain sensitive to the

requirements of the MCA, the views and needs of a wide and diverse group of depository institutions and to our continuing responsibilities regarding the efficiency and integrity of the payments mechanism. In all of this, we believe good progress has been made in a relatively short amount of time and that we are well on the road to fulfilling the expectations embodied in the MCA.

We might add that to a significant degree our progress to date has been facilitated by coordination and cooperation among the 12 Federal Reserve Districts. Each Reserve Bank administers prices locally for certain services furnished in its territory based on relevant volume, cost, and other factors for those services. Broader questions of pricing policy and strategy are coordinated through the System Pricing Policy Committee chaired by President Corrigan, which includes both Federal Reserve Board and Reserve Bank personnel, and the Conferences of Presidents and First Vice Presidents of all 12 Reserve Banks.

Reserve Requirements

A major objective of the MCA was to extend reserve maintenance and reporting requirements to all depository institutions in order to attain a higher degree of control over the money supply. This approach has obviously entailed significant costs as well as benefits. From the standpoint of the Reserve Banks, both the large

increase in the volume of data to be handled and the need to service and collect data from a wide range of new institutions--most of them very small and with differing financial structures--led to a substantial increase in resources dedicated to this activity--both human and computer. These additional costs to the System were a natural consequence of the imposition of universal reserves.

As for those depository institutions that were subjected to reserve requirements for the first time, the additional burdens imposed upon them fall into two broad categories: the cost of holding reserves in the form of non-interest bearing assets, and the operating costs associated with reporting requirements. We recognized early on that relatively little additional improvement in monetary control would result from imposing these burdens on the thousands of very small institutions; thus, there has been a broad consensus within the Federal Reserve--as, we believe, in the Congress as well--that the smaller institutions be exempted from the more burdensome aspects of reserve requirements where possible. The only question is how best to do this.

To date, the potential problem posed by the imposition of reserves on these smaller institutions has been held to a minimum. The Congress made an important contribution in this regard by allowing for the orderly phase-in of reserves for nonmembers. We have seen a high

degree of cooperation among the nonmember banks, the thrifts, the credit unions and their respective primary supervisors in smoothing the phase-in of reporting and reserve requirements.

For our part, the Reserve Banks have made intensive efforts to minimize the burdens as well. We have permitted the small institutions--under \$15 million in deposits--that are not exempt from reporting requirements to file reports with us quarterly--rather than weekly--at their option. We have also held field meetings which have enabled us to make contact with literally thousands of institutions to explain reserve requirements and our reporting and reserve maintenance procedures.

As you know, the Federal Reserve Board has been providing an administrative deferral from reserve and reporting requirements for institutions with less than \$2 million in deposits measured as of year-end 1979. This administrative deferral is scheduled to expire at the end of this year and we believe it should be replaced by legislative action of a more permanent nature. In this regard, we are pleased that the House has acted favorably upon the proposed Reserve Requirements Reform Act of 1982 (H.R. 6222) which represents a sensible approach to this matter, in our view. It provides that the first \$2 million in reserveable deposits for all institutions (with an annual adjustment) would be exempt from reserve requirements.

In testifying on the Senate proposal toward the same ends last fall, Chairman Volcker indicated that either the \$5 million deposit size cutoff in that bill, or exempting the first \$2 million in reserveable liabilities--the approach taken in your bill, Mr. Chairman--was acceptable. More recently, in testimony before this Subcommittee regarding your proposal, Vice Chairman Martin expressed the Board's support for a legislative solution to replace its administrative exemption.

To put the matter into perspective, of some 40,000 depository institutions in the United States only a bit more than half are presently filing regular deposit reports. (Substantially all of the non-reporting institutions are credit unions.) Furthermore, approximately 80 percent of the institutions that do report need not actually hold reserves with the Reserve Banks. This is because their reserve requirements can be and are being met by their holdings of vault cash. In a sense, no additional monetary cost is being imposed on them--other than the cost of reporting itself.

In the absence of legislation along the lines of the bill passed by the House last week, the result would be that an additional 18,000 depository institutions--44 percent of the total of such institutions--would have reserve requirements extended to them when the Board's administrative exemption expires. Under your proposal,

all of these institutions, plus an estimated 6,000 that are presently subject to reserves, would be exempt. In our view, this should be quite adequate to alleviate the burdens on the smaller institutions, while not compromising in an important way the Federal Reserve's degree of control over the money supply. On balance, although other approaches are obviously possible, we think this approach is a good one and we would endorse its adoption by the Senate.

Degree of Cooperation Between the
Reserve Banks and the Commercial Banks
and Thrift Institutions

The MCA brought about very significant changes in the relationship between the Federal Reserve System and the thrift institutions, as well as large numbers of commercial banks that had not previously been members of the Federal Reserve. We recognized from the outset the need to open lines of communication to these institutions and develop working relationships as quickly as possible. We also recognized the desirability of incorporating their views and concerns more explicitly into the decision-making processes of the Federal Reserve System.

One area in which this can and should be achieved is by providing for representation of these

institutions on Reserve Bank and branch Boards of Directors. We would like to briefly review some of the mechanisms that are in place already.

Thrift Institutions Advisory Committees

To date, eight of the Reserve Banks have formed some type of advisory committee to explicitly solicit the views and concerns of thrifts and other nonmember depository institutions. While the exact format and composition of these committees vary among the different Reserve Banks, in general they all provide a forum for the discussion of the broadest possible range of issues of mutual interest to the Federal Reserve and the affected institutions. By and large, membership of these committees consists of senior officials of savings and loan associations, mutual savings banks, and credit unions. In some cases, officers of the respective trade associations participate as well. Senior officials of the Reserve Banks meet with these advisory groups on a periodic basis, and a full interchange of information and advice is encouraged. These sessions typically deal with matters such as Reserve Bank services, discount window administration, and issues arising in connection with the work of the Depository Institutions Deregulation Committee.

Financial Institutions'
Visiting Program

All 12 of the Federal Reserve Banks have established formal programs under which their officers or designated representatives make periodic visits to the commercial banks and thrift institutions in their Districts. Many purposes are served by these visits, including: informing the institutions and their managements, many of whom have little or no prior direct experience with the Federal Reserve, of our policies and operations; discussing and explaining the services offered by the Reserve Bank and the related prices; assisting in the resolution of operating problems that may arise in the use of Reserve Bank services (this is obviously especially important for our many first-time users); developing a feel for the effect of Federal Reserve policies at the "micro" level, in terms of the day-to-day experiences of small depository institutions; and ascertaining the views of their officers regarding current trends and developments.

Meetings for Chief Executive Officers

Shortly after the passage of the MCA, the Reserve Banks began a variety of educational meetings for nonmember commercial banks and thrift institutions to explain the implications of that major legislation and to open discussions with senior officials of the thrift industry. On an ongoing basis, about half the Reserve Banks regularly sponsor

meetings for chief executive officers of various types of financial institutions, including the thrifts.

To sum up, we have made much progress in establishing lines of communication with thrift institutions and nonmember banks. Just as important, we have established close and cooperative relationships with the Federal Home Loan Banks and other primary regulatory authorities for these institutions. Obviously, much remains to be done, and the mutual learning process goes on--but we are confident that we are moving in the right direction.

Reserve Bank Boards of Directors

The final topic for which we felt a joint response was appropriate is the composition of the Reserve Banks' Boards of Directors, proposals for increasing the representation of thrift institutions on the Boards, and the role of the Boards in formulating policy.

With respect to the present composition of the Reserve Bank Boards, in terms of representation of women, minorities, and the thrift industry, we are submitting the relevant data from all 12 Reserve Banks and their branches as an exhibit with this statement. The exhibit sets forth the names and primary business affiliations of all of the directors of the Reserve Banks and their branches, and also gives breakdowns according to the occupations currently represented, the number of women and minorities on the

Boards, the representation of women and minorities in each year since 1975, and the representation of thrift institutions. While these data should furnish the "long" answer to your question, we would like now to present the "short" answer highlighting the more significant points.

First, a very broad spectrum of interests and backgrounds is represented on the boards of the Reserve Banks and their branches. The occupations occurring most frequently are, in descending order, banking, manufacturing, education, agriculture, real estate and construction, wholesale and retail trade, non-bank financial institutions, and services. Over the 1975 to 1982 period, progress has been made in adding women and minorities to our boards:

- The number of women on Bank and branch boards has grown from four in 1975, about one percent of all Reserve Bank directors to 30 in 1982, for about 11 percent of the total. This includes 11 women on the Reserve Bank head office boards, of which two presently serve as Chairpersons.
- There were 13 minority group members, or 5 percent of the total in 1975 and 16 minority group members, or 6 percent of the total this year, with somewhat higher representation in the 1979-1981 period. One minority group member presently serves as a Deputy Chairman of a Reserve Bank board.

We believe there is room for improvement in representation of minority group members and women on the

Reserve Bank and branch Boards of Directors, and we consider increased participation by both groups to be an objective we are committed to achieving. In this regard, you have asked us to discuss our plans for achieving increases in 1983 and beyond.

First, by way of background it should be noted that there are some practical limitations on the rate at which progress can be achieved in increasing the representation of women and minorities. Since the three directors within each Class serve staggered terms, normally only one appointment will be made each year in each Class. Also, six of the nine directors on the Reserve Bank boards--those in Classes A and B--are elected by the member institutions, and the degree to which they solicit recommendations from the Reserve Bank management varies from District to District. However, the Board of Governors does request our recommendations in fulfilling its responsibility to appoint the Class C directors, and this has been a primary vehicle for accommodating additional representation for women and minorities.

On the other hand, a majority of the directors of the Reserve Bank branches are appointed directly by the Reserve Bank boards, with the remainder appointed by the Board of Governors, and the Federal Reserve Act does not specify any particular qualifications or other criteria for their appointment. In addition, there are

25 Federal Reserve Bank branches altogether, as compared with 12 parent Federal Reserve Banks. Finally, the branches by and large serve smaller geographic regions than do their parent banks. With all of these considerations in mind, we regard the branch boards as a logical means for increasing the representation of women and minorities, as well as of thrift institutions.

At the present time, some of the Reserve Banks have completed their plans regarding appointment of branch directors for 1983, as well as for recommendations to the Board of Governors regarding both branch and Class C appointments to the Reserve Bank boards. However, we understand that some other Reserve Banks have not completed their plans, and we can thus reply only in general terms. But our understanding is that among those that have established plans, the proposed representation of women and minorities--as well as of thrift institutions--will generally be maintained or increased.

Thrift Institutions

The representation of thrift institutions poses a somewhat different question from that of women and minorities. At present, there are no representatives of thrift institutions on Reserve Bank boards, and only 5 on branch boards. There are, however, one Reserve

Bank director and six branch directors who are affiliated with thrift institutions in a significant capacity--director, advisory director, trustee, or officer--but not as their primary occupation.

We in the Federal Reserve are in general agreement that thrift representation should be increased, especially now that the thrift institutions hold reserves and have access to Federal Reserve services under the MCA. Over the past several years, the Reserve Banks and the Board of Governors have examined a variety of proposals to achieve this objective. On balance, we would favor the approach outlined below.

First, there is obviously room to increase the representation of thrift institutions on the branch boards. We believe this approach is especially advantageous for the smaller thrift institutions that furnish credit, and may seek to use Reserve Bank services, in the regional territories served by the Reserve Bank branches. Since there are no statutory restrictions on the qualifications of branch directors, the branch boards provide a logical way to increase their representation in a straightforward manner.

Second, we favor increased thrift representation on the Reserve Bank head office boards as well. In our judgment, this can be achieved through the present

structure, by means of the Reserve Banks making recommendations to the Board of Governors for appointment of thrift industry representatives in Class C. Under the Federal Reserve Act, including the 1977 amendments, the Class C directors are appointed to represent the public generally, giving due--but not exclusive--consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. In our judgment, these criteria are broad enough to encompass thrift institutions, and do not impose any legal impediment to their appointment through Class C.

Historically, the Board of Governors had taken the stance that as a matter of policy representatives of institutions engaged in any form of lending should not be included in Class C, since the interests of lending institutions were already represented by the Class A directors. However, with the enactment of the 1977 amendments to the Federal Reserve Act we have noted, and especially the MCA, this consideration no longer carries the weight that it did in the early days of the Federal Reserve System. Accordingly, we understand that the Board as a general matter is willing to appoint thrift industry representatives as Class C directors.

Role of Directors in Policy Formulation

Finally, we would like to briefly discuss the role of our directors in the formulation of policy. As you know, the Reserve Bank directors have the initial responsibility for setting the discount rate, subject to review and determination by the Board of Governors. In discharging this responsibility, the directors regularly report on, and take into account, general economic and business conditions as well as economic conditions in their local areas. The Boards of Directors may, if they wish--and often do--communicate these observations directly to the Board of Governors in connection with their actions on the discount rate.

Furthermore, in our experience, the directors often use the opportunity of a discount rate discussion to comment on underlying economic conditions, monetary policy, fiscal policy, and related matters. Indeed, it is necessary for them to consider and discuss these matters in order to make well-informed decisions regarding the discount rate, since that policy tool does not operate in a vacuum.

The directors' reports on business conditions are used by most of the Reserve Banks in compiling the "Current Economic Comment by District"--which we refer to colloquially as the "Red Book"--a briefing document

given to FOMC members, in advance of each FOMC meeting. The "Red Book" is prepared for the purpose of aiding the FOMC in identifying economic and financial developments in addition to economic expectations in various industries and regions of the country.

One other way in which the directors serve as a conduit for regional input to national policy formulation is through the Conference of Chairmen and Deputy Chairmen of the Federal Reserve Banks. This group meets semi-annually with the Federal Reserve Board in Washington, affording an opportunity for the interchange of views.

It might be added that these interchanges operate in both directions. Their ongoing contact with Federal Reserve policy formulation through discussion of the discount rate, as well as through the other avenues we have noted, enables our directors to communicate the overall thrust of Federal Reserve policy in general terms to their respective business and regional communities.

Finally, it should be mentioned that the directors play a significant role in the oversight of the management and operation of the Reserve Banks. They bring the knowledge and expertise garnered in their own business and community activities to such matters as reviews of budgets, expenses and major capital acquisitions, development of personnel and compensation policy, appointment of Reserve Bank officers, and operating and financial audits of Reserve Bank operations.

Exhibit I

FEDERAL RESERVE BANK OF BOSTON

| <u>Class A:</u> | <u>Group</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--------------|--|-------------------------------------|--------------------------|
| Mr. H. Alan Timm * 1-15-26/\$70m ** 207-622-7161 | 2 | President Bank of Maine, N.A. 244 Water Street Augusta, Maine 04330 | 1982 | 1-1-80 |
| Mr. Henry S. Woodbridge, Jr. 12-11-28/\$1.7b 401-278-8410 | 1 | Chairman of the Board and Chief Executive Officer Rhode Island Hospital Trust National Bank One Hospital Trust Plaza Providence, Rhode Island 02903 | 1983 | 1-1-81 |
| Mr. James Stokes Hatch 8-22-43/\$15mm 203-824-5423 | 3 | President Chief Executive Officer c/o The Canaan National Bank Main Street Canaan, Connecticut 06018 | 1984 | 1-1-82 |
| <u>Class B:</u> | | | | |
| Mrs. Carol R. Goldberg 3-25-31/\$345m 617-463-4323 | 2 | Senior Vice President The Stop & Shop Companies, Inc. P.O. Box 369 Boston, Massachusetts 02101 | 1982 | 8-3-78 |
| Mr. Joseph A. Baute 1-30-28/\$72m 603-352-4448 | 1 | Chairman and Chief Executive Officer Markem Corporation 150 Congress Street Keene, New Hampshire 03431 | 1983 | 1-1-81 |
| Dr. George N. Hatsopoulos 1-7-27/\$250m sales 617-890-8700 | 3 | Chairman of the Board and President Thermo Electron Corporation 101 First Avenue P.O. Box 459 Waltham, Massachusetts 02254 | 1984 | 3-8-82 |

- 1 - Member, Executive Committee,
Conference of Chairmen
- 2 - Chairman, Executive Committee,
Conference of Chairmen
- 3 - Vice Chairman, Executive Committee,
Conference of Chairmen

* Date of birth.

** Dollar amounts represent assets of banking institutions, and assets or annual sales of nonbanking institutions.

| <u>Class C:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. Thomas I. Atkins 3-2-39/Not available 212-245-2100 <u>DEPUTY CHAIRMAN</u> | General Counsel National Association for the Advancement of Colored People 1790 Broadway New York, New York 10019 | 1982 | 1-1-80 |
| Mr. Michael J. Harrington 9-2-36/Not available 617-246-3420 | Harrington, Keefe, and Schork, Inc. 40 Salem Street Lynnfield, Massachusetts 01940 | 1983 | 1-1-81 |
| Mr. Robert P. Henderson 4-9-31/\$173m 617-276-3003 <u>CHAIRMAN</u> | Chairman and Chief Executive Officer Itel Corporation 10 Maguire Road Lexington, Massachusetts 02173 | 1984 | 1-1-79 |

FEDERAL RESERVE BANK OF NEW YORK

| <u>Class A:</u> | <u>Group</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--------------|---|-------------------------------------|--------------------------|
| Mr. Gordon I. Wallis 8-15-19/\$16.7b 212-487-6330 | 1 | Chairman of the Board Irving Trust Company One Wall Street New York, New York 10015 | 1982 | 1-15-80 |
| Mr. Peter D. Kiernan 8-15-23/\$2.3b 518-447-4488 | 2 | Chairman and President Norstar Bancorp Inc. 1450 Western Avenue Albany, New York 12203 | 1983 | 1-01-81 |
| Mr. Robert A. Rough 5-9-39/\$78m 201-948-3300 | 3 | President The National Bank of Sussex County Branchville, New Jersey 07826 | 1984 | 1-1-82 |
| <u>Class B:</u> | | | | |
| Mr. William S. Cook 09-06-22/\$6.2b 212-826-8208 | 1 | President Union Pacific Corporation 345 Park Avenue New York, New York 10154 | 1982 | 8-6-80 |
| Mr. John R. Opel 1-5-25/\$27b 914-765-4750 | 2 | President and Chief Executive Officer International Business Machines Corporation Old Orchard Road Armonk, New York 10504 | 1983 | 1-14-81 |
| Mr. Edward L. Hennessy, Jr. 3-22-28/\$5.5b 201-455-4811 | 3 | Chairman of the Board Allied Corporation P.O. Box 3000 R Morristown, New Jersey 07960 | 1984 | 1-01-82 |
| <u>Class C:</u> | | | | |
| Dr. Boris Yavitz 6-4-23/1,250 Students 212-280-3401 <u>DEPUTY CHAIRMAN</u> | | Paul Garrett Professor of Public Policy and Business Responsibility Columbia University 703 Uris Hall New York, New York 10027 | 1982 | 6-17-77 |
| Robert H. Knight, Esq. 2-27-19/2nd largest in U.S. 212-483-1000 <u>CHAIRMAN</u> | | Senior Partner Shearman and Sterling, Attorneys 53 Wall Street New York, New York 10005 | 1983 | 2-6-76 |
| Mrs. Gertrude G. Michelson 6-3-25/\$2.7b 212-560-4312 | | Senior Vice President R. H. Macy & Company, Inc. 151 W. 34th Street New York, New York 10001 | 1984 | 2-10-78 |

BUFFALO BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Miss M. Jane Dickman 8-14-23/Among top ten 716-856-6565 | Partner Touche Ross & Co. Main Seneca Building 237 Main Street - Suite 1602 Buffalo, New York 14203 | 1982 | 1-01-77 |
| Mr. Arthur W. Richardson 12-29-26/\$1.3b 716-262-2982 | Chairman of the Board Chief Executive Officer Security Trust Company 1 East Avenue Rochester, New York 14638 | 1982 | 1-01-80 |
| Mr. Carl F. Ulmer 11-17-26/\$32m 716-549-1000 | President The Evans National Bank of Angola Box 191 Angola, New York 14006 | 1983 | 1-01-81 |
| Mr. Edward W. Duffy 4-30-26/\$18.4b 716-843-5881 | Chairman of the Board Marine Midland Bank, N.A. One Marine Midland Center Buffalo, New York 14240 | 1984 | 1-01-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Frederick D. Berkeley, III 8-7-28/\$28.7m 716-343-2216 <u>CHAIRMAN</u> | Chairman of the Board and President Graham Manufacturing Company, Inc. 26 Harvester Avenue Batavia, New York 14020 | 1982 | 2-02-77 |
| Mr. John R. Burwell 10-25-39/\$2.1m 716-232-2450 | President Rollins Container Corporation 100 Nassau Street Rochester, New York 14605 | 1983 | 1-01-79 |
| Mr. George L. Wessel 10-2-23/122,000 members 716-852-0375 | President Buffalo AFL/CIO Council 686 Ellicott Square Building Buffalo, New York 14203 | 1984 | 1-01-79 |

FEDERAL RESERVE BANK OF PHILADELPHIA

| <u>Class A:</u> | <u>Group</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--------------|--|-------------------------------------|--------------------------|
| Mr. Donald J. Seehold 9-6-22/\$51.6m 717-275-3740 | 3 | President The First National Bank of Danville Corner Mill and Bloom Streets (P.O. Box 279) Danville, Pennsylvania 17821 | 1982 | 6-26-78 |
| Mr. Roger S. Hillas 4-11-27/\$2.7b 215-585-5228 | 1 | Chairman and President Provident National Bank P.O. Box 7648 Philadelphia, Pennsylvania 19101 | 1983 | 1-01-81 |
| Mr. Douglas Eugene Johnson 6-15-39/\$185.6m 201-892-1900 x358 | 2 | Chairman and President Ocean County National Bank 501 Arnold Avenue Point Pleasant Beach, New Jersey 08742 | 1984 | 1-01-82 |
| <u>Class B:</u> | | | | |
| Mr. Eberhard Faber, IV 10-22-36/\$16m 717-474-6711 | 1 | Chairman of the Board and Chief Executive Officer Eberhard Faber, Inc. Crestwood Wilkes-Barre, Pennsylvania 18773 | 1982 | 1-01-80 |
| Mr. Harry A. Jensen 7-17-18/\$891m 717-397-0611, X2212 | 2 | President and Chief Executive Officer Armstrong World Industries, Inc. Liberty and Charlot Streets (P.O. Box 3001) Lancaster, Pennsylvania 17604 | 1983 | 1-01-80 |
| Mr. Richard P. Hauser 12-20-34/\$2.4b 215-422-1885 | 3 | Chairman and Chief Executive Officer John Wanamaker 1300 Market Street Philadelphia, Pennsylvania 19101 | 1984 | 1-01-79 |
| <u>Class C:</u> | | | | |
| Dr. Jean A. Crockett 4-20-19/15,864 Students 215-243-7637 <u>CHAIRMAN</u> | | Chairman Professor of Finance Department of Finance Wharton School University of Pennsylvania Philadelphia, Pennsylvania 19104 | 1982 | 1-01-77 |
| Robert M. Landis, Esquire 12-21-20/188 Lawyers 215-972-3765 <u>DEPUTY CHAIRMAN</u> | | Partner Dechert Price & Rhoads 3400 Centre Square West 1500 Market Street Philadelphia, Pennsylvania 19102 | 1983 | 1-01-81 |
| Mr. George E. Bartol, III 4-20-21/\$49.4m 215-732-7700 | | Chairman of the Board Hunt Manufacturing Company Suite 1300, 1405 Locust Street | 1984 | 1-01-82 |

FEDERAL RESERVE BANK OF CLEVELAND

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. John W. Alford 10-21-12/\$248.5m 614-349-8451 | 2 Chairman of the Board and Chief Executive Officer The Park National Bank 50 North Third Street Newark, Ohio 43055 | 1982 | 1-01-77 |
| Mr. J. David Barnes 8-23-29/\$14.9b 412-232-4961 | 1 Chairman of the Board Mellon Bank, N.A. Mellon Square Pittsburgh, Pennsylvania 15230 | 1983 | 1-01-81 |
| Mr. Raymond D. Campbell | 3 Director The Oberlin Savings Bank Co. Oberlin, Ohio 44074 | 1984 | 1-01-82 |
| <u>Class B:</u> | | | |
| Mr. John W. Kessler 3-7-36/Not available 614-224-9561 | 2 President John W. Kessler Company 100 East Broad Street Suite 1501 Columbus, Ohio 43215 | 1982 | 1-01-80 |
| Mr. E. Mandell de Windt 3-31-21/\$3.4b 216-523-4617 | 1 Chairman of the Board Eaton Corporation 100 Erieview Plaza Cleveland, Ohio 44114 | 1983 | 1-01-81 |
| Mr. Richard D. Hannan 9-16-30/ 513-272-1111 | 3 Chairman of the Board and President Mercury Instruments, Inc. 394D Virginia Avenue Cincinnati, Ohio 45227 | 1984 | 1-01-82 |
| <u>Class C:</u> | | | |
| Mr. W. H. Knoll 8-1-24/\$779.3m 412-343-4626 <u>DEPUTY CHAIRMAN</u> | President and Chief Executive Officer Cyclops Corporation 650 Washington Road Pittsburgh, Pennsylvania 15228 | 1983 | 1-15-81 |
| Mr. John D. Anderson 5-17-22/\$800m 419-893-5050 | Senior Partner The Andersons P.O. Box 119 Maumee, Ohio 43537 | 1982 | 1-01-81 |
| Mr. J. L. Jackson 1-31-32/\$55m 606-231-5310 <u>CHAIRMAN</u> | Executive Vice President and President - Coal Unit Diamond Shamrock Corporation 1200 First Security Plaza Lexington, Kentucky 40507 | 1984 | 1-01-79 |

CINCINNATI BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. Oliver W. Birckhead 6-20-22/\$1.2b 513-651-8900 | Chairman of the Board and Chief Executive Officer The Central Trust Company, N.A. Fifth and Main Streets Cincinnati, Ohio 45202 | 1982 | 1-01-80 |
| Mr. D. T. Dorton 6-15-20/\$69m 606-789-4001 | President Citizens National Bank P.O. Box 670 Paintsville, Kentucky 41240 | 1983 | 1-01-81 |
| Mr. Richard Fitton 4-18-27/\$386m 513-867-4711 | President and Chief Executive Officer First National Bank of Southwestern Ohio P.O. Box 476 Hamilton, Ohio 45012 | 1984 | 1-01-81 |
| Mr. Sherrill Cleland 9-21-24/1,250 Students 614-373-4643 | President Marietta College Marietta, Ohio 45750 | 1984 | 1-01-81 |
| <u>Appointed by Board of Governors:</u> | | | |
| Sister Grace Marie Hiltz 4-20-20/3,500 Beds 513-922-9775 | President Sisters of Charity Health Care Systems, Inc. 345 Neeb Road Cincinnati, Ohio 45238 | 1982 | 1-01-80 |
| Mr. Clifford R. Meyer 9-25-23/Not available 513-841-8225 <u>CHAIRMAN</u> | President and Chief Operating Officer Cincinnati Milacron Inc. 4701 Marburg Avenue Cincinnati, Ohio 45209 | 1983 | 5-01-81 |
| Mr. Don Ross 3-29-27/Not Available 606-299-5334 | Owner Dunreath Farm 6335 Winchester Pike Lexington, Kentucky 40509 | 1984 | 1-01-82 |

PITTSBURGH BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. William D. McKain 3-29-27/\$83.3m 304-232-0110 | President Wheeling National Bank 1145 Market Street Wheeling, West Virginia 26003 | 1982 | 1-01-80 |
| Mr. Ernest L. Lake 12-27-22/\$42m 814-725-4541 | President The National Bank of North East P.O. Box 270 North East, Pennsylvania 16428 | 1983 | 1-01-81 |
| Mr. Robert C. Milsom 12-15-24/\$6.5b 412-355-2251 | President Pittsburgh National Bank Fifth Avenue and Wood Street Pittsburgh, Pennsylvania 15222 | 1984 | 1-01-82 |
| Mr. James S. Pasman, Jr. 12-20-30/\$5.2b 412-553-4715 | Executive Vice President of Finance Aluminum Company of America 1501 Alcoa Building Pittsburgh, Pennsylvania 15219 | 1984 | 1-01-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Dr. Robert S. Kaplan 5-2-40/5,500 Students 412-578-2265 | Dean Graduate School of Industrial Administration Carnegie-Mellon University Pittsburgh, Pennsylvania 15213 | 1982 | 2-08-80 |
| Mr. Milton G. Hulme, Jr. 10-12-26/\$243m 412-273-5268 <u>CHAIRMAN</u> | President and Chief Executive Officer Mine Safety Appliances Company 600 Penn Center Boulevard Pittsburgh, Pennsylvania 15235 | 1983 | 1-08-80 |
| Mr. Quentin C. McKenna 9-2-26/\$312m 412-539-5221 | President and Chief Executive Officer Kennametal Inc. P.O. Box 231 Latrobe, Pennsylvania 15650 | 1984 | 1-01-82 |

FEDERAL RESERVE BANK OF RICHMOND

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--------------|---|--------------------------|
| Mr. William M. Dickson 11-21-29/\$41.9m 304-647-4500 | 2 | President & Senior Trust Officer The First National Bank in Ronceverte P.O. Drawer 457 Ronceverte, West Virginia 24970 | 1982 1-01-80 |
| Mr. J. Banks Scarborough 8-20-28/\$27m 803-346-3181 | 3 | Chairman and President Pee Dee State Bank P.O. Box 458 Timmonsville, South Carolina 29161 | 1983 1-01-81 |
| Mr. Joseph A. Jennings 8-12-20/\$3.8b 804-782-5202 | 1 | Chairman and Chief Executive Officer United Virginia Bankshares Inc. and United Virginia Bank P. O. Box 26665 Richmond, Va 23261 | 1984 1-01-82 |
| <u>Class B:</u> | | | |
| Mr. James A. Chapman, Jr. 9-30-21/\$30.2m 803-472-2121 | 3 | Chairman of the Board and Chief Executive Officer Inman Mills P.O. Box 207 Inman, South Carolina 29349 | 1982 1-01-80 |
| Mr. Leon A. Dunn, Jr. 10-6-38/\$15.4m 919-443-4101 | 2 | Chairman, President, and Chief Executive Officer Guardian Corporation and Subsidiaries P.O. Box 4305 Rocky Mount, North Carolina 27801 | 1983 1-01-81 |
| Mr. Paul G. Miller 12-13-22/\$5.3b 301-332-3760 | 1 | Chairman of the Board and Chief Executive Officer Commercial Credit Company 300 St. Paul Place Baltimore, Maryland 21202 | 1984 1-01-82 |
| <u>Class C:</u> | | | |
| Mr. Paul E. Reichardt 4-26-18/\$479m 202-624-6191 <u>DEPUTY CHAIRMAN</u> | | Chairman of the Board Washington Gas Light Company 1100 H Street, N.W. Washington, D.C. 20080 | 1982 7-20-79 |
| Dr. Steven Muller 11-22-27/9,555 Students, \$555.2m 301-366-3590 <u>CHAIRMAN</u> | | President The Johns Hopkins University Charles and 34th Streets Baltimore, Maryland 21218 | 1983 1-1-78 |
| Mr. William S. Lee, III 6-23-29/\$6.1b 704-373-4283 | | Chairman of the Board and Chief Executive Officer Duke Power Company P. O. Box 33189 Charlotte, North Carolina 28242 | 1984 1-01-82 |

BALTIMORE BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. Hugh D. Shires 4-14-18/\$116.2m 301-777-4600 | Senior Vice President First National Bank of Maryland P.O. Box 1685 Cumberland, Maryland 21502 | 1982 | 1-01-80 |
| Mr. A. R. Reppert 3-4-19/\$216.9m 304-624-3400 | President The Union National Bank of Clarksburg P.O. Box 2330 Clarksburg, West Virginia 26301 | 1982 | 1-01-77 |
| Mr. Joseph M. Gough, Jr. 8-8-27/\$65m 301-475-8081 | President The First National Bank of St. Mary's 5 East Park Avenue Leonardtown, Maryland 20650 | 1983 | 1-01-78 |
| Dr. Pearl C. Brackett 1-6-19/\$6.3m 301-467-9905 | Deputy Manager Baltimore Regional Chapter of American Red Cross (MAILING ADDRESS: 4100 North Charles Street Baltimore, Maryland 21218) | 1984 | 1-01-78 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Edward H. Covell 4-15-21/\$18m 301-822-3000 <u>CHAIRMAN</u> | Vice President for Governmental and Industry Affairs Country Pride Foods Limited P.O. Box 799 Easton, Maryland 21601 | 1982 | 1-01-80 |
| Mr. Robert L. Tate 6-13-24/\$25m 301-539-0787 | Chairman Tate Industries 601 W. West Street Baltimore, Maryland 21230 | 1983 | 1-01-81 |
| Mr. Thomas H. Maddux 10-2-27 301-837-9550 | Executive Vice President and Chief Operating Officer Easco Corporation 201 North Charles Street Baltimore, Maryland 21201 | 1984 | 1-01-82 |

