THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

HEARING

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

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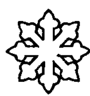

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THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

THURSDAY, OCTOBER 7, 1993

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

The committee met, pursuant to notice, at 9:41 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the committee] presiding.

Present: Chairman Gonzalez, Representatives Neal, Schumer, Frank, Kennedy, Flake, Mfume, Klein, Gutierrez, Rush, Barrett, Wynn, Watt, Dooley, Klink, Leach, McCollum, McCandless, Thomas, Johnson, Pryce, Knollenberg, and Huffington.

The CHAIRMAN. The committee will please come to order.

Today, after 80 years following the passage of the Federal Reserve Act, the committee begins the first of a series of hearings on the Federal Reserve System reform. This is not a new subject. The Congress reorganized the Federal Reserve in 1935 at the time the fundamental 1935 Banking Act was approved. And, of course, the Banking Committee has had important hearings on this subject in the 1930's and in 1964.

The 1935 reorganization occurred after the Federal Reserve miserably failed to carry out its initial function of being the "lender of last resort" to failing banks. In the early 1930's, as one-third of the commercial banks failed or were merged because of bank runs that drained their cash reserves, the Federal Reserve stood idly by and let the money supply collapse by one-third. The Federal Reserve's inaction turned a serious recession into our country's worst depression.

Power to manage the money supply was put in the hands of the Federal Open Market Committee, composed of about 12 members. Five of the FOMC members are private citizens serving as presidents of the Federal Reserve Banks. The presidents are selected by their individual bank's board of directors, two-thirds of whom are voted into office by the member commercial banks in each district.

Testifying before the House Banking Committee on April 13, 1938, Federal Reserve Chairman Marriner S. Eccles was probably the last truly uncompromised Federal Reserve Chairman, who served as Chairman for over 13 years until 1948, the most critical in our Nation's history, and he repeated his strong convictions.

He thought that the 1935 reorganization of the Federal Reserve was seriously incomplete as long as private citizen Federal Reserve Bank presidents voted on the Nation's money supply.

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He said, and I am going to quote—and I would suggest to my colleagues that they borrow from the Library of Congress Marriner Eccles' memoirs and see, if just given the dates change and the penalty, if it is not the same thing all over again. And I am going to quote now: "As I have said before, I am in favor of placing Open Market Committee's functions with the Board of Governors, which is a public body appointed by the President and confirmed by the Senate, to represent the public interest. I do not wish to imply that the bank representatives are less conscientious than the Board members or that they do not act in good faith with the best of intentions. But since they are presidents of the Reserve banks and are elected by the directors of those banks, two-thirds of whom are, in turn, elected by the member banks, their viewpoint necessarily is likely to reflect that of member banks. I feel that a committee which is entrusted with the monetary policies as important as those given to this committee should consist entirely of persons representing the public interest," end of quote.

To illustrate Federal Reserve Chairman Eccles' point, that the Federal Reserve Bank presidents represented banking interests and not the public interest one has only to look at the pool of bankers and their friends from which nearly all Federal Reserve Bank presidents have been drawn. There has been only one woman and no minority bank presidents in the Federal Reserve System's 80-year history. I want to take the "bankers and their friends" sign off the door to this exclusive club and open it up to all competent Americans.

Since Federal Reserve Chairman Marriner Eccles spoke, the FOMC, including these private citizen Federal Reserve presidents, greatly expanded their authority.

For example, in 1962, the FOMC gave itself authority to intervene in foreign exchange markets to manage the foreign value of the U.S. dollar. At FOMC meetings in 1962, the Vice Chairman of the Federal Reserve, J.L. Robertson, criticized the Federal Reserve's actions, saying that its main advantage was to give the Federal Reserve an "unlimited pocketbook." Limited funds had been appropriated by Congress for intervention purposes and placed with the Exchange Stabilization Fund in the Treasury. FOMC minutes of February 13, 1962, page 62, reflect this transaction. Today that so-called SWAP fund amounts to $30.1 billion.

And in the Treasury-Federal Reserve accord of March 3, 1951, the U.S. Treasury relinquished its authority to manage the money supply. The Federal Reserve was given complete and sole authority to manage the Nation's money supply.

Believe it or not, these 12 people on the FOMC Committee, whom we entrust with these functions crucial to the economic health of our Nation, decided in 1976 to stop taking minutes of their meetings so the American public would not know what they are discussing.

I want to thank a substantial number of my colleagues that have become cosponsors of my bill and also members of this committee. My legislation, H.R. 28, will require the 12 Federal Reserve presidents who serve, 5 at a time, on the FOMC, to be nominated by the President and confirmed by the Senate. This will enable the

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public to learn just who it is that is making decisions on monetary policy.

H.R. 28 would also require a record to be kept of FOMC meetings that would be made public within 60 days and release of information on policy changes within 1 week.

H.R. 28 also allows the GAO to investigate the FED's massive interventions in foreign currency markets and daily open market auctions to see if these operations are efficient and secure from leaks of inside information.

The power of the Federal Reserve to operate without public scrutiny and accountability is evidenced in its expenditures. Because it is not subject to the same scrutiny as those agencies that use budgeted funds, the Federal Reserve makes its own rules, some of which involve expenditures that would be illegal for budgeted funds.

For example: One, the Federal Reserve spent $346,000 buying individual memberships in private organizations for many of its employees in 1990, expenditures that are illegal for budgeted funds. Federal Reserve Chairman Alan Greenspan refused to comply with my request for a listing of memberships for 1992 and 1993. Chairman Greenspan wrote to me on September 15, 1993, that since he is changing the policy, quote, "a new survey would not be useful and would not justify the cost of collecting the information," end of quote.

Two, the Federal Reserve tells me that although it employs a large army of 730 professionals (more than 450 economists alone, statisticians, research assistants) in its research departments in 1993—it still needs to spend nearly $100,000 a month to pay for outside economists mostly drawn from academia.

Sixty-seven economists received 82 contracts from the Federal Reserve from 1991 to mid-1993 for more than $10,000 each for a total of $2.3 million. This expense does not cover total research costs, which I would like Chairman Greenspan to reveal to us when he comes before the committee next week on Wednesday, October 13.

It is interesting to speculate why the Federal Reserve keeps these outside economic consultants on its payroll. Nobel Laureate Economist Milton Friedman, commenting on these practices, has said that the Federal Reserve is trying to buy off, quote, "its most likely critics" and that few among the academic community are prepared to criticize the Federal Reserve.

H.R. 28 would require an independent audit of the FED's budget so that in the future the Federal Reserve could not refuse the Congress' request for information about its spending habits. With the new administration calling for a streamlined, efficient government, it is essential that all government agencies indicate where the fat is and what part of that could be cut.

The changes I am proposing to the Federal Reserve System are quite modest. There is nothing to fear. I am not seeking to politicize the central bank nor take away its independence. I am not calling for policies that would cause inflation or deflation. My legislation does not require the Federal Reserve to set any particular monetary targets, nor is Congress required to micromanage the central bank. Rather, I am only asking that the central bank be accountable to the American public and abide by the Constitution of

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the United States by requiring those who manage our money supply to present their credentials in Senate confirmation hearings.

I look forward to the testimony of our esteemed panel of witnesses on their ideas for making our central bank more accountable to the Nation it serves. We are honored to begin this series of hearings on Federal Reserve reform with the distinguished panel that we have here before us this morning.

The fact is that I must report that Congressman Lee Hamilton has been called to the White House and, for that reason, is not here at this time.

[The prepared statements of Mr. Hamilton, Ms. Roybal-Allard, and Mr. Gutierrez can be found in the appendix.]

The CHAIRMAN. As you can see, we have a distinguished array of Members, including our colleagues from the Senate here this morning. I want to thank each and every one of you in advance.

Also, I am very happy to see the very smiling face of our former chairman of this committee, Henry Reuss. He was aboard when I first came to the Congress 32 years ago and was, at that time, chairman of the Subcommittee on International Finance. And I remember, as if it were today, his expertise in that area.

With that, I recognize Mr. Leach.

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

Mr. LEACH. Thank you, Mr. Chairman. I apologize; but on behalf of the minority, at risk of presumption, I do have a statement that I would like to read quickly.

Few institutional issues are more fraught with real and perceived problems than those relating to the structure and accountability of the Federal Reserve System.

In the context of today's hearings, it should be clear that what is at stake is change, not necessarily reform, modest tinkering, not radical reorganization.

Since its inception, the Fed, in effect, has become a quasi-fourth branch of government with authority largely delegated to it by the first branch—the legislature—on the assumption that there are aspects of monetary policy and financial services regulation that demand independent, consistent, and professional attention that a legislative branch of political generalists is not, by nature, equipped to provide.

At this time, the Federal Reserve System is well led and well respected; its leadership as well as sheer existence has provided an anchor of financial stability in a time of economic uncertainty and worldwide disequilibrium.

When we look at things that might have gone disastrously askew with the economy over the last several decades, it is apparent that there are a lot of dogs that did not bite and lot of bites that did not prove contagious, in part because of Fed leadership.

One can make a powerful case that a system that is not broken should not be fixed. On the other hand, one can also credibly suggest that the best time to make modest adjustments in policy and structural arrangements is when crises are not at hand. My sense is that Congress should be chary about pushing radical change at the Fed at any time but should be open to periodically considering modest changes.

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Basically, the Federal Reserve has two responsibilities: One is monetary policy, the other is bank regulation, with attendant safety net concerns for individual institutions and the economy at large.

Regarding monetary policy, there is an unseemly dimension to the fact that open market decisions affecting interest rates are made in part by individuals who are neither chosen by the executive nor confirmed by the legislature. But like all circumstances, there is an implicit counterbalancing positive: Regional Federal Reserve Bank presidents represent the best of decentralized public leadership. While our regional Fed Reserve Bank presidents are public employees, because of their manner of selection, they provide the Federal Government at a very high level a unique private/public partnership which in political science terms may be awkward but which through experience has generally proven to be both ethical and effective.

There are two principal approaches on the table affecting open market decisions—one involves senatorial confirmation, and the other involves giving more authority to current members of the Federal Reserve Board in Washington by simply withdrawing the right to vote—although not necessarily participation in meetings—of regional Fed presidents.

Of these two approaches, my instinctive preference is for the second. But I am not convinced of the need in the first place to establish a new institutional arrangement.

On the issue of transparency, the case for modest increase in openness appears reasonable, but care must be taken not to hamstring the Fed in its traditional decisionmaking which demands coordination with and cooperation from foreign governments and which has significant effects on various financial markets, of which the taxpayer—through the U.S. Treasury and Fed—may be a participant.

Regarding regulation, the Federal Reserve System has major responsibilities, particularly in supervising larger banks, foreign financial institutions operating in the United States, and sophisticated bank holding company operations.

There are a number of approaches to the reform of the regulatory structure that are being considered in Congress and by the Executive today. My preference, as reflected in legislation I introduced last March (H.R. 1227), is not to move in the direction of a single regulator but instead to consolidate regulators and the regulation of institutions.

In particular, I advocate merging the OCC and the OTS and keeping the Fed responsible for regulating all of the Nation's larger banks (those with assets over $25 billion) and their holding companies.

In addition, I believe the Fed's authority to regulate foreign financial institutions in the United States should be retained.

In conclusion, I would like to stress two circumstances. All of us have individual assessments of whether the Fed, at various points, has conducted too tight or too loose monetary policy. At this time, however, it is impressive how stable the American currency is especially given the spectacularly loose fiscal policy conducted by Congress.

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It is hard not to sympathize with the dilemma of Fed policymakers given the constraints that fiscal policy has provided them; and, based on the record, it is impossible not to be skeptical about any approaches which would enhance Congress' role in monetary policy.

If Congress' record in fiscal policy is a guide, the danger is very real that any effort by the first estate to recapture powers reserved by the Constitution to it could lead to a butchering of monetary policy.

In all institutional circumstances—governmental and nongovernmental—there is an element of tradition that goes beyond the drawing of lines of authority relationships on charts.

In this context, it deserves to be noted that the American Federal Reserve System at this moment has developed an expertise of signal dimension respect, particularly in the financial markets and overseas, far higher than any other institution of the U.S. Government.

Hence, any change diminishing Fed responsibilities, even of modest dimension, demands a compelling burden of proof not immediately self-evident to this Member.

The country will do just fine if none of the approaches propounded by any of us this morning is adopted. On the other hand, this fact is not sufficient to rationalize a "never change" legislative mantra. This noncrisis environment may be the most propitious time to undertake small improvements in the system to help ensure that, at a time of greater crisis in the future, the Fed is not susceptible to challenges of either Democratic legitimacy or institutional arrogance or stultification.

Mr. Chairman, with this philosophical framework, I welcome the thoughts and concerns of our distinguished panel of witnesses.

The CHAIRMAN. Thank you very much, Mr. Leach.

The Chair is going to recognize the ranking majority Member and chairman of the Subcommittee on Financial Institutions for a brief statement.

And then I am asking unanimous consent that all members be permitted to provide, in writing, any opening remarks they may wish to enter into the record.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. I will be brief. But this is a subject that interests me greatly, and I want to join you in welcoming our very distinguished panel this morning. And I really mean that sincerely.

We have among us some of our very finest Congressmen and one of the most distinguished Members who ever served here, former Chairman Reuss.

This subject of monetary policy has interested me for a long time. For almost 20 years I have been on the subcommittee of this committee which has the responsibility for overseeing Fed policy. My friend, Chairman Reuss, helped me Chair that subcommittee the first time in my first term here. There were some unusual circumstances that led to that opportunity, and it was one that I welcomed greatly because inflation was the issue at that time in 1975. It was the economic issue. And I didn't understand being it and the chairman gave me an opportunity, in fact a responsibility, to dig

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in and try to understand it as well as I could. And as I say, I have followed it carefully for all of these years.

I started out as a very harsh critic of the Fed and I must say a fairly uninformed one. And over the years, as I say, I have studied and I have come to think that there is one proper goal for Fed monetary policy. There is one policy that if we will pursue it, the Fed will pursue it, will help our economy greatly. The Fed can't do it all but will help us achieve every other financial objective, every economic objective that we want for our country. It will help us achieve maximum sustained economic growth, maximum sustainable employment, the lowest possible interest rates, the highest level of savings, and, therefore, the highest levels of investment and economic opportunity for our people.

And that one policy is price stability or zero inflation. The lowest possible inflation, if we will sustain it, will lead to all of these other policies.

And so it is against this standard that I am inclined to measure any other suggested changes in Fed policy. And so the question I ask as we pursue these hearings is: Will the policies that are suggested by this legislation, by our very fine chairman and the other cosponsors, help promote Fed independence and, therefore, its ability to take the long-term view and help us achieve and maintain zero inflation? Or will the changes tend to politicize the Fed and force it into more short-term policies, which again sound good for the short term but which will inevitably lead to more inflation, higher interest rates, low growth, and so on.

So it is with that perspective that I come to these hearings and welcome them. I think it gives us a great opportunity to discuss a very important subject for our country. And I thank the distinguished chairman for giving us this opportunity. And I thank my friends who are here to help us explore these subjects today. And I look forward to the hearings.

Mr. Chairman, I thank you for that opportunity to say a few words.

The CHAIRMAN. Thank you very much.

Since we have Members that have come across from the rotunda, and I am sure they have pressing business and may even have rollcalls, we will proceed and recognize the first witness, our distinguished Senator from Maryland, and friend and great legislator, and thank him again for accepting the invitation, Senator Sarbanes.

