Statement by

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Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

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Mr Chairman and members of the Committee I would like to begin by expressing my appreciation to President Clinton for nominating me for another term as Chairman of the Board of Governors of the Federal Reserve System I am honored at the confidence he has shown in me and pledge to him, to you, and to the American people that if I am confirmed I will continue to do my best to merit that confidence

I also want to thank you, Mr Chairman, for scheduling this hearing so expeditiously I like to think that I have had a good, productive relationship with this Committee and the Congress during my tenure at the Federal Reserve If you and the Senate chose to confirm my nomination, I intend to continue to work closely with you and your colleagues in both houses on the many issues confronting our financial system and our economy

As you know, I have come before you frequently to discuss a variety of specific issues related to the conduct of monetary policy and to banking and financial markets I thought it appropriate on this occasion to step back from day-to-day concerns and take a bit of a longer view of the forces, especially the evidently more rapid pace of technological change and innovation, that will affect how the Federal Reserve carries out its legislative mandates over the years ahead

Last month, my testimony was concentrated on the impact of these forces on the economy Today I want to address their effects on the Federal Reserve in three main areas of responsibility--supervision and regulation of banks, stewardship of the payments system and monetary policy

The way we supervise financial institutions is an area in
which technology is both creating problems and simultaneously
giving us and the institutions we supervise the tools to solve
them   New instruments and changing business practices have made
obsolete in many respects our previous emphasis on balance sheets
in examinations   A generation ago, a month old balance sheet was
fairly indicative of the current state of an institution   Today,
owing to the proliferation of transactions, a day old balance
sheet can be obsolete   Moreover, much of what is important for
the health of an institution never finds its way onto the balance
sheet, except ultimately through its bottom line effect on
capital   Accordingly, banks and other intermediaries are relying
increasingly on statistical models to measure and manage risk
By monitoring these models and by using them to test for
vulnerabilities, the Federal Reserve can leverage off of this
trend to enhance our own capabilities to ensure a safe and sound
banking system

Ultimately, the smooth functioning of our financial mar-
kets and economy rests on the payments system   Congress
recognized this when it created the Federal Reserve, making
improvements to the payments system one of our preeminent
tasks in 1913   We haven't lost sight of that objective, but
it has been complicated by the speed and volume of transac-
tions within the United States and between the United States and
other countries   Because large shocks can be transmitted rapidly

around the world, a breakdown in the payments system anywhere can have adverse effects on the United States

Here again, technology is being harnessed to reduce the risk of a breakdown, especially by shortening the time that passes between when a transaction is initiated and when it is settled Events occurring in that period that prevent the completion of the transaction can threaten the stability of the financial system We have been able to reduce the interval between initiating and finalizing many types of securities transactions, and I expect that reducing it further will be a high priority in years to come Ideally we seek a system in which a transaction would be settled when it was initiated Facilities to do that, however, are costly Sometimes it is better to accept a minor system risk owing to float, than to invest in resources required to eliminate it Fortunately, technology is rapidly reducing costs, perhaps enabling the real world to approach more closely the ideal

We in the United States have a special responsibility, since the dollar is the world's leading currency, and a breakdown in dollar payments would have repercussions far beyond our borders as well as at home Maintaining the key role of the dollar is important to American growth and standards of living Because foreigners want to invest in dollar securities, our markets are more liquid and our interest rates are lower than they otherwise would be Because foreigners are willing to hold vast amounts of

U S currency, the interest costs of funding the U S government debt is reduced by $10 to $15 billion yearly

A sound payments system is only one of our responsibilities as the central bank for the world's leading currency   Just as essential is a sound currency--one whose value is not eroding significantly or erratically   But price stability is not an objective you have given monetary policy just to satisfy international investors   Rather, the fundamental reason for this goal is that its fulfillment is an essential element in enabling the economy to reach its full potential

A challenge we at the Federal Reserve face, as we have discussed on a number of occasions, is to assess how innovation and technical change are affecting the workings of the economy and its response to monetary policy actions   Indeed, technological change has begun to be felt at the very beginning of the policy implementation process, enabling depositories to avoid holding noninterest-earning required reserves and shrinking the reserve base through which we work, we are looking at how we may have to adapt to this development

Change always presents problems   Nonetheless, I look forward to the opportunity, if you confirm my nomination, to continue to work with you, the President, and my colleagues at the Federal Reserve to help the American people realize the full benefits our innovative and entrepreneurial spirit can bestow