CHARLOTTE BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. W. B. Apple, Jr. 11-4-30/\$54.2m 919-342-3346 | President First National Bank of Reidsville P.O. Box 2037 Reidsville, North Carolina 27320 | 1982 | 12-27-74 |
| Mr. Marvin D. Trapp 12-24-29/\$197m 803-775-1211 | President and Chief Executive Officer The National Bank of South Carolina P. O. Drawer 1798 Sumter, South Carolina 29150 | 1982 | 2-11-82 |
| Mr. Nicholas W. Mitchell 5-31-13/\$277m 919-725-5371 | Chairman of the Board Piedmont Federal Savings and Loan Association P.O. Box 215 Winston-Salem, North Carolina 27102 | 1983 | 1-01-81 |
| Mr. Hugh M. Chapman 9-11-32/\$970m 803-765-8203 | Chairman of the Board The Citizens & Southern National Bank of South Carolina P.O. Box 727 Columbia, South Carolina 29222 | 1984 | 1-01-79 |
| <u>Appointed by Board of Governors:</u> | | | |
| Dr. Naomi G. Albanese 10-17-16/950 Students 919-379-5980 <u>CHAIRMAN</u> | Dean School of Home Economics University of North Carolina at Greensboro Greensboro, North Carolina 27412 | 1982 | 1-01-77 |
| Mr. Wallace J. Jorgenson 10-23-23/\$7m+ 704-374-3761 | President Jefferson-Pilot Broadcasting Co. One Julian Price Place Charlotte, North Carolina 28208 | 1983 | 1-01-82 |
| Dr. Henry Ponder 3-28-28/2,000 Students 803-254-7253 | President Benedict College Harden and Blanding Streets Columbia, South Carolina 29204 | 1984 | 1-01-79 |

FEDERAL RESERVE BANK OF ATLANTA

| <u>Class A:</u> | <u>Group</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--------------|---|-------------------------------------|--------------------------|
| Mr. Dan B. Andrews 7-13-27/\$46m 615-446-5151 | 2 | President First National Bank P.O. Box 666 Dickson, Tennessee 37055 | 1982 | 1-1-80 |
| Mr. Hugh M. Willson 9-20-25/\$22m 615-745-0261 | 3 | President Citizens National Bank P.O. Box 220 Athens, Tennessee 37303 | 1983 | 1-1-78 |
| Mr. Guy W. Botts 7-12-14/\$3.7b 904-791-7714 | 1 | Chairman of the Board Barnett Banks of Florida, Inc. P.O. Box 40789 Jacksonville, Florida 32231 | 1984 | 1-1-79 |
| <u>Class B:</u> | | | | |
| Mrs. Jean McArthur Davis 7-9-24/\$12m 305-754-4521 | 3 | President McArthur Dairy, Inc. 6851 N.E. Second Avenue Miami, Florida 33138 | 1982 | 12-1-77 |
| Mr. Harold B. Blach, Jr. 10-29-31/\$6m 205-322-3551 | 1 | President Blach's Inc. 1928 Third Avenue, North Birmingham, Alabama 35203 | 1983 | 1-1-81 |
| Mr. Horatio C. Thompson 8-5-14/\$608m 504-775-6181 | 2 | President Horatio Thompson Investment, Inc. P.O. Box 1027 Baton Rouge, Louisiana 70821 | 1984 | 2-16-79 |
| <u>Class C:</u> | | | | |
| Mr. John H. Weitnauer, Jr. 5-21-26/\$205m in sales 404-586-2810 <u>DEPUTY CHAIRMAN</u> | | Chairman and Chief Executive Officer Richway P.O. Box 50359 Atlanta, Georgia 30302 | 1982 | 1-1-80 |
| Mr. William A. Fickling, Jr. 7-23-32/\$95m 912-742-1161 <u>CHAIRMAN</u> | | Chairman and Chief Executive Charter Medical Corporation P.O. Box 209 Macon, Georgia 31202 | 1983 | 3-6-78 |
| Mrs. Jane C. Cousins 6-29-24/300 licensed salespersons 305-667-4815 | | President and Chief Executive Officer Merrill Lynch Realty/Cousins 5830 S.W. 73rd Street Miami, Florida 33143 | 1984 | 1-8-82 |

BIRMINGHAM BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. C. Gordon Jones 9-27-27/\$85m 205-353-0941 | President and Chief Executive Officer First National Bank of Decatur P.O. Box 1488 Decatur, Alabama 35602 | 1982 | 1-1-80 |
| Miss Martha A. McInnis 7-28-37/Not available 205-277-7050 | Executive Vice President Alabama Environmental Quality Association 3815 Interstate Court Suite 202 Montgomery, Alabama 36109 | 1982 | 1-1-80 |
| Mr. Henry A. Leslie 10-15-21/\$253m 205-265-8201 | President and Chief Executive Officer Union Bank and Trust Company P.O. Box 2191 Montgomery, Alabama 36197 | 1983 | 1-1-81 |
| Mr. William M. Schroeder 8-1-42/\$26.6m 205-668-0711 | Chairman and President Central State Bank P.O. Box 180 Calera, Alabama 35040 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. William H. Martin, III 2-17-31/\$26m 205-767-0330 <u>CHAIRMAN</u> | President and Chief Executive Officer Martin Industries, Inc. P.O. Box 128 Florence, Alabama 35630 | 1982 | 12-4-75 |
| Mr. Samuel R. Hill, Jr. 5-19-23/14,000 Students 205-934-3493 | President University of Alabama in Birmingham Office of the President University Station Birmingham, Alabama 35294 | 1983 | 1-1-81 |
| Mr. Louis J. Willie 8-22-23/\$20m 205-328-5454 | Executive Vice President Booker T. Washington Insurance Co. P.O. Box 697 Birmingham, Alabama 35201 | 1984 | 1-1-79 |

JACKSONVILLE BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Whitfield M. Palmer, Jr. 3-28-29/\$25m in sales 904-732-2715 | Chairman Mid-Florida Mining Company P.O. Box 367 Ocala, Florida 32670 | 1982 | 1-1-80 |
| Mr. Billy J. Walker 3-4-31/\$1.8b 904-358-6930 | President Atlantic Bancorporation General Mail Center Jacksonville, Florida 32231 | 1982 | 1-1-80 |
| Mr. Gordon W. Campbell 8-17-32/\$1.2b 813-224-5616 | President and Chief Executive Officer Exchange Bancorporation, Inc. P.O. Box 25900 Tampa, Florida 33630 | 1983 | 1-1-81 |
| Mr. Lewis A. Doman 3-21-30/\$90m 904-433-2299 | President The Citizens and Peoples National Bank P.O. Box 1072 Pensacola, Florida 32595 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Copeland D. Newbern 8-22-11/\$10m 813-971-0440 <u>CHAIRMAN</u> | Chairman of the Board Newbern Groves, Inc. P.O. Box 17237 Tampa, Florida 33682 | 1982 | 1-1-77 |
| Mrs. Joan W. Stein 2-2-29/\$28m 904-725-9272 | Partner Regency Square Properties, Inc. 1200 Barnett Regency Tower Jacksonville, Florida 32211 (MAILING ADDRESS: P.O. Box 2718 Jacksonville, Florida 32232-0033) | 1983 | 1-1-78 |
| Dr. Jerome P. Keuper 1-12-21/5,000 Students 305-723-3701 | President Florida Institute of Technology P.O. Box 1150 Melbourne, Florida 32901 | 1984 | 1-1-79 |

MIAMI BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. M. G. Sanchez 12-4-34/\$409m 305-941-2810 | President and Chief Executive Officer First Bankers Corporation of Florida P.O. Box T Pompano Beach, Florida 33061 | 1982 | 1-1-80 |
| Mr. Daniel S. Goodrum 7-11-26/\$1b 305-457-5300 | President and Chief Executive Officer Century Banks, Inc. P.O. Box 757 Ft. Lauderdale, Florida 33302 | 1983 | 1-1-81 |
| Mr. E. Llwyd Ecclestone, Jr. | Managing Partner PGA National P.O. Box 3267 West Palm Beach, Florida 33402 | 1984 | 7-1-82 |
| Mr. Stephen G. Zahorian 8-24-38/\$160m 813-936-6656 | President Barnett Bank of Fort Myers, N.A. P.O. Box 338 Fort Myers, Florida 33902 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Ms. Sue McCourt Cobb 8-18-37/80 Attorneys 305-579-0543 | Attorney Greenberg, Traurig, Askew, Hoffman, Lipoff, Quentel and Wolff, P. A. 1401 Brickell Avenue - PH-1 Miami, Florida 33131 | 1982 | 1-1-82 |
| Mr. Eugene E. Cohen 11-1-17/Not available 305-448-5522 <u>CHAIRMAN</u> | Chief Financial Officer and Treasurer Howard Hughes Medical Institute P.O. Box 330837 Coconut Grove, Florida 33133 | 1983 | 1-1-81 |
| Mr. Roy Vandegrift, Jr. 12-5-20/\$3.6m 305-924-5551 | President Roy-Van, Inc. P.O. Box 619 Pahokee, Florida 33476 | 1984 | 2-19-79 |

NASHVILLE BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. Charles J. Kane 1-2-20/\$1b 615-748-4177 | Chairman and Chief Executive Officer Third National Bank in Nashville Nashville, Tennessee 37244 | 1982 | 1-1-80 |
| Mr. John R. King 10-16-24/\$60m 615-246-4121 | President The Mason and Dixon Lines, Inc. P.O. Box 969 Kingsport, Tennessee 37662 | 1982 | 1-1-80 |
| Mr. James F. Smith, Jr. 12-11-29/\$500m 615-521-5134 | Chairman and Chief Executive Officer Park National Bank P.O. Box 511 Knoxville, Tennessee 37902 | 1983 | 1-1-81 |
| Mr. Michael T. Christian 1-24-43/\$75m 615-639-2181 | President and Chief Executive Officer First National Bank of Greeneville P.O. Box 777 Greeneville, Tennessee 37743 | 1984 | 1-1-82 |

Appointed by Board of Governors:

| | | | |
|--|--|------|----------|
| Mrs. Cecelia Adkins 9-3-23/represents 6.3m people 615-256-5284 <u>CHAIRMAN</u> | Executive Director Sunday School Publishing Board 330 Charlotte Avenue Room 319 Nashville, Tennessee 37201 | 1982 | 1-1-77 |
| Mr. Robert C. H. Mathews, Jr. 6-16-27/Not available 615-244-2130 | Managing General Partner R. C. Mathews, Contractor P.O. Box 22149 Nashville, Tennessee 37202 | 1983 | 12-21-76 |
| Mr. C. Warren Neel 12-6-38/\$500 Undergrad 615-974-5061 | Dean College of Business Administration 716 Stokely Management Center The University of Tennessee Knoxville, Tennessee 37916 | 1984 | 1-1-82 |

NEW ORLEANS BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. Patrick A. Delaney 6-19-32/\$1.7b 504-586-7209 | Chairman and President Whitney National Bank of New Orleans P.O. Box 61260 New Orleans, Louisiana 70161 | 1982 | 1-1-80 |
| Mr. Ben M. Radcliff 9-26-24/\$702,000 205-666-7252 | President Ben M. Radcliff Contractor, Inc. P.O. Box 8277 Mobile, Alabama 36608 | 1982 | 1-1-80 |
| Mr. Paul W. McMullan 2-6-29/\$373m 601-544-4211 | Chairman and Chief Executive Officer First Mississippi National Bank P.O. Box 1231 Hattiesburg, Mississippi 39401 | 1983 | 1-1-81 |
| Mr. Jerry W. Brents 11-10-41/\$402m 318-232-1211 | President and Chief Executive Officer First National Bank P.O. Box 90-F Lafayette, Louisiana 70509 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Ms. Sharon A. Perlis 11-2-44/Not Available 504-834-3700 | Attorney Suite 215 433 Metairie Road Metairie, Louisiana 70005 | 1982 | 1-1-82 |
| Mr. Leslie B. Lampton 7-30-25/\$95m 601-948-3472 <u>CHAIRMAN</u> | President Ergon, Inc. P.O. Box 1308 Jackson, Mississippi 39205 | 1983 | 1-1-81 |
| Mr. Roosevelt Steptoe 11-28-34/ 504-771-5020 | Chancellor Southern University Baton Rouge Campus Southern Baton Rouge Post Office Baton Rouge, Louisiana 70813 | 1984 | 1-1-82 |

FEDERAL RESERVE BANK OF CHICAGO

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. Patrick E. McNary 4-16-36/\$140m 219-722-4111 | 2 President First National Bank of Logansport One First National Plaza Logansport, Indiana 46947 | 1982 | 1-1-80 |
| Mr. Ollie Jay Tomson 5-3-36/\$35m 515-228-5315 | 3 President The Citizens National Bank of Charles City P.O. Box 517 Charles City, Iowa 50616 | 1983 | 1-1-81 |
| Mr. Roger E. Anderson 7-29-21/\$41h 312-828-7703 | 1 Chairman of the Board Continental Illinois National Bank and Trust Company of Chicago 231 South La Salle Street Chicago, Illinois 60693 | 1984 | 8-26-80 |
| <u>Class B:</u> | | | |
| Mrs. Mary Garst 3-25-28/Not available 712-684-2266 | 1 Manager of Cattle Division Garst Company 218 South Fifth Coon Rapids, Iowa 50058 | 1982 | 1-1-79 |
| Mr. Leon T. Kendall 5-20-28/\$756m 414-347-6486 | 2 Chairman of the Board and Chief Executive Officer Mortgage Guaranty Insurance Corp. 250 E. Kilbourn Avenue Milwaukee, Wisconsin 53202 | 1983 | 1-1-81 |
| Mr. Dennis W. Hunt 3-21-32/\$1.3m 712-297-7571 | 3 President Hunt Truck Lines, Inc. West High Street Rockwell City, Iowa 50579 | 1984 | 1-1-79 |
| <u>Class C:</u> | | | |
| Mr. Stanton R. Cook 7-2-25/\$947m 312-222-3300 <u>DEPUTY CHAIRMAN</u> | President Tribune Company 435 North Michigan Avenue Chicago, Illinois 60611 | 1982 | 1-7-80 |
| Mr. John Sagan 3-9-21/\$23.5b 313-323-2450 <u>CHAIRMAN</u> | Vice President - Treasurer Ford Motor Company The American Road Dearborn, Michigan 48121 | 1983 | 1-30-78 |
| Mr. Edward F. Brabec 12-17-30/6,500 members 312-421-1010 | Business Manager Chicago Journeymen Plumbers Local Union 130, U.A. 1340 West Washington Blvd. Chicago, Illinois 60607 | 1984 | 2-3-78 |

DETROIT BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. Dean E. Richardson 12-27-27/\$4.5b 313-222-4970 | Chairman Manufacturers National Bank of Detroit 100 Renaissance Center Detroit, Michigan 48243 | 1982 | 1-1-80 |
| Mr. Lawrence A. Johns 10-10-28/\$59m 517-772-9471 | President Isabella Bank and Trust P.O. Drawer 100 Mount Pleasant, Michigan 48858 | 1983 | 1-1-78 |
| Mr. James H. Duncan 6-13-25/\$1.7b 616-383-9297 | Chairman and Chief Executive Officer First American Bank Corporation 108 E. Michigan Avenue Kalamazoo, Michigan 49007 | 1984 | 1-1-79 |
| Mr. Thomas R. Ricketts 3-4-31/\$3.5b 313-643-9600 | Chairman and President Standard Federal Savings and Loan Association 2401 W. Big Beaver Troy, Michigan 48084 | 1984 | 3-1-81 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Russell G. Mawby 2-23-28/\$792m 616-965-1221 <u>CHAIRMAN</u> | President and Trustee W. K. Kellogg Foundation 400 North Avenue Battle Creek, Michigan 49016 | 1982 | 1-1-80 |
| Dr. Karl D. Gregory 3-26-31/12,000 Students 313-377-3295 | Professor; Management and Economic Consultant School of Economics and Management Oakland University Rochester, Michigan 48063 | 1983 | 3-24-81 |
| Mr. Robert E. Brewer 1-9-32/\$16.5b sales 313-643-1640 | Executive Vice President Finance K mart Corporation 3100 West Big Beaver Road Troy, Michigan 48084 | 1984 | 1-1-82 |

FEDERAL RESERVE BANK OF ST. LOUIS

| <u>Class A:</u> | <u>Group</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--------------|--|-------------------------------------|--------------------------|
| Mr. Donald L. Hunt 9-1-37/\$23m 618-295-2364 | 3 | President First National Bank of Marissa 111 North Main Street Marissa, Illinois 62257 | 1982 | 1-1-80 |
| Mr. Clarence C. Barksdale 6-4-32/\$3.2b 314-554-6201 | 1 | Chairman and Chief Executive Officer Center Bank National Association P.O. Box 267 St. Louis, Missouri 63166 | 1983 | 1-1-81 |
| Mr. George M. Ryrie 11-3-21/\$97m 618-463-2211 | 2 | President First National Bank & Trust Co. P.O. Box 517 Alton, Illinois 62002 | 1984 | 1-1-79 |
| <u>Class B:</u> | | | | |
| Mrs. Mary P. Holt 2-26-21/\$379,000 501-664-3177 | 2 | President Clothes Horse 5 Fields Building University Avenue at "R" Street Little Rock, Arkansas 72207 | 1982 | 1-1-80 |
| Mr. Frank A. Jones, Jr. 4-8-27/\$6m sales (home phone) 901-685-6916 | 3 | President Dietz Forge Company (Mailing Address: 137 Perkins Extended Memphis, Tennessee 38117) | 1983 | 1-1-81 |
| Mr. Jesse M. Shaver 11-16-19/\$1.5b 502-589-2108 | 1 | Consultant Allis-Chalmers Corporation 455 South Fourth Street Louisville, Kentucky 40202 | 1984 | 1-1-82 |
| <u>Class C:</u> | | | | |
| Mr. Armand C. Stalnaker 4-24-16/\$1.5b 314-444-0652 <u>CHAIRMAN</u> | | Chairman of the Board General American Life Insurance Co. P.O. Box 396 St. Louis, Missouri 63166 | 1982 | 1-1-77 |
| Dr. William H. Stroube 6-24-24/13,490 Students 502-745-3151 | | Department of Agriculture Western Kentucky University Bowling Green, Kentucky 42101 | 1983 | 2-7-78 |
| Mr. W. L. Hadley Griffin 5-17-18/\$400m 314-854-4100 <u>DEPUTY CHAIRMAN</u> | | Chairman of the Board Chief Executive Officer Brown Group, Inc. P.O. Box 29 St. Louis, Missouri 63166 | 1984 | 1-1-82 |

LITTLE ROCK BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. William H. Bowen 5-6-23/\$403.6m 501-378-3221 | Chairman and Chief Executive Officer The Commercial National Bank of Little Rock P.O. Box 1331 Little Rock, Arkansas 72203 | 1982 | 1-1-80 |
| Mr. William H. Kennedy, Jr. 9-8-17/\$157.2m 501-534-1131 | Chairman of the Board National Bank of Commerce of Pine Bluff P.O. Box 6208 Pine Bluff, Arkansas 71611 | 1983 | 1-1-81 |
| Mr. Gordon E. Parker 1-6-24/\$146.3m 501-863-3181 | Chairman of the Board and President The First National Bank of El Dorado P.O. Box 751 El Dorado, Arkansas 71730 | 1984 | 1-1-79 |
| Mrs. Shirley J. Pine 9-18-30/9,238 enrollment 501-569-3155 | Department of Communicative Disorders University of Arkansas at Little Rock 33rd & University Little Rock, Arkansas 72204 | 1984 | 1-1-79 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. E. Ray Kemp, Jr. 9-15-24/\$250.5m in sales 501-376-5200 | Vice Chairman of the Board and Chief Administrative Officer Dillard Department Stores, Inc. P.O. Box 486 Little Rock, Arkansas 72203 | 1982 | 3-4-77 |
| Mr. Richard Y. Warner 5-23-29/\$980m 501-226-2611 <u>CHAIRMAN</u> | Group Vice President Wood Products Group Potlatch Corporation P.O. Box 390 Warren, Arkansas 71671 | 1983 | 1-1-81 |
| Mr. Sheffield Nelson 2-23-41/\$1b 501-372-6241 | Chairman of the Board, President and Chief Executive Officer Arkla, Inc. P.O. Box 751 Little Rock, Arkansas 72203 | 1984 | 1-1-82 |

LOUISVILLE BRANCH

| | | Term expires Dec. 31 | Service Began |
|---|--|----------------------------|------------------|
| <u>Appointed by Federal Reserve Bank:</u> | | | |
| Mr. Howard Brenner 9-16-19/\$61.3m 812-547-2323 | Vice Chairman of the Board Tell City National Bank P.O. Box 128 Tell City, Indiana 47586 | 1982 | 1-1-77 |
| Mr. Frank B. Hower, Jr. 11-26-28/\$1b 502-566-2708 | Chairman and Chief Executive Officer Liberty National Bank and Trust Company P.O. Box 32500 Louisville, Kentucky 40232 | 1983 | 1-1-81 |
| Mr. R. I. Kerr, Jr. 4-10-23/\$551m 502-587-8891 | President and Managing Officer Greater Louisville First Federal Savings and Loan Association One Financial Square Louisville, Kentucky 40270 | 1984 | 1-1-82 |
| Mr. John E. Darnell, Jr. 10-20-21/\$200m 502-926-3232 | Chairman of the Board, President and Chief Executive The Owensboro National Bank P.O. Box 787 Owensboro, Kentucky 42301 | 1984 | 3-23-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Dr. James F. Thompson 6-1-26/8,000 Enrollment 502-762-4188 <u>CHAIRMAN</u> | Professor of Economics Murray State University Murray, Kentucky 42071 | 1982 | 1-1-77 |
| Mr. William C. Ballard, Jr. 9-10-40/\$1.3b 502-561-2087 | Executive Vice President - Finance and Administration Humana, Inc. P.O. Box 1438 Louisville, Kentucky 40201 | 1983 | 12-11-80 |
| Sister Eileen M. Egan 1-11-25/1,000 Students 502-585-9911 | President Spalding College 851 S. Fourth Street Louisville, Kentucky 40203 | 1984 | 1-1-79 |

MEMPHIS BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Earl L. McCarroll 5-2-15/\$62.3m 501-763-8101 | President The Farmers Bank & Trust Co. P.O. Box 688 Blytheville, Arkansas 72315 | 1982 | 4-13-78 |
| Mr. Wayne W. Pyeatt 9-22-24/Not available 901-725-1311 | President Memphis Fire Insurance Company P.O. Box 40968 Memphis, Tennessee 38104 | 1983 | 1-1-81 |
| Mr. Edgar H. Bailey 5-8-26/\$1.1b 901-523-2961 | Chairman and President Leader Federal Savings and Loan Association P.O. Box 3410 Memphis, Tennessee 38103 | 1984 | 1-1-82 |
| Mr. William M. Matthews, Jr. 8-25-32/\$1.2b 901-523-6101 | Chairman of the Board and Chief Executive Officer Union Planters National Bank of Memphis P.O. Box 387 Memphis, Tennessee 38147 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mrs. Patricia W. Shaw 7-26-39/\$56m 901-525-3641 | Executive Vice President Universal Life Insurance Company 480 Linden Avenue Memphis, Tennessee 38126 | 1982 | 9-22-80 |
| Mr. Donald B. Weis 3-21-35/\$1.3m 501-735-4501 <u>CHAIRMAN</u> | President Tamak Transportation Corp. P.O. Box 1985 West Memphis, Arkansas 72301 | 1983 | 1-1-81 |
| Mr. G. Rives Neblett 5-25-43/Not Available 501-398-5121 | Attorney Neblett, Bobo & Chapman P.O. Box 63 Shelby, Mississippi 38774 | 1984 | 1-1-82 |

FEDERAL RESERVE BANK OF MINNEAPOLIS

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Henry N. Ness 2-21-18/\$110m 701-293-2261 | 1 Senior Vice President The Fargo National Bank Main at Broadway Fargo, North Dakota 58124 | 1982 | 1-1-80 |
| Mr. Vern A. Marquardt 7-5-22/\$24m 906-524-6172 | 2 President Commercial National Bank of L'Anse 1 E. Broad Street L'Anse, Michigan 49946 | 1983 | 1-1-81 |
| Mr. Dale W. Fern 2-25-27/\$34m 715-684-3366 | 3 President and Chairman of the Board The First National Bank of Baldwin, Wisconsin P.O. Box 145 Baldwin, Wisconsin 54002 | 1984 | 1-1-82 |
| <u>Class B:</u> | | | |
| Mr. Joe F. Kirby 12-14-22/\$38m 605-336-0850 | 1 Chairman Western Surety Company 908 West Avenue North Sioux Falls, South Dakota 57101 | 1982 | 1-1-80 |
| Mr. Harold F. Zigmund 4-11-19/\$180,000 218-327-6201 | 3 President and Chief Executive Officer Blandin Paper Company 115 South West First Street Grand Rapids, Minnesota 55744 | 1983 | 1-1-81 |
| Mr. William L. Mathers 9-29-23/\$3.5m 406-232-4425 | 2 President Mathers Land Company, Inc. 314 So. Merriam Miles City, Montana 59301 | 1984 | 1-1-82 |
| <u>Class C:</u> | | | |
| Sister Generose Gervais 9-18-19/1,050 Beds 507-285-5158 | Administrator St. Mary's Hospital 2414 South Seventh Street Rochester, Minnesota 55901 | 1982 | 10-10-78 |
| Mr. William G. Phillips 3-3-20/\$387.4m 612-340-3301 <u>CHAIRMAN</u> | Chairman and Chief Executive Officer International Multifoods 1200 Multifoods Building Minneapolis, Minnesota 55402 | 1984 | 1-1-79 |
| Dr. John B. Davis, Jr. 9-14-21/1730 Students 612-696-6207 <u>DEPUTY CHAIRMAN</u> | President Macalester College St. Paul, Minnesota 55105 | 1984 | 1-1-82 |

HELENA BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Jase O. Morsworthy 2-21-26/\$4.3m 406-252-8432 | President The M.R.G. Company Box 1315 Billings, Montana 59103 | 1982 | 1-1-79 |
| Mr. Roger H. Ulrich 5-15-25/Not Available 406-654-2340 | President The First State Bank of Malta Malta, Montana 59538 | 1983 | 1-1-82 |
| Mr. Harry W. Newlon 6-14-31/\$97m 406-587-9222 | President First National Bank P.O. Box 730 Bozeman, Montana 59715 | 1982 | 1-1-80 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Ernest B. Corrick 11-25-20/\$4b 406-258-5511 <u>CHAIRMAN</u> | Vice President and General Manager Champion International Corporation Timberlands - Rocky Mountain Operation (MAILING ADDRESS: 115 Takima Drive Missoula, Montana 59801) | 1982 | 1-1-81 |
| Mr. Gene J. Etchart 12-26-15/Not available 406-228-2835 | Past President Hinsdale Livestock Company P.O. Box 429 Glasgow, Montana 59230 | 1983 | 1-1-82 |

FEDERAL RESERVE BANK OF KANSAS CITY

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-----------------------------|----------------------|
| Mr. Howard K. Loomis 4-9-27/\$63m 316-672-5611 | 2 President The Peoples Bank (MAILING ADDRESS: Krey Co. Ltd., P.O. Box 928, Pratt, Kansas 67124) | 1982 | 5-10-79 |
| Dr. Wayne D. Angell 6-28-30/\$8m 913-242-6100 | 3 President Council Grove National Bank (MAILING ADDRESS: 1341 South Mulberry, Ottawa, Kansas 66067) | 1983 | 6-13-79 |
| Mr. John D. Woods 12-6-29/\$807m 402-348-7990 | 1 Chairman and Chief Executive Officer The Omaha National Bank 17th and Farnam Omaha, Nebraska 68102 | 1984 | 1-1-79 |
| <u>Class B:</u> | | | |
| Mr. Charles C. Gates 5-27-21/Not available 303-744-4288 | 1 President and Chairman of the Board Gates Rubber Company 999 South Broadway P.O. Box 5887 Denver, Colorado 80217 | 1982 | 1-1-80 |
| Mr. James G. Harlow, Jr. 5-29-34/\$1.7b 405-272-3195 | 3 President and Chief Executive Officer Oklahoma Gas and Electric Co. P.O. Box 321 Oklahoma City, Oklahoma 73101 | 1983 | 1-1-78 |
| Mr. Duane Acker 3-13-31/19,982 Students 913-532-6221 | 2 President Kansas State University Anderson Hall Manhattan, Kansas 66506 | 1984 | 1-1-82 |
| <u>Class C:</u> | | | |
| Mr. Paul H. Henson 7-22-25/\$4.4b 913-676-3301 <u>CHAIRMAN</u> | Chairman United Telecommunications, Inc. (MAILING ADDRESS: United Telecom, Box 11315, Kansas City, Missouri 64112) | 1982 | 1-1-77 |
| Mr. John F. Anderson 4-12-24/\$2.1b 816-459-6216 | President and Chief Executive Officer Farmland Industries, Inc. 3315 North Oak Traffic Way Kansas City, Missouri 64116 | 1983 | 1-1-81 |
| Dr. Doris M. Drury 11-18-28/7,858 Students 303-753-2427 <u>DEPUTY CHAIRMAN</u> | Professor of Economics: Director of Public Affairs Program - University of Denver 10879 E. Powers Drive Englewood, Colorado 80111 | 1984 | 1-1-80 |

DENVER BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Delano E. Scott 1-3-19/\$77m 303-879-0550 | President and Chairman The Routt County National Bank of Steamboat Springs P.O. Box 1237 Steamboat Springs, Colorado 80477 | 1982 | 1-1-77 |
| Mr. George S. Jenks 3-11-27/\$900m 505-765-2525 | Chairman and Chief Executive Officer Albuquerque National Bank P.O. Box 1344 Albuquerque, New Mexico 87103 | 1982 | 1-1-81 |
| Mr. Kenneth C. Naramore 11-27-20/\$127m 307-682-5144 | President Stockmen's Bank & Trust Company Box 3004 Gillette, Wyoming 82716 | 1983 | 1-1-80 |
| Mr. Donald D. Hoffman 11-2-23/\$900m 303-893-3456 | Chairman Central Bank of Denver P.O. Box 5548 T.A. Denver, Colorado 80292 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Alvin F. Grospiron 4-17-16/Retired 303-988-6930 | 2771 South Eaton Way Denver, Colorado 80227 | 1982 | 1-1-80 |
| Vacancy | | | |
| Mr. James E. Nielson 5-24-40/Not Available 307-578-1322 | President and Chief Executive Officer J.N., Inc. P.O. Box 2850 Cody, Wyoming 82414 | 1984 | 2-1-82 |

OKLAHOMA CITY BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. Marcus R. Tower 4-12-20/\$1.1b 918-588-6541 | Vice Chairman of the Board Chairman of the Credit Policy Committee Bank of Oklahoma P.O. Box 2300 Tulsa, Oklahoma 74192 | 1982 | 1-1-81 |
| Mr. Walter L. Stephenson, Jr. 1-22-30/\$170m 405-233-3535 | Chairman and Chief Executive Officer Central National Bank and Trust Company P.O. Box 3448 Enid, Oklahoma 73701 | 1982 | 1-1-77 |
| Mr. William H. Crawford 5-4-38/\$40m 405-335-2126 | President and Chief Executive Officer First National Bank and Trust Company P.O. Box A Frederick, Oklahoma 73542 | 1983 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Samuel R. Noble 8-12-25/Not available 405-226-1900 | Chairman of the Board Noble Affiliates, Inc. P.O. Box 1486 Ardmore, Oklahoma 73401 | 1982 | 1-1-79 |
| Mrs. Christine H. Anthony 12-18-16/Retired 405-843-4785 <u>CHAIRMAN</u> | 6707 N.W. Grand Boulevard Oklahoma City, Oklahoma 73116 | 1983 | 1-14-78 |

OMAHA BRANCH

| | | Term expires Dec. 31 | Service Began |
|---|--|----------------------------|------------------|
| <u>Appointed by Federal Reserve Bank:</u> | | | |
| Mr. Donald J. Murphy 3-15-18/\$475m 402-536-2102 | Chairman and Chief Executive Officer United States National Bank of Omaha P.O. Box 3408 Omaha, Nebraska 68103 | 1982 | 1-1-81 |
| Mr. Joseph J. Huckfeldt 3-23-34/\$59m 308-436-5061 | President Gering National Bank and Trust Company P.O. Box 100 Gering, Nebraska 69341 | 1983 | 1-1-78 |
| Mr. William W. Cook, Jr. 2-19-37/\$50m 402-228-3333 | President Beatrice National Bank and Trust Company P.O. Box 100 Beatrice, Nebraska 68310 | 1983 | 1-17-80 |

Appointed by Board of Governors:

| | | | |
|---|--|------|--------|
| Mr. Robert G. Lueder 11-14-22/\$30m 402-339-1000 <u>CHAIRMAN</u> | President Lueder Construction Company Suite 500 11128 John Galt Boulevard Omaha, Nebraska 68137 | 1982 | 1-1-79 |
| Mrs. Gretchen S. Velde 8-16-23/Not available 402-391-8400 | Chairman of the Board Swanson Enterprises The Swanson Building, Suite 304 8701 West Dodge Road Omaha, Nebraska 68114 | 1983 | 1-1-80 |