STATEMENT OF HON. PAUL S. SARBANES, A SENATOR IN CONGRESS FROM THE STATE OF MARYLAND

Senator SARBANES. Thank you very much, Mr. Chairman, members of the committee, I appreciate this opportunity to testify on the issue of changes in the structure of the Federal Reserve System.

In this country and, indeed, around the world in the public sector and in the private sector, we are living in an era of institutional reform. Everywhere you turn, people are trying to restructure their institutions to make them more effective and more accountable.

Of course, the Congress created the Federal Reserve System 80 years ago, and in the 1930's the Congress created a structure for

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monetary policy, the Federal Open Market Committee; although the FOMC plays a role in today's economy, that could not have been imagined in 1935, it is—Congress has left its structure unchanged.

Mr. Chairman, I am going to submit my full statement for the record and try to move through it.

The CHAIRMAN. Certainly. Without objection, the statements that you have given to us in writing will be submitted for the record.

Senator SARBANES. Let me make an observation. I listened very carefully to the opening statements, and I want to commend you for what I perceive to be a careful set of hearings on the subject.

Any time that you try to examine the structure, the role of the Federal Reserve, you immediately have all these screams that there is an effort to impinge upon its preponderance of the evidence. If that is the case, it is worth examining. There is an argument to be made for a certain degree of independence for the Federal Reserve in making its decisions.

On the other hand, it seems to me a careful analysis of the existing arrangements would lead one to conclude that certain changes would, in fact, enhance the legitimacy of the Federal Reserve and, in effect, give them greater credibility rather than less.

And, in that regard, I do think it is important to address this issue at a time when it is not perceived that there is a pressing crisis. Because if it is addressed at a time when, indeed, there is a pressing crisis, the heat of that moment may lead to decisions that subsequently people would say, well, that wasn't carefully thought through. So I commend you for holding these hearings.

Now I have taken a somewhat different approach to this question of accountability than you have in your legislation, Mr. Chairman—I think the goal is essentially the same—which would be to make those who make monetary policy decisions rest solely with those who have been nominated by the President and confirmed by the Senate.

In other words, to remove the anomaly that individuals selected by private interests cast almost half the votes on the body that sets the Nation's monetary policy.

Now the approach in your legislation is to require them to be nominated and confirmed. The approach in the legislation that I and some of my colleagues, Senator Dorgan and Riegle and Sasser, have introduced in the Senate would be to take them off the Open Market Committee so the presidents would still be picked the way they are. They would consult with the Open Market Committee, but they would not vote.

The votes on monetary policy would be cast by the seven members of the Board of Governors of the Federal Reserve. A change, incidentally which I might note, would enhance—enhance rather than diminish—the power of the Board of Governors of the Federal Reserve System. I just want to make that observation.

I, obviously, don't need to go into the structure of decisionmaking at the Federal Reserve before this committee, which is the next part of my statement.

I would note that the 12 Federal Reserve Bank presidents are selected for 5-year terms by the board of directors of each regional bank. By law, the commercial banks in each region directly selects

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six of the nine members on the regional bank board of directors, three from amongst bankers and three from amongst nonbankers in the region. But those choices are made by the commercial banks. They pick the six of the nine directors. The other three members are chosen by the Federal Reserve Board of Governors.

Neither the President nor Congress has any role in selecting the presidents of the Federal Reserve Banks. Nonetheless, they participate in monetary policy decisions through their membership on the Federal Reserve Open Market Committee where they cast 5 of the 12 votes on a rotating basis.

An article in the *Wall Street Journal* a couple of years ago in August 1991, entitled "Fed Banks' Presidents Hold Private Positions But Major Public Role." A question of accountability. And it went on to describe one Federal Reserve Bank president, regional president in these terms: "He straddles an odd but awesome combination of public and private power. He is paid like a private banker, $175,600 a year. His shareholders are private banks. His board members are private citizens. His budget is free of congressional scrutiny. He works in a spacious corner office atop a striking skyscraper with a fine view. Once every 6 weeks he abandoned that's conservatives and goes to Washington where he assumes the role of powerful government official."

And the article goes on to point out that there he sets interest rate policies that profoundly affect the Nation's economy.

Now while most government agencies, including the Fed make extensive use of private citizens as advisors, in no other agency is actual decisionmaking power vested in individuals who are formerly accountable to private parties instead of to the public.

Now, we have set out some of the legislative history of the Federal Reserve Act going back, of course, to Woodrow Wilson's tenure as President.

I just want to pull out a couple of quotes of Wilsons. At the time when they were setting up the Board of Governors of the Federal Reserve, there was an argument about instead of the government appointing all of them that the banks should choose some of the members of Federal Reserve Board.

Wilson rejected that. He took the view that the government should control every member on the Board on the ground that it was the function of the government to supervise the system and no individual, however respectable, should be on the Board representing private interests.

In the end, that was what was done, as we know. In fact, Wilson met with a group of bankers who were concerned about this; and, apparently, he asked them which of these gentlemen thinks that railroads should select members of the Interstate Commerce Commission? Apparently, there was a dead silence in the room to that question, and I think Wilson felt he had made his point.

What was not done at the time was the whole problem of the Open Market Committee was left unsettled in that legislation. That became more of a problem in the 1920's. In fact, Secretary of Treasury Mellon pressed hard to try to change the arrangements.

In the 1930's, we gave the FOMC statutory recognition, the Congress did, when the President appointed Marriner Eccles to head the Federal Reserve. Eccles proposed to give the Board increased

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control over monetary policy by making it, rather than the Open Market Committee, responsible for open market operations.

As we know, in the end, there was a compromise and, in a sense, a political compromise. And you have the seven members of the Board of Governors and a rotating group of five of the Federal Reserve Banks.

Now, when we started looking at this, we said, what do they do in other countries? I mean, obviously people are going to react, and they are—there is a kind of mystique that is built up around the Federal Reserve, a limited amount I think is probably useful; but too much of which I think carries perhaps the seeds of its own demise.

So we commissioned a study in the Joint Economic Committee to look at the making of monetary policy in other countries. This arrangement of giving formal power in the conduct of monetary policy to individuals selected by private industry doesn't find a parallel among major central banks abroad.

The study on central bank government relations in the major industrialized countries found that central bank officials who make monetary policy decisions in those countries are duly appointed public officials who are accountable to the public and not to private interests.

Where central bank officials that are not directly appointed by the government have a role, as in Italy, it is usually advisory. Ultimate policy control still rests with government appointees. Even in Germany, which some believe to have the most independence of all central banks, the 11 bank presidents who participate in monetary policy decisions are all appointed by the upper House of the German Parliament.

So in every instance, there is some source of public legitimacy for these public officials making important economic decisions.

In other words, they can trace their presence as a decisionmaker at table to some—they do it in different ways—but to some form of public legitimacy and, therefore, accountability.

Now, this is not the case in our system with respect to the five regional bank presidents who sit on the Federal Open Market Committee. And you could correct that in either one of the two ways that have been put here before the committee.

The legislation I have introduced would dissolve the Open Market Committee and give its responsibilities to the Board of Governors. It would create an advisory council made up of the presidents of the 12 Federal Reserve Banks so they would have an important consultative role, but monetary policy decisions would be the responsibility of accountable public officials.

Now, Mr. Chairman, let me just turn to a few of the other items very quickly that are contained in this legislation which you are going to address in these hearings. I won't touch on all of them, but there are three of them in particular that I want to touch on.

First, I think we need to look for better ways to coordinate monetary and fiscal policy. At a minimum, this requires better communication of the Fed with the administration and the Congress. There are some proposals for regularized consultation within the executive branch with the Fed. It seems that those are worthy of consideration.

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I have also, on other occasions, indicated support for the view that the 4-year term for the Chairman of the Federal Reserve should begin 6 months to 1 year after a Presidential election, perhaps at the end of that first year so that a new President has an opportunity to select a Chairman fairly early into his term.

The current system gives a 4-year term; and it may have been thought at the time it was established that you would get this kind of spacing; but, of course, it is a 4-year term from the time the person is named as a Chairman. It is not a 4-year fixed term on a fixed schedule that clicked in after a reasonable period of time with the election of a new President.

So in the current circumstances, the selection of the Chairman of the Federal Reserve will not come up until March 1996, in other words, 10 months at the end of this President's term. And, of course, that appointment, if made for 4 years would then give the next President a Chairman for almost the full 4-year term. If this particular President is reelected, that is fine; if you get a new one, he is confronted with the same problem.

Second, communications between the Fed and the Congress also has problems. The Humphrey-Hawkins Act of 19 years ago is based on the assumption that twice a year the Fed would inform Congress of the goals for monetary aggregates that would have clear policy implications.

For several years now, the Fed has been playing down its monetary targets. In July, the Fed reported to us that it has no confidence in the meaning of monetary aggregates for policy. When this issue was raised with Nobel Prize winning economist Jim Tobin at a hearing earlier this year, he made the follows statement:

> ". . . it is more important to have the Federal Reserve come to the Congress and express its goals for macroeconomic performance on things that really matter, and that is growth of GNP, what happens to employment and unemployment, investment and foreign balance and inflation and talk about their appreciation of the macroeconomic circumstances in which they are making policy and the general directions in which they hope to move the economy in the coming 6 months or the coming year. . . .
>
> ". . . those goals could be discussed between the Congress and the administration and the Federal Reserve so there is a coherent macroeconomic plan on fiscal and monetary policy. . . ."

It seems to me that is a subject worth exploring.

And, finally, on the issue of transparency and openness, it seems clear to me that some way must be found to provide more information to the public about the activities and the decisions of the Federal Reserve.

The way the system now works, as a matter of fact, is members of the Open Market Committee could make absolutely disastrous judgments about what policy ought to be and you will never know it. They no longer keep minutes. They don't publish them. You have no way of following in any careful way what their deliberations are.

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There has been some allegations that there are leaks about the decisions reached by the Fed, which if, in fact, the case, would be quite worrying and troublesome.

So I think the proposals that have been put forth in the various pieces of legislation addressing this question of transparency and openness are well worth very careful exploration.

Mr. Chairman and members of the committee, let me conclude by saying I believe this is a very important series of hearings that you have launched today. I will follow them with close interest. I think we will also benefit from a careful airing of the arguments for and against each proposal. And it seems to me the effort to get more openness and accountability done in a reasonable and responsible way, as I think it essentially is in all of the proposals that are before you, merits our very careful consideration.

Thank you.

The CHAIRMAN. Thank you, Mr. Chairman.

[The prepared statement of Mr. Sarbanes can be found in the appendix.]

Senator Dorgan.

STATEMENT OF HON. BYRON L. DORGAN, A SENATOR IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Senator DORGAN. Thank you.

As I was listening to Senator Sarbanes, I was recalling the many times that I have testified before committees on Federal Reserve Board issues over 13 years and wondering whether it is purely therapy or whether it will ever lead to policy change. If you talk about fixing the door jamb at a Fed, they accuse you of being part of a demolition crew.

There is no thoughtful discussion about what exactly we are trying to do. We are in an age when the lexicon is reinventing government, openness, and public scrutiny. The last of the policy dinosaurs that existed in this town is the Fed. It operates in the shadow with great secrecy, but makes decisions that have enormous impact on every single American.

I recall testifying about a year or two ago on legislation that Congressman Hamilton and I introduced before Chairman Neal's subcommittee. It would be hard to understate the enthusiasm with which the chairman greeted our suggestions.

I noticed in his opening statement today he too has not changed his mind very much about these issues. But I think it is important and helpful for us to discuss the proposal that Senator Sarbanes has made, of which I am a cosponsor; the chairman's proposal, which I think is interesting, and the proposal that Congressman Hamilton and I have introduced in this Congress, which, on the Senate side, it is S. 212.

Let me briefly add a word to what Senator Sarbanes said about the method by which people make decisions on the Federal Open Market Committee.

It is, it seems to me totally indefensible to have folks who are not accountable, who are not appointed, not elected, to be making the kinds of decisions that are made down at the Fed about monetary policy.

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And it seems to me that we must change that, and we must do it in a thoughtful way. We tend, it seems to me, to react only to crises around here. When something explodes in our face, we run around and say, yes, we need to fix this, this is wrong. But the Fed's Open Market Committee is set up wrong. Let's fix it before it explodes. This is a good time to fix it given our current monetary and fiscal policy.

I won't reiterate the good reasons that Senator Sarbanes has listed, the compelling reasons to fix this problem. Let me mention the legislation that Congressman Hamilton and I have introduced.

First the President's top economic advisors would be required to meet three times a year with the Federal Open Market Committee. We are not suggesting that you force a marriage, but formalize channels by which those who are involved in fiscal policy and those who are involved in monetary policy are able to discuss where they are heading. They are involved in the economy of the same country, and yet there is no formalized channels by which those discussions take place.

Second, the President would be empowered to appoint a new Chairman of the Federal Reserve near the beginning of his term rather than toward the end.

And, third, the Fed would be required to disclose any changes in targets for the money supply. Some of you may have read, as I did, an article in the *Wall Street Journal* in which they were talking about some people using voice stress analyzers on speech. In particular, they analyzed the remarks of the Chairman of the Fed to determine what kinds of decisions had been made earlier that day in the Open Market Committee.

That is how bizarre monetary policy has become. It seems to me that when the Open Market Committee makes a decision, the OMC should disclose it to the world. We now allow the Fed to wait 6 weeks. By that time, the most sophisticated financiers in the country are able to figure out what has gone on and the little investors are left to their own devices. When the Fed makes decision, announce it. Eliminate the shroud of secrecy.

And, fourth, the Comptroller General will be required to conduct more thorough audits, including of policy procedures and processes.

And, fifth, the Fed would be required to publish its budget in the budget of the U.S. Government. A small part is published, but the rest is not. The information that is in limited distribution, is so opaque as to be almost impossible to understand, and bears no relationship to financial data published by any other Federal agency that I am aware of.

These modest steps would provide a little fresh air and allow a little light into the operations of the enterprise that essentially makes monetary policy in our country.

It is sad that a century ago we used to debate these things in barber shops all across America. This used to be a good public debate: What should monetary policy be in this country? But it isn't. Yesterday, a basketball star retired, and it is front page. It will get 1 million times more press and analysis and more thought and discussion than that monetary policy in this country.

And yet what is more important to the lives of our children and the rest of the American people?

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And so I commend you, Mr. Chairman, for holding this hearing. I hope it is not just therapy. I hope one day soon all of us will decide we should reconstruct and reinvent the Fed so that it helps all Americans.

Thank you very much.

The CHAIRMAN. Thank you, Senator. I can assure you that we are dead earnest and will proceed as fast as our processes will allow us.

[The prepared statement of Mr. Dorgan can be found in the appendix.]

With the indulgence of our former chairman, I will recognize the sitting Member and a very distinguished member of this committee from Maryland, the distinguished Mr. Mfume.

STATEMENT OF HON. KWEISI MFUME, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Mr. MFUME. Thank you very much, Mr. Chairman and fellow members of the committee.

I am here, as we all are, to discuss concerns about the Federal Reserve and issues involving H.R. 28, the Federal Reserve System Accountability Act of 1993. As a cosponsor of the act and as a member of this committee, I am honored to have the opportunity to share specific concerns this morning with my colleagues.

The accountability of the Federal Reserve and the constitutionality of allowing private citizens to vote on the Nation's money supply, I think, are very, very important questions before us today.

H.R. 28 is designed to make the Federal Reserve, the Nation's central bank, more accountable to the public it is there to serve.

