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Statement of

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Vice Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

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Chairman Shelby, Senator Sarbanes, and members of the Committee, I am pleased to appear before you today as President Bush's nominee to serve as Vice Chairman of the Board of Governors of the Federal Reserve System. I am honored that the President has nominated me to serve a second term in that capacity. I thank you for holding this hearing.

It has been my privilege to serve our fellow citizens as a member of the Federal Reserve Board since 1997 and as Vice Chairman since 1999. I have given this role my undivided attention, and I hope to be able to continue in that service. The policy decisions of the Federal Reserve influence the economic well-being of all Americans. During my tenure, we have faced challenges in many of our areas of responsibility, and I would like to review briefly some of those developments and our responses to them.

Congress has given the Federal Reserve three monetary policy objectives: maximum employment, stable prices and moderate long-term interest rates. We have viewed these objectives as congruent with a goal of maximum sustainable growth that can occur only in the context of long-run price stability. Fostering financial conditions in which Americans can realize their full potential has presented a number of challenges in recent years. The impressive step-up in the advance of technological and organizational efficiencies and a rapid accumulation of physical capital in the late 1990s have been the key factors affecting our economy's performance in the past decade. These developments have made workers increasingly productive. But faster productivity growth, despite its long-term benefits, has not insulated the economy from cyclical swings. The sharp reevaluation that occurred in equity markets and the retrenchment in business investment and spending that occurred over the past several years--together with the effects of terrorist attacks, wars, and corporate scandals--battered the confidence of households and businesses. In response, the Federal Reserve made substantial adjustments to its policy interest rate in order to cushion the effects of these developments on the broader economy. Other forces--

particularly the growing interconnectedness of the global economy--have been important background factors in setting monetary policy. Of late, policymakers have been mindful of the virtual eradication of inflation and their need to set policy so that the economy remains in the zone of price stability. But all of our policy changes have been undertaken in pursuit of maximum sustainable growth and stable prices.

Making monetary policy has been only part of the challenge. During my tenure at the Federal Reserve, we have also worked diligently to communicate to the public what we are doing and why. Transparency in policymaking is a key part of the democratic process and fosters efficient decisionmaking in the private sector. Becoming more transparent has been an important goal of the central bank in recent years, keeping in mind that we must balance being open and accountable with the need to maintain an effective process of decisionmaking by the Federal Open Market Committee. Transparency requires that we periodically review our procedures, as we did in 1999 and again last month, to ensure that they appropriately balance these considerations. I do not know what future changes, if any, might be called for in how we communicate, but I am confident that the Federal Reserve will continue to look for ways to communicate and explain our policies clearly.

While macroeconomic conditions are of central importance, the role of the Federal Reserve is broader than monetary policy. Financial stability is an essential precondition for maintaining a strong economy, and the Federal Reserve played a key role in maintaining financial and economic stability in the aftermath of the terrorist attacks on September 11, 2001. As the only Board member in Washington, D.C., on that day, I had responsibility for overseeing the Federal Reserve System's response to the terrorist attacks. Working with many able colleagues in the System, the U.S. government and the private sector, we at the Federal Reserve responded effectively to the attacks. By providing ample liquidity and reassuring the public and the banking community, we helped our financial markets and the supporting infrastructure recover very quickly. Since that terrible day, I have done all in my power to enhance the resilience of the financial system of the United States, and I pledge to continue to work on these issues in the years ahead.

The Federal Reserve executes its important financial stability responsibilities in less stressful times through its role in supervising and regulating our nation's banking system. The Federal Reserve and other regulators must foster a competitive environment that will benefit the users of financial services, while also promoting safety and soundness. I believe that we should achieve these objectives with a minimum of regulatory burden and without leaving the impression that any institution is too big to fail. Currently, we face the challenge of meeting these goals by developing a new capital accord to apply to the largest, most complex internationally active institutions. As I have testified before this Committee, the existing accord no longer suffices for these institutions. Now we need to work with our financial institutions and other regulators to replace the existing accord with a new one that is more risk-sensitive, builds on advances in risk measurement and management, and provides proper incentives. And we must do so without unnecessary complexity and without creating undesirable competitive imbalances or other unintended consequences.

Technology and deregulation have encouraged consolidation in the financial sector. With central bank and treasury officials from twelve other major industrial economies, I have reviewed the likely effects of the global trend toward consolidation and its implications for central banks and regulators. Because financial systems will continue to consolidate, the regulatory community needs to monitor developments closely. But our study also found that existing policies appear adequate to allow regulators to maintain safe and sound financial industries now and in the intermediate term. This is true both for financial stability and for the maintenance of markets through which monetary policy can continue to work using the same mechanisms as in the past.

Lastly, our payment system is a real presence in the economic lives of every consumer and business. This system too has been, and will continue to be, changed greatly by emerging technologies. From its very founding, the Federal Reserve has had the responsibility to foster an efficient, safe and accessible payment system. In a dynamic economy, markets appropriately play the key role in guiding the development of the payments infrastructure. This means that innovation and competition will be central to the future development of the payment system--as they are in other areas of the economy. Regulators and Congress should strive to remove barriers to innovation when we can do so without sacrificing important public policy objectives. I have been privileged to work with this Committee on one such initiative, the Check Truncation Act, or Check 21. This legislation removes a legal impediment and should, over time, foster greater use of electronics in the check-clearing process while also preserving the right of consumers and banks to receive paper checks. Ultimately, Check 21 should allow depository institutions to provide new and beneficial services to their customers. I look forward, as I know you do, to its prompt enactment. And I thank the Committee and its staff for the strong support you have provided.

Mr. Chairman and members of the Committee, during my years on the Board of Governors, I have done my best to contribute positively to all aspects of the Federal Reserve's many responsibilities. I look forward to the opportunity to continue to work with you and serve the nation as Vice Chairman of the Board of Governors. Thank you for your attention and for considering my nomination. I would be pleased to answer any questions.