FEDERAL RESERVE BANK OF DALLAS

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. John P. Gilliam 12-24-37/\$9m 817-932-5204 | 3 President and Chief Executive Officer First National Bank in Valley Mills Box 278 Valley Mills, Texas 76689 | 1982 | 1-1-80 |
| Mr. Miles D. Wilson 1-7-33/\$39m 713-865-3181 | 2 Chairman of the Board & President The First National Bank of Bellville P.O. Box 128 Bellville, Texas 77418 | 1983 | 1-1-81 |
| Mr. Lewis H. Bond 7-31-21/\$2b 817-338-8110 | 1 Chairman of the Board and Chief Executive Officer Texas American Bancshares Inc. P.O. Box 2050 Ft. Worth, Texas 76101 | 1984 | 1-1-79 |
| <u>Class B:</u> | | | |
| Mr. Robert D. Rogers 6-10-36/\$313m 214-637-3100 | 1 President Texas Industries, Inc. 8100 Carpenter Freeway Dallas, Texas 75247 | 1982 | 1-1-80 |
| Dr. Kent Gilbreath 12-28-45/9,702 Students 817-755-1211 | 3 Associate Dean Hankamer School of Business Baylor University Waco, Texas 76798 | 1983 | 3-22-79 |
| Dr. J. Wayland Bennett 10-13-23/23,129 Students 806-742-2876 | 2 Charles C. Thompson, Professor of Agricultural Finance and Associate Dean College of Agricultural Sciences Texas Tech University P.O. Box 4190 Lubbock, Texas 79409 | 1984 | 1-1-79 |
| <u>Class C:</u> | | | |
| Mrs. Margaret S. Wilson 8-7-30/\$9m 512-451-8448 | Chairman of the Board and Chief Executive Officer Scarboroughs Stores P.O. Box 5879 Austin, Texas 78763 | 1982 | 1-1-77 |
| Mr. John V. James 7-24-18/\$2.9b 214-746-6704 <u>DEPUTY CHAIRMAN</u> | Chairman of the Board Dresser Industries, Inc. P.O. Box 718 Dallas, Texas 75221 | 1983 | 1-1-81 |
| Mr. Gerald D. Hines 8-15-25/\$480m 713-621-8000 <u>CHAIRMAN</u> | Owner Gerald D. Hines Interests 2100 Post Oak Tower Houston, Texas 77056 (MAILING ADDRESS: Federal Reserve Bank of Dallas. Station K Dallas) | 1984 | 1-1-79 |

EL PASO BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Stanley J. Jarmiolowski 5-18-39/\$34m 915-593-1333 | Chairman of the Board and Chief Executive Officer Interfirst Bank El Paso, National Association Box 9715 El Paso, Texas 79987 | 1982 | 7-9-81 |
| Mr. Claude E. Leyendecker 10-15-22/\$29.8m 505-546-8871 | President Mimbres Valley Bank P.O. Box 1050 Deming, New Mexico 88030 | 1983 | 1-1-78 |
| Mr. Ernest M. Schur 8-25-18/\$175m 915-332-7311 | Chairman of the Executive Committee Interfirst Bank Odessa, National Association P.O. Box 4798 Odessa, Texas 79760 | 1984 | 3-13-80 |
| Mr. Gerald W. Thomas 8-3-19/17,066 Students 505-646-2035 | President New Mexico State University Drawer 38C Las Cruces, New Mexico 88003 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. A. J. Losee 1-18-25/\$500,000 505-746-3508 <u>CHAIRMAN</u> | Shareholder Losee, Carson, & Dickerson Professional Association P.O. Drawer 239 Artesia, New Mexico 88210 | 1982 | 1-1-77 |
| Mr. Chester J. Kesey 4-17-25/\$3m 915-447-2324 <u>CHAIRMAN PRO TEM</u> | C. J. Kesey Enterprises (MAILING ADDRESS: 2 Briarwood Circle Pecos, Texas 79772) | 1983 | 1-1-78 |
| Ms. Mary Carmen Saucedo 2-5-25/60,173 Students 915-779-5481 | Associate Superintendent Central Area El Paso Independent School District 6101 Hughey Drive El Paso, Texas 79925 | 1984 | 1-1-82 |

HOUSTON BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|--|-------------------------------------|--------------------------|
| Mr. Will E. Wilson 2-29-16/\$325m 713-838-9288 | Chairman of the Board and Chief Executive Officer First Security Bank of Beaumont, N.A. P.O. Box 3391 Beaumont, Texas 77704 | 1982 | 1-1-80 |
| Professor Raymond L. Britton 8-20-24/28,900 Students 713-749-1277 | Labor Arbitrator and Professor of Law University of Houston (MAILING ADDRESS: 6146 Olympia Drive, Houston, Texas 77057) | 1983 | 10-12-78 |
| Mr. Ralph E. David 10-31-27/\$80m 713-233-4401 | President First Freeport National Bank P.O. Drawer H Freeport, Texas 77541 | 1984 | 1-1-79 |
| Mr. Thomas B. McDade 6-21-23/\$12b 713-236-5413 | Vice Chairman Texas Commerce Bancshares, Inc. P.O. Box 2558 Houston, Texas 77001 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Jerome L. Howard 8-4-16/\$174m 713-525-8000 <u>CHAIRMAN</u> | Chairman of the Board and Chief Executive Officer Mortgage & Trust, Inc. P.O. Box 2885 Houston, Texas 77001 | 1982 | 1-1-77 |
| Mr. Paul H. Howell 9-13-18/\$139m 713-658-4000 <u>CHAIRMAN PRO TEM</u> | Chairman of the Board and President Howell Corporation 1010 Lamar Building Suite 1800 Houston, Texas 77002 | 1983 | 1-1-81 |
| Mr. George V. Smith, Sr. 3-19-26/\$5m 713-453-8546 | President Smith Pipe & Supply, Inc. P.O. Box 24099 Houston, Texas 77015 | 1984 | 2-29-80 |

SAN ANTONIO BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. George Brannies 12-25-43/\$30m 915-347-6375 | Chairman of the Board and President The Mason National Bank P.O. Box N Mason, Texas 76856 | 1982 | 1-1-80 |
| Mr. John H. Garner 4-1-21/\$343m 512-881-6878 | President and Chief Executive Officer Corpus Christi National Bank P.O. Box 301 Corpus Christi, Texas 78403 | 1983 | 1-1-78 |
| Mr. Charles E. Cheever, Jr. 5-17-28/\$191m 512-824-0444 | President Broadway National Bank P.O. Box 17001 San Antonio, Texas 78286 | 1984 | 1-1-79 |
| Mr. Joe D. Barbee 12-26-23/\$11.4m 512-968-7502 | President and Chief Executive Officer Barbee-Neuhaus Implement Company P.O. Box 386 Weslaco, Texas 78596 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Pat Legan 1-7-21/\$14m 512-341-7206 <u>CHAIRMAN PRO TEM</u> | Owner Legan Properties 4402 Vance Jackson, Suite 200 San Antonio, Texas 78230 | 1982 | 1-1-77 |
| Dr. Lawrence L. Crum 7-25-33/43,000 Students 512-471-4368 <u>CHAIRMAN</u> | Professor of Banking and Finance The University of Texas at Austin (MAILING ADDRESS: 3920 Sierra Drive, Austin, Texas 78731) | 1983 | 1-1-80 |
| Mr. Carlos A. Zuniga 11-1-27/\$1m 512-723-6311 | Zuniga Freight Services, Inc. P.O. Box 89 Laredo, Texas 78040 | 1984 | 1-1-79 |

FEDERAL RESERVE BANK OF SAN FRANCISCO

| <u>Class A:</u> | <u>Group</u> | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. Frederick G. Larkin, Jr. 12-28-13/\$26.1b 213-613-6037 | 1 Chairman of the Executive Committee Security Pacific National Bank P.O. Box 2097, Terminal Annex Los Angeles, California 90051 | 1982 | 1-1-77 |
| Mr. Ole R. Mettler 9-7-17/\$197m 209-334-1101 | 2 President and Chairman Farmers & Merchants Bank of Central California P.O. Box 380 Lodi, California 95240 | 1983 | 1-1-78 |
| Mr. Robert A. Young 10-28-20/\$51m 206-695-1311 | 3 Chairman and President Northwest National Bank P.O. Box 1867 Vancouver, Washington 98668 | 1984 | 1-1-79 |
| <u>Class B:</u> | | | |
| Mr. Clair L. Peck, Jr. 11-18-20/Not available 213-381-6711 | 3 Chairman of the Board C. L. Peck Contractor 3303 Wilshire Boulevard Los Angeles, California 90010 | 1982 | 1-1-74 |
| Mr. J. R. Vaughan 1-28-16/Not available 213-626-8484 | 1 Senior Member Richards, Watson, Dreyfuss & Gershon 333 South Hope Street Los Angeles, California 90071 | 1983 | 1-1-78 |
| Mr. George H. Weyerhauser 8-8-26/\$4.9b 206-924-3000 | President and CEO Weyerhauser Company Tacoma, Washington 98477 | 1984 | 1-1-82 |
| <u>Class C:</u> | | | |
| Mrs. Caroline Leonetti Ahmanson 4-12-18/275 Students 213-275-4282 <u>CHAIRMAN</u> | Chairman of the Board Caroline Leonetti, Ltd. c/o Mrs. Howard Ahmanson 9500 Wilshire Boulevard Hollywood, California 90212 | 1982 | 1-1-80 |
| Mr. Alan C. Furth 9-16-22/\$4.3b 415-541-2136 <u>DEPUTY CHAIRMAN</u> | President Southern Pacific Company 1 Market Plaza San Francisco, California 94105 | 1984 | 1-1-80 |
| Mr. Fred W. Andrew 1-26-27/\$68.3m 805-832-1111 | President and Chief Executive Officer Superior Farming Company 3501 Stockdale Highway Bakersfield, California 93309 | 1983 | 1-1-80 |

LOS ANGELES BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|--|-------------------------------------|--------------------------|
| Mr. Bram Goldsmith 2-22-23/\$1.4b 213-550-5711 | Chairman of the Board City National Bank 400 North Roxbury Drive Beverly Hills, California 90210 | 1982 | 1-1-80 |
| Mr. William L. Tooley 4-23-34/2.5m sq. ft. of office space 213-382-8211 | Managing Partner Tooley and Company, Investment Builders 3303 Wilshire Boulevard Los Angeles, California 90010 | 1982 | 1-1-82 |
| Mr. James D. McMahon 1-20-26/\$100m 805-255-9611 | President Santa Clarita National Bank 23929 W. Valencia Boulevard Valencia, California 91355 | 1983 | 1-1-78 |
| Mr. Robert R. Dockson 11-6-17/\$6b 213-932-4001 | Chairman and Chief Executive Officer California Federal Savings 5670 Wilshire Boulevard - 15th floor Los Angeles, California 90069 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Togo W. Tanaka 1-7-16/\$5m 213-620-5760 | President Gramercy Enterprises 445 South Figueroa, Suite 3750 Los Angeles, California 90071 | 1982 | 1-1-79 |
| Mrs. Lola M. McAlpin-Grant 9-23-41/1,223 Students 213-642-2914 | Assistant Dean Loyola Law School 1440 West Ninth Street Los Angeles, California 90015 | 1983 | 1-1-80 |
| Mr. Bruce M. Schwaegler 4-23-37/\$500m 213-486-5363 <u>CHAIRMAN</u> | President Bullock's - Bullocks Wilshire 7th and Hill Street Los Angeles, California 90014 | 1984 | 1-1-82 |

PORTLAND BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. Herman C. Bradley, Jr. 4-23-31/\$11m 503-998-8734 | President and Chief Executive Officer Tri-County Banking Company P.O. Box 377 Junction City, Oregon 97448 | 1982 | 5-29-81 |
| Mr. William S. Naito 9-16-25/\$11m 503-228-7404 | Vice President Morcrest China Company P.O. Box 3458 Portland, Oregon 97208 | 1983 | 1-1-81 |
| Mr. Jack W. Gustavel 12-31-39/\$84m 208-664-1446 | President and Chief Executive Officer The First National Bank of North Idaho P.O. Box 1409 Coeur d'Alene, Idaho 83814 | 1984 | 1-1-79 |
| Mr. John A. Elorriaga 10-20-23/\$5.1m 503-225-5778 | Chairman of the Board and Chief Executive Officer United States National Bank of Oregon P.O. Box 4412 Portland, Oregon 97208 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Phillip W. Schneider 9-22-13/4,000,000 members 503-292-2759 | Former Northwest Regional Executive National Wildlife Federation 8755 S.W. Woodside Drive Portland, Oregon 97225 | 1982 | 1-1-78 |
| Mr. John C. Hampton 2-10-26/Not available 503-297-7691 <u>CHAIRMAN</u> | Chairman and President Williamina Lumber Company 9400 Southwest Barns Road Suite 400 Portland, Oregon 97225 | 1983 | 1-1-81 |
| Ms. Carolyn S. Chambers 9-15-31/\$79m 503-485-5611 | Executive Vice President and Treasurer Liberty Communications, Inc. P.O. Box 7009 Eugene, Oregon 97401 | 1984 | 1-1-82 |

SALT LAKE CITY BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|---|---|-------------------------------------|--------------------------|
| Mr. Fred H. Stringham 12-19-26/\$349m 801-973-5020 | President Valley Bank and Trust Company 2510 South State Street South Salt Lake, Utah 84115 | 1982 | 1-1-78 |
| Mr. Albert C. Gianoli 12-18-18/\$8m 702-289-4441 | President and Chairman of the Board First National Bank of Ely P.O. Box 479 Ely, Nevada 89301 | 1983 | 1-1-81 |
| Mr. Spencer F. Eccles 8-24-34/\$3.6b 801-350-5329 | President and Chief Executive Officer First Security Corporation P.O. Box 30006 Salt Lake City, Utah 84125 | 1984 | 4-30-80 |
| Mrs. Lela M. Ence 9-19-27/22,000 Students 801-581-6995 | Executive Director University of Utah Alumni Association 155 South Central Campus Drive Salt Lake City, Utah 84112 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Robert A. Erkins 1-20-24/Not available 208-352-4460 | Geothermal Agri/Aquaculturist White Arrow Ranch Box 108 Bliss, Idaho 83314 | 1982 | 1-1-78 |
| Mr. J. L. Terteling 1-25-37/\$25m 208-376-6700 | President The Terteling Company, Inc. P.O. Box 4127 Boise, Idaho 83704 | 1983 | 1-1-78 |
| Mr. Wendell J. Ashton 10-31-12/71,000 Circulation 801-237-2188 <u>CHAIRMAN</u> | Publisher Deseret News P.O. Box 1257 Salt Lake City, Utah 84110 | 1984 | 1-1-79 |

SEATTLE BRANCH

| <u>Appointed by Federal Reserve Bank:</u> | | <u>Term expires Dec. 31</u> | <u>Service Began</u> |
|--|---|-------------------------------------|--------------------------|
| Mr. Donald L. Mellish 11-1-27/\$600m 907-265-2929 | Chairman of the Board National Bank of Alaska P.O. Box 600 Anchorage, Alaska 99510 | 1982 | 1-1-78 |
| Mr. Lonnie G. Bailey 12-5-39/\$50m 509-928-9600 | Chief Operating Officer and Executive Vice President Farmers & Merchants Bank of Rockford N. 10 Argonne Road Spokane, Washington 99206 | 1983 | 1-1-81 |
| Mr. John N. Nordstrom 3-14-37/Not Available 206-628-2357 | Co-Chairman of the Board Nordstrom, Inc. 1501 Fifth Avenue Seattle, Washington 98101 | 1984 | 1-1-82 |
| Mr. G. Robert Truex, Jr. 5-29-24/\$5m | Chairman Rainier Bancorporation and Rainier National Bank P.O. Box 3966 T24-1 Seattle, Washington 98124 | 1984 | 1-1-82 |
| <u>Appointed by Board of Governors:</u> | | | |
| Mr. Merle D. Adlum 2-21-19/Not available 206-623-0733 | President Puget Sound District Council Maritime Trades Department, AFL/CIO 1501 Morton Building Seattle, Washington 98104 | 1982 | 1-1-78 |
| Dr. Virginia L. Parks 5-1-39/4,150 Students 206-626-6605 | Vice President for Finance and Treasurer Seattle University 12th and Columbia Seattle, Washington 98122 | 1983 | 1-1-78 |
| Mr. John W. Ellis 9-14-28/\$450m 306-453-6731 <u>CHAIRMAN</u> | President and Chief Executive Officer Puget Sound Power & Light Company Puget Power Building Bellevue, Washington 98009 | 1984 | 1-1-82 |

Exhibit IIOCCUPATION CHARACTERISTICS OF
FEDERAL RESERVE BANK AND BRANCH DIRECTORS

(as of August 1982)

| Occupational Category | Federal Reserve Banks | | Branches | | Totals | |
|---|-----------------------|----------|----------|----------|--------|----------|
| | No. | % of 108 | No. | % of 169 | No. | % of 277 |
| 1. Banking | 36 | 33 | 73 | 43 | 109 | 39 |
| 2. Manufacturing | 19 | 18 | 11 | 7 | 30 | 11 |
| 3. Education | 9 | 8 | 19 | 11 | 28 | 10 |
| 4. Agriculture | 8 | 7 | 10 | 6 | 18 | 6 |
| 5. Wholesale & Retail Trade | 7 | 6 | 6 | 4 | 13 | 5 |
| 6. Services | 3 | 3 | 7 | 4 | 10 | 4 |
| 7. Professional | 4 | 4 | 5 | 3 | 9 | 3 |
| 8. Real Estate & Construction | 7 | 6 | 7 | 4 | 14 | 5 |
| 9. Communications | 2 | 2 | 4 | 2 | 6 | 2 |
| 10. Non-Bank Fi- nancial | 4 | 4 | 9 | 5 | 13 | 5 |
| 11. Labor and Arbitration | 1 | 1 | 3 | 2 | 4 | 1 |
| 12. Consumer & Civic Representatives | 1 | 1 | 5 | 3 | 6 | 2 |
| 13. Utilities | 3 | 3 | 2 | 1 | 5 | 2 |
| 14. Mining & Ex- traction | 1 | 1 | 5 | 3 | 6 | 2 |
| 15. Transportation | 3 | 3 | 3 | 2 | 6 | 2 |
| 16. Unclassified | - | - | - | - | - | - |
| 17. Vacancies | - | - | - | - | - | - |
| Total* | 108 | 100 | 169 | 100 | 277 | 100% |

* NOTE: Totals may vary due to rounding.

REPRESENTATION BY WOMEN AND MINORITIES

ON BOARD OF DIRECTORS OF THE
FEDERAL RESERVE BANKS AND BRANCHES

(As of August, 1982)

| | <u>Federal Reserve Banks</u> | | | | <u>Branches</u> | | | <u>Total</u> |
|---------------------|------------------------------|----------|----------|--------------|-----------------------|------------------------|--------------|--------------|
| | <u>A</u> | <u>B</u> | <u>C</u> | <u>Total</u> | <u>Bank Appointed</u> | <u>Board Appointed</u> | <u>Total</u> | |
| Women | - | 4 | 7 | 11 | 6 | 13 | 19 | 30 |
| Minorities | | | | | | | | |
| a. Blacks | - | - | 1 | 1 | 1 | 9 | 10 | 11 |
| b. Hispanics | - | - | - | - | 1 | 2 | 3 | 3 |
| c. Orientals | - | - | - | - | 1 | 1 | 2 | 2 |
| d. Native Americans | - | - | - | - | - | - | - | - |
| Total Minorities | - | - | 1 | 1 | 3 | 12 | 15 | 16 |

REPRESENTATION BY WOMEN AND MINORITIES
ON BOARDS OF DIRECTORS OF THE
FEDERAL RESERVE BANKS AND BRANCHES

| | <u>1975</u> | | <u>1976</u> | | <u>1977</u> | | <u>1978</u> | | <u>1979</u> | | <u>1980</u> | | <u>1981</u> | | <u>1982</u> | |
|----------------------|-------------|----------|-------------|----------|-------------|----------|-------------|----------|-------------|----------|-------------|----------|-------------|----------|-------------|----------|
| | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> | <u>#</u> | <u>%</u> |
| Women | 4 | 1% | 6 | 2% | 17 | 6% | 23 | 8% | 30 | 11% | 30 | 11% | 28 | 10% | 30 | 11% |
| <hr/> | | | | | | | | | | | | | | | | |
| Minorities | | | | | | | | | | | | | | | | |
| a. Blacks * | | | 5 | 2% | 6 | 2% | 7 | 3% | 13 | 5% | 14 | 5% | 13 | 5% | 11 | 4% |
| b. Hispanics * | | | 5 | 2% | 7 | 3% | 7 | 3% | 5 | 2% | 5 | 2% | 5 | 2% | 3 | 1% |
| c. Orientals * | | | 1 | | 1 | - | 1 | - | 1 | | 1 | | 2 | 1% | 2 | 1% |
| d. Native American * | | | 2 | 1% | 2 | 1% | | | | | | | | | | |
| <hr/> | | | | | | | | | | | | | | | | |
| Total Minorities * | | | 13 | 5% | 16 | 6% | 15 | 5% | 20 | 7% | 21 | 8% | 20 | 7% | 16 | 6% |
| <hr/> | | | | | | | | | | | | | | | | |
| BASE | 269 | | 269 | | 269 | | 269 | | 275 | | --- | | 275 | | --- | |

* Information not available.
Percentages are rounded to the nearest number

REPRESENTATION OF THRIFT INSTITUTIONS
ON BOARDS OF DIRECTORS OF THE
FEDERAL RESERVE BANKS AND BRANCHES

(As of August 1982)

Directors Whose Primary Occupations Are With Thrift Institutions

| | |
|-----------------------------|----------|
| Federal Reserve Bank Boards | 0 |
| Branch Boards | <u>5</u> |
| Total | 5 |

Directors Otherwise Affiliated With Thrift Institutions

| | |
|-----------------------------|----------|
| Federal Reserve Bank Boards | 1 |
| Branch Boards | <u>6</u> |
| Total | 7 |

Chairman FAUNTROY. Pursuant to your suggestion, we will yield now to Mr. Boykin for his statement.

Mr. NEAL. Would the chairman yield to me for a question.

My own interest is primarily in the interest of monetary policy and the appropriateness of current monetary policy and so on. And I am aware that we probably won't be able to meet beyond about noon; is that not correct?

Chairman FAUNTROY. I will be able to continue until at least 12:30.

Mr. NEAL. I was just wondering if we might be able to focus a little bit more on that than some of the other more technical questions. Or if it is your desire to move in another direction, I yield to that.

I want to express my own opinion, if we could concentrate more on that issue, that would be my desire.

Mr. PATMAN. Mr. Chairman, I wonder if we could go ahead and have the questions now. We have all had an opportunity to read the statements.

Chairman FAUNTROY. I am certainly appreciative of the sentiments expressed by both gentlemen. However, I would like to have each president briefly summarize his statement. We will enter the statements, in their entirety, in the record, and move quickly then to questioning, as I am sure many members would want to do. Mr. Boykin, and other members of the panel, feel free to go into whatever detail you think is required to get your points over.

STATEMENT OF ROBERT H. BOYKIN

Mr. BOYKIN. Thank you, Mr. Chairman. It is a pleasure to be here for these hearings. I will try to be as brief as I can.

With respect to the community and scholarly activities in my prepared statement, we have listed the efforts in our bank, in our district, with regard to our work training program, upward mobility program, affirmative action policies, and community and scholarly activities. And while I will go over that material very hurriedly, and it is listed, I hope it is clear that we take this responsibility very seriously, and we are dedicated in all of these areas. So, I would not want it to be construed as passing over that lightly.

Beginning with some of the questions that relate more to the economy, and turning to the question of liquidity first, of course the cash flow positions of businesses throughout the country and the 11th District are still showing some strain.

We have some of the cash flow problems obviously in the business sector. This is generating some earnings pressure in the financial sector. And, of course, earnings pressures in savings and loan institutions resulting from the high funding costs remain a source of concern. However, the commercial banking sector is relatively liquid at this time. Business loan growth since July has moderated and discount window borrowings have dropped off sharply in recent months. In the 11th District weakness is primarily concentrated in the energy sector. Here we are talking about manufacturing energy equipment, drilling, and the energy servicing industry. And similar to the national picture, high borrowing costs have increased liquidity pressures in small- to medium-sized firms, auto dealerships, and residential homebuilders.

But even having said this, I think our part of the country seems to be fareing a little better than other parts of the country. Our financial institutions have been among the top performers during the past several years. Implications for monetary policy of liquidity strains in both the financial and business sectors are certainly taken into consideration when setting policy. Recently both long- and short-term interest rates have dropped sharply, and if this decline is sustained, it should significantly reduce liquidity strains during the second half of this year.

Economic indicators seem to imply some improvement in the economy in the near future. But we recognize at the present time the economy still is rather weak.

The 11th District, of course, has been affected by the recession. I have already referred to what is going on in the energy industry. In addition to that, our district retailing is weaker than normal. In our district, farmers are suffering from low prices. We have had quite a bit of crop damage down our way. And we have had substantial loss of employment in the farming sector.

Although the inflationary rate abated in July, many of our Nation's economic problems are still tied to inflation and to inflationary expectations. Certainly high interest rates reflect investors' fears of high inflation. The difficulties which have occurred this year in the capital goods market, the housing market and to some extent the automobile market, are legacies of past high inflation rates and resulting high interest rates.

Consequently, the implications of the current state of the economy for monetary policy must be weighed carefully. While the current situation is serious, it is my view at least that any quick fix that could be given by an expansionary monetary policy would refuel inflation and the expectation of more inflation. Such a policy would ultimately drive up interest rates and erode our economic base even further. And this suggests that despite the current weakness of the economy, it is to the long-run benefit for everyone to encourage an environment of stable prices so that productivity and employment can expand.

We have learned a very painful lesson in this country about inflation, and if left unchecked, inflation will lead to high and volatile interest rates, increased uncertainty about the future economic environment and reduced incentives for investment. Inflation ultimately contributes to inadequate productivity, living standards and employment opportunities. This realization led the Federal Reserve System to adopt a long-term program to slowly reduce the rate of inflation. Much progress has been made: By almost any measure the rate of inflation has been cut in half in the last several years. Nevertheless, public skepticism regarding the permanence of this progress, together with swelling Federal deficits, kept interest rates high even while inflation was moderating. And this represented a sharp increase in the so-called real, or inflation-adjusted, interest rate that is the primary cause of current economic weakness.

Recently, however, the public has accepted some of the reductions in inflation as more permanent, fostering significant reduction in interest rates. And were we to relax our vigil against inflation, public expectations would reverse that decline. Consequently, we feel our current policy provides the only hope for enduring diminution of interest rates.

With respect to the monetary aggregates that the FOMC uses as targets, I think they have been helpful. I think they will help guide policies which will further reduce inflation, make possible economic recovery and sustainable growth. Nevertheless, structural changes in our economy and our financial markets can affect patterns of monetary growth, and we must be willing to adjust our growth targets, revise the definitions of our aggregates, or even change the types of targets we use when evidence suggests this is necessary.

For some years, with particular emphasis during the past 3 years, we have used the monetary and credit aggregates as targets. Statistical studies over a number of years have shown that changes in these aggregates are related to future changes in economic activity. Of special importance is the evidence that reduction in the rates of growth of these aggregates will lead to reductions in the rate of inflation. Experience in the last 3 years points out the importance of flexibility and judgment in using these aggregates. The rapid pace of change of financial markets and temporary shifts in the liquidity needs of firms and households have required us to deviate from our long-term targets from time to time. We must continue to reexamine the aggregates behavior and their relationship with our economic goals as we set our long-term growth targets. And in setting our short-term targets, we must continue to view recent changes in money growth in the context of a whole host of

economic variables and indicators, to determine if short-run deviations from our targeting are appropriate.

In your letter of invitation, you mentioned alternative ways of viewing monetary policy. One, the monetary base—quickly, I would say that there are also problems with that. It does seem to me in some work that has been done at our bank that there are probably more problems with the monetary base than there are with the monetary aggregates.

The use of interest rates is another frequently discussed alternative, but I think our unhappy experience with putting more emphasis on interest rates in the 1960's and 1970's is precisely what led us to greater emphasis on the monetary aggregates 3 years ago. Real interest rates have also been mentioned, and this, of course, attempts to adjust nominal interest rates for the rate of inflation. Unfortunately, the rate of inflation needed to make the adjustment properly is the rate expected by borrowers and lenders over the life of loans or deposits, and this number is unobservable.

The use of nominal GNP as an explicit target of Federal Reserve policy has some appeal. A policy of limiting increases in this variable to those justified by long-term trends in labor force and productivity growth would insure our success in controlling inflation without preventing the economic growth we strongly desire. The disadvantage here is that the Federal Reserve has no direct control over GNP, because GNP is affected not only by monetary policy, but also by our Nation's budget and regulatory policies, international events and unanticipated domestic economic developments. Recent attention has also been given to using a broad credit aggregate as a policy target. Again, this is something that cannot be easily controlled by the Federal Reserve.

In concluding, Mr. Chairman, it is my judgment that our current set of monetary targeting variables is the best of a very imperfect set of possible choices. The search for better policy guides will and should continue, but until they are found, careful and flexible use of our current targets offers our greatest hope of reducing inflation and providing the foundation for long-term growth.

Thank you.

[The prepared statement of Robert H. Boykin follows:]

Statement
of
Robert H. Boykin, President
Federal Reserve Bank of Dallas
before the
Subcommittee on Domestic Monetary
Policy of the Committee on Banking,
Finance and Urban Affairs
United States House of Representatives
September 23, 1982

Introduction

It is a pleasure to appear at this hearing to discuss the Activities and Policies of the Federal Reserve Banks and their Implications for Monetary Policy.

As you know, certain areas of your inquiries have been addressed in the joint statement of the five Federal Reserve Bank Presidents who have been called to appear. My responses to the issues not covered in the joint statement are as follows.

What has been your bank's involvement with community and scholarly activities? In this connection, I would be pleased to know what work-training programs, upward mobility programs, affirmative action policies, forums for small and minority businesses, and research activities your bank has been and is presently engaged in doing.

The following is a listing of the major activities of the Bank with respect to community and scholarly activities:

Work-Training Programs

- Computer-trainee program in conjunction with Skyline High School, Dallas, Texas.
- Summer intern programs with minority schools such as Bishop College, Texas Southern University, and Prairie View A&M University.
- In-House training, including typing, shorthand, and word processing classes.
- Maintenance, electrical and equipment repair training in the Facilities Department of the Bank.
- Bank supported educational program offering full payment for tuition and books for bank related/job related courses at colleges in the area.

Upward Mobility Programs

- Executive Development Program - emphasis on management development for potential managers and officers.
- Executive Secretarial Program - emphasis on upward mobility for clerical workers.

- Administrative Assistant Program - emphasis on exposing new college graduates to various areas of the Bank.
- Career Ladder Establishment - a Bankwide program that establishes career paths in many areas of the organization.
- Job Posting System - allows employees to bid for jobs in other departments before outside recruiting begins.

Affirmative Action Policies

- Recruits at minority colleges.
- Advertises in minority newspapers and publications.
- Establishes targets toward upward mobility for women and minorities.
- Seeks and encourages job applications from members of minority groups.
- Cooperates in educational programs with Texas Southern University and Bishop College.
- Staff members participate in community service activities, particularly those designed to serve the needs of disadvantaged members of the community.
- Conducts In-House EEO awareness seminars.
- Participates in career day at minority schools.
- Two of our branches are heavy minority employers with minorities representing half of their staffs. All of our offices have excellent minority representation when compared to community standards.

Community and Scholarly Activities

- Conducts meetings on community reinvestment activities with individuals and organizations throughout the Eleventh Federal Reserve District.
- Gives speeches on all aspects of Federal Reserve System activities.
- Participates in activities with the Joint Council on Economic Education, the Texas Council on Economic Education, and the Educational Center for Economic Education at North Texas State University.
- Cooperates with universities in programs designed to enhance economic education and to bring about an improved understanding of monetary and economic policy.

- Participates in community consumer educational fairs, activities, and various other consumer education meetings.
- Hosts meetings and participates in various activities that are initiated to enhance small business financing and operational needs.
- Participates in the Volunteer Business Council.
- Hosts meetings involving community leaders, bankers, businessmen, and various other groups such as students and community organizations.
- Provides support to community activities such as the annual United Way Campaign, Wadley Blood Bank, and other community sponsored programs designed to improve the conditions and environment of all citizens.
- The officers and staff of this Bank are members of, or are involved in, the following organizations and activities:

American Economics Association
 Dallas Economists Club
 Advisory Council, East Texas State University, Bank Operations
 Institute
 Dallas Personnel Association
 American Society of Personnel Administrators
 Advisory Board, Texas A&M University Executive Development
 Program
 American Institute of Banking
 Advisory Committee, Computer Science Cluster at Dallas
 Independent School District
 American Institute of Certified Accountants
 Texas Society of Certified Public Accountants
 State Bar of Texas
 Dallas Bar Association
 American Bar Association
 Dallas Management Association
 Junior Chamber of Commerce
 Chamber of Commerce
 American Statistical Association
 Zonta Club of Dallas I
 Bank Administration Institute
 Dallas Agricultural Club
 Dallas Council U.S. Navy League
 Rotary International
 Southwest Roundtable
 Houston Personnel Association
 American Agricultural Economics Association
 Southwestern Social Science Association
 Counselor, Southwest Graduate School of Banking, Southern
 Methodist University
 Lions International

Optimist International
 Advisory Council, School of Management, University of Texas
 at Dallas
 Advisory Council, Center of Banking Education, Texas Southern
 University
 Advisory Council, Texas Tech School of Banking at Lubbock

The status of business and financial liquidity, in the economy as a whole and in your District, and the implications for monetary policy.