The Federal Reserve exerts immense influence over the economy, as was stated earlier, because of its ability to influence interest rates, employment, inflation, and the international value of the U.S. dollar.

As such, I think we all are in agreement that its role should not be taken lightly.

H.R. 28 requires that members of the Federal Open Market Committee, the Federal Reserve's decisionmaking committee, who vote on our money supply, be appointed by the President and have their views examined publicly during Senate confirmation hearings.

In addition, the President must include representatives of agriculture, small business, labor, consumer, and community groups, women and minorities among his nominees. Bringing more diverse representation to the Federal Reserve decisionmaking roles is a reasonable and a desirable objective for any policymaking entity.

Reforms that we will be discussing for most of the morning embodied in H.R. 28, I think, are very modest and simple. I want to focus specifically on the issue of diversity.

H.R. 28 contains language which will help the Federal Reserve's discrimination against minorities and women as we see it come to an end. The legislation requires the Federal Reserve to abide by the Civil Rights Act of 1964, which guarantees employees's basic civil rights, including the ability to pursue the Federal Reserve for discrimination.

A quick review of the history of diversity issues with the Federal Reserve will show that holding the central bank much more ac-

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countable than has been in the past, legislatively, is perhaps the only course of action left for us to take.

The record is clear, and it shows that women and minorities have virtually little or no say in the conduct of our Nation's monetary policy or in bank regulation.

In 1977, this particular committee issued a report noting, quote, "the virtual exclusion of women, minorities, and representatives of labor unions, consumer interest organizations, nonmanagerial, and nonproducer groups," in policymaking positions regarding money supply.

In response to this committee's action, the Congress passed the Federal Reserve Reform Act of 1977, which required that all Federal Reserve Bank directors be chosen, quote, "without discrimination on the basis of race, creed, color, sex, or national origin."

Then at the beginning of 1978, it was thought by many that served on this committee and in this Congress that there would begin to occur a change when the 12 Federal Reserve Banks had 37 directorships vacant, 12 were in class A, 12 in class B, and 13 in class C.

Of the first 21 that were filled with new persons, 7 were in each class. There was no increase in diversification at all in class A directors. There was one woman appointed to class B and one woman appointed to class C.

In defense of that action, which many of us believe violated the spirit of the 1977 act, the Federal Reserve pointed out that the Federal Reserve Reform Act was not passed until November 1977; and, therefore, there was no great deal of time to turn the situation around.

Well, 13 years after that enactment, in 1990, an extensive study entitled "Racial, Gender and Background Profiles of the Directors of the Federal Reserve Banks and Branches" revealed that diversity still had not occurred as specified in the law and went further to show continuing indifference on the part of the Federal Reserve.

According to that report, 13 years later in 1990, among the 72 class A and B directors who were chosen by private member banks in the 12 Federal Reserve districts, there was 1 African-American, no Hispanic Americans, and only 3 women.

Of 36 class C directors chosen by the members of the Board of Governors which are supposed to, quote, "represent the public," 50 percent were former bank directors and none worked for consumer or labor organizations.

And so the upper echelons of the Federal Reserve management consisting of top staff of the Board of Governors, the 12 presidents of the Reserve banks, and the 7 members of the Board of Governors, continues to be practically devoid of women and minorities.

And since 1913 there has only been 1 woman and no minorities serving as 1 of the 12 Federal Reserve Bank presidents.

Many of us believe that this lack of female and minority representation essentially alienates millions of Americans of any sense of representation; and this, unfortunately, is true for all the bank regulatory agencies in one way or another.

Chairman Gonzalez has allowed me to use some of the data from his 1993 study of diversity in hiring in the Federal Reserve System. This study has not yet been made public.

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I want to thank the chairman for undertaking the study and for making part of it available to me today.

I would like, Mr. Chairman, to submit for the record 2 charts from that study of each of the 12 Federal Reserve Banks and the Board of Governors. One chart will show the distribution of jobs for the highest paid 10 percent of the employees and the other for the lowest paid 10 percent.

The CHAIRMAN. Without objection, so ordered.

Mr. MFUME. These charts clearly show that women and minorities are significantly underrepresented at the highest paying positions in the Federal Reserve System. And at the lower levels, they make up the majority.

This kind of blatant blueprint of discriminatory hiring practices is shameful. The truth is that there are many qualified minorities and women. Our country has a large pool of qualified persons and they deserve, as most others would expect, an opportunity to participate.

Regarding the issue of access to credit, since 1990, the Congress has been requiring Federal bank regulators to track bank lending according to race, gender, and income. The results have shown and continue to show a disturbing pattern of discrimination in bank lending. The Federal Reserve itself recently reported extensive bias against minorities in bank lending—something that Community Reinvestment Act supporters have fought hard to counter for years.

The fact that this lending discrimination reappears year after year leads one to wonder whether bank regulators such as the Federal Reserve would move more vigorously to eradicate this discrimination if they, themselves, were composed of the personnel more reflective of the country diversity and thus sensitive to the borrowing needs of all Americans.

The central bank may be a starting point to remedy this problem. Banks cannot take seriously the Federal Government's commitment to eradicate discrimination as long as agencies like the Federal Reserve remain as exclusive as ever.

The following changes, as recommended in the 1990 study, are necessary to affect diversification within the Federal Reserve. We recommend, one, that the Federal Reserve Boards' and Federal Reserve Banks' exemption from Title VII of the Civil Rights Act of 1964 should be repealed.

Two, nomination of the 12 Federal bank presidents should be by the President of the United States with confirmation by the Senate.

Three, six of the nine directors of each board of directors should be appointed by the Board of Governors in Washington instead of the present three of nine; and these members should include a wider representation of the U.S. citizens largely stipulated previously in the act of 1977.

Four, there should be authorization of an 18-month Federal Reserve Reform Commission to examine a number of areas, including the affect of the regulations of the Board and of the operations of the Board on low- and moderate-income families, including the availability and the cost of financial services and credit.

Five, we believe the Federal Reserve Act should contain a definition of the term "public." A comprehensive definition would make

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it difficult for the Federal Reserve to abrogate the intent of Congress regarding director diversity.

Six, an individual that has been an officer, director, or employee of the bank within the preceding 3-year period should be ineligible to hold a public director slot.

Seven, the qualifications of the branch directors should be defined in legislation. At present, the Federal Reserve determines the branch directors' qualifications.

And last, each district should be required to establish consumer, labor, and small business advisory councils.

Further, in identifying eligible women and minority candidates, we believe the Federal Reserve should also utilize the U.S. Treasury's nationwide list of minority-owned banks participating in the Minority Bank Deposit Program and to work with trade organizations like the National Bankers Association which represents minority and women-owned banks and has been operating for over 65 years.

The Federal Reserve should also enter into an agreement to establish a plan involving historically black colleges and universities in order to track eligible candidates for the pipeline that we all desperately want to increase.

And so I wanted to speak specifically about the issue of diversity, Mr. Chairman, because it goes to the core of something that has troubled many of us in this particular committee and many of us in the Congress. Because, as has been said by both Senator Sarbanes and Senator Dorgan, this absolute belief that the slightest tinkering is to do away with the principles, the precepts, and foundation of the Reserve, we think, frankly, doesn't hold a lot of water.

And so I want to thank you, Mr. Chairman and members of this committee, for allowing me to add my testimony. And I, like Senator Dorgan, also hope that it is much more than therapeutic.

The CHAIRMAN. Thank you very much and for your support as a member of this committee.

[The prepared statement of Mr. Mfume can be found in the appendix.]

Chairman Reuss.

STATEMENT OF HENRY REUSS, FORMER CHAIRMAN, COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Mr. REUSS. Thank you, Mr. Chairman. We are privileged to be here for this opening session in what all agree is a worthy inquiry by the Banking Committee into accountability by the Fed.

And this is part of a worldwide movement, not just reinventing government here in Washington, but in Europe, home of the "democratic deficit" as it is called, people are concerned that the European Community's Commission isn't chosen by the people.

I agree with almost everything you said in your opening statement, Mr. Chairman, and with what my colleague witnesses have said and with a great deal of what Mr. Leach and Mr. Neal said in their opening statements.

So I will be very brief about my fundamental point, which is that really now in this noncrisis time is an excellent time to change, in a minor way, the money-creating powers of the Federal Reserve so

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that it is exercised as the Constitution requires, by public officials. That, I believe, must be done.

I want to make a point that hasn't been touched on yet. Under a rather ludicrous 1935 law which sets up this system whereby private commercial bankers select public officials, there is a nonsensical disproportion between what different areas of the country have to say. For instance, New York is on Open Market Committee there all the time, but banks like Boston, Philadelphia, Richmond, Atlanta Dallas, St. Louis, Kansas City, and San Francisco, are on the Federal Open Market Committee just one-third of the time. Now, without poor-mouthing New York, I would not think that it is three times as brilliant as say Boston or say California. So any change in the modalities of the Federal Reserve ought to do something about that disproportion.

Most important of all, perhaps, is this: Even if one said that it doesn't matter very much substantively whether you have a few private bankers' appointees making crucial governmental monetary policy—even if one said that, the fact remains that it is unconstitutional. Congress in acting to do what it did in 1935, didn't have the benefit of the very important unanimous decision of the U.S. Supreme Court in 1976 in *Buckley* v. *Valeo*, which said that public officials must be nominated by the President and confirmed by the Senate. That decision was unanimous.

I am sure that the Attorney General, Ms. Reno, who is an excellent lawyer, if this question were put to her, would pronounce the present system totally unconstitutional. And the courts have told us that it can only be changed by Congress, so to speak, cleaning up its own mess and getting constitutional.

So Open Market Committee reform is the first order of business. There are some other things that need to be done. There is another fiction on the books stemming from the dream that the Federal Reserve is really just like other private commercial banks.

As you know, member banks now hold about $3 billion worth of preferred stock in the Federal Reserve. They are not particularly overjoyed about it, because they could be doing better things with that $3 billion, like for example lending money on housing, lending money to small business. So why not end that rather silly fiction, repay the $3 billion, add it to banks' capital and they could then do their bit on dealing with the credit crunch.

Another piece of Federal Reserve structure crying for attention, in my view, is that of the seven Governors. Who in this room can offhand name the seven Governors of the Fed however eminent and worthy they may be? How can the public fix responsibility when it is spread out among seven? Why not, therefore, reduce the number of Governors to say five, like in the Federal Trade Commission or in the Federal Communications Commission or even three, like in the Council of Economic Advisors or the SEC?

Reducing the number of Governors, incidentally, would make it fiscally and politically possible to pay the Federal Reserve Governors a decent salary. Now they get $123,000 a year, less than the $161,000 they pay their top staff, less than the $250,000 they pay the President of the New York district Federal Reserve Bank, and less than the $148,000 paid to cabinet officers.

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And this might appeal, Mr. Leach, to your side of the aisle: Why not put in a bill entitled—"bill to pay the Federal Reserve Governors a decent and adequate salary, and for other purposes"? Then we could get the whole reform through.

One final and perhaps heretical thought, not for today but for the future as far as human eyes can see, maybe in the year 2000, what is it that the Federal Reserve district banks really do? The thing they really do is to clear checks. A worthy function. And they have been doing it since 1914.

But we now live, I read, in an increasingly checkless society and one wonders how we are adjusting to this. Now, has one ever made a study of how much it costs the taxpayers to keep up with this archaic system of check clearance to see whether it couldn't be done more effectively and cheaper privately?

So I would hope that maybe the General Accounting Office and the Office of Technology Assessment could make a study of how much all of this ultimately costs the taxpayers. And if it turns out that it can be done more efficiently, the world is not going to come to an end if in, say, the year 2000 when, one is told, the glut of prime office space in our leading cities is finally going to disappear and new office space will be needed, and when we are also told that the Federal budget deficit, temporarily under control, is going to burgeon once again, if there is nothing left for these district banks to do to simply sell off the office space and concentrate monetary power where it ought to be, in the very important Governors of the Federal Reserve System.

So that is something to be thinking about in the future.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Reuss can be found in the appendix.]

The CHAIRMAN. Well, thank you, Chairman Reuss. And you are outlining something that I know you have been espousing and advocating since before you became chairman of the full Banking Committee. And I recall vividly.

Let me say that I have nothing but gratitude to each and every one of you because you have encompassed, in your presentation and, in fact, forestalled any particular question I have as to structural or legislative changes. I think if we are lucky enough and we have some form of House action, we will have plenty of time to work out the Senate's contribution in the regular course of events.

But I did have one particular question while I have Senator Sarbanes, and it is something that is bothering me. I don't have any other specific questions that I should delay you because I think you took care of them in your statement.

But in my opening statement I referred to the SWAP fund of $30.1 billion for the purposes of intervening in foreign currency markets. The claim that is made is that this process is independent of politics.

I called a hearing 3 years ago this month on the specific issue at that time involving Mexico. And the Deputy Secretary of the Treasury for Monetary Affairs presented himself. I think we were out of session, so we didn't have many Members and it was kind of overlooked. But I thought it was very significant.

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In that particular case—and I am going to hotline it here to show that despite the claims of political independence, these things do have very serious, and in some ways ominous, undertones.

In April 1976, for instance, the first time I recall—but it was done again in 1990—the Fed allowed Mexico to draw on its full $36 million SWAP line, didn't require Mexico to pay back until after the Mexican Presidential July election. This had the effect of propping up the value of the dollar—I mean of the peso, which, of course, in 1982 collapsed and created a crisis then.

Now this had the effect of propping up the peso at that time and it helped, immeasurably, the Mexican ruling party to win the election. It was really the equivalent of a foreign loan or a loan to a foreign entity.

But in 1990, through the so-called zero coupon, Mexico was a beneficiary of about $280 million worth; and that simply was just written off.

Our question at the time when we had the hearing, was the constitutional issue of the Fed and Treasury avoiding the constitutional mandate to have an appropriation process, an authorization and appropriation on the authorization and that was obscured because of lack of interest.

Then, subsequent to that, we had the development of the Brady Bonds which, in effect, permitted, through zero coupon, the Mexican Government with the issuance of the zero coupon bonds by the U.S. Treasury to go out and issue its bonds. There is an implication there of U.S. support or guarantee.

About 1½ years ago, the Japanese were able to buy about $8 billion worth of those Mexican bonds. Now, what I am saying is that all of this is done in a way that ordinarily would be required by our processes to call for an appropriation and translates as a foreign assistance-type of loan.

What I would like to know is if any one of you gentlemen, particularly Chairman Sarbanes and Chairman Reuss, who is very knowledgeable in this area, if you have any opinions on this; or if, on thinking it over, you would supply something for the record in writing?

Senator SARBANES. Mr. Chairman, I would like to think about it. I do think that one of the difficulties we have is, of course, the assertion is made, not without some merit, that first of all they have to have some authorities to move quickly in some of these currency issues.

But that does not counter the notion that somehow the parameters within which they were going to move should have been thought through ahead of time and that they shouldn't have, as it were, total discretion to do whatever, whenever they may want.

You see, the argument that is constantly given to you is, look, we have to operate—we are dealing in markets and, therefore, we have to operate—we can't lay everything out on the table ahead of time because if we do that, then people play the market accordingly; and, second, when we do act, we have to act very quickly.

My own view is that there is some merit to both of those arguments but that they have both been carried much too far in terms of appropriate review of Fed policy and that the issues you are raising are very important issues and they need to be very care-

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fully examined. I do not have a sort of definitive answer for you. But I do think the question you have put is a very important question.

The CHAIRMAN. Thank you, sir.

Chairman Reuss.

Mr. REUSS. Man is a political animal. And I think we have to settle for Federal Reserve Governors—men, and I hope soon, women—will be political. And I agree with Senator Sarbanes that our monetary authorities do need an exchange intervention kitty to operate.

I think it isn't a bad system whereby you, the energetic chairman of the Banking Committee, informs himself of this and spreads it on the record. It keeps the dabblers in exchange rate policy from being too gross in their activities.

So I guess I don't view this kitty as the kind of a problem that really needs attention right now, other than the vigilant surveillance which this committee should give.

The CHAIRMAN. It is a $30.1 billion kitty. It is substantial.

Senator SARBANES. It is a big kitty, no question about it.

The CHAIRMAN. Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. I just wanted to raise one aspect that is very seldom talked about in terms of the appropriateness of how public officials come to be selected at the regional bank level.

And as we all have kind of come to understand, the Federal Reserve System has three broad areas of work. One is in the macroeconomic area of interest rates; one is in the microeconomic area of bank regulation; and the final one in the commercial area where it clears checks for the banks. Fortunately, if there is a profit, it goes into the Treasury.

The macroeconomic policy is much talked about in terms of appropriateness of regional bank presidents serving on the Open Market Committee. But one aspect of regional bank authority that is very seldom dwelled upon is that the regional banks have a major role in bank regulation. And so to the degree that leadership is chosen in partial measure by the banks themselves, it isn't the fox guarding the chicken coop; it is the fox guarding the fox. Granted, there is a relationship in which the larger policy on regulation is reserved to some degree to the Fed here in Washington, but a great deal of regulatory responsibility accrues to the regional banks themselves.

Now, one of the things that has occurred in the last several decades is that, like all the 80 years of Fed policy, there has been a lot of public discourse on whether the Fed's monetary policy has been too loose or too tight but, surprisingly, little attention and public criticism given to whether or not their regulatory policies have been inappropriate.

One of the interesting aspects of national banking policy today that I, as a Midwesterner, feel very deeply about has been the practice for much of the last several generations of subjecting larger banks to less regulation than smaller banks under the assumption that larger banks have larger deposit bases.

Experience in the last decade or so has indicated that this is not necessarily a greater protection. It has also indicated that the Fed

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has made some mistakes in terms of regulation for which the Fed itself has received shockingly little criticism.

Although I think there are some things that the Fed has done well. In the last 7 or 8 years, certainly the Fed has moved in the direction of shoring up the large institutions.

The 10 years before that, however, Fed policy didn't look very impressive. But that raises this issue: Is there something about the selection of regional bank presidents and directors in relationship to the Fed's duty to regulate banks that is troubling and deserves public attention?

The CHAIRMAN. Will the gentleman yield to me at this point? I have noticed that our colleague, Congressman Mfume, should have been at the White House a few minutes ago but has remained here thinking that perhaps some of us will have a question for him.

Does any member have a question for Mr. Mfume?

Mr. FRANK. Yes.

When are you going to talk about the weather?

Mr. LEACH. Before Mr. Mfume leaves, I don't have a question, but his statement was one of the most thoughtful presentations that has been given to this committee for a long time. The committee is going to have to take seriously a number of the concerns that Mr. Mfume has raised.

Mr. NEAL. I don't have a question, but I want to say that while I disagree with a number of recommendations—and I will comment on that when I have a chance—I want to say that I agree with my friend that there should be no discrimination based on race or gender at the Fed or anywhere else.

And I am surprised, frankly, that there hasn't been more progress in terms of getting more people, minority races, at the Fed. So I want him to know that. I think it is an important subject that he has brought to our attention.

Mr. MFUME. Thank you, Mr. Chairman.

My thanks to the minority ranking Member as well.

The CHAIRMAN. You can feel free to go; but if you have a chance, put in a good word for our efforts to the President. He has communicated his skepticism about doing anything about an operation that is working.

So with that, the gentleman is excused.

Mr. MFUME. Thank you, Mr. Chairman.

And I have submitted my full statement for the record.

The CHAIRMAN. Thank you, and it will be in the record as you submitted it.

Thank you, very much.

Thank you, gentlemen, for yielding to me there.

Senator SARBANES. Could I say to Congressman Leach, first of all, I think that is a very perceptive observation. If you follow it out, it would probably argue for following Chairman Gonzalez' approach toward picking the bank presidents so you get a public accountability to them.

My approach was only to get them out of macroeconomic policy because they had no legitimacy. It didn't address the fact that they would still continue as bank presidents, having been picked essentially by the banking community whom they were called upon to regulate to some extent in their capacities as the bank president.

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I think it is another instance, though, of this system needing to be examined. I mean, the very issue you put raises important questions. And there is—they are simply not being addressed. And there is this resistance to addressing them. And my expectation is that if they are not addressed in a rational way and fairly reasonable circumstances, a crisis is going to come along and they will get addressed then, but perhaps in a way that is not as constructive.

Mr. LEACH. Well, I appreciate that.

I would like to raise the issue Chairman Reuss mentioned concerning the preferential treatment of one regional bank over another. We all recognize New York has more banking assets than the other regions. Putting that aside, one of the issues of the S&L situation—and it is one of the larger issues—is that when you give an element of the financial industry weaker regulation than another element you, in effect, skew asset growth in either the region or the kind of institution that has the weaker regulation. You give it more assets.

And so if you say a particular district shall have lower standards than another district, by definition you have put more assets in that region. Therefore, you skew economic growth toward that region.

That is one of the reasons why I object strenuously to discriminatory rules on capital ratios for one kind of institution versus another. It comes back to who is doing the regulation and where the authority is. If you have selection from the institutions in a particular region with regulatory accountability, you have a very awkward circumstance that biases economic growth. I just think it is something that deserves some attention. Now, what the conclusion is I am not sure.

In the Department of Treasury the Secretary chooses, in effect, the regional district officers of the Treasury. It is an odd relationship because it is a step removed from the Executive, but it does to some degree deal with that issue, although maybe not as appropriately in all circumstances.

But the only other issue I would raise is that sometimes institutionally you have arrangements that seem to be conflicts of interest, but sometimes they work. In my State, we have a tradition that the Superintendent of Banking be an active banker in the State. He usually serves for a 2- to 4-year period. I think that structurally one might say that is a conflict of interest, but it has worked astonishingly well, and the bank presidents that have been made superintendents have gone out of their way to be tough.

So you have a tradition that kind of overrides some of the unseemliness. Whether the unseemliness is overridden by tradition, in this instance, I don't know. But I think it is worth very serious thinking about by those who are advocating changes in the system today.

Senator SARBANES. I assume that superintendent is not picked by the banking committees.

Mr. LEACH. No, he is chosen by the Governor.

Mr. REUSS. Tradition is a great thing, and you use it well in Iowa. But, as Senator Sarbanes has said, it is the Governor who picks the Banking Commissioner. And that is as it should be. Then if the Banking Commissioner doesn't do his job, the Governor has

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to explain his choice. The fact that he is a banker doesn't bother me in the least, nor does it bother me to have bankers on the Federal Reserve Board of Governors. They should not dominate it, as no group should.

Mr. LEACH. Thank you.

The CHAIRMAN. Mr. Neal.

Mr. NEAL. Thanks.

Just on that point, I don't think that any of the bank presidents are bankers. There may be an exception to that, but I think most of them came up through the ranks. They are sort of professional Federal Reserve types. And the Board of Governors has veto power over the bankers. So it is almost like they are appointing them. No one gets appointed that they don't agree with.

On a broader point that I think everyone is making here, Mr. Chairman, that the Fed should be accountable. I couldn't agree more. They are a branch of our government and should certainly be accountable. But I think the question is, accountable for what? And, in my view, they should be accountable for pursuing the best policy. And that policy—I think that we know what it is. And that, I think, will be the subject of some discussion as we go through these hearings.

I won't go into all the details of it now. We don't have time. But I don't disagree that the Fed should be accountable. They should be. But they should be accountable for doing what should be done by the Fed, which is to conduct the best monetary policy.

Now, I just want to offer a little different perspective on this question of the desirability of letting a new President name a new Fed Chairman. Of course, much of what we are trying to do historically and much of what I think makes sense and a lot of people think makes sense is to keep monetary policy out of the political process so that we can have a long-term monetary policy, not a short-term monetary policy subject to political whim.

And I remember vividly the horrible damage that a horrible monetary policy did to President Carter. In fact, it defeated him. And I remember the people that ran the Fed for him just did a horrible job. They ran the rate of inflation way up. Interest rates finally hit almost 20 percent.

And I remember going down to the White House one day. And toward the end of President Carter's term he knew of my interest in this, and I was a great admirer of his. And I went down there for another purpose. And he said, we are going to announce someone tomorrow, a new person to head the Fed with the sole objective of fighting this inflation and winning that war against inflation.

Of course, that was Chairman Volcker. And Chairman Volcker went about that task avidly, and, of course, it always takes time, and he just wasn't able to make it clear in time to help save President Carter.

And I think the high inflation, high interest rates essentially beat President Carter, not only—that is a minor political point in the overall scheme of things, but it was a horrible policy for our country and one that we are just now recovering from so it certainly ought to be the goal to keep political pressures off of the Fed. So it is a good idea to not let maybe a new President that comes

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in who is not so aware of this get in there and ruin things immediately anyway.

President Clinton, interestingly, has been extremely sensible on Federal Reserve policy at every turn. He has been asked about it on several occasions and in every case has supported an independent Fed, low inflation. And most recently there was a newspaper article which reported on his response to Chairman Gonzalez when asked if he supported his legislation, and President Clinton said, no, that he thought the Fed was doing a good job, and he would not want to make a change as Chairman Gonzalez mentioned a few months ago.

On another point, there is no reason to formalize relations between the Fed and the administration. They talk all the time. And if you ask the Fed Chairman, Secretary of the Treasury, I think you would find that they talk once a week.

And the idea of this desirability of so-called coordinating fiscal and monetary policy, that is to say, to try to get the Fed to conduct its monetary policy in harmony with a bad fiscal policy, I mean, I can't think of a worse possible idea. In fact, the Fed over recent years has, in spite of a horrible fiscal policy all throughout the 1980's, has been able to bring inflation under control. And if we had this idea or something in place where the Fed would have had to follow along and harmonize and coordinate and support this fiscal policy—which couldn't have been worse—just think of the additional damage that would have been done.

As it is, the Fed has been able to pursue an independent policy, bring down inflation, bring down interest rates, even in the face of this very destructive, short-sighted fiscal policy.

So, I—and there are several other issues raised by this, and I know that we will have other chances to comment.

Just a couple of others, if I may.

This question that Senator Dorgan raised about the budget. We now have annual hearings on the Fed budget. They come down here once a year and present their budget in open session. I will point out that it is very poorly attended—I used to chair these, and almost no one shows up for it, and it has very little press interest. But the fact is that the budget of the Fed is publicly discussed once a year for anyone who is interested.

Well, there is much more that can be said, and I won't have time to say it, and I see the red light, but I want to make one other point, if the chairman will permit me.

So far none of our witnesses, nor anyone else, has raised the point of what the proper policy should be for the Fed. I mean, that is the critical question it seems to me. What should the policy be? This is like—I don't have a good analogy for it now—but I hope that we will turn more attention to that, because that is the key subject. These details are interesting, and I am not certain if there is some way to improve something.

But the most important question is what is the proper policy, and, again, I am certainly convinced that that proper policy is the lowest possible—to attain and sustain the lowest possible inflation, which will give us everything else we want including low interest rates, increased savings, increased investments, job growth, economic growth, efficiency in the economy, and so on.

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So I thank the Chairman.

Mr. SARBANES. The bankers argue about it. The consumer groups argue about it. There is no kind of magic answer written in stone. And I am frank to tell you that I think a monetary policy which would give you price stability but might plunge you into depression is not adequate to the economic challenges confronting a nation.

On the other hand, a monetary policy that gave you a lot of growth but gave you runaway inflation would also not be adequate. And people differ about that, and I recognize that, and there may be sharp differences. The question is, on what basis of legitimacy are the people going to make those very important decisions to operate?

And, in the current system, you have people making very important public decision who have no claim to public legitimacy and no accountability. I mean, they are picked by a particular limited segment of the economy.

Now they may make the right decision. I mean, you know, look, you can pick them the way I want and put them to the Federal Reserve Board and then I may disagree sharply with the substance of the decision they are making. And in the current circumstances, from what I am able to glean out of the Open Market Committee's activities, which involves a little bit of what my colleague, Senator Dorgan, was saying about using a voice-measuring instrument to get the nuances of what people are saying—but in some of these instances I think probably some of the regional bank presidents on substance have been taking an approach toward monetary policy that I am more sympathetic to than it is an approach taken by some of the members of the Board of Governors.

So what we are talking about doesn't define the substance of the policy. But it does define the legitimacy of the people determining the policy, and it does give the President a chance to have an input when he nominates and, of course, the Congress a chance in the course of confirmation, so I think that is very important. I mean, you may think they are following a very good policy, and someone else may think they are following a very bad policy. But, at a minimum, someone ought to say, well, they are legitimately there making this decision.

And the other point I wanted to make, I thought you were a little too hard on the chairman with respect to the President's letter, which I have in front of me. The President says, your suggestion has merit. There is no doubt about it.

He then goes on to indicate that he is not certain that this is the right time to try to address these issues because he thinks it may have an impact of making people uneasy, which is always the problem you have when you try to address these Fed questions. As soon as you bring them up they come pouring out, saying you can't do that. You can't look at this at all. Like my colleague, Senator Dorgan says, if you want to fix the doorjamb, they say you are trying to wreck the building. That is not a rational way to discuss important public issues.

Mr. REUSS. Briefly, this was a hearing on the structure of the Fed and not on monetary policy. Had it been one on monetary policy I certainly would have been heard from.

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And in answer to your question of what is a good monetary policy that you could put on a bumper sticker I would say, "Lean against the wind." If the danger is unemployment and stagnation, ease it up. If the danger is a looming inflation, tighten it. Until a better one comes along, that isn't bad.

A word on the President's letter to Chairman Gonzalez. I agree with Senator Sarbanes. The President did say, you, Mr. Gonzalez, "raised a valid point about legitimacy, and I shall keep it in mind". For a President who, when he wrote this letter, is beleaguered by Somalia and the fall of the Kremlin as it seemed to be, not to take the lead in a fight against the bankers is utterly understandable.

And I commend you, Mr. Chairman, for getting more out of a President on this than any chairman has in history.

The CHAIRMAN. Well, thank you very much. I appreciate that.

Mr. NEAL. I just want to say I apologize to the chairman if I have mischaracterized. I don't mean to be hard on him. He is my favorite chairman. I don't mean that. But I meant to say that the President didn't support the legislation. Isn't that a fair characterization?

Senator SARBANES. At this time, I think he said——

Mr. NEAL. And it is at this time that we are discussing it.

Senator SARBANES. Chairman Reuss is right. Most other Presidents would be a lot harder on this issue. I regard this as fairly forthcoming, having seen how other Presidents have reacted.

Mr. NEAL. The larger point it seems to me is that—I would say to my distinguished friends, I think—and this is where I think we could have a fruitful debate—I think there is a monetary policy that will serve our interests the best under all circumstances. And that I think is where we may differ and where there would be room for lots of interesting discussion and fruitful debate. I am trying to say that I hope we get to that point at some point because that is the most important thing we can be discussing.

The CHAIRMAN. Let me say for the record that I count my blessings. President Clinton is the first President that answers my letters since Lyndon Johnson.

So, Mr. Knollenberg.