Cash flow positions at businesses throughout the country and in the Eleventh District are still showing some strain. Liquidity pressures at small- to medium-sized firms have increased, as evidenced by the number of bankruptcies reported. Cash flow problems among agricultural producers are also evident. High and rising production costs, together with falling crop and livestock prices, have significantly reduced net farm earnings, and the number of forced farm sales is up.

Cash flow problems in the business sector have also generated earnings pressures in the financial sector. Recent business and financial failures, together with concerns about Mexican and other international credits, have increased tension in U.S. financial markets. In recent months loan loss provisions at commercial banks have been increased and more attention is being given to problem loan areas. Earnings pressures at savings and loan institutions, resulting from high funding costs, remain a source of concern.

Lenders are exhibiting some preferences for quality credits and risk premiums have increased in several sectors. In the commercial paper market, the interest rate spread between the medium- and top-quality paper has widened. The spread between CD rates and Treasury yields also widened temporarily following recent bankruptcy announcements.

However, the commercial banking sector is relatively liquid at this time. Business loan growth since July has moderated and discount window

borrowings have dropped off sharply in recent months. Similarly, in contrast to 1974, access to the commercial paper and corporate bond markets has not been closed to lower-rated borrowers. Both financial and nonfinancial firms have been able to raise a substantial amount of funds in the credit markets with most of the borrowing concentrated in the shorter maturity range.

In the Eleventh District, weakness is primarily concentrated in the energy sector--manufacturing of energy equipment, drilling and energy servicing industries. Moreover, similar to the national picture, high borrowing costs have increased liquidity pressures at small- to medium-sized firms, particularly auto dealerships and residential home builders. However, despite the weak energy sector, economic activity in our District is still relatively strong compared to the rest of the country, and our major financial institutions have been among the top performers during the last several years.

Implications for monetary policy of liquidity strains in both the financial and business sectors are taken into consideration when setting policy. Recently, both long- and short-term interest rates have dropped sharply and if this decline is sustained, it should significantly reduce liquidity strains during the second half of this year.

Employment and business conditions in the economy, as a whole and in your District, and the implications for monetary policy.

Economic indicators seem to imply some improvement in the economy in the near future. The index of leading economic indicators has risen for four consecutive months. In July, new factory orders rose at their highest rate since December 1980. The biggest gain appeared in orders for nondefense capital goods. Movements in that statistic often are indicative of future changes in plant and equipment spending.

However, at the present time the economy still is rather weak. The manufacturing sector in general, and capital goods manufacturing in particular, have been hit hard by the recession. Auto and home sales are slow. The index of coincident economic indicators fell in June and again in July, and in August the U.S. unemployment rate was at its highest level since 1941.

The Eleventh District has been hit by recession also. Last year, growing weakness in some manufacturing sectors was more than offset by strength in the energy industry. But the District economy started to show signs of recession in the first quarter of 1982, when oil and gas drilling activity began to decline. Employment in a number of energy-related industries--including drilling, oil field equipment manufacture and primary metals--peaked in March.

Devaluations of the Mexican peso in February and again in August severely affected retail sales on the border and in San Antonio, one hundred fifty miles away. As a result of the devaluations, and because of the sluggish economy, District retailing has been weak.

District farmers are suffering from low prices and crop damage. Over the last two years, Texas farm employment has fallen by more than 10,000. Low sales in the national housing markets have hurt the District's forest products industry.

Although the inflation rate abated in July, many of our nation's economic problems are still tied to inflation and to inflationary expectations. Certainly, high interest rates reflect investor fears of high inflation. The difficulties which have occurred this year in the capital goods markets, the housing market and, to some extent, the automobile market, are legacies of past high inflation rates and the resulting high interest rates.

Consequently, the implications of the current state of the economy for monetary policy must be weighed carefully. While the current economic situation is serious, any quick fix that could be given by an expansionary monetary policy would refuel inflation and the expectation of more inflation. Such a policy would ultimately drive up interest rates and erode our economic base even further. This suggests that despite the current weakness of the economy, it is to the long-run benefit for everyone to encourage an environment of stable prices in which productivity and employment can expand.

The relative importance of further reductions in inflation at this time compared with the state of employment and business conditions and liquidity.

We have learned a very painful lesson in this country about inflation. If left unchecked, inflation will lead to high and volatile interest rates, increased uncertainty about the future economic environment, and reduced savings and investment. Through these channels, inflation ultimately contributes to inadequate growth in productivity, living standards, and employment opportunities.

This realization led the Federal Reserve System to adopt a long-term program to slowly reduce the rate of inflation. Much progress has been made: by almost any measure the rate of inflation has been cut in half in the last several years. Nevertheless, public skepticism regarding the permanence of this progress, together with swelling Federal deficits, kept interest rates high, even while inflation was moderating. This represented a sharp increase in the so-called "real", or inflation-adjusted, interest rate, that is the primary cause of current economic weakness.

Recently, however, the public has accepted some of the reduction in inflation as more permanent, fostering significant reduction in interest rates.

Were we to relax our vigil against inflation, public expectations would reverse that decline. Consequently, we feel our current policy provides the only hope for enduring diminution of interest rates.

Although the choice of an appropriate short-run policy always involves tradeoffs between competing objectives, the dilemmas are less troublesome now that substantial progress has been made against inflation. Present monetary growth targets can provide sufficient liquidity and credit for a sustainable economic recovery, which is apparently under way. Yet these targets are, at the same time, consistent with further reductions in inflation and interest rates.

The appropriateness and viability of the monetary targets currently used by the Federal Reserve, specifically the M-1 aggregate, and your views on alternative targets, including the monetary base, a credit target, GNP, or targetting of real or nominal interest rates.

The monetary aggregates the FOMC uses as targets have helped and, I believe, will help guide policies which will further reduce inflation and make possible economic recovery and sustainable growth. Nevertheless, structural changes in our economy and our financial markets can affect patterns of monetary growth, and we must be willing to adjust our growth targets, revise the definitions of our aggregates, or even change the type of targets we use when evidence suggests this is necessary.

For some years, with particular emphasis during the past three, we have used the monetary and credit aggregates as targets. Statistical studies over a number of years have shown that changes in these aggregates are related to future changes in economic activity. Of special importance is the evidence that reductions in the rates of growth of these aggregates will lead to reductions in the rate of inflation.

Tighter control of these aggregates over the last three years has helped cut the inflation rate in half. Further gradual reductions in the rates of monetary growth will ensure further reductions in inflation. But our experience in the last three years points out the importance of flexibility and judgment in using these aggregates. The rapid pace of change in financial markets and temporary shifts in the liquidity needs of firms and households have required us to deviate from our long-term targets from time to time. We must continue to reexamine the aggregates' behavior and their relationships with our economic goals as we set our long-term growth targets. And, in setting our short-term targets, we must continue to view recent changes in money growth in the context of a whole host of economic variables and indicators to determine if short-run deviations from our targets are appropriate.

Other strategies, based on alternative targets, appear less attractive. Among those frequently mentioned is the monetary base. Although the concept--merely the sum of bank reserves and currency--appears simple, a problem arises in adjusting the base for changes in reserve requirements. If reserve requirements are increased, for example, a higher amount of base is necessary to support the same level of deposits and economic activity. Different adjustment procedures can yield substantially different results.

The base has several other deficiencies as well. Like the money aggregates, the base is affected by shifts among different types of deposits such as those caused by the nationwide introduction of NOW accounts in 1981, or shifts from bank deposits to money market mutual funds shares over a longer period. In addition, the economy's need for base money is also affected by shifts in the public's demand for currency relative to bank deposits and shifts in deposits among institutions with different reserve requirements.

Direct control of interest rates is another frequently discussed alternative. However, our unhappy experience with putting more emphasis on interest rates in the '60s and '70s is precisely what led us to greater emphasis on the monetary aggregates three years ago. When inflation is accelerating, small rises in interest rates are unlikely to slow it down. It has been possible for interest rates to rise over a long period of time and yet have inflation accelerate as well, which renders nominal interest rates of little value in guiding monetary policy.

Real interest rates, which attempt to adjust nominal interest rates for the rate of inflation, appear to be an improvement. Unfortunately, the rate of inflation needed to make the adjustment properly is the rate expected by borrowers and lenders over the life of the loans or deposits on which the interest will be paid. This number is unobservable, so the true real interest rates are, to some extent, a matter of conjecture. Furthermore, many factors can be expected to change the relationships between real interest rates and other economic variables. Changes in the rate of inflation, tax structure, productivity of our capital stock, and size of Federal budget deficits all alter the level of the real interest rate which would best help us achieve our goals. Research done at our Bank indicates that the relationship between real interest rates and the level of business activities, while significant, is highly variable and undependable.

The use of nominal GNP as an explicit target of Federal Reserve policy has some appeal. A policy of limiting increases in this variable to those justified by long-term trends in labor force and productivity growth would ensure our success in controlling inflation without preventing the economic growth we strongly desire. The disadvantage is that the Federal Reserve has no direct control over GNP. GNP is affected not only by monetary

policy, but also by our nation's budget and regulatory policies, international events, and unanticipated domestic economic developments. Because of the long lags involved in monetary policy, current policy decisions cannot be based on GNP behavior of the recent past but rather would have to be based on expected GNP behavior in the distant future. Such a policy strategy would require highly accurate forecasts of the future course of our economy--as yet, economic science has not progressed enough to provide us with such forecasts.

Recent attention has also been given to using a broad credit aggregate as a policy target. While such aggregates are closely related to GNP, it currently takes several months to compile the data necessary to compute them. Also, as is the case with GNP, broad credit aggregates cannot be easily controlled by the Federal Reserve. They are relatively insensitive in the short run to changes in either bank reserves or market interest rates. We do currently use a credit aggregate, bank credit, as one of our target variables. Because it is restricted to banks which are required to keep reserves, it falls much more closely under our control.

In my judgement, our current set of monetary target variables is the best of a very imperfect set of possible choices. The search for better policy guides will and should continue, but, until they are found, careful and flexible use of our current targets offers our greatest hope of reducing inflation and providing the foundation for long-term growth.

Chairman FAUNTROY. Gentlemen, our members are chafing at the bit to get into a dialog with you. For that reason, may I respectfully suggest, Mr. Corrigan, Mr. Roos, Mr. Solomon, and Mr. Morris enter your statements in their entirety in the record at this point, and we will immediately begin the questioning on the part of the members.

[The prepared statements of E. Gerald Corrigan, Lawrence K. Roos, Anthony M. Solomon, and Frank E. Morris follow:]

Statement by
E. Gerald Corrigan
President
Federal Reserve Bank of Minneapolis
Before the
U.S. House of Representatives
Subcommittee on Domestic Monetary Policy
September 23, 1982

Mr. Chairman, members of the Subcommittee, I appreciate this opportunity to testify before the House Subcommittee on Domestic Monetary Policy. In addition to the joint statement submitted by the five presidents, I would like to comment on the several questions you have raised that relate more directly to the Federal Reserve Bank of Minneapolis.

The first of these questions concerns the Minneapolis Fed's involvement with community and scholarly activities and its efforts and programs in the area of affirmative action.

Our community involvement activities can be grouped in three broad categories: education, communications, and corporate responsibility. I have attached, for the record, a summary of such efforts, and will briefly describe highlights of our programs.

Our economic education programs reflect the philosophy that by providing materials and assistance that fill curriculum gaps and by focusing on teacher training programs, we can serve the greatest number of people at the lowest cost. Examples of these efforts include providing staff to elementary schools to assist teachers in developing materials on economic issues generally and on the role of the Federal Reserve particularly and providing teacher training in economics for educators involved in a program for high-potential elementary students.

One of our most significant curriculum projects was the development of an instructional unit on consumer credit. The curriculum materials in this unit are being used in community/adult education programs and in high schools throughout the country, with more than 3,500 units distributed to date. I should add that all of our economic education efforts are closely coordinated with the State Councils on Economic Education. In addition, I am a trustee of the Joint Council on Economic Education.

Another important curriculum material developed by the Bank has been "You're the Banker," a simulation game designed to acquaint students and adults with the

basic economic principles related to money and banking. We are currently extending use of "You're the Banker" from a board game to use as a computer simulation game.

In the area of communications, we have made special efforts to reach three groups: depository institutions, agricultural and small business groups, and the business community generally. Communication efforts directed at these groups take several forms. In 1981, Minneapolis Fed personnel gave over 180 speeches to banking, business, construction, labor, agricultural, educational and service groups throughout the six states in our district. We have also held a series of seminars around the state of Minnesota on issues related primarily to agricultural finance, and we have provided program and administrative support to a district organization concerned with agricultural credit. One of our most significant recent initiatives was the development and presentation of a seminar on economic issues for small business representatives from the district. More generally, we have defined as an important objective the development of working ties between the Small Business Administration, the Minnesota Commission on Small Business and the Task Force on Small Business and Economic Stability. From my experience with these programs I would suggest that their value lies not simply in the information we impart but, as important, the information, attitudes and concerns that we receive from these diverse sources.

We meet our corporate responsibilities through two broad functions. First, we try to participate fully—while acknowledging the special constraints imposed on a Federal Reserve Bank—in community-based programs. This participation includes a role within the Minority Business Opportunity Committee; providing staff to the local chapter of the National Alliance of Businessmen for a program that identifies summer jobs for minority youth; board membership on the Minnesota Project, a center for public policy study and community development; active involvement—in terms of staff assistance and solicitations—with the United Way of Minneapolis; and support services to the Minnesota Special Olympics.

Second, we try to initiate and support programs that are consistent with our overall responsibilities and that address specific community needs. Examples of these programs include a joint education program we have undertaken in cooperation with the Minneapolis Urban League to provide community residents with practical and useful skills to cope with individual and family finances. This "Personal Economic Management Workshop" includes information on budgeting, borrowing, debt repayment, and tax preparation. Our Consumer Affairs office has, in cooperation with the FDIC, provided staff assistance to help financial institutions and local groups in a district community develop a community reinvestment program. One such program has been completed and another is planned for the near future.

In a similar vein, and in cooperation with other agencies and educational institutions, we arranged for conferences and special studies related to economic development issues on Indian reservations in the district. A final example of efforts to match our particular expertise with community need would be educational programs and briefings on economic conditions that we have provided to the Metropolitan Economic Development Council, a group formed to provide support to minority businesses.

You also raised, Mr. Chairman, specific questions regarding work-training programs, upward mobility programs and affirmative action policies.

The Federal Reserve Bank of Minneapolis has, long before my tenure as president, had a strong commitment to an effective affirmative action program. On an annual basis, we prepare, monitor, and update an affirmative action plan that sets our objectives for increasing the representation of women and minorities in the Bank in general and particularly in professional positions.

I do not believe, however, that numbers are necessarily a good measure of the actual effectiveness of an affirmative action program. To my mind, the real test of successful affirmative action is to create an environment in which targeted groups are a functioning, contributing force within the organization. This points to the need for a

range of initiatives in areas including recruitment, placement and training of minorities and other protected classes.

We also have an active program for the handicapped. There are four objectives in that program: eliminating physical and attitudinal barriers, expanding employment and advancement opportunities, providing job-related programs and services, and supporting community efforts to expand employment for the handicapped.

The research program at the Federal Reserve Bank of Minneapolis is a balanced effort aimed at making meaningful contributions in three broad areas: first, macroeconomic research, with an emphasis on issues related to public policy; second, regional and national issues related to the evolving financial structure; and third, regional economic issues with particular emphasis on agriculture.

While our research staff is small, it has made and continues to make important contributions in each of these areas, including frequent contributions to scholarly journals. Also, in the past year, one of our economists was on leave to a major university and two members of the research staff were on leave to the staff of the U.S. Senate Budget Committee. Similarly, when consistent with our public responsibilities, our research staff has participated on special commissions and studies related to state and local government policy issues here in the Ninth District.

Given the thrust and reputation of the Bank's research program, it is not surprising that we have maintained close relations with the district's academic community and particularly the University of Minnesota. We have also, through contract arrangements, made use of academic advisors to our research work.

I would like now to respond briefly to the questions you raised in four policy-related areas: the liquidity position of nonfinancial and financial businesses; employment and business conditions; the trade-offs between further reductions in inflation and improvements in business conditions; and, finally, the appropriateness and viability of the monetary targets currently used by the Federal Reserve.

On a nationwide basis, the liquidity of nonfinancial businesses is at historically low levels by most standards. While some of the decline in business liquidity in recent years may reflect growing sophistication in corporate financial and cash management techniques, it is clear that much of the recent slippage in corporate liquidity reflects patterns of economic performance we have witnessed over the last several years.

For example, the long period of essentially escalating inflation experienced over the past decade or more made borrowing and leveraging very tempting because it was so easy to paper over mistakes with successively higher product prices. To make matters worse, the high levels of interest rates that inevitably accompany the inflationary process effectively closed down our long-term capital and equity markets for many borrowers. Thus, increasingly, the debt incurred in recent years has been of the short-term variety. For this reason, reopening and keeping open our long-term capital markets and our equity markets must remain one of the central goals of economic policy generally and monetary policy specifically. In my judgment, this goal can best be realized (or perhaps can only be realized) in the context of policies that get inflation down and keep it down.

While it is difficult to find meaningful statistics that focus exclusively on the liquidity situation of business firms located in the Ninth Federal Reserve District, I have no reason to believe the situation in the Upper Midwest is materially different than it is in the nation as a whole. It is possible—given the nature of some of the major business firms in the Twin Cities area—that in the nonfarm sector things may be a shade better than is suggested by the national statistics. However, when allowance is made for conditions in the farm sector—which has a very substantial presence in the Ninth District—the overall nonfinancial business liquidity situation in the district is not likely to differ from the national picture.

The situation with respect to the liquidity of financial firms—banks in particular—is a little more difficult to read. For example, in the Ninth Federal Reserve

District, certain conventional measures of bank liquidity—such as loan-to-deposit ratios and liquid asset ratios—suggest that bank liquidity is generally satisfactory. However, on closer inspection, it would appear that at least some of that statistical evidence reflects curtailed levels of borrowing growing out of overall economic conditions—particularly in the farm sector. It is also true in the Ninth District—as for the nation as a whole—that recent months have seen a deterioration in the quality of credit, as heavy debt burdens in combination with general economic conditions have cut into the net cash flow and profit positions of many firms.

Any discussion of liquidity trends would not be complete without adding a word or two about consumer liquidity, where there are some signs of improvement. For example, there is now a smattering of evidence to suggest that consumer saving rates have risen somewhat. Similarly, the rate at which the consumer sector has taken on new debt has diminished over the past few years. These developments, in combination, have strengthened the liquidity position of the consumer and, in the aggregate, augur well for some step-up in spending.

Turning now to employment and business conditions more generally, I would characterize current conditions for the nation and for the Ninth District as about flat. In recent months there have been some scattered signs—some straws in the wind—to suggest that overall economic activity and employment might be picking up a bit, but hard evidence of a generalized recovery is not yet available. When that evidence is at hand, I expect we will see a recovery which, in its early stages, is modest in strength and driven largely by consumer spending. The durability and sustainability of the recovery, and thus its capacity to encompass other sectors of the economy, will depend importantly on our ability to make and sustain further progress on the inflation front and to avoid another resurgence of strains and pressures in financial markets stemming from the combination of private and public credit demands.

Having said earlier that I do not perceive any major overall differences in business conditions and employment in the Ninth Federal Reserve District relative to the economy as a whole, let me make two qualifications to that statement. First, on balance I believe it is fair to say that the Ninth Federal Reserve District may have fared somewhat better than the nation as a whole in this recent recessionary period. Certainly, comparative unemployment rates would suggest that conclusion. For example, during the second quarter of 1982, unemployment for the district as a whole averaged 7.3 percent, sharply below the national average. The second qualification I would make is that these overall statistics mask some serious specific problems. Agriculture is one, but in addition there are geographic pockets within the Ninth District where sharp declines in the production of wood products and copper and iron ore, have produced very high levels of unemployment and economic distress. More recently, the coal, oil and natural gas producing belts within the district have also been adversely affected by the worldwide conditions in the energy and related industries.

These circumstances lead quite naturally to your next question regarding the trade-offs between economic conditions and controlling inflation. In my judgment, it is important to bear in mind, that in the current circumstances, further reductions in inflation can and should go hand-in-hand with improvement in employment, business activity, and liquidity. But, even over the longer term, the economic choices we face do not involve either/or decisions. What is before us is a package deal: if we want to improve the employment picture, increase liquidity, and create the right environment for lasting and healthy business growth, we have to make further and sustained progress against inflation. To be sure, there has been meaningful and encouraging progress on the inflation side, as evidenced by the widespread deceleration in both price and wage increases that has already occurred. But we are by no means "home free" on the inflation front—a proposition that in my view is underscored by the still-high level of long-term interest rates prevailing in our financial markets. Such rates suggest to me, and suggest

rather strongly and directly, that investors are not yet convinced that progress against inflation will be extended or, indeed, even maintained.

If my reading of the message in long-term interest rates is correct, then it follows that improvement in employment, and in economic performance more generally, requires further progress on the inflation side. For, as long as long-term interest rates, girded by stubbornly persistent inflationary expectations, remain high, recovery in the interest sensitive sectors of our economy—homebuilding, autos, other consumer durables, business capital spending—may be sluggish and short-lived. In short, I doubt that we can have the kind of recovery we desire over time without the full participation of these sectors—participation that over time will depend upon lower long-term interest rates.

More broadly, I would maintain that the economic history of the past 15 years or so has demonstrated rather unmistakably that perceptions about trade-offs between inflation and unemployment—while seductive and perhaps relevant in the short run—were misplaced; inflation and true economic prosperity are fundamentally in conflict. If we want to regain our economic health—and I know that this is not an issue of debate—then it is essential to bring inflation down and keep it down. Only through this channel can we, in my opinion, reestablish the lower interest rates so critical to a broad, durable, and sustainable expansion in our economy. Fortunately, I sense that we are now in a position in which we can have economic recovery and further progress in winding down inflation. Maintaining that condition will, however, require persistent discipline on the part of both monetary and fiscal policy.

Finally, let me respond to your question regarding the current monetary targets. Admittedly, monetary aggregate targets have limitations. We do not always fully understand, for example, the factors contributing to short-run, week-to-week or even month-to-month fluctuations in aggregates. And we are aware that, over longer periods, the full range of money supply measures are influenced and affected by innovations in financial instruments and practices, as well as by monetary policy and financial

and economic developments. All of these forces, and others, can at times make it difficult both to predict and to interpret trends in money growth.

But recognizing that the aggregates have some problems does not imply, in my judgment, that they ought to be abandoned as policy targets. Indeed, I am satisfied that they are more than adequate guides for policy, given our current institutional and operating arrangements. The problems that I alluded to earlier do suggest, though, the necessity of applying experience, judgment, and old fashioned "common sense" in establishing, and then trying to achieve, specific monetary targets. They point out the continuing virtue of closely following several rather than a single aggregate such as M1—both because a particular measure may, from time to time, be influenced by transitory forces and because there is, in any event, potentially valuable policy information contained in the broader aggregates.

Innovations in payment practices may, at some point in the future, raise sufficiently serious questions of definition, measurement, and control of the monetary aggregates that alternative policy targets and techniques will have to be considered. However, that day is not here. Having said that, let me add that the alternative targets that have been proffered have serious shortcomings in their own right. While I do not want to repeat the complete litany here, I would simply suggest that the other potential policy targets frequently mentioned—real or nominal interest rates, the monetary base, and so on—will not yield magical solutions to our economic problems. And, while one particular target may have certain technical advantages over another, even those technical advantages have to be weighed against each other. And, at least to date, I am satisfied that the weight of the evidence still points to the wisdom of sticking with the family of monetary aggregates—with particular emphasis on M1— as the primary guide for monetary policy. That is not to suggest that we can be, should be or, in fact, are indifferent to other considerations in the short run. Nor is it to say that I cannot conceive of conditions and circumstances which might lead me to a different view. However, it is to say that balanced and judicious use of the aggregates is operationally and intellectually the best game in town for contemporary monetary policy. And to repeat myself, the use of an alternative target will not eradicate the hard choices we face nor would it eliminate the need for the persistent discipline in our financial policies that is essential to sustained economic growth and prosperity.

Community Involvement Projects: Summary

1. Urban League--joint education program

The League's overall program provides community residents with practical and useful skills to help increase their interest in, and skills to cope with, the current economic situation. The Personal Economic Management Workshop Series includes:

- . Budgeting
- . Borrowing
- . Debt repayment
- . Tax preparation and other topics.

2. Neighborhood Housing Services

Neighborhood Housing Services (NHS) programs are designed to stimulate reinvestment in neighborhoods. The service is based on a partnership of financial institutions, community residents, and local government. The Bank hosts luncheons to enable the NHS staff to report to their supporters and solicit new support.

3. Indian Economic Development Programs

A series of studies was designed to provide the following planning and management tools in a reservation setting:

- . Resource identity
- . Management techniques
- . Threshold analysis, economic base study
- . Linear programming

Three conferences and four special studies were generated in cooperation with other agencies and educational institutions.

4. Metropolitan Economic Development Council

The Bank has assisted MEDA, a minority business development advocate, by supporting internal growth through educational programs, training, and briefings on current economic conditions. (See also Memberships, Minority Purchasing Council.)

5. Food and Agricultural Policy Seminars, co-sponsor, University of Minnesota

A series of seminars was held around the state of Minnesota on issues important to agricultural interests in the Ninth District. Most were related to agricultural finance. The Bank helped bring in speakers and provided other resources to maximize the value of the seminars for participants.

6. Opportunity Workshop

When projects of an appropriate nature arise, e.g., assembling media catalogs, the Bank uses Opportunity Workshop, a sheltered workshop in Minneapolis.

7. Community Resource Volunteers Program

The Bank provides resource people to elementary classrooms to assist teachers in planning and teaching about forms of money and the Fed's role in an efficient payments mechanism.

8. Omnibus (A program for high-potential elementary students)

The Bank has provided training sessions for volunteers teaching special units in economics to Omnibus students.

9. Business Community Resource Volunteer Program

Bank staff members serve as resource people who participate in career discussions with senior high school students.

10. Twin Cities Opportunity Industrial Center

The center retrains hard-to-employ adults for entry into the labor market. The Bank has provided resource people for classes and seminars in connection with training programs.

11. Consumer Education Unit

An instructional unit on consumer credit development has been developed in conjunction with educators and representatives of the credit industry. The unit is to be used in the teaching of consumer credit concepts and skills in schools, community/adult education programs, and other similar programs.

12. State Councils for Economic Education

In cooperation with State Councils in the Ninth District states, the Bank provides a variety of resources in setting up educational programs and seminars for teachers, e.g., our teacher-banker workshops. Council programs are then developed and aimed at teachers and students. This represents a major involvement by Bank.

13. Tours

Tours are available to the public and to special groups upon request. In 1981 and 1982, groups have included in addition to school groups:

- o business clubs,
- o senior citizens,
- o junior achievement classes,
- o farmers' groups,
- o Native American school groups,
- o AAUW and other women's groups, and
- o conventions, e.g., finance managers and agricultural economics professionals and foreign visitors.

14. Northside Child Development Center

With other businesses, the Bank was involved in founding a child development center in an urban area of Minneapolis.

15. Upper Midwest Agricultural Credit Council (UMACC)

The Council is an organization of bank credit specialists that functions as an educational forum for bankers serving rural communities in the Upper Midwest. A Bank staff person is executive secretary of UMACC, and the Office of Public Information provides substantial administrative support.

16. Upper Midwest Council

The Bank was a major supporter of the Council, a regional research group, until its demise this year.

17. Small Business Seminars, Initiatives

a. White House Conference on Small Business

The Bank provided substantial planning, personnel, and administrative assistance to state planning meetings leading up to the 1980 conference.

b. Small Business Liaison

The Office of Public Information has, as a key objective, maintained close ties with District (see Memberships, Participations) states' small business. This has been accomplished, for example, through ties with the Small Business Administration, the Minnesota Commission on Small Business (attendance at annual and regional meetings), and the Task Force on Small Business and Economic Stability (organized by SBA to assist small firms with financial problems caused by high money costs).

Examples of interaction with small business groups include:

- o Small and minority business-sponsored meeting on the effects of economic policy in March 1982 (Corrigan and staff),
- o Meetings with small and minority business groups in November 1981 (Corrigan), and
- o Meeting with the Task Force on Small Business and Economic Stability for discussion of credit and monetary policy in August 1980.

18. Minnesota Special Olympics

The Bank provides support services for the Minnesota Special Olympics, thus allowing Special Olympics to devote more of its resources to programming.

19. Support for the Arts

a. Purchases

The Bank purchases for its collection the works of regional artists and has made an effort to include works by minority and women artists.

b. Exhibitions

A program of temporary exhibitions has focused on Black artists (a Black History Week event) and plans to highlight the Southeast Asian community (Hmong tapestries) and correctional facilities inmates (Arts in Corrections) in upcoming months.

20. United Way of Minneapolis Area

The Bank provides substantial support to the annual United Way campaign. Each year a staff member, who remains on salary at the Bank, spends three to four months as a United Way Loaned Executive. Bank departments provide members for solicitation and administrative work, and the Bank holds rallies for employees on Bank time.

21. You're the Banker

The simulation game, You're the Banker, was developed by the Bank to acquaint players with the basic economic principles related to money and banking. The game, in board and computer versions, is used to bring students, educators, and members of the community in contact with the financial institutions. The game is generally distributed to schools and banks at the cost of production.

22. Community Catalyst Role

Presidents of the Bank have been instrumental in concluding a significant study on future choices facing Minnesota (Commission on Minnesota Futures), initiating an organization to support academicians studying regional issues (Mid-Continent Regional Science Association), and arbitrating a major dispute between the University of Minnesota and black students (following the assassination of Martin Luther King, Jr.).

23. Community Reinvestment Act/Truth in Lending Activities

The Consumer Affairs Department provides educational services that include speaking on regulatory issues, distribution of brochures and other materials produced throughout the Federal Reserve System, and responding to consumers' telephone inquiries.

The department has also provided a staff person for up to one week to help an individual SMSA group develop a CRA program (in cooperation with FDIC). One program has been completed and another is planned for the near future.

Memberships, ParticipationsSmall Business Administration Advisory Committee Council

One staff member serves as a member of the Council Board, which serves as an interface between small business and the SBA. The Council recommends policies that will enable SBA to better serve its constituency.

Minority Business Opportunity Committee, Federal Executive Board

Even though not a member of the Federal Executive Board, the Bank elected to participate fully in the Committee's work promoting the development of minority-owned business, both because of our financial expertise and our commitment to minority business development.

Minority Purchasing Council

The Council is a subgroup of the Metropolitan Economic Development Council, a minority business development advocate. The Bank participates in the Minority Business Exchange, the Council's trade fair, and attends the Council's annual meeting.

National Alliance of Businessmen

Each year since 1972, the Bank has loaned the local NAB chapter a senior staff person to participate in a program that identifies summer jobs for minority youth.

The Minnesota Project, Board Membership

The Project is a center for public policy study and community development, with an emphasis on the implications of public policy decisions for all strata of the state's communities.

Minnesota Charities Review Council, Board Membership

The Council oversees solicitation and allocation of donations by charitable organizations operating within the state.

TESTIMONY OF

LAWRENCE K. ROOS

PRESIDENT

FEDERAL RESERVE BANK OF ST. LOUIS

BEFORE THE

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC

SEPTEMBER 23, 1982

Question 3:

What has been your bank's involvement with community and scholarly activities? In this connection, I would be pleased to know what work-training programs, upward mobility programs, affirmative action policies, forums for small and minority businesses, and research activities your bank has been and is presently engaged in doing?

The Federal Reserve Bank of St. Louis has maintained a formal Affirmative Action Plan for the past 10 years. The plan is designed to encourage women and minorities to apply for positions particularly in the management, professional, and technical fields such as administration, operations, data processing, and bank examination. The results reflect that the Bank has been able to maintain or increase the number of women and minorities in upper grade levels during the past several years while the total number of staff members has declined.

Achievement of the Bank's Affirmative Action Plan has been supported by its accelerated commitment to the following community work-training and scholar cooperative programs consisting of 60 percent females and minorities:

- . American Institute of Banking Work Study Program
- . St. Louis University Cooperative Program
- . Southern Illinois University Cooperative Program
- . International Visiting Scholar Program

The Bank through its upward mobility programs has promoted 179 staff members of which 62 percent were females and 26

percent were minorities. Programs that we have found to be the most successful include the:

- . District Management Development Program
- . System Management Development Program
- . Bank Job Posting Program
- . Bank Career Planning Program
- . Special entry level training programs

In addition, our Bank has participated in local community activities involving forums, workshops, and special projects for small and minority businesses. Our role in these activities is to provide technical assistance in community reinvestment to both the public and the banks. Those organizations with which we have close contact are the:

- . Small Business Association
- . Neighborhood Housing Services of St. Louis
- . Community Development Commissioners of St. Louis and St. Louis County
- . St. Louis Association of Community Organizations

The research activities of our Bank are primarily concentrated in the area of monetary theory and policy. Among the topics investigated are: relationships between money growth and income, output and employment; relationships between fiscal policy and economic activity; relationships between reserve variables and money; impact of bank regulation on financial markets; and studies in individual bank behavior.