Mr. KNOLLENBERG. Thank you, Mr. Chairman.

The CHAIRMAN. If you don't mind, for what purpose does the gentleman——

Mr. FRANK. I just wonder if we could get to the questioning. I was afraid that we would lose our chance.

Mr. LEACH. If the chairman would yield for 5 seconds, though. While it is unfair to impute motivation, a possible motive for the President's nice comments was that he was trying to say nice things to our chairman because of his powerful role. But this letter says he doesn't favor legislation, and I don't think it should be read any other way.

I mean, the President isn't going to write the distinguished chairman of the Banking Committee and say, you fool, you proposed another foolish idea. So, I think this issue of forthcomingness ought to be tempered a bit.

The CHAIRMAN. They may say it, but they haven't written it thus far. I have good reason to feel——

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Mr. KNOLLENBERG. I, too, don't want to step on the chairman's toes, but I view that letter as some evidence that the President was making a statement. And it is today—and, yes, he could change his mind, but, yes, this is his attitude today.

If you look at the problems that face this country, most of them can be traced right here to Congress. We spend too much money, and we run up huge deficits. The Fed, on the other hand, has done a pretty good job, I think, by ensuring a stable money supply. In fact, I would say the Fed is the envy of most of the world in terms of their success rate.

Now, furthermore, over half of the people that are appointed to the Federal Open Market Committee are subject to Presidential appointment and Senate confirmation, and, Senator, obviously you have something to say about that. But I would like a few more specifics on how the current Fed could do better, let's say.

And another thing that bothers me is that I have heard it said that there is no accountability. Well, from a political perspective perhaps there is not, but there is accountability because, in fact, if it wasn't working, we could fix it through legislation. But do we have to go to the extent of politicizing it? I am concerned about that side of it, that end of it, if that is the solution that is sought here.

So I would like the comments from either the Senator or Chairman Reuss on that view.

Senator SARBANES. Interestingly enough, I agree with Secretary Brady and President Bush when they thought the Fed was not responsive enough in bringing down interest rates as we went into the economic downturn in late 1990 and into 1991. The Fed has been sharply criticized by economists, Samuelson and Tobin on one side and Milton Friedman and Paul McCracken on the other, who were critical of its policy.

I never understood why this side of the aisle didn't focus on the Fed and its monetary policy more sharply in the period 1990 to 1992. Actually, you had a Republican administration, and some of the criticism—who was criticizing the Fed, I think with some legitimacy.

The criticism here in the Congress largely was from our side, not entirely. And I think that the Fed's failure to ease monetary policy in the light of the economic downturn contributed further to the downturn. It went deeper. And the consequence of the downturn was that the deficit targets which had been established in the 1990 agreement were not reached.

The Congress, interestingly enough, stayed within all of the spending limitations that were contained in the 1990 budget agreement. We didn't exceed any of those. But what did happen is that you had—contrary to the predictions, the premises of the agreement with respect to how the economy was going to go, the economy actually went down, in effect, out of fiscal policy that was contracting because of the agreement. And the Fed did not ease the monetary policy fast enough. They did ease it over time by little steps. Finally, in December the Fed took a 1 percent drop in the discount rate.

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Mr. KNOLLENBERG. Senator, if I might interrupt. My point, though, to this, would it be any better if it were politicized? If, in fact, the President made all of those appointments?

Senator SARBANES. I don't know whether it would be better or worse. At least then you would say that the policy had been made by people who were publicly accountable. We do know that at one point in the late 1980's that Greenspan had to fly to Chicago in order to try to move the Fed Bank presidents to pursue an ease in policy, that it was being very strongly resisted.

But I don't premise this proposal on the substance of I want to get legitimacy in the decisionmakings. They may make good decisions or bad decisions, just like Members of the Congress. You get elected. You make important decisions. You may make good ones or bad ones. The same is true for me.

But I don't know that anyone would suggest that the kind of public decisions that you make ought to be made by, in effect, a person selected by private interest, and that is my concern here with respect to very personal macroeconomic decisions made by the Federal Open Market Committee.

Mr. KNOLLENBERG. Could I have Chairman Reuss' comments on that same point?

Mr. REUSS. Yes, I would like to comment particularly, Mr. Knollenberg, on the point you made that the legislature and the executive branch have produced in this country in recent years a very irresponsible fiscal policy resulting in tremendous deficits so that the Fed at various times has had to make interest rates much higher than they would have otherwise been to palliate the sins of the fiscal policy part of government. I believe that was your point.

And I completely agree with you and would make the related point that the Fed cannot really wholly undo the harm that bad fiscal policy can cause because, to undo the harm, it has to bring interest rates so high that you create a bad recession and much unemployment to set matters straight again.

You had a beautiful example of this case in the German Federal Republic in the last 2 or 3 years where, confronted with the task of reuniting with East Germany, they decided, the Bundestag and the government, to write every East German in effect a check for $2,000 on that one-to-one currency exchange, but they didn't do anything about compensating for that enormous drain on the German Treasury by either lowering spending or raising taxes, whatever combination you wanted. So the Bundestag, in order to compensate for this, raised interest rates tremendously and has caused havoc and a bad recession over all of Europe.

So I think your point is well taken. Both fiscal and monetary policy are essential, and he who disregards this is the prime cause of the ensuing troubles.

Mr. KNOLLENBERG. Thank you. I appreciate the comments of both gentlemen.

Mr. Chairman, thank you for your indulgence.

Mr. FRANK. Mr. Chairman.

I appreciated Senator Sarbanes' statement that it was important to focus in on the procedures, not the substance. And I am somewhat struck—I was struck with the previous questioner with the

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use of his word politization. It seems that he used politization interchangeably with democratization.

And I think that is a very important point that we have to stress here. We have heard a great deal in this country in the last couple of years about the need to democratize the procedures of Congress and government and openness, responsiveness.

And people who make those arguments about the importance of more democracy and more procedural fairness and openness in everything but monetary policy and then defend very undemocratic ways of conducting monetary policy convince me that what they are really talking about is substance and not procedure at all. That all the talk about democratization is kind of a curtain behind which they can make substantive arguments.

If people are legitimately concerned about these principles, I don't understand why they don't apply to the Federal Reserve. Why is monetary policy somehow one area of American Government where all the reformers and the democratization doesn't apply?

I think the gentleman from North Carolina was being very honest when he said what he wanted is a policy where the Fed concentrates on zero inflation virtually to the exclusion of any other policy. That is a legitimate position for one to take, although it is one that I disagree with you about.

I don't understand why anyone would argue that the public is not to have any say about this. When you set up the Fed the way we have, you bias it toward this kind of circumstance. You take people who are in the banking business, and it is no surprise that they have some sort of a bias toward policies that would come out that way, in which unemployment would be less of a concern, some of the other social issues would be less of a concern.

So the point that the Senator made is a perfectly valid one. Arguments that it is OK to ignore the democratic principles to which people otherwise profess allegiance because they bring about a substantive result that we want here don't seem to be good ways to argue. I don't see why the American people should be trusted to have control over military or trade issues but monetary is so delicate that they have to keep their grubby hands off of it. And that is, essentially, what we are arguing.

As for the President, I think the President did show appropriate respect for our outstanding chairman. But I have to say this. I am not sure, because of what Senator Sarbanes pointed out—he has Alan Greenspan for the next 3 years, and, clearly, it is in the President's interest to reach accommodation with Alan Greenspan. And it is my understanding that Greenspan has been reasonable, and the President writes letters like this, and they are not wholly unrelated. We all know that the anklebone is connected to the shoulder bone in government.

And I think the President's position—if he had been able to appoint his own Chairman of the Federal Reserve and not have to bother about making sure that he palliated Mr. Greenspan who I think substantively has been good.

But I was appalled a couple of weeks ago to see two Republican rollovers on the Federal Reserve trying to talk down the stock market, Mr. Lindsey and Mr. Mullins, announcing that the stock market was overvalued. When did it become the prerogative of the Fed-

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eral Reserve to try to talk down the stock market? That doesn't appear to me to be an appropriate thing for them to be doing and for them to be insulated from the democratic process. So we disagree with this.

But I wanted to say that people who defend the very undemocratic institution of the Federal Open Market Committee and the Presidential appointments and all the secrecy and then in another context being great democratizers suggests to me that the principle of democracy and open government is not really what they are talking about, but they are only looking for various convenient ways to justify their substantive preferences.

And I don't pretend that was a question, Mr. Chairman. I appreciate the chance to say it.

It is nice to see Mr. Reuss in duplication there with Reuss the younger and Reuss the elder seated out there.

Senator SARBANES. Well, let me just say that I don't expect the President to sort of take on this issue, given all the other issues he has at hand. I think Chairman Reuss was right.

But I don't read the letter to mean that if the Congress worked out a reasonable piece of legislation addressing some of these issues which we talked about here today which reflected careful and perceptive thought that that might not be regarded as a constructive contribution. Therefore, it would become law.

Mr. FRANK. I think that is very appropriate. Certainly, the administration has other ways of communicating to Members of Congress its displeasure about legislation, and I haven't gotten any of those communications in this case.

Senator SARBANES. Some of those Governors are desperate to get the interest rates up. They tried to hook a couple of months of interest rates. But the real problem is the lack of adequate economic growth and the restoration of jobs. So now they are searching for some other basis. So they say, the runup in the stock market is the basis on which to do it. It is interesting. They keep trying to shift the rationale to find something that they can advocate to get the interest rates up.

Of course, if the interest rates go up, we are going to, in effect, impede the resumption of economic activity, when we are looking to the monetary policy to help on that score; since we finally tried to tackle this deficit problem on the fiscal side and tried to bring the deficit down. If the economy doesn't pick up, the deficit is not going to be solved.

That is what happened to Bush. The economy went down, and the deficit went up.

Mr. FRANK. I agree with the Senator, and I think these are valid issues for people to pursue, but they shouldn't be allowed to do it in insulation from the normal democratic processes. I can't think of a comparable area of public policy where people are given that degree of power and insulation from any kind of democracy. And I don't understand why people who are great defenders of democracy—every day people are talking about: Listen to the people. You are ignoring the people. But somewhere in John Locke or Rousseau there is a footnote that says none of this applies to monetary policy. It wasn't included. I must have read the pulverized edition.

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Senator SARBANES. You talk about politicizing. The members of the Board of Governors on confirmation get a 14-year term. Now, a lot of them are not serving it out because, unfortunately, in my opinion, the Board is now being used as a stepping stone toward other positions, which I very much regret. That was not the case for a long time in our history.

But the Board is seen as a sort of pinnacle of your career. Now people get on it, stay on it a few years, and then get off and parlay that experience into a very large compensation out in the private sector.

But the only people we are trying to address is these people that sit on the Federal Open Market Committee and get there completely through a private selection process.

Mr. FRANK. But, by any definition, the Board is already politicized in the sense that it is dealing with these public issues and people having other legitimate interests to pursue. The question is not whether it should be politicized but whether it should be politicized without being democratized.

The CHAIRMAN. The time of the gentleman has expired, and we have to move on. Mr. Barrett.

Mr. BARRETT. Thank you, Mr. Chairman.

I don't have any questions, but I wanted to welcome Chairman Reuss as a person who has the honor of filling the seat that he filled for many, many years. I realize it is a tough act to follow, and, as I mentioned to him before the hearing this morning, it was only 3 days ago when I was back in the district and one of my constituents was chastising me for the need to think more like Henry Reuss. And what I was thinking was, the guy has been gone for 10 years. Give me a break. But there is still a lot of respect for Mr. Reuss.

Mr. REUSS. I wish I had heard from him when I was still in Congress.

The CHAIRMAN. Thank you, Mr. Barrett.

Mr. KLEIN. Mr. Chairman, you seem to be doing so well without me, I will let it continue on that basis.

The CHAIRMAN. I appreciate that.

I want to ask unanimous consent to place in the record a news item that was printed. The Fed names chairmen of 12 regional banks. Every one of them with one exception, a woman from Dallas, are white males, not a minority. And I just want to put that list here in view of the testimony we heard, particularly from our colleague, Mr. Mfume.

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

Senator SARBANES. Mr. Chairman, I want to say that I thought that was very powerful testimony that Congressman Mfume gave. And clearly in an area that affects so much of our Nation's economic activity, the failure to draw in the broad sweep of American society is a glaring omission.

The CHAIRMAN. If you will allow me—Mr. Schumer, I thought he had absented himself, but he is back, and we recognize Mr. Schumer.

Mr. SCHUMER. Thank you, Mr. Chairman. I know you are concluding, so I will be very brief.

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You know, this is a fascinating proposal in the sense that I think there is a thread of history that goes throughout all of this. I mean, I just started thinking about it a few days ago. When you think about the arguments back in the Federalist papers—and I have to say to everybody that there is no clear-cut answer on, quote, how much democracy should be in what parts of government. The Supreme Court is a lot less responsive to the people than the House of Representatives.

And there is a continuum. I don't agree with my friend from Massachusetts. I think that the continuum of policy—or with the good Senator from Maryland—I think that you cannot separate the substance from the procedure. I think the two are inextricably linked. And there is a good reason why the Supreme Court, which is supposed to uphold things like the Bill of Rights, is less democratic than the House of Representatives which is supposed to deal with spending the government's money and all sorts of other things. So I think you have to look at the two together.

It seems to me that in the area of a monetary policy there is a need to insulate that policy from—and I say vicissitudes—but I don't mean to degrade them from the short-term zigs and zags that our government goes through and should go through as a democracy. That is point number one.

I really don't know how the Senator's bill would affect that issue. I just don't know how it would affect it because you take the five people of the Open Market Committee off—I haven't done a study, and I am sure he knows more than me how those people vote differently than the others. But that is my hunch.

One of the reasons that we do have the big budget deficit, which President Clinton, I think, deserved a lot of credit for trying to tackle, is that all of us in the legislature and the President, too—one of the many reasons—wanted to respond to the short-term needs as opposed to the long-term and less-direct needs. So, I think that if there is a place in our government where there should be some insulation, the Supreme Court is one, Bill of Rights, but probably monetary policy is another. Because we have elections and there will be pressure to loosen up the money supply and that makes a better result in 6 months but worse result in 1 year and 6 months, and that is natural in the push and pull of democracy.

Senator SARBANES. If you have a 14—I am sorry.

Mr. SCHUMER. Go ahead. I would like to get your answers.

Senator SARBANES. If you had a 14-year term, wouldn't you regard that as a considerable degree of insulation from political pressures? That is what the members of the Board of Governors of the Federal Reserve have. In some respects, you know, I guess we could get in an argument whether that is——

Mr. SCHUMER. Too much.

Senator SARBANES. Too much. But it is barely short of what the judges get. It seems to me a tremendous amount of insulation. And these are very important public decisions about which there is considerable controversy.

Leave aside the 14-year term, you have then got people on the Open Market Committee who get there because they are picked, essentially, by the banking community.

Mr. SCHUMER. Right.

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Senator SARBANES. Why don't we set up some other economic interest in the country to pick the members of the Open Market Committee? So you could say we don't want five members on there reflecting a particular economic group. Let's get some other economic groupings. I am not arguing that. I am just arguing pick them out through the public sector.

Mr. SCHUMER. I guess the point I was going to make, and the Senator really made the same point with a different emphasis, is this isn't that much an issue of democratization because there is a great deal of insulation even on the Federal Reserve Board, as you pointed out.

Then you run into the issue of public-private, but to me because the issue is not one—no one here in this room is suggesting that we have 2-year publicly elected terms for Federal Reserve officers, maybe some people would, but no one here is saying we should elect the Federal Reserve like we do the Congress, perhaps 8-year terms, or 2-year terms and they run for office. But then you get to the question of history, how well has it worked.

In my judgment it has worked pretty well and, therefore, at least to this point, the burden of proof has not been established that we ought to change it. That was ultimately—I don't believe in changing it for a theoretical purpose. Really, in that way I agree with my colleague from Massachusetts, but I don't believe this is going to be an area any of us are going to choose for the closest level or highest level of democratization so, therefore, why do it? That is all I have to say.

I would welcome comments of some of the most thoughtful people I know in government who are sitting at that table.

Mr. REUSS. Does the distinguished gentleman from New York disagree with the unanimous 9 to zero decision of the Supreme Court in 1976 in *Buckley* v. *Valleo*?

Mr. SCHUMER. Yes.

Mr. REUSS. That it is unconstitutional?

Mr. SCHUMER. Yes, I do.

Mr. REUSS. You disagree that it is constitutional?

Mr. SCHUMER. I do disagree.

Mr. NEAL. Would the gentleman yield?

Mr. SCHUMER. Yes.

Mr. NEAL. I have an opinion by Judge Errol Green in 1986 in which he says very clearly that the composition of the Federal Open Market Committee may be unusual but it is not unconstitutional, and before that he says, this has been a subject of considerable legislative discussion over many years. So I honestly, Mr. Chairman, I just cannot see how anyone could possibly claim that this is an unconstitutional arrangement.

Mr. REUSS. Errol Green versus the nine? I don't know.

The CHAIRMAN. The Chair will state that we have gotten notice that we have a rollcall vote and the gentleman from New York's time has expired.

We must move on.

I wanted to remind my colleagues that if you could, return to the hearing room as soon as we cast our vote because we have two witnesses remaining.

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Mr. FRANK. Given the volatility of the subject, could I designate a respectable private citizen of my district to come in my place perhaps, to create a certain calm and lassitude to this proceeding?

Mr. SCHUMER. But with only five-twelfths of a vote.

The CHAIRMAN. Only if you allow us to set up a de facto screening.

Mr. FRANK. Delighted to. You would probably need one in my district.

The CHAIRMAN. Senator, and Mr. Chairman, thank you very much. You have been most patient. We have gone right up to the noon hour and you have been most helpful.

Senator SARBANES. Thank you.

Mr. REUSS. Thank you.

The CHAIRMAN. We will be in communication with you as we go along.

We have two gentlemen that I wanted to thank also for their cooperation in accepting this invitation, and to urge my colleagues to come back and let's listen to them and expedite the hearing.

We have listed them as a panel 2 and panel 3, but because of the time we will join them and have them at the table at the same time when we come back. They are Mr. William Greider and Mr. Grasty Crews, II.

We will stand in recess for about 5 or 10 minutes to record our vote.

[Brief recess.]

The CHAIRMAN. All right. The committee will resume. We will hear from our two friends.

Some of the members are on their way back; others have indicated that if they can, that they will be submitting some questions in writing. So if there is no objection from Mr. Crews, we will recognize Mr. Greider first. And thank you again for your appearance today.

STATEMENT OF WILLIAM GREIDER, AUTHOR, "SECRETS OF THE TEMPLE"

Mr. GREIDER. Thank you, Mr. Chairman. It looks like we are down to the hard core on this subject now.

As you know, I have no professional credentials to testify before this committee. I am not an economist, not a political scientist, never worked for a bank, never worked for the government. I am basically a reporter and have always declined requests from various congressional committees to appear because I think it just complicates the life of a reporter to do that.

I said yes to your request because I think you put a really important idea on the table that looks very simple and innocuous and in fact might actually improve things. I am talking now about your proposal to get the Federal Reserve to produce a verbatim transcript of their Federal Open Market Committee hearings within a reasonable period of time whether it is 2 months, 3 months after their deliberations. I will get into why I think that is significant, but first let me deal briefly with some of the other ideas.

The reason I am here is I spent a lot of years exploring the Fed as a reporter and wrote a very long book about it. I came across the history of virtually all of these ideas that are being discussed

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and, as you know, the late Wright Patman, who looks down upon us, offered all of these and many more over and over again over more than 30 years. None of them were adopted.

I think most of them are wonderful ideas and some of them sound kind of sexy, the notion that bank presidents get to vote on government policy and yet they are not confirmed or appointed by the President and the Congress. Frankly, I think they are diversions in the sense that even if you were to get that idea through Congress, it wouldn't get at the heart of the problem.

The Fed, after all, is going to be close to bankers. They are going to consult bankers. I mean, bankers in the broad sense, brokerages, economists at banks, foreign and domestic banks, it would be odd if the Fed didn't consult bankers. So detaching them a bit from the Federal Open Market Committee isn't really going to change the nature of how decisions are made.

Second, I think—this I am giving you from my book—it is a slightly more complicated relationship than what has been described here. My understanding is that all 12 bank presidents are on the Federal Open Market Committee as members with the 7 Governors, with only 5, it is true, getting to vote, but all 12 at the deliberations express opinions and they go around the table and give their analysis.

Second, if you study how they vote, the bank presidents are slightly more conservative than the Board, the Governors who have served on the Board. That has been the finding of political scientists that have researched that over the years. In fact, it is not a large difference, however.

So the point raised by some of the Members—what is the effect of this? I don't agree with them that there is nothing that needs fixing, but I do agree that change by itself, though it may sound right for democracy, won't really have a deep impact on the behavior of the Fed.

I do think your idea of simply requiring the Federal Reserve to publish a transcript of those deliberations inside the Federal Open Market Committee would have a therapeutic effect.

Let me talk a little bit about the institution as I learned it. I spent several years both immersing myself in the economics and financial details of the institution and also interviewing scores, maybe hundreds, of people inside and outside the institution, present and former Governors, bank presidents, senior officials, the people who sit inside those meetings.

Basically, the question I asked them was why did you decide this; what were you thinking in the autumn of 1979 when you decided to shift to a monetarist way of operating; and what were you thinking in the spring of 1982 when the country was in a deep recession and you decided to hold firm for another month or so; and what were you thinking in August 1982 when you decided to ease and so forth and so on?

The one theme that came back from everybody repeatedly was to emphasize: A, the difficulty of what they do; and, B, their own fallibility.

I say that with respect. These are smart, dedicated well-educated people who are in fact arguing among themselves over what is the right thing to do and they have, like the Congress, they have un-

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certain assumptions, they have squishy numbers, they have really difficult tradeoffs between competing objectives. So they make mistakes. Just like us other mortals.

The difference, of course, is that when the Fed makes a mistake it can have a devastating impact on lots and lots of people. They can turn viable businesses into bankruptcies, they can drive debtors to the wall, they can put millions of people out of work, they can turn losers into winners, punish some investors, reward others, they can literally reverse the tide of economic growth, and they do that obviously with reluctance and some misgiving but the Fed has the power to do that.

Given these vast powers, it is fatuous to contend the Fed is non-political. If I say one thing at all and it gets implanted in the record, it is that the Federal Reserve is, of course, a political institution. I want to make it clear what I mean by that.

I do not mean, as some Fed critics have always said over the years, that the Federal Reserve is made up of conservative bankers, represents wealth, and so forth, takes care of the Republicans and punishes the Democrats.

I think the history of the central bank pretty clearly refutes that. As somebody mentioned, if the Fed were dedicated to taking care of the Republicans, George Bush would be serving his second term right now, and, without a doubt, Richard Nixon would have won the 1960 election.

Nor do I suggest, as a lot of economists argue, that the Fed privately takes instruction from the White House. They don't like to do that in public but that is the way it works.

Yes, the Fed listens to the White House; no doubt about it. The Fed listens to financial markets, to Wall Street, to commercial banks, to a whole array of players all the time and it tries to steer between those rocks as any political institution would.

But again, as somebody even mentioned, if the Fed simply followed the wishes of the White House then probably Jimmy Carter would have gotten a second term and maybe Gerald Ford would have been elected. You could go through the history and see this again and again.

What I am trying to describe is a political institution in the generic sense—making big public decisions with the force of government and with an absence or at least a very weak connection of accountability. We can all kind of see that that is wrong in our sense of democracy, it doesn't—in theory—fit.

Yet, we also have to concede it has been there 80 years. Both political parties have supported this arrangement. It is Woodrow Wilson's grand compromise. It is not likely to be easily altered.

Well, what I see as the first problem is that this political dialog that goes on all the time privately, semiprivately, is very distorted. Some citizens have a very large voice in it and most citizens have none.

The Fed, obviously, doesn't have to face elections. That is the way it was designed. But, frankly, to be blunt, the Fed really doesn't have to face intelligent scrutiny from those people elected to represent them. That is the Congress.

I have been to a lot of hearings of this committee and the Senate Banking Committee and I would say, candidly, oversight hearings

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on the Federal Reserve, those semiannual Humphrey-Hawkins reports, are generally not terribly edifying.

A lot of the questioning is posturing and sort of the bile of the moment. Misinformed little traps are laid for the Fed Chairman, and I have watched Fed chairmen step out of those traps quite easily because the questions are not all that profound or intelligent.

I think the truth is that most Members of Congress defer to the Fed's wisdom because they don't understand it. They, like most Americans, are spooked by the mystery and the power and it is tough stuff, it is complex, it is daunting. So they may stand up and rail at the Fed Chairman—why are you putting my people out of work, and so forth—but in fact there is a kind of willingness on the part of Congress not to know and not to understand. I have to add that the news media enforces that. If you become a critic—and I mean a serious, intelligent, ongoing critic of the Federal Reserve—you can pretty much count on the press beating up on you and accusing you of, quote, political meddling with this supposedly nonpolitical institution.

I think this matters. Distorted politics matters to everybody in pretty powerful ways, because the effect is a kind of institution which given its own natural biases, takes a very narrow view of economic reality, and tends to exclude those competing views of economic reality.

I think if your proposal were to become law and the Fed were to make public its internal debates, most everybody would agree that that is the case. I base that on my own reporting and discussions with Fed Governors, and some of them acknowledge that. Others denied it, and some of them anguished over it, and some of them dismissed it, but they all could talk about their fallibility. Yes, of course, we are in this narrow trench trying to do the best we can with the complexities of the economy.

Wall Street, as you know—I use that term broadly—spends a lot of money hiring, quote, Fed watchers. And they need to do that. They have to have some sense of where monetary policy, credit, and interest rates are going because it will affect not just credit markets but economic activity across every sector.

Meanwhile, the public is regularly blind sided because nobody in government gave them an intelligent explanation, intelligible explanation of what is coming and why.

Again, I don't blame the Fed solely for that.

If you are talking about reforming the Federal Reserve, if you are really serious about it, you are really talking about the behavior of other institutions as well, including the Congress. If you asked me in some sort of pie-in-the-sky manner to design a form of the system, I undoubtedly would come up with ideas a good deal more radical than anything that is on the table. But I thought about this a long time, and I came to the conclusion that while those ideas in theory might be sound, as a practical matter they don't belong on the table yet because the level of ignorance is so profound and it would be so difficult for the Federal Reserve to be rearranged and to share power more openly with the rest of government. So that is why I settle on your idea.

I think it is a reasonable basis of accountability. You are not asking the Fed to do anything more than any other agency of govern-

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ment perhaps excepting the Central Intelligence Agency is required to do. A President, you know, proposes legislation, and you have the power to demand exhaustive documentation from him or from any executive agency: Why are you proposing this? Where are your facts? What is your argument?

Every Member of Congress is required to do the same. That is what debate and argument and deliberations are about. Creating a record for accountability. So I actually think if you could accomplish this, it would have some modest effect on the Fed's behavior perhaps but it might also have a larger effect on the general public and on the Congress. I am talking about the beginning—it is only a beginning—of a mature understanding of how monetary policy relates to everything else.

You are simply asking them some simple questions: What happened at your meeting? Why did you decide these things? What did the economic reality look like to you when you made these decisions? What did you think your policy was going to accomplish?

That gives us all a baseline for beginning to judge their behavior.

One of the things it took me a while to grasp but as I spent months and a number of years talking to Fed Governors and Fed economists, they kept saying to me: Monetary policy is a continuum; it is not one moment in time, it is not one decision.

I finally did grasp that that was not a cliche. It is quite true. They are following a stream of interlocking forces in the economy and they are making a judgment in March which they hope will produce some results by June or maybe by September and they are adjusting that decision constantly. That is what they argue about in those meetings. And they have to take not 3 or 4 things but a dozen or 20 things into account as they make those judgments.

So, of course, there are arguments about who is right and who is wrong. I think until average citizens—not to mention Members of Congress—begin to accept that reality and look at monetary policy in those terms, then it will always be a kind of game of catch in which you try to nail them in saying something inappropriate or getting them in some kind of a minor deception.

Now, what would we get if the Fed produced these documents? Believe me, it would be a very hard slog through some very dense reading. I base that on my reading of several years of the old FOMC minutes which, as you know, were really just a secretary's rough minutes of the meeting. They were not a verbatim transcript, and Arthur Burns unilaterally abolished them in 1975 or 1976. But I read a lot of them. They are at the Fed library and, believe me, you would not take this stuff to the beach for light summer reading.

What you would get? You wouldn't get name calling and you wouldn't get political plots and you wouldn't get people making accusations and, you know, at the least this might lay to rest some of the more lurid conspiracy theories that surround the Fed. What you would get I think is a very earnest, dense discussion of economics and an argument that once you got used to reading them you could hear the argument but you would have to be pretty sophisticated even then to understand that Governor X is saying Governor Y is wrong or that Governor Y said this back in January and, look here, we are in June and it turns out to be the opposite.

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But that is the grist of these discussions. They are competing analyses of the economy, arguments over what is happening and what is likely to happen, and over how monetary policy will affect everything from bank lending to manufacturing, retail sales, unemployment, global capital flows, and so forth.

You are not going to get any big headlines out of this. But what you will get, I think, is the basis for serious people who are willing to spend the time and energy to begin tracking monetary policy over time to get a coherent understanding of what the debate is about. Presumably, that starts with Congress, if Congress has the energy for that; then I think, yes, there are a lot of interests that don't get to sit at that table and they feel excluded. I am talking about the obvious ones, labor unions, homebuilders, farmers, oil drillers, manufacturing. They understand they are not direct players in finance and they are really not experienced in doing this. They are not so good at lobbying the Fed and they will scream and yell at the Fed, but they don't have a terribly sound grasp of the subject either.

So I think this is a modest step toward public education and accountability. Would it lead to more dramatic reforms, so-called politicization of the Fed? Well, it might but, frankly, I think history is against that. As I mentioned, Wright Patman didn't get far trying to change the nature of the Fed. I think a lot of it would depend on events. Are people shocked by what they read, or reassured? I am not prepared to say which that would be.

Would it change the behavior of the Fed? Maybe a little bit. It would certainly make them sensitive to the fact that their words will be more widely distributed. I don't think that is bad. Members of Congress have to subject themselves to that. Yes, they might even make some speeches in those meetings designed for public consumption. I don't think that is bad either.

I think that is what Members of Congress do in their debates. They know they will not change votes but they are making a record which other people can consume and learn from.

Now, why is doing this so important if it is only having these slight effects? I actually, ironically, believe that this sunshine would make the Fed a more effective institution of government. The reason I think that is because, A, it would, at least a little bit, raise the level of the economic debate in American politics which is at a pretty low level now in terms of intelligence and seriousness. It would perhaps enhance the Fed's credibility with the public as people get at least a glimpse of what is being argued over here.