The results of these studies are published in the Federal Reserve Bank of St. Louis Review. In addition, the Bank publishes data on monetary, economic, agricultural, regional, and international trends. The research staff participates widely in teaching and disseminating information on monetary policy in seminars at colleges and universities, as well as at meetings of a great variety for local, national, and international organizations.

Question 1:

The status of business and financial liquidity, in the economy as a whole and in your District, and the implications for monetary policy.

Financial liquidity reflects simply the ability of financial institutions to lend to prospective borrowers. Financial institutions in our district do not appear to lack loanable funds. Despite the increase in business bankruptcies and some resultant losses to financial institutions in this district, financial institutions are aggressively seeking new borrowers and continuing their lines of credit with existing borrowers. This is particularly true of smaller institutions which sell their surplus funds in the federal funds market because their loan demand is low compared to their available loanable funds.

Business liquidity also reflects the ability of businesses to borrow. There is evidence that financial institutions are displaying increased selectivity in their lending activity as they have become increasingly conscious of greater non-repayment risk. Even though most large and visible

business failures have been associated more with mismanagement than with a general credit squeeze, financial institutions are currently wary of making marginal loans, even at what might have previously been considered reasonable interest rates.

Consequently, businesses that are perceived as being higher-risk borrowers, either because of their product line or for other factors, are finding funds to be less available at current rates. In this sense, their liquidity has been impaired.

In summary, I see little evidence that credit flows are overly restricted because of any significant lack of bank reserves. Therefore, I do not believe that a more expansive monetary policy would improve the liquidity of businesses that now find themselves unable to borrow at current market rates.

Question 2:

Employment and business conditions in the economy, as a whole and in your District, and the implications for monetary policy.

In the 8th Federal Reserve District, business conditions are "flat." Manufacturing activity has been declining, retail sales in real terms are about on par with last year's. Service industries, however, are expanding. Residential construction is slightly above its postwar low, and commercial construction is slowing from its all-time high. Although average agricultural income in this district will be somewhat lower than last year, the drop has not reached crisis proportions. Livestock growers are enjoying excellent margins and grain growers expect a bumper crop. Prices, however, will be lower. Hardest hit are the approximately 2.5 percent of all farmers who bought land at extremely high prices and have had to finance it at high interest rates.

Unemployment in the district, on average, is similar to the national level. Illinois, Indiana, Kentucky, Mississippi and Tennessee have higher-than-national unemployment (in the 10 - 12 percent range); Missouri and Arkansas are lower (8.5 - 9.5 percent range).

For the economy as a whole, I expect output growth to be slow for the remainder of the year. If money continues to grow at a rate of 5 - 5-1/2 percent, economic activity should pick up in the second or third quarter of 1983. This implies that there will not be much improvement in unemployment until the middle of 1983.

I would like to point out, however, that while unemployment figures are very high, total civilian employment as a percent of population is also very high--almost as high as the percent achieved at previous cyclical peaks. About 58 percent of the population was employed in July 1982 as compared with 57 percent in 1951, 58 percent in 1956, 1969 and 1973, and 60 percent in 1979. Each of these years was viewed as a full employment period. Thus, current unemployment figures do not imply the serious contraction in spending that similar statistics would have implied in the past.

Regarding monetary policy, I have no doubt that a sharp acceleration in money growth would produce a temporary increase in output growth and a temporary decrease in unemployment. But I would like to underscore the word "temporary." Because economic decisionmakers have learned that inflation is related to money growth, and that inflation is not easily eliminated, markets now respond to monetary acceleration much more quickly than they did in the past. This means that inflationary expectations are formed very rapidly and that any boost in money growth is quickly translated into higher prices and higher interest rates. Thus, output and employment gains resulting from monetary expansion would be short-lived and would lead ultimately only to permanently higher inflation and higher interest rates. I, therefore, believe that the best policy to restore normal output growth and thereby reduce unemployment would be to maintain M1 growth currently at 5.5 percent rate (the top of the Federal Reserve's announced M1 growth target range), deviate as little as possible from that figure, and reduce M1 growth in the future by no more than one percent per year.

Question 3:

The relative importance of further reductions in inflation at this time compared with the state of employment and business conditions and liquidity.

All the evidence that we have accumulated indicates that the basic rate of inflation begins to decline about one or two years after monetary growth is reduced. For example, current reductions in inflation are the result of the reduced monetary growth since 1979. This implies that inflation will continue to decline, or at least remain at current levels, for a year or so irrespective of what we do at this time. But if we are concerned with current interest rate levels, which are based on inflationary expectations, a further gradual reduction in money growth becomes important. This is particularly true since our evidence indicates that gradual and steady reduction in money growth has very little negative effect on output and employment. Thus, if we want to lower interest rate levels without adverse effects on output and employment, a gradual and steady reduction in money growth, which implies a continuing slow reduction in inflation, is both feasible and desirable.

Question 4:

The appropriateness and viability of the monetary targets currently used by the Federal Reserve, specifically the M-1 aggregate, and your views on alternative targets, including the monetary base, a credit target, GNP, or targeting of real or nominal interest rates.

The goal of monetary policy is to affect economic activity (GNP). Because the Federal Reserve can directly control only the monetary base, any policy target--M1, interest rates, or any other, is simply a short-term indicator of what changes we can expect to occur in GNP.

Targeting on either the monetary base or GNP alone would mean that there would be no short-term indicator of policy actions. As a result, we would incur both a loss of information and a greater probability of errors that might easily compound over time. Thus, it is generally preferable to target on some variable that is predictably related both to the monetary base and to GNP, and one that can be observed in the short run.

Using interest rates as targets brought us to the economic disarray that prompted a change of emphasis towards monetary aggregates in 1979. Interest rates as targets suffer from three serious deficiencies: (1) The relationship between interest rates and GNP is tenuous; (2) it is doubtful that monetary authorities can control interest rates, even in the short run; and (3) because interest rates are highly visible, there will always be pressures on the monetary authority to try to stabilize them at the cost of destabilizing economic activity as

a whole. For example, when GNP is increasing at a fast pace, both credit demands and interest rates rise. Under such circumstances, attempts to prevent an increase in interest rates usually result in supplying additional credit and money, which further stimulates GNP. Therefore, policy actions produce exactly the opposite of what economic stabilization would require. Similar procyclical actions typically occur when GNP growth is falling and reserves are withdrawn to counter any decline in interest rates.

Although a credit variable may be well correlated with GNP, it is difficult, if not impossible, to control. In the absence of direct credit controls and credit allocation by some governmental agency, monetary authorities can influence only a small part of total credit--only that part which arises out of newly created reserves of financial institutions. I have serious reservations about direct credit controls and doubt that credit allocation would be acceptable to our society.

This leaves M1 which, despite financial innovations and despite changes in economic behavior, has been reliably related to the central bank's control variable--the monetary base--and has reliably predicted movements in prices and output. This does not mean that some other variable might not perform better. I simply don't know of any that would do so. In the absence of a better alternative, I would be extremely reluctant to abandon M1 targeting and subject the economy to the greater volatility and greater inflation dangers that would result.

Statement by

Anthony M. Solomon

President, Federal Reserve Bank of New York

before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

Washington, D. C.

September 23, 1982

Good morning, Mr. Chairman. I am Anthony Solomon, President of the Federal Reserve Bank of New York, and I thank you for this opportunity to contribute to your examination of the activities and policies of the Federal Reserve district banks and their implications for monetary policy. After consulting with the Subcommittee, Presidents Boykin, Corrigan, Morris, Roos and I have submitted a joint statement addressing some of your questions and areas of concern with respect to the Reserve Banks collectively. Therefore, in my separate remarks today, I will present my own views and those of the New York Reserve Bank regarding the following matters:

- (1) our Bank's involvement with community and scholarly activities, including forums for small and minority business and other members of the community and our economic research efforts;
- (2) our policies and practices in the area of equal employment opportunity and affirmative action, and related matters;
- (3) economic conditions in the economy as a whole and in our District, including employment and

business liquidity and how they factor into our thinking regarding inflation and monetary policy; and

- (4) the appropriateness and viability of the monetary targets being used, specifically M1, and the possible use of alternative measures.

For convenience, I will discuss these topics in the order they are presented in your inquiry.

Community and Scholarly Activities

The Federal Reserve Bank of New York maintains extensive links with consumer and community groups in the District. We are also committed to providing a full range of informational and educational publications concerning the work and objectives of the Federal Reserve to general audiences as well as more detailed and analytical publications aimed at professional and scholarly audiences.

In order to inform the public about their rights and responsibilities under consumer credit legislation, we produce a large number of pamphlets, including some in the Spanish language in recognition of New York's sizeable Hispanic community. We meet with consumer groups to discuss common concerns and, when we receive complaints from bank customers that might imply a violation of the regulations, we investigate and

assure that an appropriate response is made to the customer.

We also conduct educational seminars, some of them in conjunction with the New York City Department of Consumer Affairs and the Board of Education, for such varied audiences as instructors of the Youth Opportunity Program, counselors at the Budget and Consumer Credit Counseling Services, school teachers of social studies and members of the Harlem Consumer Education Council. Thus far in 1982, we have held nine of these seminars.

We reach other audiences, too. About once a month I host a meeting for business and community leaders in our District, where we exchange viewpoints on the current state of the economy. Other senior officials of the Bank hold similar meetings around the District, three times a year.

We are aware of the importance of the Community Reinvestment Act and have an active and ongoing contact with groups, both private and governmental, whose major focus is housing and urban lending. This is in addition to our statutory duty to monitor compliance by state-chartered member banks, which we fulfill through the bank examination process.

We also are responsive to inquiries we receive from the general public. In the first half of 1982, the

Public Information division in New York responded to almost 100,000 inquiries. Many of these involved our role as fiscal agent for the Treasury, as people wanted to know about government securities and how to buy and sell them. Other questions were about regulation or the central bank services we perform, and we have prepared a number of educational booklets about the work of the Federal Reserve that we send out on request.

Research and Scholarly Activities

Our research and scholarly activities are quite extensive. The primary publication outlet for these efforts is our Quarterly Review, a widely read journal of economics containing articles that range from discussions of the regional economy to examinations of money market instruments and monetary policy options. To give you a complete picture of all the types of matters covered in our Quarterly Review, I have submitted as an exhibit a listing of all of our articles over the past few years. We also make available a variety of economic papers written by our research staff. We keep in close touch with the academic community and other economists. We invite professors and others to conduct seminars at the Bank and our economists are frequently invited to lecture or conduct seminars

at universities and elsewhere. In addition, we conduct special seminars at the Bank for college teachers of money and banking, and for members of international organizations and foreign central banks.

The research activities at the Federal Reserve Bank of New York are basically policy oriented--they are geared to assist in the formulation of domestic and international policies in the broadest sense. A good part of our research work is devoted to current analyses of economic and financial developments in the United States, in foreign economies and international markets, and in our region.

At the national level, we follow very closely innovative practices in the financial markets that might affect the interpretation of the monetary aggregates, the implementation of monetary policy, or the stability of our economic and financial system. We are concerned with the implementation of monetary targets and with the outlook for the Federal deficit. Some of the issues we have examined recently are the effects of tight short-run control of money, the role of money market funds as a substitute for money, and the relationship between the Eurodollar market and domestic financial markets.

We are also very concerned about the prospects for economic growth and inflation. In that connection we have recently studied the effect of the international

value of the dollar on exports and imports and on domestic prices.

Internationally, we have examined other nations' fiscal and monetary policies and have looked into their experiences with financial innovation. We have investigated their methods of implementing monetary policy and the effects of developments abroad on U.S. economic growth and inflation. We also analyze the situation of the less-developed countries, with particular focus on their balance of payments and their international debt, and the economic and financial position of the OPEC nations.

At the regional level, we have done a number of studies of New York City's tax structure and have examined regional economic growth and inflation compared with that of the nation as a whole. In evaluating New York City's attractiveness as a place to work and for employers to locate, we have looked into such matters as the cost to businesses and individuals of subway delays, and have started a study of the costs of crime.

Equal Opportunity Policy

As an employer and member of the community, the Federal Reserve Bank of New York is committed to

maintaining a work environment in which all individuals receive equal treatment and equal opportunity without regard to their race, color, religion, national origin, sex, age, or handicap. This commitment is an integral aspect of our personnel management and employee relations activities including recruitment, selection, promotion, compensation, benefits, training and education, and counseling.

Affirmative Action

Since the early 1970's the New York Reserve Bank has conducted an Affirmative Action Program, which is aimed at increasing the representation of minorities and women in upper level salary grades and in our official staff, primarily by promotion from within the Bank. In the aggregate, minorities and women are well represented at our Bank, comprising 40 percent and 55 percent of our total staff, respectively. Each year we review our targets and our progress in meeting them, and set new goals for the current year.

In broad terms, our Affirmative Action Program consists of four major efforts:

First--Establishing specific Affirmative
Action goals which are approved
by our Board of Directors;

Second--Developing detailed action plans
for recruitment and advancement
of minorities and women;

Third--Implementing or carrying out of
these action plans;

Fourth--Monitoring our results against
goals and reporting them to our
Directors.

We have a record of continuing progress toward increasing our representation of minorities and women in senior level jobs and in official positions. Over the past five years minority representation in our senior salary grades has improved from 12 percent in 1977 to 15.5 percent in 1982. Women have increased their representation in those grades from almost 19 percent in 1977 to 24 percent in 1982. There were five minority group members in our official ranks in 1977; today we have eight, and our goal for 1982 is 10 (or 7.5 percent of our official staff). There were 12 women officers at the Bank in 1977; today there are 24, and we intend to have 27 women officers (or 26 percent of our official staff) by year-end.

Affirmative Action for the Handicapped

Since 1976, the Bank's Board of Directors has approved an Affirmative Action Program for the Handicapped.

The Bank recruits handicapped individuals and insures equal opportunity for all handicapped employees. The Bank has instituted programs designed to increase supervisors' awareness and understanding of the concerns of handicapped employees and has made alterations to its physical plant to accommodate the disabled.

Bank-Sponsored Upward Mobility Programs

Over 40 in-Bank training programs are offered each year to assist our employees in developing job-related skills and to prepare them for increased responsibility. Among the courses offered are English as a second language, supervisory training, writing and office skills, and management skills training. In addition, an equal employment opportunity awareness program "Fair Play," is presented to supervisory personnel. Interview skills workshops are held to improve employees' interviewing skills and prepare them for opportunities available through our job posting system.

Most job openings at the Bank are filled through the job posting system, which emphasizes equal opportunity for all qualified applicants. Counseling is available to all employees to assist them in reviewing career opportunities at the Bank and in

determining their qualifications for specific job openings.

This summer, the Bank sponsored a Minority Summer Internship Program. This program provided summer employment in professional positions to minority college students interested in a career in the banking industry. The objective of the program is to assist in the identification and recruitment of qualified minority students about to enter the marketplace. The program was limited to college juniors and seniors. We feel it was highly successful and plan to repeat it in 1983.

During the past years, we have increased participation by minorities and women in our Executive Training and Development Program, and the Management Training Program. These programs are designed specifically to identify and develop promising candidates for supervisory and managerial positions. Special emphasis is placed on the following areas:

- . Seminars to help upwardly mobile employees to objectively identify their career aspirations and strengths;
- . Instruction in communication skills (both written and oral) and confidence building;

- . Increasing exposure to Federal Reserve policies, procedures, projects, etc.
and
- . Development of interpersonal and leadership skills to prepare the employee to supervise others.

Community Involvement

The Bank supplements its internal affirmative action efforts by participating in a variety of special community action programs, and actively pursues new opportunities to enhance its community involvement.

Some of these are as follows:

1. National Urban League's Black Executive Exchange Program (BEEP) -- A program in which black businessmen and women from a variety of fields lecture at pre-dominantly black colleges and universities to supplement classroom instruction, acquaint students with a wide variety of career opportunities, and provide positive role identification.
2. American Economic Association (AEA) Summer Program for Minorities -- This program is administered by AEA, hosted by Yale University, and funded by the Sloan

Foundation, the AEA, the Board of Governors of the Federal Reserve System and a number of Federal Reserve Banks, including the Federal Reserve Bank of New York. The objective of the program is to identify promising prospective minority Ph.D. candidates with the necessary undergraduate training in economic theory and analysis.

3. Open Housing Center -- An employer-sponsored service which provides assistance in locating housing in New York City for employees and assists employees who feel they have been discriminated against in locating suitable housing.
4. Various New York City and New York State Sponsored Programs
 - a. Youth Opportunity Campaign - A program administered by the New York State Employment Service which provides summer jobs for economically disadvantaged high school and college students.

- b. School Work Exploratory Educational Program (SWEEP) -- A workshop sponsored by the New York City Board of Education and the National Alliance of businessmen to provide high school students with exposure to a variety of career opportunities through on-the-job observations.

On many occasions, our officers and employees are asked to participate in business and career forums sponsored by corporate and academic institutions. To give just two examples:

New York University and Citibank Business Career Forum for Minority Students -- A program designed to acquaint minority students with graduate-level study in business and businessmen and women who are also members of minority groups.

Minority Job Fair -- Sponsored by the National Organization of Black University and College Students held at Howard University in Washington, D.C.

Finally, I should add that in the coming month, we will become a member of the New York/New Jersey Minority Purchasing Council, Inc. to enhance participation

by minority vendors in supplying goods and services to the Bank.

Economic Conditions and Monetary Policy

The long-run goal of monetary policy is to reduce inflationary pressures by gradually slowing the growth of money to a rate consistent with noninflationary expansion in business activity. And the Federal Reserve has been moving toward that goal. M1 growth in 1979 was less than in 1978, in 1980 less than in 1979, and in 1981 below 1980. This slowing in money growth is now being reflected in lower inflation rates and in expectations of reduced inflationary pressures for some time to come. The financial markets are becoming convinced of the Federal Reserve's resolve on the inflation front.

Because inflationary psychology had become deeply entrenched in economic decisions and expectations, the reduction in inflation has been a painful process. Profit margins have been squeezed, especially in those firms that had bet on a continuation of inflation, and unemployment is up sharply. Nor have the effects been even across all regions or sectors of the economy. Homebuilding and the auto industry have been among the hardest hit because of their sensitivity to the cost of credit. But hopefully the worst of the bad economic

news appears to be behind us, and we believe that the Federal Reserve's monetary targets are sufficient to permit economic growth in a noninflationary environment. To foster such growth, the FOMC has tentatively decided to retain the 1982 targets for M1 growth for 1983.

While the Federal Reserve generally expresses its long-term goals in terms of monetary targets, particularly M1 growth, many other economic factors are taken into consideration. Broader measures of money and liquidity as well as credit aggregates are monitored by the Federal Reserve System. In addition, the Federal Reserve Bank of New York, like the other Reserve Banks, keeps in touch with business conditions in its District as well as national economic trends. The New York Bank, however, is unique in that it operates in the Government securities market on behalf of the FOMC, as well as in the foreign exchange markets.

Moreover, the Second District contains the world's foremost financial center. Most dealers in U.S. securities are located in New York City, many of the nation's largest banks are headquartered there, and more than half of the Treasury's securities are sold through New York financial institutions. As a result, the New York Federal Reserve carefully follows developments in the national and international financial markets and brings that perspective to FOMC meetings.

In recent months, the strength and resiliency of our financial markets have been tested by events like the failures of Drysdale Government Securities and Penn Square National Bank. There is also market concern about a number of domestic and international credits. Appropriately, reviews of market practices and credit procedures are being undertaken which will ultimately strengthen our financial system.

At the New York Reserve Bank, we have taken a particularly active role in working to improve practices in the Government securities market. We have also been closely involved with efforts to relieve concerns in the international financial markets--notably involving Mexico in recent weeks.

Along with a perspective on financial markets, the New York Reserve Bank brings an overview of the regional economy -- one of the nation's largest -- to FOMC meetings. Business conditions in the Second District have deteriorated during the current recession, but the decline has not been as severe as in other parts of the nation. Total employment in New York State has not fallen nearly as much on a percentage basis as it has for the nation as a whole.

In part, this is due to the concentration in New York of financial and service industries which tend to be less sensitive to business downturns. Manufacturing employment, although declining sharply in New York since last summer, has not fallen as much as it has nationwide. So while the recession has affected New York, there are also reasons to be optimistic about the ability of New York's economy to withstand recessionary forces better than in the past when New York's losses were considerably greater than for the nation.

And at this juncture, there are also reasons to be less pessimistic about the national outlook as well. Inflation rates are down, interest rates have declined, and most of the inventory adjustment has been completed. Thus, while some questions remain about the exact timing, the economy appears to be poised for a period of modest business recovery -- a recovery that will not be accompanied by a resurgence of inflationary pressures as long as the Federal Reserve maintains its monetary discipline and the Congress continues to work toward a closer balancing of Federal receipts and expenditures.

The Federal Reserve's commitment to monetary discipline, however, should not be interpreted as rigid adherence to monetary targets, particularly in the short run. The Federal Reserve is prepared to allow money growth to be above or below target for brief periods of time when the circumstances suggest that special factors are coming into play. In 1981, the rapid growth of money market funds appeared to be reducing M1 growth as consumers transferred part of their transactions balances to money funds, and others learned what a convenient mechanism money funds could be for managing cash balances more efficiently. Under such circumstances, the Federal Reserve was willing to tolerate below-target growth for a period of time.

In contrast, during 1982, special factors seemed to be adding to M1 growth. The sharp decline in business activity late last year and early this year prompted consumers to build up their precautionary balances -- primarily in the form of NOW accounts and savings deposits. With M1 being raised by growth in nontransaction deposits during late 1981 and early 1982, the Federal Reserve felt that M1 growth around the top of the annual range was acceptable.

The buildup in precautionary balances eased in the second quarter of this year, but if economic turbulence and uncertainty led again to stronger than anticipated demands for money and liquidity, the FOMC would tolerate growth somewhat in excess of the annual range for a period of time. The Federal Reserve would look to a variety of factors in making such a decision, including the behavior of different components of the money supply, movements in velocity, and the condition of banking and financial markets. But we do not plan to respond strongly to various "bulges" or "valleys" in monetary growth at times when the demands for money and liquidity may be exceptionally volatile.

The Federal Reserve will need to continue its flexible approach to policy in the long run also as the financial markets continue to change and new ways are found to manage cash balances more efficiently. Sweep accounts, NOW accounts, money funds, retail and corporate RPs, and Eurodollars -- all have raised enough questions in recent years about the usefulness of M1 by itself as a guide to policy.

In summary, we have traveled a long way on the road toward greater price stability and a healthy foundation for sound economic expansion. It would be

a tragic mistake not to finish the journey. The Federal Reserve remains firm in its anti-inflationary stance, but flexible in its approach to policy, and fully intends to aim for money growth consistent with economic recovery in the years to come. In that sense, the Federal Reserve's M1 target, after allowance for normal velocity, can be viewed as effectively setting a cap on nominal GNP growth. As inflation recedes, the monetary targets will automatically permit more room for real economic growth. And that appears to be the stage of the process we are now entering -- less inflation and more economic growth.

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Statement by

Frank E. Morris

President, Federal Reserve Bank of Boston

before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

Washington, D.C.

September 23, 1982

I am pleased to be able to participate in this Hearing. The following are my responses to the questions posed by Chairman Fauntroy which are not dealt with in our joint statement.

What has been your bank's involvement with community and scholarly activities? In this connection, I would be pleased to know what work-training programs, upward mobility programs, affirmative action policies, forms for small and minority businesses, and research activities your bank has been and is presently engaged in doing.

Perhaps the most fundamental contribution of the Bank to the region we serve is our research program on the New England economy. This program which absorbs a sizable part of our research budget, has over the years led to the Bank becoming known as a center for objective expertise on New England economic problems. Our regional research staff routinely services requests for data and analysis from New England Governors and Mayors. They were actively involved in the resolution of the financial crises of the State of Massachusetts and the City of Boston.

We have cultivated close contacts with the New England academic community. Two prominent economists, James Duesenberry of Harvard and Robert Solow of MIT, have served as Chairmen of the Board of Directors of our Bank. We solicit the views of a panel of prominent New England economists prior to each FOMC meeting and transmit them

to the FOMC members as part of our contribution to the Red Book. We sponsor one or two conferences a year on some topic of pressing interest. These conferences have served to strengthen the ties between the Bank and the academic community. In a conference to be given next month on government policies to influence the savings rate, we will have papers presented by faculty members from Harvard, MIT and Yale, as well as by economists from outside the region.

The Bank is actively involved in efforts to resolve the social, as well as the economic problems, of our region. I serve as chairman of the Tri-Lateral Council for Quality Education, a business group which seeks to improve the quality of the Boston School System. I am also Vice Chairman of the Boston Private Industry Council, a member of the Advisory Council to the Coalition of Northeast Governors and a member of the Coordinating Committee (sometimes known as "The Vault"), which is a business group concerned with the problems of the City of Boston. We encourage Bank officers to get involved in community affairs. Among other affiliations, our officers are directors of the Neighborhood Housing Services, the Massachusetts Higher Education Assistance Corporation and the New England Education Loan Marketing Corporation.

As a member of the Tri-Lateral Council for Quality Education, the Bank has entered into a partnership arrangement with South Boston High School under which we contribute to enriching the educational experience of the

students. We also seek to prepare students for entry into the world of work by counseling, teaching them how to participate in a job interview, and providing the experience of a part-time or summer job. Twenty-five students from the South Boston High School worked in the Bank this summer.

The Bank operates a Skills Development Center in which disadvantaged young people who do not meet our minimum employment standards are taught clerical skills and good work habits. Seventy-eight trainees have graduated from the program and have been placed in permanent jobs, including sixty-six placements within the Bank. One graduate of the Skills Development Center is now a computer programmer.

The Bank is a member of the New England Minority Purchasing Council and, as part of our affirmative action program, has an annual target for purchases from minority vendors.

The status of business and financial liquidity, in the economy as a whole and in your District, and the implications for monetary policy.

The lack of economic growth during the past three years, together with declining profitability and high interest rates, has depressed business liquidity to a record post-war low. For nonfinancial corporations, the debt-to-asset ratio now has reached 60%, well above the customary 50% established in the late 1960s and 70s. During the 1980s to date, about two-thirds of business borrowing has been short term. High leverage and high

interest rates have pushed the ratio of debt service charges to cash flow above 50%, well above the 30% ratio that prevailed during most of the 1970s. A drop in the rate of return on assets has been responsible for much of the erosion in business liquidity. The rate of return on total nonfinancial corporate assets is only about two-thirds of its level in the late 1960s and early 1970s.

While we have no direct estimates of regional business liquidity, there is no reason to believe that conditions in New England differ sharply from those nationally. Nonetheless, we know of no major New England corporation which is currently suffering a severe liquidity squeeze. The major decline in interest rates of recent weeks has undoubtedly helped to ease the situation of many firms and the sharp rise in common stock prices should make it feasible for some of them to strengthen their equity positions.

The commercial banks of New England are in good condition, undoubtedly reflecting the relatively strong performance of the New England economy. While it is too early in the game to form a final conclusion, my impression is that loan losses at New England commercial banks, while showing a rising trend, may not be as serious as the loan losses suffered in the 1974-75 recession.

The thrift institutions of New England are highly liquid, reflecting very conservative asset management since 1975. We have seen very few forced mergers of

thrift institutions in New England, in large part because their capital positions tend to be substantially stronger than the thrift industry nationally.

The implication for monetary policy is that the Federal Reserve must remain alert to evidence of any generalized liquidity problem and to any development which might threaten the viability of the financial markets.

Employment and business conditions in the economy, as a whole and in your District, and the implications for monetary policy.

The New England States have weathered the recession relatively well. Unemployment rates throughout most of the region have been consistently below the national average. During the first six months of 1982, the average unemployment rate in New England was 7.8 percent, which compares with the U.S. figure of 9.1 percent. Total employment has tracked closely the national trend, despite the loss of approximately 50,000 state and local government jobs in Massachusetts attributable to Proposition 2½.

This relatively strong performance reflects the transformation of the New England economy, with competitive high technology companies gradually replacing the old-line industries. Some of our high technology companies have been adding to their employment rolls right through the recession. New England is also benefiting from the upturn in defense procurement, which is cushioning, for many companies, the decline in consumer demand for their products.

On the other hand, New England is heavily dependent on capital goods production. Many high technology products are investment goods, and the region is still active in machine tools and other more traditional capital goods industries. These companies have been living off their order backlogs. New orders are weak because of high interest rates and the strength of the dollar on the foreign exchange markets, which has made our exports less competitive in world markets. More than anything else, these companies need public policies which will reduce the cost of capital and render financially feasible investments which have been shelved because of high cost of money. Policies which expand total demand without bringing interest rates down are not going to meet the needs of New England's capital goods producers.

The relative importance of further reductions in inflation at this time compared with the state of employment and business conditions and liquidity.

We are at a delicate juncture for monetary policy. We must have a policy which provides a financial base for a sustained upturn in economic activity while, at the same time, providing assurance to the financial markets that the Federal Reserve continues determined to reduce the rate of inflation in the years ahead. To restore the economy to a healthy state, produce a substantial decline in the unemployment rate, and generate the increases in productivity necessary to produce rising

real incomes for the people of the United States, we must reduce the costs of capital for new investment. A precondition for a healthy economy is a healthy bond and stock market. To generate a healthy bond and stock market, we must convince the investor that the inflation rate is going to continue to decline in the years ahead. This is why inflation control must not take a back seat to any other policy objective.

Disinflation is a painful business. We have paid a heavy price for the gains we have made thus far, but the gains are real and critically important. The inflation rate is down substantially, we have seen a surprisingly large decline in the rate of advance in wages and salaries and there is evidence of fundamental changes which will show up in sizable productivity gains as the economy turns up. We have begun to lay the foundation for a strong economy for the balance of the 1980s.

Yet these developments are viewed with a heavy layer of skepticism by many players in the investment markets. They saw the inflation rate decline and wage rate increases decelerate in the wake of the 1974-75 recession, but it proved to be purely a cyclical phenomenon. Because we were unwilling then to continue to give high priority to inflation control coming out of the 1974-75 recession, the gains won at such heavy cost soon evaporated and we moved quickly back to stagflation--with high unemployment and double digit inflation.

After the 1974-75 recession business liquidity improved only superficially. During the late 1970s, rising inflation eroded business profitability while inevitably increasing the cost of long-term financing. As a result of this experience, I believe that a steady reduction of inflation is a precondition for sustaining growth and attaining acceptable levels of employment and business liquidity in the 1980s.

We should learn from the experience following the 1974-75 recession, but many in the financial markets are not sure that we will. When they are convinced that we will stay the anti-inflation course, long-term interest rates will come down sharply.

The appropriateness and viability of the monetary targets currently used by the Federal Reserve, specifically the M-1 aggregate, and your views on alternative targets, including the monetary base, a credit target, GNP, or targetting of real or nominal interest rates.

I have come to the conclusion that we can no longer measure the money supply of the United States with any kind of precision. By that I mean that we can no longer draw a clear line between money and other liquid assets. Innovation and the computerization of the financial system are revolutionizing the manner in which the American people handle their cash balances. This has brought us to the point where any definition of the money supply must be arbitrary and unsatisfactory; i.e.,

it must include assets that some people view as short-term investments (not transactions balances) and exclude other assets that some people consider part of their transactions balances. Cash Management, Sweep, and Money Market Accounts are making "idle" transactions balances disappear. In the future, people may have much less need for transactions balances--funds may pass from a buyer's cash management account to a seller's cash management account, existing as transactions balances only long enough to complete the trip.

All of the monetary aggregates can be distorted by shifts from one type of liquid asset to another, shifts which have no significance for monetary policy. To an increasing degree, longer-term securities and real assets have also become an abode of purchasing power because these assets may be tapped for transactions purchases on demand through modern credit arrangements. More and more purchasers look to their "lines of credit" rather than their check book balances in completing their transactions.

Thus, we have a serious measurement problem with the concept of money. We have been attempting to deal with this problem by periodically revising the definition of the money supply. This raises another issue. What we call M-1 in 1982 is not the same thing that we called M-1 in 1975. There is no necessary reason to believe, therefore, that the new M-1 (and its successors of future

years) will behave in the same manner relative to nominal GNP as the old M-1. Furthermore, M-1 velocities have risen more rapidly in recent years in response to rising interest rates. Presumably, as interest rates move down, we should expect a slowing in velocity--but when and by how much? With all the uncertainties surrounding both the measurement of M-1 and its relationship to the nominal GNP, I have concluded that the monetary aggregates, particularly M-1, are no longer suitable guidelines for monetary policy.

My suggested alternative is total liquid assets, which is both stably related to the nominal GNP and unaffected by shifts from one type of liquid asset to another.

I should add that the problems with M-1 as a target for policy are problems for the future, not the present. If we had been implementing a total liquid assets target in 1982, we should probably have chosen a range of 8 to 11 percent. The growth rate for total liquid assets thus far in 1982 has been somewhat above the upper limit of this range. Thus, a switch to total liquid assets would not have produced an appreciable difference in monetary policy in 1982.