More importantly, and I think you could talk to Fed Governors and Fed chairmen about this, including the incumbent Chairman, the Federal Reserve is often in the posture of trying to persuade public behavior. Chairman Volcker was doing this all the time but sort of warning, imploring, scolding either investors, consumers, or businessmen, telling them to slow down, telling them to be more prudent. Frankly, that message just falls on deaf ears partly because those people outside sophisticated circles don't understand what is being said to them.

So this reform would have the first effect of pushing the Federal Reserve Governors to speak a little more plainly in terms that normal, ordinary, uneducated—that is noneconomists—could under-

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stand; and, second, I think their ability to alter economic behavior by persuasion would actually get stronger.

Now, the other major effect is I think really the most important one and that is about, as was mentioned here, the coordination of fiscal policy and monetary policy.

The late Mr. Patman called the Fed a car with two drivers; one driver has his foot on the gas, the other has his foot on the brake. He meant Congress controls the fiscal policy of taxes and spending and the Fed does money supply, credit, access to credit, and interest rates.

As we know, from recent history in fact, those two drivers are sometimes going in opposite directions and the side effects of that are horrendous and we have experienced some of them in just the last 15 years. I am not, I emphasize, saying the Congress and the executive branch were right in their fiscal policy and the Fed was wrong. In fact, in some instances I think it was reversed. But what I am saying is the refusal of these two power centers to deal with each other in a rational, coherent way is itself very destructive and we are paying for the misunderstandings and lack of communication right now.

Again, to be blunt, I think both sides like it like that. I don't think the President and the Congress want to consult with the Federal Reserve in any serious way about fiscal policy. I think they have seen the Fed as this spooky temple that will clean up the mess if they are having excesses and they don't want to be responsible for that.

Likewise, the other side, for more obvious reasons, does not wish to consult with the executive branch about how our monetary and fiscal policy are going to fit, in any visible manner at least, because that will somehow crimp their style. So both of them are free to go their own way. And then we get the consequences.

Now, it is difficult to start from zero and say this is how they ought to coordinate. It is true that they, the Fed Chairman meets with the Treasury Secretary; in fact, there are not just formal meetings, there are dozens and dozens of meetings and conversations. I think that is not what makes a process accountable and reliable. I think you have to formalize it. I don't have any strong idea about how you do that, but I think making the Fed's arguments more visible and the present situation of its policy will, first of all, have some impact on the Congress.

I have been talking abstractly; let me be very tangible with my examples. In 1981, when the Reagan economic policy was adopted, huge tax cuts and a huge defense buildup, the effects of that were highly stimulative to the economy. The Federal Reserve under Chairman Volcker was already embarked in the opposite direction, they had interest rates at 20 percent with a very obvious purpose of wrenching the inflation out of this economy and that means, yes, probably a recession. It didn't say that in public but anybody with any sophistication understood that that is what was coming.

Nonetheless, Congress and the President went ahead with a program in going in an opposite direction. The Federal Reserve, out of its own lights, and I have some sympathy for the situation it found itself in, said we have to counter that. So it held interest

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rates high. We went into a deep recession and did not get any stimulus effect from the deficits until after the recession.

This was the car with two drivers and the country wound up in the ditch.

Would the Congress have gone forward anyway if it had understood that it was going right into the wall of Federal Reserve monetary policy? Maybe. I can't claim that the Congress would have been totally rational on this. I don't think that events of 1981 were totally rational but at least there would have been visible debate.

After the recession of 1982 was over, the Federal Reserve resolved in private—never announced this decision—that because the huge stimulus from the deficits is pouring into the economy, we have to keep interest rates at an extraordinarily high level to check that stimulus. They did that.

Again, let's not argue over whether that was the right decision or wrong decision. The fact is the interest rates of the 1980's in real terms were the highest of this century and my authority for that is the Chairman of the Federal Reserve Board, Mr. Greenspan.

Up to this point, we have an argument between these two power centers and we have not chosen which is right.

Now let's look at just some of the collateral consequences of this collision, again, not blaming one or the other. One is that the savings and loan crisis was dramatically worsened by the level of interest rates through the 1980's. We all know the history of the savings and loan crisis, and we all know there were other causes along the way including some political neglect, and so forth, but I have talked to Fed economists who were inside the Fed at the time who would put projections in front of the Federal Reserve Governors saying if you keep this policy, you are going to lose 1,000 S&Ls or 2,000. I forget the numbers. Inside the Fed, the Vice Chairman of the Federal Reserve, Preston Martin, because he came out of that industry was pleading with his fellow Governors month after month to ease that policy or do something to take care of the S&Ls because he saw what was happening. His remark to me was, quote, "We threw them to the wolves."

Two, the trade deficit soared from 1980 to 1985 primarily because the Fed followed its high interest rate policy which sent the dollar soaring against foreign currencies. Inside the Fed, Paul Volcker and Anthony Solomon, who was president of New York Fed, anguished about this all the time and in fact they wanted the Treasury to get active in some kind of dollar policy that might have lessened the damage. Believe me, this was not a public debate. It was private conversations.

Lee Iacocca was complaining rather regularly that once these foreign producers get these market shares from U.S. companies, it is going to be very hard to get them back. Turns out he was right. Here we are, the dollar weakened, and a lot of history passed since 1985 but the market shares have not changed that much. That is a permanent damage to the structure of American manufacturing.

Again, I am not blaming the Fed, but I am saying it was a result of this collision between fiscal and monetary policy.

Third, the collapse of Third World debt was directly triggered by the high-interest rates generated by the Fed.

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I am not blaming the Fed for making all those loans. I am not blaming the Fed for the dilemma it was faced with but nobody ever acknowledged that in 1982 when the Fed suddenly reversed policy and began easing. It was easing in July, August, 1982 partly because the whole economy was going through the floor but especially because it was now confronted with a default from Mexico and it knew Brazil and Argentina and a bunch of other countries were right behind and that, in fact, imperiled the American banking system at the very top.

You can take a line, and I will not bother you with this argument, but you can trace those events, those decisions to the debate before you now with NAFTA and our trade relations with Mexico.

I am sure you have thought your way through this. Again, I am just saying that there is a continuum of cause and effect here that almost never surfaces in serious debates about the Federal Reserve.

Finally, I mentioned the farm crisis, not to blame the Fed for the farmers taking on too much debt but to make a somewhat different point. Neither the farmers nor other kinds of debtors were given fair warning about what was about to happen to them. I documented this in case after case, literally. Your Federal agencies, Small Business Administration, Farmers Home, and a whole bunch of others were making loans and guaranteeing loans in 1980 through 1982 that were absolutely doomed to fail by the Federal Reserve's own policy.

So I complained in terms of democracy that the Fed or the Federal Government didn't give those farmers fair warning of what was going to happen to them, but they didn't even tell other Federal agencies what was going to happen to them.

Let me jump to one other example which is tangible and more current. That is about the present Fed and the present Chairman and the present Congress.

In 1988, naturally enough, both candidates for President promised the voters that they would deliver economic growth and jobs, and so forth, and at the very time they were doing that, the Federal Reserve was embarking on the opposite policy. In the summer of 1988, the Fed started ratcheting up interest rates out of its own perception of what needed to be done, and its goal was to suppress consumption, slow down the economy, and presumably reduce the inflation rate.

I am not arguing that that was the right goal or the wrong goal. I am simply saying that here you have the American voters listening to one sermon while the government in fact was doing the opposite.

When the Fed pushed short-term interest rates up above long-term interest rates, they were flirting with recession and that happened in 1989. The Chairman of the Fed said he didn't want a recession, and I am willing to take him at his word but that is what the country got.

There is a pretty good rule which I discovered in my study of monetary history; when short rates are above long rates and they are held there, called an inverted yield curve in financial markets, then a recession follows.

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If you go back through history, back to World War II and before that every recession has been preceded by that condition.

So, question: Did Congress know that the Fed's monetary policy was pushing the economy toward a contraction? Evidently, not because in the fall of 1990 the Congress adopts the famous budget deal which raises taxes, cuts spending, and right in the teeth of a recession adds pain and destruction.

My question is, would they have done that if they had understood what the Fed was embarked on?

Now, maybe they would have. Maybe they would have gone ahead anyway. Maybe they decided that that was the right thing. But it seems to me in a country of this complexity, particularly given our democratic values, that those questions ought to be somewhere visible to normal people. Whether they come from the Fed or they are put in the face of Congress, these are pretty big decisions on people's lives and we are paying for them still.

At the time, as you may recall, the Chairman of the Fed was urging Congress to adopt that budget deal and he was assuring you that there wasn't a recession. As I said, the Fed is not infallible on these matters.

To summarize, I see two goals that your limited proposal would go toward and only really begin to produce change.

The two goals are: One, to force some kind of more accountability not just on the Fed but on all of the levers of macroeconomic policy so that they at least confront their own contradictions; and, two, to open up this cloistered debate a little bit so that many more voices could be heard. Thank you.

The CHAIRMAN. Thank you very much, Mr. Greider. Your prepared text of the remarks you submitted will be printed in the record following your oral presentation.

[The prepared statement of Mr. Greider can be found in the appendix.]

Mr. Crews, let me say for the benefit of the new Members that Mr. Crews has a very distinguished record of service to this committee. And my only regret is that when I did come aboard as chairman I had some pretty anguishing discoveries, one, the decision was made informally in December 1988 that I would be chairman. It wasn't official, but I was facing a deficiency, that our equivalent of our auditor and treasurer explained to me that the December payroll would not be able to be met unless we did something and they asked, well, we are not going to get any money; and I said, well, no. This last October 1 the chairman had turned back $300,000 to the House Administration Committee, and because of some—maze and ledger domain of budgetary and accountability that we have in the Congress affecting committee funding, we were able to refigure it out and meet the payroll.

But what I wanted to say was that otherwise if Mr. Crews had been willing he would probably have been aboard as once again helping the committee. So thank you very much for responding to our request, Mr. Crews. You are recognized.

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STATEMENT OF GRASTY CREWS II, FORMER COUNSEL FOR THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS; FORMER GENERAL COUNSEL FOR DRUG POLICY OFFICE IN THE EXECUTIVE OFFICE OF THE PRESIDENT UNDER PRESIDENTS NIXON AND FORD; FORMER MEMBER OF THE LEGISLATIVE COUNSEL, U.S. HOUSE OF REPRESENTATIVES; FORMER ADVISOR, LEGAL DIVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. CREWS. Thank you, Mr. Chairman.

It is a great pleasure for me to be here and I appreciate the opportunity. I remember very vividly when this committee met across the street in what we then called the New House Office Building and then the ranking, not yet chairman of the committee, Wright Patman, introduced a young Congressman from Texas, and I have long since forgotten what we discussed at that meeting but I will never forget the shy smile with which you acknowledged Mr. Patman's introduction, you took your seat for the first time at an executive session of the committee. I never dreamed I would be in this building at this time, but I am very happy to be here.

I am not going to try to repeat what is in the prepared statement. A lot of it has been covered by other witnesses. There are two things that were brought up in the informal discussion that I would like to address briefly.

Mr. Neal quoted from Judge Green's opinion and I think it is very important to understand the status of that opinion. It was vacated. That means it no longer has any force or effectiveness for any purpose, even as a precedent.

When a court of appeals considers a lower court opinion, it is often confronted with two different kinds of questions, a procedural or jurisdictional question—namely, do we have a right to even get at this thing or not—and, second, the substantive question that the party below tried to raise.

Now, if the court is in agreement with the lower court's substantive determination, it will often say so, and a good example occurred in this area because at the same time, just by coincidence, that Federal Reserve Open Market Committee membership was being challenged by one Member of Congress, Senator Melcher, another Member of Congress was challenging the constitutionality of the pay-setting mechanism for Congress. That went to a different judge down below and they happened to be heard in the court of appeals at about the same time.

You have three judges chosen by—at random for each of these hearings, and again a coincidence, there was an overlapping on the part of two judges. In other words, two judges heard both cases and there was an additional judge in one and an additional judge in the other.

In the pay-setting case, the court of appeals said Judge Oberdorfer should not have considered this case at all. He didn't have standing. But in case it is held upstairs, that they did have standing after all, we hold that the pay-setting system was perfectly constitutional. So even if they had had standing, they would have still lost.

In Senator Melcher's case, the court was very careful not to touch the substantive question with a 10-foot pole. They said nothing fa-

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vorable about Judge Green's determination, that that setup was institutional. They simply vacated on the grounds that the plaintiff in the case did not have standing to bring this issue to the courts.

You can draw your own conclusions from that but that is the way it happened.

I don't think this is the proper forum for me to get into a discussion of standing, it would be more of interest to your colleagues on the Judiciary Committee, I am sure.

The other thing I would like to comment on briefly is why we are in this problem. Why we have this problem. I think that goes to the essence of the institution of the constitutionality question.

We have it because the mechanism for regulating the value of money contemplated by the Framers of the Constitution is no longer workable. We simply can't do it that way anymore. We have not done it that way for about 60 or 70 years.

The relevant provisions of the Constitution are these: Section 8 confers on Congress, in so many words, the power to coin money, regulate the value thereof, and of foreign coin.

Section 10 explicitly withdraws the coinage power from the States, and implicitly mandates a precious metal standard as the means by which Congress is to regulate the value of money.

In section 10, it specifically says: "No State shall coin Money, emit Bills of Credit"—that is an 18th century way of saying issue paper money—"or make any Thing but gold and silver Coin a Tender of debts."

That means to regulate the value of coins under that system, you change the weight of gold in the dollar or a silver dollar, whatever. But that was the way it was done. And there is this clear separation between money, or what we in modern economic parlance call the monetary base, and everything else which is credit.

When we instituted the modern Federal Reserve System with the Banking Act of 1935, we literally didn't know what we were doing. In fact, we had not completely done it yet. We retained gold as the monetary base, it was still used in international transactions and would continue to be for many years but it was no longer interconvertible with money as it had been at the founding.

So we sort of eased into, without real public debate, without a real understanding of what we were doing, into this situation we have now where the power that controls the Federal—controls the monetary base is in exactly the same position that the Congress was in 1789 when we began, and for many years thereafter, where Congress specified that the dollar shall consist of so many grains of gold and such and such fine.

The winds of change now blow not only too hard but too erratically for the price or value of any commodity to be expected to stay in step with the needs of a worldwide economy. So we cannot go back to that system. But this leaves us in a place where the very foundation of the system assumed to exist has been swept away.

It is hard for me to escape the conclusion that the accommodations that the FOMC made to first the needs of the Democratic and then a Republican administration to simultaneously finance a war in East Asia and urgently needed social programs here at home, contributed to a subsequent acceleration in the rise of prices, especially in real estate.

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I am just going to take 1 minute to repeat something of a thought that has already been expressed.

At the end of the 1970's, efforts to counteract the effect of those accommodations led to a rate of change in interest rates far in excess of anything that many depository institutions specializing in long-term real estate loans, savings and loans, could reasonably be expected to adjust to. As a result, they quite predictably went broke in droves.

Although I think a strong case can be made for the proposition that the Fed's action was necessary to brake an ingrained expectation that price rises would continually outpace interest rates, I think the Fed had a responsibility to warn what else was going to be broken in the process, especially when that something else was something that the government itself was obligated to fix.

If we can't go back to the method of regulating the value of money that was contemplated by the Framers, I am convinced that we can't, then we must think anew of how to achieve the objective they sought, but by means which are available in our time. In one man's working lifetime, which I hope hasn't quite ended yet, we have seen a devaluation of the dollar by more than 90 percent. My first job was as a minimum-wage laborer at 40 cents an hour and yet that 40 cents would by buy more than what the minimum wage would buy today.