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Chairman FAUNTROY. Let me begin by first saying to you, Mr. Solomon, how much I appreciate the support and cooperation the New York Federal Reserve Bank has extended to the subcommittee in all of its activities. That does not suggest that other district banks don't provide help—each of them does; but, New York, which is a major financial center, is often the focus of a number of concerns, and I just wanted to let you know how much I appreciate your cooperation.

Second, I want to focus on a comment in your individual statement. On page 14, where you stated:

The long-run goal of monetary policy is to reduce inflationary pressures by gradually slowing the growth of money. * * *

That is certainly an important goal with which I do not disagree. But where is the goal of employment? More importantly, how do you and your colleagues, in setting monetary policy, see the relative benefits of reduced inflation as against the costs of increased unemployment? In short, what is the worth in an additional 1-percent reduction in inflation as against increased unemployment?

Mr. SOLOMON. Mr. Chairman, I have been in the public sector off and on 20 years with intermittent stops in the private sector. I have come to the conclusion, I think most of the country has come to the conclusion, that if we want sustained employment, at satisfactory levels, we have to handle the inflationary problem much better than we have been handling it. There is no trade-off except possibly in the very, very shortest timeframe between inflation and unemployment, in my view. I was particularly struck by this in the Carter administration, where I was Under Secretary of the Treasury, that the economic models, the macromodels, were very misleading. They consistently underestimated the inflation that we could expect from the analysis of percentage utilization of capacity in the country.

We all share in the Federal Reserve banks your concern about getting a satisfactory and sustained recovery, which will bring down unemployment levels. We believe, although there may be individual nuances among us—we do believe that the monetary policy that we are currently following does leave room, does permit a modest recovery in the next year or so, and presumably we also believe that that is compatible with a further accomplishment in the reduction of the rate of inflation. As you know, it has been halved approximately in the last couple of years, and we believe that there will be further gains next year, at the same time that there will be modest recovery.

So I don't think of it as a trade-off. And I would hope that members of the committee would also be aware of our experience over the last decade in which we, I think, have seen ample evidence that it is not a trade-off, except as I say possibly in the very shortest timeframe. I hope that answers your question, Mr. Chairman.

Chairman FAUNTROY. It does. Mr. Roos, you said in your statement that if money continues to grow at a rate of 5 to 5½ percent, economic activity should pick up in the second and third quarters of 1983. You note, however, that this implies little improvement in unemployment until the middle of 1983. A number of economists have suggested that a somewhat faster growth of money is needed

to encourage the economy to pick up and grow, a minimum of 6- to 6½-percent growth has been suggested by a number of people. What would be the result of a somewhat higher M_1 growth rate? Also, what do you think might be the improvement in unemployment with that slightly higher growth rate?

Mr. Roos. Well, Mr. Chairman, the statement that I included in my prepared statement was perhaps a little more precise than anyone is able to really formulate, in saying that it would be until the second or third quarter of next year where we would see improvement. If money grows at 5½ percent—the upper limit of the FOMC ranges, I think that there will be a gradual improvement between now and the end of the year, or at least an absence of any further downward trend, and that into next year we would see future further steady and gradual improvement. I don't think it can be precisely timed in advance, although we do believe that there is a strong relationship between the rate at which money grows and economic activity.

In terms of speeding up the rate of money growth rather dramatically in order to bring current relief to the serious problems of unemployment, to bring stimulus to the economy, I believe that if money were to grow significantly more quickly than the targeted range, I think that we might see a very temporary reduction of unemployment, and a very temporary improvement in economic activity. However, I think that the financial markets would view an expansion of the rate of money growth to be a signal of further inflation, and I think that interest rates would be adjusted upward in the anticipation of increased inflation. And I think that any long-range improvement or growth in the economy would be frustrated thereby.

So I would—I personally feel that our M_1 target is reasonable, we ought to stick with this target, and we ought to gradually reduce them in the years ahead until we have really squeezed out inflation as a major problem in our economy. I think everybody would be better off if we do so.

Chairman FAUNTROY. Thank you, Mr. Roos.

Mr. Paul?

Mr. PAUL. Thank you, Mr. Chairman.

My first question is to Mr. Roos.

In the first 6 months of this year, the St. Louis Federal Reserve reported that the adjusted monetary base was growing at a 10.1-percent rate. The report from the Washington Federal Reserve shows the monetary base is growing at 7.4 percent. I am interested in knowing why there is a discrepancy there, and also I am wondering if you yourself prefer to watch the monetary base, rather than M_1 . If these figures—if your figures—reveal that the monetary base is growing at 10.1 percent, and it is an important figure, does this mean there is more money growth than the Federal Reserve is really admitting to, and does this mean in the next several months we may have more price inflation than a lot of people are anticipating?

Also, what has happened to the monetary base since those figures came out? They took us up to the end of June. Have July and August shown rapid growth in the monetary base?

Mr. Roos. Well, first of all, from time to time there are differences in the growth of the monetary base as measured by St. Louis and by the Federal Reserve Board of Governors. I think these are due essentially to the way in which each of us handles the impact of reserve requirement changes. These differences are usually short term in nature.

We do watch the growth of the monetary base, because we think it is related to the growth of M_1 . After all, the monetary base and the money multiplier affect money growth. And we, of course, place a lot of importance on the rate at which money grows. The monetary base has grown at a slower rate in the past 8 weeks. From June 16 to the present the growth of the base as we measure it has been about 4.6 percent. Actually, the rate over the past 6 months has averaged about 7 to 7½ percent. So we are not concerned. We think that the growth of the base has been consistent with what we believe the growth of M_1 should be, and we are not too concerned by the current fast growth in the base. In fact, until recently we have been more concerned about a period of slow money growth which we feel if continued could have had adverse effects on the economy in the next year. But we think that the way things are going now, there is less of a chance that money growth will remain overly slow.

Mr. PAUL. Does this strike you as a problem, the fact that there is discrepancy on a report of 3 percent? It seems that within our own Federal Reserve System we get discrepancy of 3 percent, and sometimes we have arguments about the definition of money. Over the past 10 years we have changed definitions, targets, aggregates. Does that not indicate a fruitless task? It seems that it is overwhelming insofar as defining money and regulating it, if we cannot even get two branches to agree on these figures. If we happen to be following a monetary base rule, the biggest question is, whose figure would you be taking.

Mr. Roos. Well, let me respond in this way, Congressman Paul. First of all, there are two primary aspects, as I know it, to monetary policy. One is to find some variable that will impact spending or income; the other is to find a variable that will impact prices without adversely affecting output. Furthermore, we try to find, in choosing a target, a target which the Federal Reserve is able to control.

Now, we have done an analysis of M_1 , and found that it meets these concepts satisfactorily. Of course no economic relationship is perfect. There are short-term variations and occasional unexplained errors. But, by and large, if you examine its relationship to output over the past—even over the period since 1979—and if you examine as well as its impact on prices, M_1 has performed these two functions quite well. Second, the relationship between the growth of the monetary base and M_1 has been a fairly steady and a fairly reliable relationship.

So in summary, if I am answering the question that you have posed, while any of these aggregates and other variables are necessarily imprecise and always in need of continued examination and reassessment, we think that M_1 has continued to meet the criteria for monetary policy uses, and we think that the relationship be-

tween the base and M_1 has been very steady relationship in recent years.

Mr. PAUL. I have a quick question for Mr. Morris. Since the Monetary Control Act was passed in 1980, we have permitted the Fed to use foreign bonds as assets. And since that time, especially at the Boston Fed, we have used foreign bonds on quite a few occasions as collateral for Federal Reserve notes. Up until the end of August, the Fed has used them on 70 different occasions, not for a large sum of money, but as collateral for several billion dollar bills. What is the reason that we use foreign bonds? Do we not have enough Treasury bills to use as collateral? Why do we go ahead and use that procedure? The bond is owned by the Fed and earning interest. Why do we need to use that as a collateral for Federal Reserve notes.

Mr. MORRIS. From time to time we have small shortages of Treasury securities to meet the collateral needs, and this gives us a little more flexibility. Certainly, we do not buy foreign currencies for the purpose of collateralizing our notes. The program of foreign exchange intervention is largely under the dictates of the U.S. Treasury. We implement the policy when there is an agreement within the Government that we ought to do so. However, having these assets on our books gives us a little additional leeway in covering the collateral requirement.

Mr. PAUL. Will we use the Mexican pesos or Mexican bonds for collateral, do you think?

We have those now as assets in the Fed.

Mr. MORRIS. I will ask Mr. Solomon to answer that. He is in charge of the Mexican situation.

Mr. SOLOMON. We take Mexican denominated currency assets only in connection with our swaps. Presently we have outstanding swaps as part of the official support package—both from the Treasury exchange stabilization fund and from the Federal Reserve. In effect, these are denominated in dollars because we both buy and sell the pesos at an exchange rate that is specified in advance and will make us whole, in dollar terms, when they repay us.

Chairman FAUNTROY. The time of the gentleman has expired.

Mr. Corrigan, you have noted in your statement that there is still a high level of long-term interest rates, which suggests that investors are not yet convinced that the progress against inflation will be extended or even sustained—if I can use your own words in that regard. What do you believe is needed to convince investors that inflation is under control, and that the battle against inflation will be sustained so that long-term rates will fall? What do we have to do here on Capitol Hill and in Washington generally, to convince people we are serious about reducing inflation and keeping it down?

Mr. CORRIGAN. I think we have to recognize at the outset that in the current circumstances, interest rates and particularly these long-term rates, really are as much a state of mind as they are a statistic. And inevitably, they reflect both what has come before and what people perceive may follow.

In the case of people that put up long-term money, such as State government pension funds, the hard fact of the matter is that if you were putting up long-term money in any size over the whole

decade of the 1970's, you got burned. In some cases, you got burned very badly. And you also got burned in a context in which, from time to time over that period, there were repeated assurances, both here and around the world, that inflation indeed would come down and stay down. So within that kind of historical perspective, I think it is inevitable that lingering elements of skepticism would still be there to some extent.

When you ask the question prospectively I can only give you an opinion, because, as I said, what we are talking about is the collective state of mind of 200-odd million people. But it does seem rather unambiguous, at least to me, that a major reason for that continued skepticism has to do with the whole budget situation. We have and we can engage in these great intellectual debates, about what exactly these deficits mean, what they don't mean: Do they crowd out; don't they crowd out? Do they contribute to inflation? But my sense of it is that to the man or the woman on Main Street, at the very least, they are symptomatic that something seems to be wrong. And I think at the very least they do therefore reinforce that skepticism. I think clearly deficits are an area in which more needs to be done.

The other major relevant arm of public policy, of course, is monetary policy. Again, my perception would be that the gains we have made against inflation are very substantial. We have begun, perhaps at long last, to translate these gains into a meaningful breakdown in the inflationary psychology.

I don't think we are at a point where we are home free. And because of that, I do think that maintaining that essential restraint and discipline that we have been talking about in the area of monetary policy is very important.

If I may, too, Mr. Chairman, just tack on one point here that is not directly related to your question. On this issue of "where do we go from here?" I think that it is important to note that at least in the short run—and I fully agree with Mr. Solomon's comments earlier about the lack of a trade-off in the long run—in the short run, we may be in a very advantageous technical position.

I do, for example, firmly believe that, for a variety of technical reasons, we can expect that a modest pickup and growth in the economy will be accompanied by less inflation. Now, that is a very happy position to be in. We have not been there in a long time.

But if, for example, the economy were to start to grow even at a moderate rate of 3 or 3½ percent, something like that, it is clear to me that in the normal cyclical turn of events we would see roughly corresponding increases in productivity; increases in productivity in a context in which wage rate increases would come down dramatically.

We could, all of a sudden, find ourselves looking at a situation in which unit labor costs, which in some ways are a good proxy for inflationary pressure, are rising at a very modest rate compared to the 10 and 12 percent we had been living with for a very long period of time.

So again, I think we have a situation before us that does clearly lend itself to at least the potential of having the best of both worlds—the inflation rate continuing to come down in combination with some improvement in both employment and output.

Chairman FAUNTROY. Thank you.

Mr. Reuss?

Mr. REUSS. Thank you, Mr. Chairman.

Gentlemen, in my opening statement, I referred to our current financial predicament and wondered out loud about the role of the Federal Reserve in it. Just a week ago, I was in Vienna, sitting with the president of the Austrian National Bank and his colleagues, and I said to him, Austria's record remains a bright spot in the international horizon:

Your inflation is negligible, well under control; your unemployment is marvelous by our standards; your balance of payments is good, and you, of the Central Bank, have participated in this growing performance and have done so without excessive turning-on of the printing presses.

Their rate of growth in Austria has been on the order of 3 or 4 percent in the last 8 or 10 years, which is analogous to the productivity increase.

I asked:

How have you been able to do this and create the necessary credit which has sparked your industry, your solid agriculture, your technological growth, the amount of housing which you have continued to build in bad times and good?

The answer was that, in Austria, it is customary to invite in the 14 leading banks and see if a consensus cannot be worked out that loans for commodity speculation, or fast buck loans to far-off foreign countries, or loans for corporate megalomania and agglomeration, should be discouraged. And as a result, even with a rather controlled amount of new money in the economy, that country has been able to prosper.

My question is: What has the Federal Reserve done in recent years to prevent the Bunker Hunts from getting their hands on billions of our scarce supply of credit to gamble in silver? What has been done to prevent and tone down the wave of unproductive corporate mergers and acquisitions that have nothing to do with new investment and of which the current example is the Bendix-Martin Marietta extravaganza?

What has been done about reasoning with the large American banks about not diverting endless scarce credit resources to the Argentinas and Mexicos, while American farmers and homebuilders and small business, even large businesses, are high and dry and on the rocks.

What is the record of the Fed? What have you all done? How Austrian have you been?

Mr. SOLOMON. Well, Mr. Reuss, I would strongly argue that the reasons for the relatively satisfactory economic situation in Austria are not the reasons that you attributed it to. Roughly, 50 percent of their GNP is represented by foreign trade. They tie their schilling to the deutschemark. They benefit from the price stability relatively that the German economy has had. Since they are a small country, they have cooperation from their labor unions in terms of restraining excessive wage increases. I think that to the extent that they do discourage what you call unproductive use of credit, that it is a minor factor, frankly.

Mr. REUSS. I didn't mean to launch on a seminar on Austrian wirtschaft politics. We can do that another day.

I return to my question: What have you Federal Reserve banks—admittedly everyone of your bank districts is bigger than Austria, four or five times as big—but what have you done to take some of the starch out, in a timely fashion, from the credit-wasting Bunker Hunts and Bill Agees and the rest of the lot.

Mr. SOLOMON. Let me say this, Mr. Reuss.

The one experience that the Fed has had with a systematic effort to curtail the use of credit for so-called unproductive uses was when the Credit Control Act was invoked in March 1980.

Mr. REUSS. That, if I may say so, was a noddle-headed disaster—which I protested the next day. That fooled around with retail credit, and money market funds, all sorts of irrelevancies. It did not really come to grips with the problem I am describing here, namely, the waste of credit.

Mr. SOLOMON. You are right that the program was larger than that. But that was also a part of the program and, as you say, it did not work very well. The Fed traditionally has felt that the market mechanism for allocating credit was a more efficient mechanism; that it was very difficult for administering authorities, for Government officials, to make decisions as to which credit uses are more productive. Also it would take, I am convinced, very substantial backup legal authority to implement any views like that. Simply jawboning would not be in my view very effective, begging the question of whether that is a more efficient way and whether we have the capability of judging which credit uses are more effective.

I think there is a plausible attractiveness to what you say, although let's say in the case of a takeover—and I don't want to defend any particular set of arrangements—the money paid to stockholders of the corporation being acquired flows back into the capital market. The pool of capital is not reduced. Second, there have been cases where takeovers have resulted in more efficient and productive operations in the long run.

I am sure there are cases where takeovers have not resulted in greater productivity, either for the company or for the economy as a whole. I don't know, though, that we are really equipped to make that kind of decision. And I don't think you would want to urge that the Fed attempt to discourage—that would be ineffective anyway, jawboning—all possible takeovers. We would have to make a judgment as to which are productive and which are not. I don't think we have that capability, frankly.

Mr. REUSS. Thank you. I am over my time.

Chairman FAUNTROY. Mr. Barnard?

Mr. BARNARD. Thank you, Mr. Chairman.

I certainly want to take this opportunity to welcome all of you gentlemen here today. After your very enlightening testimony, these hearings could probably go into the far hours of the evening. But time is of some restraint.

I would like to come at you from two different questions.

Mr. Corrigan, I believe when you were discussing monetary policy, you indicated that the period of time when the Fed used interest rates to control inflation or to attempt to control inflation was a disaster. Has there been any consideration to trying to ap-

proach it from the standpoint of monetary control and interest rates, a combination of both?

Mr. BOYKIN. Congressman Barnard, in using the interest rate as a target, it is mainly a matter of emphasis. I don't believe we have used one particular target to the exclusion of all others. Nor is it true today. But the concern that I have with trying to use interest rates as the target is the difficulty of raising interest rates and raising them sufficiently to accomplish the objective.

It is a very difficult thing to do, to take a deliberate action to raise interest rates by x number of points. I think there are other ways that this can be done. Interest rates then can seek their own level.

Mr. BARNARD. What are your suggestions as to how we are going to increase demand in the marketplace? That is where our problem is today. I know this is a long-range program that we are going through.

As my colleagues on this subcommittee know, I have been very sympathetic with the Fed and what you are doing. But it is getting to the point now that if we are going to increase the gross national product, we are going to have to increase demand at some point. How do we do that?

Mr. BOYKIN. Well, my own judgment is that the policies we have in place, that our announced intentions in terms of monetary growth, as we go into 1983, provide room for this to happen. It is a longer term problem. It is a difficult problem. It seems to me that we have come pretty far down the road. And I would have a lot of concern if we shifted that course and tried to restimulate. As President Corrigan was saying, inflationary expectations might increase. And I think that is critical.

Mr. BARNARD. Because of time, I need to shift.

Mr. Corrigan, I was impressed with your report on what the Fed is doing as far as pricing services is concerned. Could you tell me what the general attitude of the Fed is as far as competing with correspondent banks? What is your general attitude toward that?

Mr. CORRIGAN. That is a difficult question to answer, Mr. Congressman. Our posture, I think I would best describe as one in which we believe that pricing or not, we have an ongoing responsibility with respect to the payments mechanism and with respect to providing at least some payment services. We feel that in order to be effective in fulfilling that responsibility, as well as being responsive to the particular stipulations of the Monetary Control Act, that we have to maintain a reasonable presence in the market, so to speak.

Mr. BARNARD. In other words, you don't feel that your policies of pricing would be so overaggressive as to take business away from correspondents?

Mr. CORRIGAN. We are certainly trying to avoid that.

Mr. BARNARD. Tell me—you probably know where I am coming from, because I have written letters to the Fed about this subject. But I am keenly interested in it.

You mentioned in your testimony that you were changing certain policies with reference to check collection, especially in the courier-type services. My understanding is that the Fed is getting ready to inaugurate a policy whereby your courier system, after

picking up items, could get there 2 hours after the others, and it would have the same day's credit, whereas if a correspondent bank was handling the same items at the same time, it would be credited the next day—am I wrong in that understanding?

Mr. CORRIGAN. I wouldn't say wrong. Let me try and—

Mr. BARNARD. I would like to understand. It appears to me in this particular instance that you are giving the Fed a 2-hour time limit advantage over private enterprise, and my evaluation of that would be that conditions of check clearing fall under the same policies as we passed in 1980 as far as pricing.

Mr. CORRIGAN. Let me try and comment on that briefly, if I may.

First of all, we are talking about an overall program that, in the first instance, is designed to accelerate the collection of checks, and it will do that beyond dispute. Part of the mechanism that allows us to do that is condensing our own processing times, and part of it is that we have changed, or we are proposing to change, certain transportation requirements.

Under the proposal put out for comments, checks are going from Chicago to Atlanta, and they are on the Fed network, and they are unprocessed, they can get there later than if they came in from some other sources. The reason for that is an operational one, it is an attempt to build in some control.

Mr. BARNARD. But you don't think that is discrimination?

Mr. CORRIGAN. Let me finish, please.

It is a problem. I fully agree with that. We are actively exploring ways in which the necessary controls can be maintained and that particular problem can be dealt with. Even now, as the proposal stands, a correspondent bank could deliver a so-called package of checks at the later hour, but it could not deliver unsorted checks. We are trying to figure out a way in which the overall objectives of the program can be maintained while permitting some kind of accommodation of that very problem.

Mr. BARNARD. You don't think that subject is important enough to extend the period of comment? I know you have turned us down completely on the comment period. It appears that they would talk about a highly sensitive subject.

Mr. CORRIGAN. The formal comment period, as you suggest, was terminated. We have received something in excess of 500 letters on the overall proposal. There will be a continuing dialog.

Mr. BARNARD. When some of these correspondent banks wake up, you are going to find 1,500 letters.

Mr. CORRIGAN. My suspicion, Mr. Congressman, is that they are all pretty well awake. I think I have a few bruises to suggest that. The point I was trying to make, though, is that while the formal comment period has ended, there is a meeting tomorrow morning between myself and some of my colleagues with the correspondent banks on this very subject. Tomorrow afternoon I am meeting with the couriers on this very subject. Next Tuesday there is a very large group of banks and thrifts that are coming in to meet with us as well. The dialog is there. And I will say that I am reasonably confident that we will be able to find a device that will preserve the broad objectives of the program and, I think, take care of the problem that you speak to.

Mr. BARNARD. Thank you very much.

Chairman FAUNTROY. The time of the gentleman has expired.
Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman. I am just wondering how much time we have to make that vote.

Chairman FAUNTROY. We have about 7 or 8 minutes.

Would you like to claim your time when you return?

Mr. NEAL. I would like to do that.

Chairman FAUNTROY. All right. Let me continue with a couple of questions that I have.

Gentlemen, you will notice the Chair has remained here during the course of several votes. That is because, while I represent more people than any single Member of the House, and more people than elect 14 Senators in the other body, the citizens of the District of Columbia still endure the tyranny of taxation without representation. And we have not as yet ratified the D.C. voting rights amendment, which would accord District residents the same rights that every other taxpaying American has, and that is the right to elect someone to represent them with a vote in the U.S. House and Senate. That aside, I would like to continue my questioning.

Mr. Solomon, you have been a leader in expressing concern and interest about innovations in the financial markets. Indeed, I recall placing into the record last year some of your thoughts from a speech that you made in New York City, and I would like to focus some on these issues. What do you foresee coming down the line in the next several years? I am particularly interested in the changing character the retailers and money funds may take as financial businesses become more oriented toward a fee-for-service structure. Are retailers able to fully understand the financial business? What will the money funds do when the higher yields that they have offered diminish considerably? Are the funds going to stretch out their maturities and go along with some increase in risk to liquidity, or, will they offer other service? What effect is the whole arena of electronic banking and interactive computer terminals likely to have on financial innovation and the ability of the Fed to control the monetary system? What does this mean for privacy? What does it mean for banking as we see it now? Will banks charge to see a teller?

Mr. SOLOMON. Well, you have asked quite a few questions there, Mr. Chairman. I will do my best.

Chairman FAUNTROY. Questions of where the banking industry is going in terms of the innovation and service.

Mr. SOLOMON. I think there are a few trends that are clear. One is that there will be more electronic use, more remote service, automatic remote service units, where individuals can do their banking. There may possibly be some development of home computers, although I think that is pretty far off, but some work is going on in that area in banking circles, whereby one can make financial transactions from one's home on terminals that would be geared into the banks.

In general, I think there is a trend toward institutions supplying a wider range of financial services. You have heard the expression, "financial one-stop supermarkets," so to speak. I would take that with some grain of salt. But I think there is an efficiency gain in a trend in that direction.

We have tended to see the erosion of specialized financial institutions. That is very obvious in terms of the future of the thrifts. The whole process of greater automation, greater convenience for individuals and the public to do their banking, I think that will likely go on.

Now, what are the implications for the Fed and for monetary policy? I don't see that the technological changes are going to cause us direct problems in running monetary policy. However, I do believe—and this is a personal view, although I think some of my colleagues share it—that over the long run if you combine the innovation that we have been seeing with full deregulation of all interest rate ceilings, so that eventually we see a spectrum of all deposits paying market interest rates, aside from the service fees charged, this does create some complications for longrun monetary policy after a few more years.

It seems to me that the Fed will have less direct control with its traditional instruments of people switching from money into non-money, and vice versa, because all money will be paying market interest rates as nonmoney instruments are paying market interest rates. Interest rate elasticity will be lowered, to use the jargon. One way of making it feasible to continue monetary control along the lines that we currently run it in that environment would be to place what I call a moat around transactions money. I think Chairman Volcker has referred to this in testimony, but I don't know if he has gone into any detail on it.

It seems to me that if we had a notice requirement separating the transaction money from other forms of money, say a 7-day or 14-day, or whatever, notice requirement, and that applied to money market funds as well as other innovative forms, we would be able to preserve a more effective monetary policy running more or less along our monetary aggregate targeting lines.

If the Congress in its wisdom does not see fit to give us that kind of authority, then I would assume, and this is a personal view, that in the long run we would have to look for some variance of our present monetary targeting approach.

I hope I have been responsive to your question, Mr. Chairman.

Chairman FAUNTROY. You have.

Mr. Weber?

Mr. WEBER. I am sorry about the disjointed nature of the questioning, and most especially the listening, because of the votes. It is unavoidable.

I think my question is directed to any member of the panel. I refer to page 9 of Mr. Corrigan's testimony, in which you have said that "I would simply suggest that the other potential policy targets frequently mentioned, real or nominal interest rates, the monetary base," and so on, "will not yield magical solutions to our economic problems."

The American public does seem to be looking for magical solutions. They seem to be of the mind that the Fed has it within their power to bring down interest rates.

I would like you to elaborate on your statement. Why won't targeting interest rates, for example, along with the monetary base, be a magical solution to the problem?

Mr. CORRIGAN. Let me first respond in general, Congressman Weber.

The point I am trying to make is that as you look at the spectrum of possible targets for monetary policy, it is my judgment that when all is said and done, the practical differences from one to the other are quite small—realizing that regardless of choice you simply have to maintain consistency.

Your specific question which I think is similar in thrust to one Mr. Barnard raised earlier, “why not look at a combination of, say, interest rates and the base of the money supply?” I think there are two points that are relevant. The first is that even if you are using the money supply or the monetary base, interest rates are obviously very important because, as a practical matter, interest rates and changes in interest rates are the vehicle around which individuals and corporations and banks and everyone else make the portfolio adjustments that in turn manifest themselves in higher or lower levels of the money supply. So they are there, no matter whether you are explicitly targeting on them or not.

Now, on the question of targeting rates in combination with something else, I think the problem is a behavioral one. At any point in time you may find that a particular level of interest rates is compatible with some particular rate of growth of money, however you define money. But at another point in time, that relationship is quite different. Right now, for example, where in round numbers the money supply is growing at $5\frac{1}{2}$ percent, and short-term interest rates, again in round numbers, are in the 9- to 10-percent range. You can go back over the last 10, 15, or 20 years and find situations in which the money supply has grown at 5 percent, and those same rates are 18 percent. You can also find periods when they were 2 or 3 percent. The relationships between interest rates and money growth are not stable in the sense that you can say with certainty, or with anything even approaching certainty, that if you target some particular interest rate, money growth is going to be what you want it to be; it is not that kind of a relationship.

Those, in combination, are some of the reasons for the thrust of my statement. But I think the really important point, at least in my mind's eye, is the one that you have pointed out: financial discipline, however you measure it, is essential and is something that is perhaps easier to maintain than to achieve. Getting financial discipline is a difficult problem, no matter what target you choose to use.

Mr. WEBER. Would any of the other members of the panel care to comment on the question?

Mr. ROOS. I would only add in the most simplistic fashion possible that I don't know of any way in which the Fed can control interest rates over any longer period of time. I think that the ball game today, the environment today, is significantly different from when I originally studied economics.

In those days the Fed, by providing, by expanding the availability of reserves, increased the supply of loanable funds and interest rates came down. Now, that was before 15 years of inflation, and exactly the opposite occurs and would occur if the Fed tried

through traditional means to reduce interest rates by increasing the supply of available money.

And I think a large portion of the public still feels that the Fed can raise and lower interest rates and can control them in the long pull. I very, very much disagree with that ability. All we can do is create the environment, the noninflationary environment, which would cause interest rates to drop, and beyond that there is nothing that I know of that the monetary authority can do to control interest rates.

Mr. WEBER. I see.

I have been advised my time has expired.

Chairman FAUNTROY. Thank you.

The time of the gentleman has expired.

Mr. Patman?

Mr. PATMAN. Gentlemen, at the time these goals are announced or indicate a tighter money supply objective by the Federal Reserve, do you keep your eyes on interest rates as well as so-called money supplies? Each one of you does? And you are getting reports all the time about that?

We hear a lot of talk about the inflationary expectations that lenders tack on in order to lend funds. Is it not true that lenders of money charge as much as they can for as long as they can?

Mr. SOLOMON. I think that is true.

Mr. MORRIS. Yes, but it is a very competitive market. You cannot charge more than your competition is charging and continue to lend to any degree.

Mr. PATMAN. Any individual lender will charge as much as he can for as long as he can?

Mr. MORRIS. That is right.

Mr. ROOS. Just as any individual borrower will try to borrow money or invest his money at the best possible return to him. This is the way the free market works.

Mr. PATMAN. Surely. Would lenders be able to charge as much as they charge now absent the tight money policy of the Fed?

Mr. ROOS. I think that if the Fed policy were more accommodating, easier, then interest rates would be significantly higher than they currently are. I think that what led to high interest rates was the willingness over past years of the Federal Reserve to create the expansion in the money supply which led to inflation—there is a direct relationship—and when inflation occurred, and people became conscious of the impact of inflation, interest rates moved upwards rather than down.

Mr. PATMAN. So what you are saying is that the Fed is helping us by keeping money tight and therefore keeping interest rates low?

Mr. ROOS. I think that by keeping monetary growth under control, yes, sir. I don't think it is tight currently, because in our district banks, lenders do have money to lend. I would not characterize present policy as tight. But certainly if the Fed became expansionary, I think we would have a significantly higher level of interest rates than we currently have.

Mr. PATMAN. Well, let me make sure I understand that each one of you agrees that when we have tight money we don't have higher interest rates, we have lower. Is that what you are telling us?

Mr. SOLOMON. I think I would make a distinction between short rates and longer rates.

Mr. PATMAN. Make that distinction. Say short rates.

Mr. SOLOMON. Well, I think that you have various factors at the short end of the market. First, if money supply goes up, you do get a market reaction in which rates, at least initially, rise. All other things being equal, I would feel that a larger money supply, feeding more reserves to the banks, would in the very short run, and at the short end of the market, tend to lower rates. However, I agree with Mr. Roos that in the longer end of the market, the markets would react quite differently. If they saw money supply being significantly increased, beyond what would seem reasonable targets, they would expect a higher level of inflation and I think in the medium- and long-term part of the market—the rates which are more significant to business investment in the country—those rates would rise.

Mr. PATMAN. I just really question what you are saying there. I hear it frequently. People who lend money will withhold that money in some way, or shift it to some other investment—begin speculating in gold, stocks, or something of that nature?

Mr. SOLOMON. There are various factors. Certainly during the period of the higher inflationary expectations we did see that there was a lot of investment in gold, collectibles, real estate, and that money was not available in the capital markets. I don't think there would be much difference of view on that.

The decisions among different kinds of financial assets that are made when inflationary expectations rise again are more complex. But even there, we have seen a virtual collapse of the bond market at a time when inflationary expectations are very high.

Mr. PATMAN. That is true of the long-term bond market when we had high rates. Now are we seeing a resurgence of long-term bonds?

Mr. SOLOMON. We have seen an improvement in the bond markets coming along with the reduction in short-term rates because the market feels that the Fed is consistent on its anti-inflationary policy.

Mr. PATMAN. Is that really true, or is it they decided they want to get the larger yield, they are available in long term, and they feel they can justify that somehow, and take a chance on inflation—that the rates would remain relatively stable? And they cannot get this higher rate on the short-term market.

Mr. SOLOMON. Well, I am in New York, which is the center of the financial markets. I see these people every day. I think it is an almost universal conviction of the players in those markets that what I have said is true.

Mr. PATMAN. Certainly it is true also that an investor would not sit out and leave his money uninvested; isn't that true?

Mr. SOLOMON. That is true. But as I say, he can either move into nonfinancial assets, or he can move into what he thinks will be somewhat less unsatisfactory inflation hedges. Those vary among the different kind of assets available, or just stay short.

Mr. PATMAN. Thank you.

My time has expired.

Chairman FAUNTROY. Thank you.

Mr. McCollum.

Mr. McCOLLUM. Thank you, Mr. Chairman. There has been a lot of discussion in our committee, on the floor of the House, and elsewhere with regard to the prime topic of concern today; interest rates and the Federal Reserve Board's role in what you have discussed today, of course. But one area has not been asked about that I would like to explore with you, and that has been the subject of considerable discussion in this subcommittee over the past few weeks.

We have seen Business Week, for example, report not too long ago that, as opposed to consumption of about 5 percent in the 1960's, that the Federal Government this year is expected to consume about 70 percent of all available capital in this country.

Now, that may be on the high side of estimates, but they did make that kind of an assertion, talking about the pool of savings, the buildup of reserves for that purpose by businesses, surpluses in State and local governments, and so forth. It is a staggering sum.

I think most of us who have thought about it recognize the only way we are really going to get the pressures off the marketplace for money is by getting the Federal Government out of the business and reducing its scope and its size and involvement in consumption of this money.

The problem that has bothered us is the inability of Congress to reach a consensus on where to make the spending reductions or the tax increases or whatever to reduce the deficit sufficiently enough to bring down that consumption, that use by the Federal Government of the money. As a result of that, we still continue to drift with what most of us believe is too high interest rates.

Some would have suggested, as they had in some proposed legislation, that the Federal Reserve Board target interest rates again. I am not going to ask you about that this morning. I don't personally agree with that.

There have been others who have very seriously suggested, and this subcommittee has been exploring, the possibility of a national usury ceiling for the short-term duration indexed to the rate of inflation. The idea being that this is not desirable, certainly not as long-term policy, but that with only a limited supply of money available, without reinflating factors taking place by your body, that this may be the only way to fairly allocate the limited resources among the American public at a price that everybody can afford, as long as Congress isn't willing and while Congress is in the process of gaining a consensus to refuse the Federal pressures involved in this by the tremendous overspending we have been doing.

I would like to ask Mr. Boykin first what is your reaction to that proposal, how would it affect the Federal Reserve System if it were enacted?

Mr. BOYKIN. Well, I would have to respond right up front that I have a bias against regulation. I have a bias against setting limits. I think that the marketplace is the best place to determine what the cost of money should be. As to what the implications for the Federal Reserve would be should there be a national usury ceiling. Frankly, I am really not prepared to address that, at this time.

Mr. McCOLLUM. Mr. Morris, do you have a thought on that?

Mr. MORRIS. The history of usury ceilings reveals that if the ceiling is below the level that the market would consider a satisfactory return, the funds are diverted to other uses. A national usury ceiling, if it was set low enough so that the investor thought he was not getting a fair return, would lead to diverting those funds outside of the financial markets to buying land or gold or what have you, or going abroad.

Mr. McCOLLUM. Isn't the question where the rate of return is, rather than can it be accomplished?

Mr. MORRIS. If the usury ceiling is higher than the price that the market sets, it is not disrupting the flow of funds, but it really is not accomplishing anything. I think it is another example of the kind of belief, a natural human reaction, that when we are in difficult times, that there has to be some simple, easy gimmick that is going to get us out of all of these problems without any pain and suffering. Unfortunately, I think the answer is there is no such gimmick. I do not think the usury ceiling would accomplish your desired purpose.

Mr. McCOLLUM. Anyone else want to comment on that?

Mr. CORRIGAN. I would be very uneasy about this, at least as you describe it for two reasons. First, even if you could figure out a way to do it, and I am not sure that is altogether easy, it would still be true that the Government itself would be the first one "in" in terms of absorbing the funds. I don't think a national usury ceiling would deal with that problem.

Second, and, I think Mr. Solomon just mentioned this and I would just emphasize—that we have a worldwide situation today with our money and capital markets in which money is extremely fungible. I would just suggest that one clear potential pitfall, beyond those Mr. Morris has mentioned, is that if you set the ceiling in a way that is in some sense binding, what you end up with is a sizable flow of money abroad. You end up with less net money available, particularly within a context where the Government itself is still going to be first in line for available funds.

Mr. McCOLLUM. One thing that has been interesting to us is the suggestion that we set it at some percentage figure, substantially above whatever the rate of inflation is at the time, which historically economists have claimed is the rate where you can make money in the banking system, and profit is there, and within the normal bound of where it historically has been. In some fashion in regard to that we would not, in fact, be threatening the free enterprise marketplace in the actuality, but simply in the expectation area.

Mr. MORRIS. The problem with that, Congressman, is that the investor, particularly when he is examining a long-term instrument, is concerned not only with what the current rate of inflation is, but what he expects the rate of inflation to be over the term of his investment. You may have a usury ceiling that doesn't look very binding in terms of the current rate of inflation, but if the investing community expects the rate of inflation to rise in the future, it is going to be binding then.

Mr. McCOLLUM. What I am suggesting is indexing it to the rate of inflation, so if the rate goes up the ceiling goes up, so it is not a fixed ceiling.

Mr. MORRIS. Yes, but you would be fixing it to the current rate of inflation.

Mr. McCOLLUM. You would be starting at some point certainly.

Mr. MORRIS. If the market thinks that the rate of inflation in the future is going to be higher, that will still mean that the instrument will be binding and cause a diversion of funds.

Mr. McCOLLUM. I follow your logic and understand.

I yield back the balance of my time, Mr. Chairman.

Chairman FAUNTROY. Thank you.

Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

Just to pursue that logic for a minute, isn't that the problem we have now. We have a national economic plan that doesn't make any sense, and the investment community understands that it does not make any sense. We are running massive budget deficits, and no one can predict what the Government is going to do over the next several years.

We have a plan that is not serious. No one takes this idea seriously that you are going to increase defense spending at the rate we are, and cut spending at the rates suggested, and cut taxes the way we have, and that is going to result in a balanced economic plan.

The investment community is looking at that and saying it doesn't add up; doesn't make any sense; is not serious. So they are saying, who knows what corrections will be made in the future—we certainly cannot stay with this?

On the one hand, we have calls for starting the printing presses again. On the other side, we cut taxes and we raise them. The question I would ask of anyone that raises these kinds of questions is, Would you give \$1,000 to someone for 20 years, at 2 percent or 3 percent over the rate of inflation today? I don't think you would. I would not. It doesn't make any sense. It is unpredictable.

It seems to me until we get some balance back into the plan, we are going to have these continuing high real interest rates. Isn't that the case? I think it is.

Everyone is nodding their heads yes. So I think they agree.

I think that is what it is going to take. The balance is not there.

I would like to get a specific response. Isn't the reason real interest rates remain high, is that there is no logical person is going to be willing—talking about long range now—no reasonable person is going to be willing to commit money for 20 years at a rate similar to historical interest rates related to inflation under these economic conditions?

Mr. ROOS. I would respond by saying, yes. Though, if we are dealing essentially with monetary policy today, I think that the Federal Reserve and its policy deserve whatever credit is forthcoming for having displayed a consistency of its policy, and I think that has been the primary reason why long-term rates have dropped even though they have dropped rather slowly. I think—and this may be impertinent to say—that the other side of this equation is for Congress and the administration to demonstrate an ability to bring down these deficits. I think that more people are aware of deficits than they are the subtle sophistication of monetary policy. If you

get out on the golf course with the guys I play with, they don't even know what M_1 is.

Mr. NEAL. I agree with you 100 percent. I believe that the Fed is to be credited 100 percent with the reductions in inflation and interest rates that have taken place over the last 2 or 3 years. And I don't think you can attribute 1 percent of it to the economic plan, if you can call it that, that we have in place in this country today. It just made matters worse.

The Federal Reserve by limiting money growth has brought down the rate of inflation, I think, and has to its credit established some predictability and consistency in the conduct of monetary policy.

Now, on the other hand, in the face of that, we have a fiscal policy that as I understand it is running counter to the monetary policy established by the Fed, and as a result we have high interest rates and have unsettled financial markets and high unemployment and a disastrous economy.

Everyone agrees with that.

Mr. SOLOMON. Will the record show the degree of nuances of our smiles or nodding?

Mr. NEAL. The balance certainly is not going to be restored on the fiscal side, by just cutting deeper into programs that affect disabled people and older people and sick people and so on. We don't have to do that to straighten things out. We have to be willing to pay our bills, it seems to me.

Let me stop speechmaking and ask another couple of questions, if I may.

May I raise one or two questions?

Chairman FAUNTROY. I will allow you one.

Mr. NEAL. I thought I heard one of you say you had some advanced view of statistics. I am curious if among those you had some idea what the unemployment figure is going to be from the Bureau of Labor statistics?

Mr. MORRIS. I may have mentioned that our directors serve as the source of intelligence as to what is going on before the statistics come out. But that doesn't extend to knowing exactly what the unemployment rate will be before it is released.

Mr. NEAL. You know, Congressman Paul and I were both on the Gold Commission. There has been a considerable interest in the question of pegging money to gold and so on. At first it is very interesting that in recent days, at a time when the rate of inflation has been coming down, clearly coming down, that the price of gold has been going up rather dramatically. I think most of those, including my friend, Mr. Paul, would want to peg money to gold, because they would want some consistency in monetary policy, and the gold would be a warning of inflation. But it seems clear to me that the price of gold has gone up for reasons totally different from any concept of the rate of domestic inflation. And in fact probably because of uncertainty in world financial conditions.

Mr. MORRIS. But also because the cost of carrying gold is down when the short-term interest rates fall. That has been a major factor, I believe.

Mr. ROOS. We don't know what the Soviet Union would have within its power to manipulate the price of gold and deal us a fight on it.

Mr. NEAL. In fact, the Soviet Union did dump some gold on the market earlier this year, and probably affected the price. Wouldn't you think that would be true?

Well, I certainly appreciate, Mr. Chairman, your indulgence.

Chairman FAUNTROY. Thank you.

Mr. Lowery.

Mr. LOWERY. Thank you, Mr. Chairman.

Gentlemen, welcome.

Do all of you serve on the Open Market Committee of the Federal Reserve?

Mr. ROOS. We all attend, but some of us are not current voting members.

Mr. LOWERY. You all attend. My first question is what things do you discuss? How do you arrive at your decisions, and why did you decide to cut the discount rate?

Mr. SOLOMON. May I answer. First of all, with regard to discount rate changes, that is done by the Board, not by the FOMC. The Board reacts to recommendations from the different Federal Reserve banks. But the final say is with the Board of Governors, not in the FOMC. But in the FOMC, to answer your earlier point, our agenda is a pretty wide one. We have a review by the staff and then by the members of the FOMC, based on their district situation as well as basic economic conditions in the country. We have a discussion of the financial and credit markets. We have a discussion of the monetary developments. And all that is before the rather protracted discussion that frequently takes place, as to what the decisions are to be. There also is a report on the international side. And, of course, the exchange rate situation is a factor as well. If you have something more specific in mind, we would be pleased to answer it.

Mr. LOWERY. The decision to cut the discount rate—you all didn't make it. But at the meetings you attend, don't you make recommendations? What is the nature of those discussions? How did the decisions come about to cut the discount rate?

Mr. ROOS. If I may, Mr. Chairman, I haven't been aware of much discussion of discount rates at the FOMC meetings. These are discussed in our various boards of directors. But I think that those of us who believe in the conduct of monetary policy by some control of some monetary aggregates recognize that that control is more easily accomplished when the discount rate is kept fairly close to short-term interest rates, specifically the Federal fund rate. And so we, for example, in our policy actions in the Eighth District, in St. Louis, we like to see the discount rate adjusted so that it remains in very close proximity to the Federal fund rate or any of the other short-term rates, because we think this minimizes any distortions in member bank borrowings at the discount window, and facilitates the conduct of monetary policy.

Mr. LOWERY. Is that universally followed by other districts?

Mr. CORRIGAN. The answer to your specific question, in this particular context, is that the reductions in the discount rate that materialized some weeks ago occurred in a context in which market

rates had, of their own momentum, come down. And broadly speaking, the money supply and other things that we look at were behaving in ways that were broadly compatible with our objectives.

Mr. LOWERY. There are many that would argue that you are not following trends, but you are rather stacking them. That prime came down after the Federal Reserve Board—

Mr. CORRIGAN. Prime had come down a bit. But the short-term market rates, the T-bill rate—

Mr. LOWERY. Prime had come down from about 21½ to about 16, 16½ percent, and the remaining 3 percent, it strikes me, is strictly a result of Federal Reserve policies.

Mr. MORRIS. I think about 90 percent of the time the changes in discount rates are made in response to changes in market rates that have earlier taken place. There are exceptions. One occasion I recall in particular where we wanted to send a strong signal to the market—our October 1979 meeting—we did discuss the discount rate and we did agree that a 2-percent increase in the discount rate would capture world attention and have a stabilizing influence on the foreign exchange market, where the dollar was then under extremely heavy pressure. So there are occasions when it is used to send a signal to the market. But in the normal course of events, it tends to follow what has already happened in the market.

Mr. LOWERY. Why were the decisions made in early summer to start cutting the discount rate, about four times now in the last 2, 2½ months. Why not in spring? What happened? What was different in June as opposed to March?

Mr. SOLOMON. We follow, given our monetary targets, certain intermediate targets on nonborrowed reserves. What you had was the M₁ money supply running negative for 3 months, in the late spring and early summer as we continued to put in nonborrowed reserves according to the targets that the committee had set, that in itself created some easing in the markets. Market rates began to fall. The discount rate affirmed the direction of that movement. And I think if you check the movement between the Federal funds rate and the discount rate, you will see that the discount rate moves were made more or less either shortly following or simultaneously.

Now, there is no secret about Federal Reserve monetary policy. Chairman Volcker has explained many times that we would like to come in around the upper end of the range, because we think that is what the economy needs. And, consistent with our sense of financial discipline and anti-inflationary monetary policy, we would like to see interest rates as low as possible, of course. But it has to be consistent with our overall approach in order for it to be a longrun sustained noninflationary growth the country will resume.

Therefore, the timing that you referred to was one where the monetary conditions, the situation in the credit markets, because also credit demand slackened at that time, permitted easing in the markets and then the discount rate cuts affirmed that movement. That was not true in the early spring, where you still had relatively strong growth, we were overrunning the money supply targets, and there was a strong demand for credit in the banks and the credit markets.

Mr. LOWERY. Mr. Chairman, I have many, many more questions. but my time has expired.

Chairman FAUNTROY. I thank you. And I thank the gentleman for remaining with us so long. We will begin a second round of questions. We are going to adhere strictly to the 5-minute rule. Of course, if witnesses have heard questions that members had already posed, they need not avail themselves of the 5 minutes.

Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

The key question it seems to me now for us is this question of interest rates. It is certainly the one attracting the most attention as regards Federal Reserve policy. As I understand the policy established by the Federal Open Market Committee, if you were to start pumping in reserves now, if you were to start exceeding your target by any significant amount, wouldn't that have the effect of raising interest rates, especially long-term rates, as opposed to bringing them down?

Mr. MORRIS. Yes.

Mr. NEAL. Would you all agree with that? That is certainly my understanding. And yet it seems to me there is a lot of debate on that subject. There are many here in the Congress who think that the way to bring down interest rates would be to start printing a lot of money. And I just find that hard to understand. But I think it is good at least to have it on the record that you say in your opinion that that would be the result, if we start pumping in the reserves, that we are going to have not lower interest rates, but higher interest rates. I believe you all agree.

Chairman FAUNTROY. We had a chorus of agreement.

Mr. LOWERY. Mr. Chairman, as I understand the ground rules, is silence acceptance?

Mr. MORRIS. I think you are getting unanimous agreement to that proposition.

Mr. SOLOMON. Particularly if you emphasize as you did long rates.

Mr. NEAL. I think that is right. Sure, you could artificially bring down short rates for a while, I guess, until people got wise to what you were doing.

Mr. CORRIGAN. I think there is a question even as to how long you could do that.

Mr. NEAL. I think that is true, too. I think you wouldn't get the short rates down for very long, unless people were making very short-term decisions to get in and out in a hurry.

But in looking for, which we all are, some way to balance this program and making it effective, to get us back to a situation where people are employed and industry is productive, clearly we need to get interest rates down. To do that, it seems to me the Fed must continue to exercise restraint, to get and keep interest rates down. And to sustain that, it seems to me we must have some balance on the fiscal side.

Now, often the answer to that is given, well, what we need to do is cut spending more. And when we ask people where they want to cut the spending, they don't want to cut it out of defense, they want to cut it usually out of other programs. If you don't cut defense, and you are going to cut spending under our system, what is left is programs that help people and usually they are the most vulnerable and helpless people in our society. We don't have too

many welfare programs for rich people. So usually people disabled, sick, or trying to promote education, science, energy, that we feel is in the national interest.

I am left with the conclusion if we are going to add balance to this program, we are going to have to raise revenues somewhere. Not that we cannot find areas to cut some spending. We certainly can. But that we are at least going to have to have a significant amount of increased revenue into a package to make it a balanced package. Would you all agree with that? And would that not have some benefit on credit markets, interest rates, the long-term, beneficial long-term financial outlook for our country?

Mr. Roos. Even though this is out of my province, I would submit that inevitably if you increase revenues you will find ways to spend those increased revenues. I still feel that the financial world and the public generally have to be convinced before increasing revenues to a further extent that every possible effort has been made to reduce costs. And I think this goes into the military costs. I am way outside of my field.

Mr. NEAL. I appreciate your comments.

You have to take these things into consideration when you make your recommendations on monetary policy, also. So you have to have opinions on it.

Mr. Roos. As the Chairman has said, I think Mr. Volcker has said repeatedly that the task of the Federal Reserve is lightened by a reduction of deficit spending. The fiscal end of it certainly does have an effect on what we do. But we don't have control over that. And I sometimes wonder if in frustration certain of our colleagues don't jump on the backs of us poor Federal Reserve officials. And I say that in a friendly way.

Chairman FAUNTROY. Mr. Paul.

Mr. PAUL. Thanks, Mr. Chairman. Before asking a question of Mr. Solomon, I would like to make a few comments about the remarks by the gentleman from North Carolina. I believe he made some very good points about the perceptions of what we are doing here, and the markets are saying they are not too convinced our program is all that good. I would have to agree strongly with that. I think that when we see that next year's budget deficit projected by the CBO is \$175 billion, we are in a lot of trouble.

I would like to suggest it is not beyond our ability to solve it—we could do it very quickly if we wanted to. I don't think there is much desire. I would simply cut the budget. And to settle the squabble between conservatives and liberals, over welfare and the military, I would just cut \$90 billion from each, a \$180 billion cut, and \$5 billion to spare. I think the markets would respond favorably. Besides, 60 percent of the so-called defense budget is used for defending other nations. So I don't think our defense would be injured. I think our defense would be enhanced by spending money on ourselves rather than everybody around the world.

But I believe the remarks the gentlemen made were very correct in that our anticipation helps keep real interest rates high. But this also is the explanation of why gold prices jumped as well. It isn't the flexibility of gold and the fluctuation of gold. It is this same anticipation of the future, this same lack of reliance and trust in the dollar that causes people to rush out to buy gold and

do other things. So I would say they are one and the same. Under the gold standard, that I advocate, we don't have a pegging of gold prices and we don't have a paper system here in relationship to gold over there. Gold is money, so you don't have a price of gold, any more than we have a price of a Federal Reserve note today. When you see the price of gold go to \$850 and sharply drop, this is the anticipation of the value of dollars that is occurring. It is a change in the anticipation.

The suggestion was made would we allow no money to be loaned at more than 2 or 3 percent above the inflation rate, and the reply was, no, nobody would loan money then. But if someone would guarantee the return of my investment in terms of gold, if I made 3 percent over the weight of gold and got the weight of gold back, it would be a very good investment and people would be willing to invest in that. But they are not willing to invest in a 20-year bond when they don't know what the interest rates and purchasing power are going to be. And that is where our main problem is.

The technical question I have for Mr. Solomon has to do with the statistics showing the reserve bank credit outstanding at the end of July was \$153 billion. Of that, \$132 billion were U.S. securities, and Federal agencies securities of \$8 billion. In that list, part of that \$153 billion, there is a \$9.9 billion of other Federal Reserve assets. Can you break that down for me? What is involved in "other Federal Reserve assets" as part of the Reserve bank credit statistic?

Mr. SOLOMON. I cannot break it down for you offhand, but I will be pleased to do so in a letter. We do hold some bank acceptances in the portfolio.

Mr. PAUL. That is separate?

Mr. SOLOMON. Yes. That would probably be shown under "other." But I don't know whether that is the full amount.

Mr. PATMAN [presiding]. Would you provide that letter to the subcommittee?

Mr. SOLOMON. I would be pleased to do so.

Mr. PAUL. I particularly want to know whether or not the holdings of the foreign bonds are in that particular category.

Mr. SOLOMON. I will supply that information as well.

Mr. PAUL. Could you show me where they appear on a statistic like this—how much the Federal Reserve holds in foreign bonds? As an asset?

Mr. SOLOMON. We don't hold bonds outright. When swap lines are exercised, we temporarily hold foreign currencies, usually invested in the equivalent of U.S. Treasury bills in those countries. We also hold the foreign currencies that were acquired over the years from past interventions to counter disorderly foreign exchange markets. Those are also invested, but in relatively short-term instruments.

Mr. PAUL. Doesn't it appear as asset supplies in the statistics?

Mr. SOLOMON. I am not sure where it is in the accounting sheet. I think you are right but I don't know exactly what part of it. I will give you the breakdown.

Mr. PAUL. Thank you.

[At the request of Congressman Paul, the following letter, dated October 19, 1982, was received from Mr. Solmon:]

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N.Y. 10045

AREA CODE 212 791-6173

ANTHONY M. SOLOMON
PRESIDENT

October 19, 1982

The Honorable Ronald E. Paul
House of Representatives
Longworth House Office Building
Room 1234
Washington, D.C. 20515

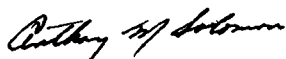
Dear Congressman Paul:

I am writing in response to the request you made during my testimony before the Subcommittee on Domestic Monetary Policy on September 23, for the composition of the "other Federal Reserve assets" figure shown in the System's Reserve Bank credit data. As you can see from the enclosed statistical information taken from the August 1982 "Federal Reserve Bulletin", total Reserve Bank assets at the end of July were about \$154 billion, of which about \$10 billion is shown as "other assets". A table breaking down the "other assets" account for July is enclosed. You'll note that foreign currency assets were about \$5.4 billion, or over half the total. To answer your question, holdings of foreign government obligations would be included in this category, and thus in the "other assets" account.

I also should note that bankers' acceptances do not appear in the "other Federal Reserve assets" account, thereby clarifying a remark I made during my testimony. Acceptances are accounted for as a separate line item, and, as you'll note on the statement, at the end of July the System held no acceptances.

Please let me know if you have further questions.

Sincerely yours,



Enclosures

A.4 Domestic Financial Statistics □ August 1982

1.11 RESERVES OF DEPOSITORY INSTITUTIONS, RESERVE BANK CREDIT

Millions of dollars

| Factors | Monthly averages of daily figures | | | Weekly averages of daily figures for week ending | | | | | | | |
|---|-----------------------------------|---------|---------|--|---------|---------|---------|----------------------|----------------------|----------------------|--|
| | 1982 | | | 1982 | | | | | | | |
| | May | June | July | June 16 | June 23 | June 30 | July 7 | July 14 ^a | July 21 ^a | July 28 ^a | |
| SUPPLYING RESERVE FUNDS | | | | | | | | | | | |
| 1 Reserve Bank credit outstanding | 151,333 | 152,140 | 153,521 | 152,095 | 152,793 | 151,778 | 153,023 | 153,460 | 155,478 | 152,591 | |
| 2 U.S. government securities ¹ | 129,656 | 130,737 | 132,400 | 131,418 | 131,337 | 130,458 | 131,485 | 131,678 | 134,155 | 132,219 | |
| 3 Bought outright | 125,964 | 120,406 | 131,540 | 131,418 | 150,497 | 130,458 | 129,098 | 131,210 | 135,214 | 132,219 | |
| 4 Held under repurchase agreements | 722 | 329 | 660 | 0 | 140 | 0 | 2,590 | 478 | 641 | 0 | |
| 5 Federal agency securities | 9,123 | 9,077 | 9,223 | 9,002 | 9,236 | 9,602 | 9,555 | 9,120 | 9,312 | 9,001 | |
| 6 Bought outright | 9,008 | 9,164 | 9,001 | 9,002 | 9,002 | 9,002 | 9,001 | 9,001 | 9,001 | 9,001 | |
| 7 Held under repurchase agreements | 115 | 73 | 222 | 0 | 234 | 0 | 553 | 119 | 311 | 0 | |
| 8 Acceptances | 164 | 149 | 300 | 0 | 289 | 0 | 742 | 96 | 488 | 0 | |
| 9 Loans | 1,105 | 1,211 | 670 | 829 | 1,014 | 1,616 | 1,070 | 859 | 595 | 548 | |
| 10 Float | 2,167 | 2,227 | 2,024 | 2,083 | 2,064 | 1,875 | 1,389 | 2,866 | 2,011 | 1,766 | |
| 11 Other Federal Reserve assets | 9,088 | 8,739 | 8,904 | 8,657 | 8,852 | 9,027 | 8,578 | 8,762 | 8,916 | 9,057 | |
| 12 Gold stock | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | |
| 13 Special drawing rights certificate account | 3,818 | 3,818 | 3,895 | 3,818 | 3,818 | 3,818 | 3,818 | 3,818 | 3,875 | 4,018 | |
| 14 Treasury currency outstanding | 15,758 | 15,774 | 15,785 | 15,772 | 15,777 | 15,781 | 15,781 | 15,786 | 15,786 | 15,786 | |
| ABSORBING RESERVE FUNDS | | | | | | | | | | | |
| 15 Currency in circulation | 144,683 | 146,504 | 147,850 | 146,915 | 146,321 | 146,121 | 147,859 | 148,804 | 147,916 | 147,124 | |
| 16 Treasury cash holdings | 489 | 464 | 429 | 484 | 455 | 466 | 442 | 432 | 424 | 419 | |
| Deposits, other than reserves, with Federal Reserve Banks | | | | | | | | | | | |
| 17 Treasury | 4,292 | 3,303 | 3,319 | 2,850 | 3,700 | 3,140 | 3,270 | 3,346 | 3,181 | 3,358 | |
| 18 Foreign | 332 | 296 | 311 | 301 | 271 | 246 | 258 | 258 | 278 | 261 | |
| 19 Other | 509 | 506 | 615 | 530 | 450 | 461 | 635 | 571 | 563 | 670 | |
| 20 Required clearing balances | 164 | 205 | 220 | 203 | 206 | 212 | 213 | 213 | 216 | 221 | |
| 21 Other Federal Reserve liabilities and capital | 5,264 | 5,373 | 5,280 | 5,306 | 5,471 | 5,244 | 5,154 | 5,195 | 5,445 | 5,330 | |
| 22 Reserve accounts ² | 24,207 | 24,220 | 24,326 | 24,162 | 24,434 | 24,460 | 22,620 | 22,591 | 26,260 | 24,160 | |
| End-of-month figures | | | | | | | | | | | |
| 1982 | | | | | | | | | | | |
| Weekly figures | | | | | | | | | | | |
| 1982 | | | | | | | | | | | |
| SUPPLYING RESERVE FUNDS | | | | | | | | | | | |
| 23 Reserve Bank credit outstanding | 149,884 | 149,003 | 153,768 | 153,126 | 152,677 | 149,603 | 154,983 | 152,031 | 154,190 | 154,673 | |
| 24 U.S. government securities ¹ | 129,420 | 127,005 | 132,440 | 130,803 | 131,021 | 127,005 | 132,143 | 131,126 | 132,907 | 132,934 | |
| 25 Bought outright | 129,420 | 127,005 | 132,440 | 130,803 | 131,021 | 127,005 | 132,143 | 131,126 | 132,907 | 132,934 | |
| 26 Held under repurchase agreements | 0 | 0 | 0 | 0 | 0 | 0 | 1,687 | 0 | 0 | 0 | |
| 27 Federal agency securities | 9,008 | 9,002 | 9,001 | 9,002 | 9,002 | 9,002 | 9,666 | 9,601 | 9,001 | 9,001 | |
| 28 Bought outright | 9,008 | 9,002 | 9,001 | 9,002 | 9,002 | 9,002 | 9,001 | 9,001 | 9,001 | 9,001 | |
| 29 Held under repurchase agreements | 0 | 0 | 0 | 0 | 0 | 0 | 664 | 0 | 0 | 0 | |
| 30 Acceptances | 0 | 0 | 0 | 0 | 0 | 0 | 862 | 0 | 0 | 0 | |
| 31 Loans | 1,058 | 1,638 | 458 | 1,504 | 1,054 | 1,638 | 680 | 651 | 750 | 1,470 | |
| 32 Float | 1,776 | 2,545 | 1,713 | 2,911 | 2,568 | 2,545 | 2,828 | 2,326 | 2,474 | 2,093 | |
| 33 Other Federal Reserve assets | 8,635 | 8,813 | 9,956 | 8,906 | 9,032 | 8,813 | 8,805 | 8,577 | 9,058 | 9,175 | |
| 34 Gold stock | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | 11,149 | |
| 35 Special drawing rights certificate account | 3,818 | 3,818 | 4,018 | 3,818 | 3,818 | 3,818 | 3,818 | 3,818 | 4,018 | 4,018 | |
| 36 Treasury currency outstanding | 13,767 | 13,781 | 13,786 | 13,776 | 13,781 | 13,781 | 13,781 | 13,786 | 13,786 | 13,786 | |
| ABSORBING RESERVE FUNDS | | | | | | | | | | | |
| 37 Currency in circulation | 145,523 | 147,134 | 147,051 | 147,099 | 146,436 | 147,148 | 148,995 | 148,856 | 147,747 | 147,547 | |
| 38 Treasury cash holdings | 477 | 460 | 418 | 462 | 453 | 446 | 436 | 426 | 421 | 418 | |
| Deposits, other than reserves, with Federal Reserve Banks | | | | | | | | | | | |
| 39 Treasury | 2,540 | 4,099 | 3,273 | 4,463 | 2,857 | 4,099 | 3,254 | 2,880 | 3,844 | 2,927 | |
| 40 Foreign | 308 | 556 | 982 | 228 | 275 | 566 | 192 | 239 | 338 | 301 | |
| 41 Other | 523 | 437 | 663 | 487 | 423 | 437 | 611 | 519 | 671 | 630 | |
| 42 Required clearing balances | 189 | 213 | 221 | 204 | 207 | 213 | 220 | 220 | 218 | 221 | |
| 43 Other Federal Reserve liabilities and capital | 5,784 | 4,837 | 5,359 | 5,135 | 5,229 | 4,837 | 5,232 | 4,990 | 5,214 | 5,127 | |
| 44 Reserve accounts ² | 23,274 | 19,985 | 24,752 | 23,871 | 25,555 | 19,985 | 24,812 | 22,654 | 24,790 | 26,455 | |

1. Includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes (if any) securities sold and scheduled to be bought back under matched sale-purchase transactions.

2. Excludes required clearing balances.

Note. For amounts of currency and coin held as reserves, see table 1.12.

"Other Federal Reserve Assets"
 July 1982
 Month-end Data
 (\$ millions)

| | |
|--|----------------|
| Reserve Bank premises | \$ 528 |
| Furniture and equipment | 164 |
| Other real estate, net | 15 |
| Reimbursable expenses and other receivables | 28 |
| Deferred charges | 5 |
| Prepaid expenses: | |
| - cost of Federal Reserve notes | 38 |
| - materials and supplies | 10 |
| - other | 28 |
| Currency and coin exhibits | 1 |
| Miscellaneous cash items | 28 |
| Accrued service income | 28 |
| Suspense Account, general | 66 |
| FDIC-assumed indebtedness | 459 |
| Foreign currency assets | 5,405 |
| Interest accrued | 2,881 |
| Premiums on securities | 240 |
| Overdrafts | 32 |
| All other | * |
| | <hr/> |
| | <u>\$9,956</u> |

* Not meaningful.

Mr. PATMAN. Gentlemen, I want to read to you an article, part of an article that appeared in yesterday's Washington Post, on page D7. It says:

A leading Wall Street economist warned today that the Nation could be plunged into a depression if the Federal Reserve Board tightens monetary policy again, sending interest rates back up.

Do you agree with that?
[The article follows:]

[From the Washington Post, Sept. 22, 1982]

WOJNILOWER FEARS RETURN TO TIGHT MONEY POLICY

(By Merrill Brown)

NEW YORK, September 21.—A leading Wall Street economist warned today that the nation could be plunged into a depression if the Federal Reserve Board tightens monetary policy again, sending interest rates back up.

Albert M. Wojnilower, chief economist at First Boston Corp., also said that the combination of massive business debt and a hesitancy on the part of major banks to continue corporate lending could block the economic recovery that administration officials say is underway.

"It is no longer altogether certain that a moderate business upturn can provide enough lift to forestall a cascading of bankruptcies," Wojnilower said in an address to executives attending a business outlook meeting sponsored by the Conference Board, a private research group.

Wojnilower's remarks on the possibility of a depression came in response to a question. "If we revert to the kind of monetary policy that prevailed prior to mid-year, there will be a depression sooner than later," he responded. Wojnilower's Aug. 16 prediction that interest rates next year are likely to be "noticeably lower" for high-quality investments helped prompt the ongoing stock market rally.

Until then, Wojnilower and Salomon Brothers Inc. economist Henry Kaufman had been predicting that interest rates were likely to remain high.

Stock market experts suggested today that Wojnilower's remarks were likely to add to the economic and political pressure on the Fed to maintain an easier policy toward the growth of the money supply, a key factor in the market's recent boom. The stock market rally continued today as the Dow Jones Industrial Average jumped by more than 18 points, hitting its highest closing mark in more than 13 months.

But there was little indication from economists and executives attending today's economic parlay that they had yet felt the effects of the predicted recovery. In fact, Albert T. Sommers, the Conference Board's chief economist, said that he does not expect the economic recovery to begin until late this year.

And at a policy conference here run by The Securities Group, a merchant bank, several academic economists agreed that a recovery this year is likely to be slow and limited. "I don't think it's going to be very vigorous," said one, Stephen Goldfeld, chairman of the Princeton University economics department. "Nobody will be very happy with it."

Mr. Roos. Mr. Patman, I think that speaking as an individual, if you took the pronouncements of all of the leading economists who are quoted in our financial press, and if you go back over the last 10 years and lay them end to end and examine the consistency or the inconsistency of the way they have viewed the same set of circumstances, you might be a little bit discouraged by the importance of, or disillusioned about the importance of those forecasts. I certainly do not share that individual's judgment. Of course, I am only one midwesterner.

Mr. PATMAN. I suppose you are speaking for the panel of five in that, is that true?

Mr. SOLOMON. Well, I think, as I understood the way you read that, Mr. Patman, you said, you quote this economist as saying if the Federal Reserve were to tighten monetary policy.

Mr. PATMAN. That is right. This is Mr. Wojnilower.

Mr. SOLOMON. He is a very respected economist.

Mr. PATMAN. It really runs contrary to what you said earlier, I think. "Warned today that the Nation could be plunged into a depression if the Federal Reserve Board tightens monetary policy again sending interest rates back up." I think you have been telling us when you tighten monetary policy, you get those rates down.

Mr. SOLOMON. Well, I think Chairman Volcker has explained what our views are on monetary policy. I don't think that that is a relevant point. We are following a fairly consistent monetary policy at the upper end of the range.

Mr. PATMAN. You say it is not a relevant point whether or not tightening monetary policy sends interest rates up.

Mr. SOLOMON. No. The question was posed, I gathered, that if we were to tighten monetary policy, the country would be in recession. I think Chairman Volcker has explained——

Mr. PATMAN. I think the recession would be the result of the tightened monetary policy, if that results in higher interest rates. Isn't that what he is saying here?

Mr. SOLOMON. From our early exchange, you know my particular views, which is that short-term rates do respond for a period of time, along the lines that you indicated; and Mr. Wojnilower has indicated that in the article. We did not agree on the question of the long end of the market, that it will be swamped by inflationary anticipation considerations. But I think at the short end of the market, for a short period of time, he is correct.

Mr. PATMAN. That interest rates would go up if you tightened monetary policy? What is he correct about? What is he saying that is correct?

Mr. SOLOMON. The tightening that he presumably means has to do with our nonborrowed reserve path. If we feed less reserves to the banking system, and in that sense we usually mean tighten, there is a short-term impact in the Federal funds market—an upward pressure in that market. So in that sense, you are correct, in my view, that a tightened monetary policy, in the sense of feeding in less reserves, tends to be a major factor, but not the only factor, in bringing about a higher Federal funds rate and it has an impact on other short-term interest rates. However, we have very little control, under our monetary policy, over the long end of the market.

Mr. PATMAN. So in the short-term then. But anyway of tightening monetary policy, whether it is by requiring larger reserves or other means, would result in higher interest rates in the short term. Is that true?

Mr. SOLOMON. I think that is true, yes, for a period of time.

Mr. PATMAN. All right. We have talked about lenders charging as much as they can for as long as they can. I think you mentioned that borrowers will pay as little as they can for as long as they can, or at least that is my interpretation of it. I appreciate Mr. Boykin's sentiments that the marketplace is the best place to determine where the interest rates should be. But isn't the Fed interjecting it into that relationship of borrower and lender by getting on the side of the lender and causing these rates to be higher than the borrow-

er would otherwise have to pay, especially in the short term, when it has a tight money policy?

Mr. Roos. I think the Federal Reserve has done more than any other institution involved in this whole issue in helping to bring down interest rates. It has done it by reducing the rate of money growth, thereby bringing down inflation, and thereby long-term rates will be reduced. I think that anyone who accuses the Federal Reserve of artificially stimulating or causing interest rates to rise is mistaken.

Mr. PATMAN. Well, there is something I wanted to comment on there.

With interest rates the highest they have been in the history of this Nation as expressed in real terms, would you feel justifiably the Fed has actually lowered interest rates?

Mr. Roos. I think interest rates are higher than they have ever been because inflation has been higher and more persistent than it has been. People have learned to be skeptical about whether indeed inflation isn't the regular pattern of the economy of this country. And so as long as they feel that way, they are going to adjust their economic decisions accordingly, and this means high interest rates. I don't think that our current policy is responsible for this.

Mr. PATMAN. Would you present us with some further information about this effect of the skepticism of the public and the inflationary expectations of the public, and how that causes higher interest rates in the long run and in our immediate situation, especially in view of the fact that we have very low inflation now, and yet we have a very high real rate of interest, the highest in the history of this Nation still.

We have had that now for some time. It seems aside from keeping your eyes on that monetary aggregate target and so forth, that it would not hurt you to keep an eye on what this is doing to interest rates, the policies on that, and what your interest rates are doing to the economy of the Nation.

Flattening out the economy by putting people out of work and putting factories out of work is not the answer, I don't think.

I will perhaps have an opportunity to talk to you again before this is over.

Mr. McCollum.

Mr. MCCOLLUM. Thank you, Mr. Patman.

Gentleman, I just would like to commend you for your diligence in the work, interest and obvious dedication you have to what I think one of you earlier stated is something most people don't understand on the golf course even when they are in the business of money.

I think coming before us today sometime can be an onerous experience. But I believe you agree most of us up here appreciate it and appreciate your patience.

I have a question of a more technical nature. But it goes, President Corrigan, to the joint statement and the pricing area that was dealt with I think in my absence a little earlier. It is one that I questioned and would like to understand better.

On page 3 of the joint statement you note that the float has been reduced dramatically since the 1980 Monetary Control Act and that "This reduction has increased our payments to the U.S. Treas-

ury by about \$350 million." I think I understand what float is. But for the record, I want to ask three or four questions.

I would like for you to explain what float is, why it is important to reduce it to zero, who benefits from the float and who loses, and how does the reduction of float translate into more money for the U.S. Treasury. That is basically a five-part question, but it all probably comes down to the same thing.

Mr. CORRIGAN. Let me try and tick them off quickly. First of all, there are many different kinds of float. Our concern here is with Federal Reserve float. In a technical sense, Federal Reserve float is checks in the process of collection.

If we credit a bank for a check that is deposited with us before we debit the payor bank, the bank that the check was ultimately drawn on still has the use of that check's money, and thus a float, in the Federal Reserve sense, is created. There are many other types of float as well. And indeed those other types of float, in the aggregate, are a lot bigger than Federal Reserve float.

But it is true that Federal Reserve float has a kind of special interest to us, and indeed to the Congress and to the Treasury, because when we create Federal Reserve float in the way I just described, we in effect end up treating that float as an asset. That is part, I think, of the missing ingredient of Mr. Paul's earlier question. To the extent that float credit is extended in the way I just described goes up, we have to make an offset on our balance sheet. And the offset, at least in a behavioral sense, is: the more float we have, the fewer Treasury securities we hold. The fewer Treasury securities we hold, obviously the less of our income on those securities we can pay back to the Treasury. So when we reduce float from \$4.9 billion to \$1.5 billion, as indicated in the statement, other things being equal, our holdings of Government securities go up by an according amount, and our payments to the Treasury therefore go up by—in round numbers—the \$350 million I referred to. That is kind of what float is, and that is how it bears on the payment to the Treasury.

The other question that you raised was, "Why be bothered about it, who benefits from it? The "why be bothered" I think basically is an efficiency question. Quite apart from whether it is Federal Reserve float or somebody else's float, the mere presence of float is symptomatic of an inefficiency in the payments process. We want the payments process to be as efficient as it can be. Potentially, and at the extreme, it can also even be a source of some risk in the payments process. So from a risk and efficiency point of view, I think it makes sense to have less float rather than more.

Mr. MCCOLLUM. What is the risk you are referring to?

Mr. CORRIGAN. In a very extreme case, if you have checks in the process of collection and a corporation that issued the checks goes bankrupt, who ends up holding the bag? That is one example; there are others like that.

Who benefits? That is a marvelous question. It is extremely difficult from an analytical point of view to answer that question. We do know that, for example, that payments practices that individuals or corporations may follow are in some cases, designed to produce float. But the net benefactor is awfully hard to identify. Is it a bank? Maybe. Is it a customer? Maybe. Which customer? It is very

difficult. And that is why the approach we have taken, in trying to respond to the requirement of the Monetary Control Act about float is to get rid of it. We attempt to eliminate float rather than simply to try and explicitly price it. We feel analytically, given the uncertainties about who really does benefit, that by forcing it out of the system you come closer to getting the incidence where it belongs.

Mr. McCOLLUM. If we could do as good a job in Congress with the broad big picture of getting things under control as you are trying to do with your efficiency housekeeping in the float area, I think we would not have the problem with the interest rates.

I again commend all of you. I appreciate your coming here.

Mr. PATMAN. Mr. Weber.

Mr. WEBER. Let me just get back into the discussion of economic policy. I don't want to belabor the point.

Let me say that I am not one to necessarily give in on that point. I believe that a policy that looks toward the continued growth of Federal spending and reduction in Federal tax rates, reduction in the regulatory burden, and a stable monetary policy is a good one.

The problem is that we don't necessarily have a budget that gives us that kind of a policy. We have got the best budget we could put together, though, that would pass. And the only signal I was receiving back in those budget hearings from the financial community was balance the budget. And some of us did vote for a balanced budget. It failed by 36 votes.

Some of us, a majority of the Congress, have voted for a balanced budget constitutional amendment. And many of us I think have signed a discharge petition to get that brought out on the floor. But we don't see it happening.

What I come back to are the words of Bob Michel a week or so ago, I think that Reaganomics is going to play better than Tiponomics. We have been forced into a situation of having to settle for the best that we could get, which to my way of thinking was the lowest rate of Federal spending, the lowest rate of taxation, the lowest deficit of those budgets that came before us back in June.

With that for the record, let me get back to the problem that we discussed earlier, and I think it really comes back to what Mr. Solomon was discussing. What is the linkage between inflation and unemployment? You know, the American public has a perception, maybe a misperception, that if we only had more inflation, we would have more people at work. Is inflation destructive of jobs or is it constructive of jobs?

Really that is a message I think that has to get to the American public. Could you elaborate again, Mr. Solomon, perhaps take the lead on that question.

Mr. SOLOMON. Well, I think that the history of the last 15 years has shown fairly clearly that the inflationary process so distorts investment decisions as well as consumer spending habits that it tends to set up a situation where periods of recovery are much shorter than they otherwise would be. The history of inflation in other countries shows that to keep employment at relatively high levels, there has to be more and more inflation. There is no such thing based on historical experience and worldwide experience, as 10- or 15-percent inflation over a few years and still maintaining the high employment.

You can get into a situation where, if your short-term consideration is employment levels, if you are worried only about the short-term impact, you have to punch out more money. But you cannot stop at a certain level. You have to keep raising the growth rate more and more. This would be very damaging to the fabric of our society. I cannot imagine over the long run a more serious way of weakening the democratic fabric of the society. That has been shown in other countries as well.

In earlier periods of time, before we permitted monetary and fiscal policy to get so loose, relative to what the objectives were, we did find in the earlier postwar period that we could run fairly sustained levels of relatively full employment with very modest rates of inflation, almost fractional inflation—1.5 percent, most of the first 7 years or so of the 1960's. The initial mistake was made, I think, in President Johnson's administration, in which I served, when he delayed too long in asking for additional tax revenues to finance both the Great Society program and the Vietnam war—you know, the famous guns and butter policy. The situation did not get corrected through a sufficient tightening of monetary and fiscal policy. It then created a wage spiral and inflationary response, and slowly over the years we have had a significant worsening, though it has become a little lessened in the last year, of deeply entrenched habits of how to respond to inflation.

The average citizen, average member of a trade union, average businessman, has certain clear conceptions of just keeping themselves up, not even getting ahead of anybody else, and just keeping up results in a worsening of the inflationary spiral. We have seen the consequences for employment.

So that I myself do not see any alternative if we are looking at, as I think we all should be, the question of what is best for our country over the long run, not simply the next few months. I don't see any alternative but a sense of consistent discipline that applies in the fiscal area as well as the monetary. The financial markets in New York are not expecting a perfectly balanced budget. You can have a modest amount of deficit spending, which increases in recession and decreases in recovery, and still not awaken inflationary expectations. But of course the size of the budget deficit that we are looking forward to, that everybody is expecting, even assuming modest recovery, is very disconcerting. And it is true, as some of my colleagues have said, that that is probably a very major factor in correcting the very stubborn inflationary expectations that have been built up over 15 years, and have been shaken somewhat in the last 2 years. But I am afraid that we have somewhat longer to go.

Mr. WEBER. Thank you.

Mr. PATMAN. Mr. Lowery.

Mr. LOWERY. Thank you, Mr. Chairman.

I will try to synthesize all these questions into one.

I would like each of you to respond.

If you were king for a day, total economic czar, the Chairman of the Federal Reserve Board, the Board of Directors, the President of the United States, the Secretary of Treasury, Director of OMB, and the House and Senate all combined, what specifically would you do to bring interest rates down and improve the economy?

Mr. Boykin.

Mr. BOYKIN. Well, I just never have visualized myself in that role. I will have to think a minute.

I would first of all, and this has been alluded to, vote to bring about a fiscal policy to where we could have the right kind of balance between monetary and fiscal policy. I would recognize that it would take some time for this to translate into real sustainable growth in the economy, and then I would hope I would have some patience and let that work its way through. This would put the country in the kind of environment where we could go forward with some assurance that we would not be encountering these problems in the near term.

Mr. LOWERY. How does that differ from where we are now?

Mr. BOYKIN. Reference has been made to the size of the projected Federal deficit. Chairman Volcker has said that the deficit does make it more difficult for us the larger it is, and places a greater burden on monetary policy.

Mr. LOWERY. So the balance you measure is in terms of the size of the deficit.

Mr. BOYKIN. Basically, yes.

Mr. LOWERY. Mr. Corrigan.

Mr. CORRIGAN. May I just make a quick analytical point. Look at this deficit. Let's not quibble about whose number is right. Let me use around \$150 billion as a point of discussion. A major part of that deficit, of course, reflects the condition of the economy right now. Underneath that there is a structural deficit. It is hard to know exactly which part of the deficit is in fact structural. But again, for purposes of your question, let me assume that it is roughly two-thirds/one-third: the structural, underlying deficit is \$60 or \$70 billion in that area.

Now if I had all those powers that you mentioned, I would cut Government spending by the amount of the structural deficit, whatever it is, just like that. Having done that, I suspect that I would also look for monetary growth targets that would even be a little lower than the ones we have right now, because in a context in which you have really dealt with the deficit problem, I suspect that you might in fact want even a little less money growth than we have ticketed for 1983, right now.

Mr. LOWERY. Mr. Roos.

Mr. ROOS. If I were king for a day, after shipping my wife and children overseas for protection, I would first of all take action to try to achieve monetary growth as presently targeted at the upper ends of our targets for this year. I would reduce that rate of monetary growth by approximately 1 percent in each succeeding year, until it was close to zero. I would reduce Federal spending to the point where the Federal deficit was significantly reduced. I would get on the airwaves and I would tell my subjects that these steps have been taken, that they will not achieve overnight results, but they represent the only and the best future for this country. Then, after pulling the telephone line out of the wall, I would probably walk with Mr. Corrigan to the corner saloon and have a nice evening.

Please don't appoint me king.

Mr. CORRIGAN. Yes, because I would have to go to the saloon with you.

Mr. SOLOMON. We all seem to have fairly orthodox views here. The common denominator here is we don't believe there is a magic fix to get interest rates down. Therefore, as I indicated earlier, I would want to see the Federal deficit reduced to levels whereby in recovery periods it approached balance.

Mr. LOWERY. Could you be more specific as to the level of the Federal deficit?

Mr. SOLOMON. I don't know if the actual level would be significant now. But I would guess that I probably wouldn't differ too much from Mr. Corrigan's views, that possibly one-third is structural, in the sense that in a recovery period the remaining two-thirds would be eliminated just by the recovery of the economy. I don't think the fine-tuning is as important as the psychological impact, which would be enormous, absolutely enormous, if people had confidence in this—that it would work.

However, I am not sure that I would reduce the monetary targets. I would want to look at that carefully. I certainly think it would deserve some careful consideration, the possibility of some further modest reduction. But I would not want to do that in an automatic way. There is a difference of view, as you gather, between Mr. Roos and myself on an approach such as that. Although we both share the view that excessive money growth does complicate our problems.

Having said all that, I would do something which is somewhat less orthodox, which is that I would then invite to a conference, if I could get a consensus in these areas which I think are the critical areas, the key labor and business leaders, because I think some of the pains of the disinflation process would be substantially reduced if one did have cooperation from labor on wage restraint. You would have more employment. There is no question about it. And if labor were convinced that this was an overall comprehensive program for the economy to recover, not just for interest rates to come down, but for higher employment levels, there might be sufficient credibility in such a program to enlist their cooperation. That has been done successfully in other countries.

After all, Japan and Germany basically run a very successful program of getting labor cooperation, because labor in those countries is convinced that fiscal and monetary policy will move in the same direction on the whole. There are periods of time when that is not true, but on the whole, there is a sense of confidence there. I think that that helps enormously in the process. So I would use all those methods.

I think the main proposals of a program which is designed to achieve what you are implying, by lowered interest rates, namely higher levels of investment and economic activity—all require a more stable price system.

Mr. LOWERY. Mr. Morris.

Mr. MORRIS. If you still want another king's judgment, I think quite clearly what this country needs is a strong investment boom so that we can increase productivity and increase the real income of the American people. The average American citizen has seen his real income on a treadmill now for 10 years. To do this we need to

do two things. First, we need to get the cost of capital down, by that I mean the cost of equity capital and the cost of long-term debt capital. To do this, we need to continue to follow a restrictive monetary policy, one that gives confidence to the long-term investor that his investments are not going to be eroded by inflation in the future. We also need to reduce the share of the savings pool being absorbed by the U.S. Government.

So I would choose to get about a \$100 billion reduction in the deficit for the next fiscal year. I would try to get half of that out of the expenditure side. To do that you have to go where the money is, and the money is not in programs for the poor people of this country—that has been pretty well gone over by this Congress, it is in the entitlement programs for the middle class, and the military budget. It seems to me that Congress has got to face up to the problems of social security and related entitlement systems, not for the poor, but for the middle class.

The other half I would get out of a tax increase oriented in a way which would not reduce the incentives for savings and investment. In this sense, you can call me a supply-sider I suppose. So I might want to take a look at a value-added tax and/or a tax on imported oil to find the other \$50 billion.

Mr. LOWERY. Thank you, gentlemen, very much, for your thought-provoking testimony.

Thank you, Mr. Chairman.

Mr. PATMAN. Thank you.

Mr. Weber brought up a good topic, and that is the balanced budget amendment. I certainly appreciate Mr. Weber's sentiments about the Reaganomics. I would like to see it work very well, and the supply-side economic theory work very well.

I just don't want them to slide off into Reaganmortis.

Tell me, do you support the balanced budget amendment?

Mr. CORRIGAN. Conceptually, in this very difficult situation we are facing. One has to, I suppose, find a certain attraction for the concept. But once you get beyond the concept, I will confess to some uneasiness about it, and the uneasiness I have come on two fronts. One is that under the best of circumstances, it would take some time to get it done, and therefore it could become an excuse for not doing anything in the meantime and that is a danger. That I think is something that we have to guard against almost at all costs.

The second source of uneasiness I would have is that we want, I think, something like that to at least have a measure of flexibility built into it, because, as I think Mr. Solomon has said very eloquently, there is no such thing as a right budget number for every year. You have to take account of the economy and other things. Thus you need flexibility. But in an effort to build in flexibility, do you construct a balanced budget amendment that is transparently not going to work?

Now, in the current version I believe the effort to get flexibility has been couched in terms of I think the 60-percent override rule. At least that is the last version I saw. I don't know if that achieves the flexibility goal, it could. But I suspect that it also entails some risk in terms of achieving it in a way that won't produce the bottom line result that we are after.

Mr. PATMAN. That will affect your monetary policy in the Fed, will it not—the balanced budget amendment.

Mr. CORRIGAN. I don't think it would be fair to say it would affect it in a direct way, that it would necessarily produce an overt change in monetary policy. If you produce a balanced budget through whatever device. I think, for example, in that setting, you would see a very substantial prospect for falling long-term interest rates. So monetary policy in some sense could look quite different. But I don't think it necessarily has to follow that the core and essence of policy would necessarily be different.

Mr. PATMAN. Anyone else care to make a comment for or against the balanced budget amendment?

Well, we have talked about the monetary aggregates in the marketplace, and interest rates, and you are thinking about whether injecting sums of money into the money supply available to the public will cause higher interest rates in the long term and short term. My concern is we just seem to be in a situation where the Fed is going to find some excuse for keeping interest rates high, regardless of—whether it is because we have inflation or whether it is because we have large deficits or something of that type—are there going to be some strong incentives for the Fed to bring interest rates down?

Or do you just feel like it is completely out of your control, even though you are tinkering with this money supply all the time?

Mr. ROOS. I think the record has shown the current Fed policy has significantly brought interest rates down. If we stick by the broad policies to which we are presently dedicated, I would think that long-term interest rates would continue to decline.

Mr. PATMAN. You are speaking about nominal interest rates, or the interest rates that the consumers pay, but not the real interest rates.

Mr. ROOS. I think the nominal and real interest rates would all be reduced accordingly. I think real interest rates will come down even more when the credibility of monetary policy supplemented by a credible fiscal policy sinks into the public.

But basically, I think, Mr. Patman, that possibly you are underestimating the significant progress that has occurred in recent months in a reduction in interest rates. I think if we continue the course we are on, those rates will not only stay down, but they will decline even more.

Mr. PATMAN. Is a large part of that a result of our having a very significant economy at this point, as Mr. Wojnilower states—likely to slide off into a depression if the interest rates go back up because of the Fed's tight money policies, or as he says, "If we revert to the kind of monetary policy that prevailed prior to midyear, there will be a depression sooner rather than later."

He says also it is no longer altogether certain that a moderate business upturn can provide enough lift to forestall a cascade of bankruptcies.

Do you feel those conditions are the result in part of the Federal policy or completely outside?

Mr. CORRIGAN. Those conditions, unfortunately, Mr. Patman, are one of the very, very insidious results of a 15-year period of inflation. The phenomenon that I believe Mr. Wojnilower is referring

to, for example, in terms of some liquidity strains that problem we see in businesses—a very sizable part of that is indeed the result of a process over a long period of time in which it was so easy for people and businesses to borrow, to leverage up. Because as as that inflation was there, and as long as that inflation was accelerating, they could simply paper over their mistakes with higher prices.

Now, there is unquestionably a corrective process associated with all that. But it is not something that would go away in the context of more inflation. Indeed it would get worse.

Mr. PATMAN. There is a concern of the banks lending money to foreign governments by charging their good customers higher interest in order to make up the money for the bad loans. Is that possible?

Mr. SOLOMON. I don't think so, Mr. Chairman. The situation has been characterized by very intense competition among banks all around the world to lend to countries that had a need of resorting to the capital markets.

Mr. PATMAN. For which they could also make substantial profits?

Mr. SOLOMON. Definitely, no question about it. The fact that some of these loans are in difficulty pending those countries straightening out their finances has not, in my opinion, resulted in higher spreads to domestic borrowers. Typically, we look very carefully at the spread between the cost of funds to the banks and the average rate at which they are lending. The prime rate is not a good guide in today's markets. If you look at the actual spread, you will see that it has tended down for a couple of years, and has gone up in the last few months somewhat. But that still tends to be on the average somewhere in the neighborhood of 200 to 250 basis points, which covers various costs as well as profit.

I don't see any evidence at this time in the behavior of the spread that would tend to substantiate or support that statement that you quoted from.

Mr. PATMAN. Of course part of their cost of borrowed funds, or part of their expenses of operation would be the balance they have to charge off.

Mr. SOLOMON. That implies a cartel-like approach which I don't think is really feasible in today's climate. We have 14,000 banks in this country, and many of them would like to expand their loan portfolio if they had customers who could afford to pay their rates. The rates are more in relation to the cost of funds, and at least so far we have not seen any evidence of the domestic interest rate spread rising because of the trouble in the foreign area.

Mr. PATMAN. Were the high interest rates charged these borrowers, like Poland and Mexico, contributing factors to the subsequent poor quality of the loans?

Mr. SOLOMON. Those foreign countries who were considered top creditworthy, didn't pay any more money than domestic borrowers would. Money is fungible, and when there is a 20-basis-point movement in our markets, you will see that reflected in the Eurodollar markets.

Mr. PATMAN. A lot of people feel rates they have been charged here have been pretty punitive. As witness people trying to run International Harvester, Chrysler, some of these other companies, that are practically on the ropes now.

Mr. SOLOMON. Correct. That has to do with the general conditions we have talked about.

Mr. PATMAN. Maybe those folks have been just too critical of the situation. There is a widespread belief among the business community that rates have been very high.

Mr. SOLOMON. I think they have been high.

Mr. PATMAN. What you are saying is these folks overseas, like Poland and Mexico, just pay the same rates everyone else pays.

Mr. SOLOMON. Correct. But what we see is that with countries, just like domestic borrowers, weaker foreign borrowers have to pay higher spreads—whereas the very creditworthy borrowers abroad, like the creditworthy borrowers here, get the advantage of a lower spread.

Mr. PATMAN. Thank you very much.

We will ask unanimous consent that the record remain open in order that members can pose questions in writing to the panel.

I will forego any questions I have if you are satisfied you have expressed all your thoughts to the committee you would like to express at this time.

Mr. SOLOMON. We have had a very fair hearing. Thank you, sir.

Mr. PATMAN. Thank you very much.

[Whereupon, at 1:30 p.m., the subcommittee was adjourned.]

[The following letter, dated October 7, 1982, was received for inclusion in the record from witness Frank E. Morris:]

FEDERAL RESERVE BANK
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October 7, 1982

The Honorable Walter E. Fauntroy
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Finance and
Urban Affairs, Room 109
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Among the questions you asked be discussed at the September 23 hearings was the Bank's involvement with community...activities," including "work training (and) upward mobility programs."

As Chairman of the Tri-Lateral Council on Quality Education and Vice Chairman of the Boston Private Industry Council, I have been part of a group of business and university leaders working with the Boston Schools Superintendent on a program to improve the city's high schools and assure jobs for qualified school graduates.

I thought you might be interested in the enclosed articles from The Boston Globe and the Christian Science Monitor describing the fruit of our efforts.

Under the terms of the Boston Compact the leaders of the business community agree to sign up 200 firms, each of which will agree to set aside a portion of their available entry-level jobs for prepared high school graduates; the school leadership, in turn, pledges to prepare young people for those jobs as part of a broad high school improvement effort. We expect many of the jobs will also include opportunities for further education.

If you or your staff want further information, please let me know.

Sincerely yours,



Frank E. Morris

Enclosure

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The Boston Compact

The announcement yesterday of ratification of the Boston Compact — an agreement between Boston's public schools and leaders of Boston's business community designed to improve the performance of the school system and to foster the hiring of graduates of that system — is as good a piece of news as the city has received in some time.

The agreement commits the school system to making systematic and measurable improvement in its high schools in attendance, graduation rates and basic achievement scores and to report regularly on its progress school by school.

The agreement signals to students in Boston's high schools that regular attendance, reasonable achievement and graduation will be rewarded; it promises students that if they perform in high school they will be given priority in the filling of entry-level jobs in Boston businesses that have a career ladder.

Perhaps the most notable aspect of the agreement, however, is that it broadens and strengthens the constituency for public education in the city.

With the signing of the Compact, the business community, at least nominally involved in the schools since the onset of desegregation, has substantially increased its participation. That is not purely altruistic. Demographic changes are reducing the number of young workers and that makes it imperative for employers that all who join the work force have the skills necessary to perform entry-level jobs. If business can define the skills it needs and the schools can in turn graduate students capable of acquiring them, employers will be the beneficiaries.

Universities in the city, notably UMass and Boston University, have signaled, by working on the design of the Compact, that they will participate constructively in efforts to upgrade the system.

The city itself is a party to the compact. At

7:30 tonight, Mayor White is scheduled to speak to the annual meeting of the Citywide Education Coalition at the Kennedy Library. He will presumably use the occasion to affirm his support for the schools, support he signalled recently by sponsoring a \$6-million supplemental appropriation for the system.

All this is terribly important. As public school enrollment has declined, as the public schools have become increasing the schools of children of poor and near-poor families, the threat that the schools might be effectively abandoned has mounted. Now, however, they have major institutional allies.

Almost three years ago, at his inauguration, White made what seemed to some at the time an impossible pledge. He proposed to guarantee a job to every graduate of Boston's public high schools who wanted one, in fact in a labor market that has about 25,000 young workers, the redeeming of that pledge to the 1000 or so public high school graduates who seek work each year is not impossible. The Boston Compact provides the mechanism which could make it a reality in the next several years.

Further, a broad-based commitment to the schools enhances the prospect that the quality of education offered by the schools will improve for all students, including those bound for college, and that a whole new spirit could pervade the beleaguered public schools. The fact that the mayor and business leaders are willing to join hands with the schools suggests that they have new confidence in the system.

An historic obligation of all cities, including Boston, has been to provide an environment for social mobility, to provide widening vistas of opportunity for those in the lower economic strata of society, improvement of the public schools is essential if Boston is to continue to meet that obligation. The Boston Compact represents a substantial opportunity to make the required improvement.

Job compact seeks to aid graduates in Boston

By Muriel Cohen
Globe Staff

Boston business and political leaders and officials of the city's troubled school system yesterday announced an agreement to provide jobs as an incentive for students to stay in school.

The agreement also involves the spending of \$3.5 million to improve the quality of public education in the city.

Called the "Boston Compact," the plan harnesses commitments made by the city, the School Department, area colleges and universities, cultural agencies and leading banks and business firms to help the thousands of the nation's least advantaged high school students.

Parties to the compact, announced at a press conference at the School Department yesterday, include:

- A 3-percent increase each year in the number of graduates who are placed in jobs or continue their education.

- A 5-percent increase each year in the number of students graduating from Boston high schools.

- By 1986 all Boston high school seniors will achieve minimum competency in reading and math needed for competency in the next grade.

Presently, only 60 percent of the School Department's high school seniors achieve these goals.

At the press conference, Mayor Kevin H. White's appearance at

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A 'compact' to provide jobs to Boston graduates

■ COMPACT

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a School Department hearing room signaled a new amity between City Hall and the School Department, groups that have battled over school spending for three years.

White is expected to elaborate on his views regarding relations between the city and the School Department at a speech tonight at the Kennedy Library.

White was the leadoff speaker at yesterday's conference.

Other speakers were John LaWare, chairman and chief executive officer of the Shawmut Bank; William Edgerly, chairman and chief executive officer of the State Street Bank and Trust Co.; Boston University president John R. Silber and School Committee President Jean Sullivan McKelue.

LaWare identified the key to the business commitment as a promise to set

aside a percentage of entry-level jobs — clerical and computer programming slots, for example — for Boston high school graduates. The business community expects to recruit 200 firms to join in the job-placement effort, LaWare said.

For the School Department's part of the pact, Spillane said, high schools will be required to produce annual reports detailing student attendance, achievement and placement.

In addition, the department will evaluate high school headmasters on the basis of their achievement of prescribed goals and their cooperation with the range of agencies offering services to the schools.

The compact also specified Spillane's intention to "seek agreement with the Boston Teachers Union on contract modifications which reflect the reality of the school system, provide stability for teachers and focus on direct educational benefits."

The department has set aside \$3.5 mil-

lion to initiate the compact goals, starting with appointment of a coordinator at \$24,000 a year and a placement specialist at the Humphrey Center at \$30,000.

Plans call for hiring attendance clerks in all high schools at a total cost of \$240,000 and two additional teachers to expand an existing Job Collaborative program from three to five high schools.

Immediate goals for business members of the compact include signing up 200 employers, providing jobs for 400 graduates next June and stepping up the city's summer jobs program by at least 33 percent.

Sponsors of the compact said the proposal would require a broad-based and flexible organizational structure to shift the plan from paper to reality.

That document cited reasons for failure of past collaborative efforts. The planners noted the weaknesses of "top-down planning that does not involve the teachers and administrators," failure to ana-

lyze and build upon prior or existing reform efforts, "inadequate understanding of the overall political and cultural environment of the system" and failure to implement educational strategies that have proved successful elsewhere.

The compact's planning group established task forces to work on each of 10 areas in which schools, businesses, colleges and universities and cultural and other agencies can help the schools: counseling, alternative education, remedial education, the arts, athletics, curriculum development, career and vocational education, computer literacy, research and evaluation and school-management assistance.

"For the first time, we have a critical mass of people who are willing to help," said William Spring, head of the Tripartite Task Force, a coalition of local businesses that has been working with Boston schools for several years.



SUPT. SPILLANE

"... a chance for a job out there"