I think it is obvious that—I think there is no way that we as a nation can feel satisfied with that record. And on that point, I would respectfully disagree with some remarks Mr. Schumer made earlier today. He said he thought that on the whole the Fed had done a good job.

I think—I would concur with my fellow witness, Mr. Greider, that the individual members have tried to do a good job, and I am not impugning their motives or integrity or anything about them. The point is that in order to change the record, I think we need institutional changes.

If we could do better with the existing institutions, we would have done it already over a period that long. I don't see that we are doing it.

I would like to conclude by urging all three of my former employers, the Federal Reserve, the executive branch, and this committee, to approach the issues raised by H.R. 28 as an opportunity for dialog with genuine communication and problem solving and not as an invitation to a power struggle. It is my deep conviction the appointment of all members of the FOMC, in accordance with the Constitution, would strengthen, not weaken, the legitimate independence of this vitally important arm of government.

In and of itself, such a change would certainly not solve the central dilemma of monetary policy, which is how best to balance short-term and long-term considerations in the context of an ever-changing global economy.

It may be that until we can devise a true global currency, a function that gold once appeared to fulfill, we may simply have to muddle through with substitutes that don't work very well. Even so, I think the muddling will be more successful and the discussion more enlightening, if it is illuminated by a candid acknowledgment

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by the FOMC of its function and by timely and candid disclosures of the reasoning behind its decisions.

I think the essential thrust of H.R. 28 is an effort to foster those objectives, and I hope it will be considered in that light.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Crews can be found in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Crews.

I, for one, am deeply grateful to both of you for what I consider to be the proper interpretation as to the motivation and the intent of this proposed legislation. As I said in my opening statement, never even in the most ambitious thoughts could I conceive of having the solution to what would be the ideal structure. I think that in the human activity that is impossible and illusory to think you could do it.

However, I am aware of the fact that the Congress has failed to approach and even discuss the critical or basic issues which now, and particularly just 5 years ago, were engulfing us in deep crisis, which we have not fully emerged from, incidentally.

Mr. GREIDER. That is right.

The CHAIRMAN. And I have watched this during the 33 years I have had the honor of being a Member of the Congress. I did speak out.

Of course, in August 1979 I didn't expect any particular attention but I became very concerned, because I took the annual Federal Reserve report which I, for one, looked at and tried to analyze as best as I could. And I came to the conclusion that the exponential increase in 1½ years in our leading banks involving loans to nations, mostly Latin America, that I knew could not pay at that time. I also happened to be chairman of the Subcommittee on International Finance, as we called it then, and having the rule of thumb that the Bank for International Settlements—these are institutional bankers that have been in the business for several years and have about what they called the 22 to 1 ratio.

When a financial institution reaches a point where it has a ratio of 22 to 1, that is debit as compared to capitalization of assets—it is gone. No return. But what these principal banks have done, just in Latin America in what is known as "sovereign debtor loans," was to have increased in less than 1½ years from $3 billion to over $47 billion.

I then made a speech on the House floor, and to my amazement, the following day in the afternoon, I had a call from General Chairman Arthur Burns and he wanted to know if I would have breakfast the following morning. I said, I would be honored. I was flabbergasted. I don't know why I would be called.

So it turned out it was either somebody—or I guess they have people looking over the record, and so on, and saw my reference to the Federal Reserve Board. And he said, well, you know, I want to tell you that your remarks were on point, and that I agree with them, and I am very, very much disturbed. In fact, last month at the convention of the bankers in Hawaii, they got quite angry with me when I admonished them about this exposure. I said, well, Mr. Chairman, what are you going to do about it?

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And he said something that I had seen in the paper, that this money was recycled Arab petrodollars. My contention was that whether they were Arab or anybody else, they were deposits in those banks and when the amount of that exposure exceeded or came near that capitalization structure, I thought the Fed had a responsibility.

So the Chairman said, well, there is nothing I can do. And I smiled and I said, you know, when I came here I didn't know what you wanted but when you first mentioned this I was kind of happy that at least you were worried about it. But now that you tell me that you don't think there is anything you can do, I am really worried. Because if you, the Chairman of the Federal Reserve Board, can't utilize even section 14-B of the Federal Reserve Board Act, then it is not that you can't do it, it is that you don't see your way of doing it. That is demanding some reserves for that exposure.

So anyway, the real issue was that soon came apparent a few minutes later when he wanted to know—I guess he assumed I had some connection with President Carter—and he wanted to know if had heard what President Carter was thinking of in appointing the Chairman. His term was up that month.

Mr. GREIDER. Nineteen hundred and seventy-eight, yes.

The CHAIRMAN. When I said no, I didn't, he was shocked, and that was the end of the visit. But I was telling him the truth. President Carter was about as accessible—well, he was slightly more accessible than President Reagan, whom I never met. So it was hard for me to explain to them.

He said, aren't you a Democrat?

I said, of course, I am, but that doesn't mean anything. And I said, you mean to tell me that you have not had any indication?

I said, then I would get worried if you are interested in being reappointed. But let me make it short by telling you that there are three things that I never have understood, don't intend to try, and two of them I gave up a long time ago.

The first one is women.

The second one is the weather.

And the last one is President Carter.

He didn't smile, so I figured I better get out of there.

The point I am trying to make is that the changes that I envisioned should have been made when Chairman Eccles was recommending them, and that was 50 years ago.

Chairman Eccles, I consider to be, as I said earlier, the last that I know of since that era, really uncompromised Chairman of the Federal Reserve Board.

Mr. GREIDER. Could I speak to that because——

The CHAIRMAN. Yes, sir.

Mr. GREIDER. Perhaps you, too, Mr. Chairman, but we have the burden of having lived through at least mentally a lot of Fed history that is now totally lost and understandably so. But in the 1935 act, I tried to understand why they did it and what were the arguments, and I like to think of Mariner Eccles as this sort of shy giant in American history that nobody appreciates fully. He is forgotten now. So we talk about the Fed being independent or don't politicize the Fed, but the Treasury Secretary and the Comptroller used to be on the Federal Reserve Board.

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The CHAIRMAN. That is right.

Mr. GREIDER. That is the way Wilson made it in 1913 and they served there up until 1935.

The reason they dropped off was just the raw politics of it. Carter Glass, then a Senator and chairman of the Senate Banking and author of the original legislation, resented their presence there and so he wanted to pull them off, and Mariner Eccles who was drafting this reform legislation, let him have that.

The reason he let him have that is that Eccles was in the White House every day of the week consulting with President Roosevelt and the Treasury. If you had said political independence, they would have said, what are you talking about, we are all one government here.

The CHAIRMAN. That is right.

Mr. GREIDER. Indeed, they were. During the Eccles regime, he was a close adviser to FDR and a principal architect of the New Deal. A lot of what the New Deal did across the government came out of his thinking, including the housing mortgages which allowed Americans to own homes.

But my point is his argument then was the President is taking too much direction from the Treasury, when it ought to be listening to the Fed. I am just——

The CHAIRMAN. You are right.

Mr. GREIDER. I go through that to suggest to you that there may be some positive qualities to these different parts of government collaborating more closely than they do. Obviously, I would like to see them do it in daylight where we can all see the process, but I think we get into one corner after another because of this pretense that the Fed is somehow independent from the rest of us.

The CHAIRMAN. I think that, in effect, they adopt the doctrine of infallibility. If you have power and you have no accountability, it is inevitable, things are going to happen and they may not be in consonance with the greatest interest of the greatest number. That is whether it is the Fed, or the Congress, or legislators, or a President or anybody, or the church.

Even the church recognizes that the Pope's infallible power is restricted in matters ex cathedra, he is not infallible, as the recent pronunciomentos he made a few months ago. Whoever cares about that.

But what I am saying is we are dealing with an institution that whether it says that is what it wants or doesn't, is really infallible. That is once it makes a decision and we say, well, we hope that they will make the right decision, it is the only decision around, and whether it is right or wrong, and history will show one thing or the other, it is immaterial.

The point is that in our processes we cannot be faithful to the basic constitutional discharge of our responsibilities either in the Congress or in the executive branch, and particularly with respect to an entity that was created by the Congress. It didn't come down from heaven. Congress created it.

Therefore, minimal actions to bring about an accountability that would result in one, in which you say in your written statement on page 2, and I quote: "As more than one Federal Reserve Governor confided to me it was very difficult, perhaps impossible for the Fed

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to have an honest discussion of monetary policy with Congress or the public because the level of ignorance and the potential for misunderstanding is so profound."

If we accept that, then we better give up on the whole system because the people expect us, their agents, elected to act as agents, to act also as educators.

How are they going to know and how is the press going to know if you don't have debate, if you don't have discussion, if you have no basis for evaluating an action taken?

Anyway, I have exceeded my time and I don't have any specific questions at this point. I may later.

But I wanted to thank both of you for your most enlightening testimony and background information you have given us in your statements.

Mr. Leach.

Mr. LEACH. Mr. Chairman, let me just say I differ with one part of your trilogy. From my perspective it should not be women, weather, and Jimmy Carter; but women, weather, and Chairman Gonzalez. You have given us a macroview from history to theology, and we will spend a lot of time trying to figure it out.

Let me repeat something that I am more concerned about than others I would like to mention to Don Winn that this will be my major question when your Chairman appears.

I am struck not by the separation but by the integration of the Fed's microresponsibilities for regulation in one sector of American industry with the macroresponsibilities it has for the economy.

I am struck by an aspect of this that I consider to be very significant. The old cliche in banking is "a bank is only as strong as its customer base" which implied that a bank's vested interest was the general economic outlook for its region of the country.

Intriguingly, in the last couple decades there have been episodic evidence, particularly in the last 4 or 5 years, that the banking industry has ups and downs not only unrelated to the economy in general but that it has prospered when the economy has stagnated; other times the economy has done well and banking has stagnated.

There are interesting aspects to that from a structural circumstance, and let me just explain.

If you take the last 4 or 5 years, we have operated a macroeconomic policy to shore up the financial intermediaries of the country. We had to do that because there are institutions which had they gone under—would have caused difficulties for the economy, and been expensive to the taxpayer. One of the reasons why such a circumstance arose was the failure of regulation.

Mr. GREIDER. That is right.

Mr. LEACH. The failure of regulation was one that the chairman indicated in his history. I don't want to go back into too much historically, but I think he is exactly right in expressing certain concerns regarding LDC debt.

The first major bill I introduced in this Congress was one to apply either a reserve requirement or capital ratios to international lending. When you had discrimination in bank regulations that were biased toward international lending, by definition you gave incentives for the financial sector to lend internationally. So we had a circumstance that regulation led not only to imprudent con-

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cerns being reflected through the institutions involved but actually clear incentives for those institutions to make imprudent loans. In making those imprudent loans, then, among other things, policymakers, particularly at the Fed, had to recover and develop macroeconomic policies to cope with that circumstance.

Mr. GREIDER. That is right.

Mr. LEACH. Which had very little to do with the economy at-large, although that was also a factor. Since the Fed is also particularly accountable for the health of the financial sector, and because of the political science oddity, by which an industry has a particularly strong representative in the Fed's policymaking function, you have potential conflicts between the good of the industry and the good of the economy at-large. That is a very serious circumstance.

Mr. GREIDER. Yes.

Mr. LEACH. Please.

Mr. GREIDER. Yes, it is a profound complication in this institution, which every Fed Governor would very quickly acknowledge to you and undoubtedly have, but that came up again and again and again in my trying to recount the history of the 1980's. Charles Partee, Henry Wallich, Paul Volcker, Lyle Gramley, all discussed with me the complexity and contradictions which they are up against.

Volcker is quoted in the book, said something to me like, you try telling the banks to slow down in the middle of a boom, you know the first thing you will hear from is their Senator.

Those are not his precise words but there is a political loop that is not just partisan about surrounding that question. The other thing that was explained to me by people like Partee and Wallich, and it was Partee, I think, who said, bank regulation is procyclical. And he meant by that that it is very difficult for a regulatory mechanism to get tough on the upside, because everybody is throwing their hat in the air and feeling good and reassuring each other and you don't want to be the Scrooge at the party; and on the downside, when the weaknesses are visible, the regulators overrun their mandate and try to prove that they are vigilant, and meanwhile the Board of Governors is trying to run a macroeconomic policy that somehow accommodates that reality.

This may sound naive on my part, but one way to get out of that rolling curve of mistakes is greater illumination and debate. I am not saying you should make the regulatory issues of enforcement public. Obviously, you can't. But those questions will arise.

You were speaking through the early 1980's, I remember that, to an audience of fellow Members of Congress who didn't have the first idea what you were talking about.

Mr. LEACH. But you were referencing things in the S&L industry, but it was in the 1970's——

Mr. GREIDER. Right, rate regulation. But the second half of what I would say is I am not—this again is not a critic's position, but I think the Federal Reserve is right when it says don't try to strip away regulatory, bank regulatory powers because those two are so intimately connected.

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Mr. LEACH. I hear you. I concur in that as well. But it has led me just in general to have a series of biases about regulation that I think have implications for monetary policy.

For example, I think that the country ought to move in the direction not only of high capital standards but also toward comparable regulation between like kinds of institutions and locales of institutions, and against making exceptions, whether it is one for international lending, or any other kinds of loans. In 1977, I introduced legislation which said the Fed ought to work with international central banks to set comparable standards—the whole process by which the Basel accords have arisen.

But those standards, I believe, are still too weak and they bias institutions toward certain types of lending. For example, you can leverage more if you make home loans, you can leverage more if you buy government securities. The only reason I raise this is every time we jiggle with these formulas, we end up skewing something in the economy at large.

So regulation ends up having macroeconomic effects which end up getting into Fed monetary policy functions and the two cannot be separated. Mr. Greider, it is one of the reasons why just as you, I have come down on the side of wanting to keep the Fed in the regulatory realm—at least for the larger banks, bank-holding companies, and foreign banks—because there is integration. But in that integration, the Fed itself has to understand that every time it caves in to a community, in this case a banking community, it is going to have some counterbalancing effects on monetary policy that may be displeasing to the public at large.

Mr. GREIDER. I think on this point, I do disagree with you that—I mean, we are not into this subject today but I think the Federal Government, including the Federal Reserve, does do things that amount to credit allocation. That is, making some borrowers preferable over other borrowers.

Mr. LEACH. Through regulation.

Mr. GREIDER. Well, through regulation, through the——

Mr. LEACH. The whole process.

Mr. GREIDER. I have had this discussion with many people who were monetary economists and, of course, the Holy Grail of monetary economics is that the government must not do that and especially the central bank must not do that.

I discussed this argument in the book, and then along comes the Basel accords, and as you have observed, the Basel accords are nothing if they are not credit allocation. Everybody in finance understands that. I don't think the American public or the Congress understands it, but that is what the meaning of those ratios is.

We prefer these loans over those loans. So I say to my friends back at the Fed, hey, if you can do that in the interest of creating a level playing field for global banking, you can do it for housing in the United States.

Mr. LEACH. This is no misunderstanding, we are doing that for housing. My concern at this time, frankly, is that our bank regulation is biased against entrepreneurial lending and widget makers of America are those, more than any other group, that ought to be complaining. But that is not a group, for whatever reason, that gets the sympathetic ear.

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Mr. GREIDER. And could be defined as a worthy user of credit and given some sort of favorable preference. Obviously, you have to weigh that with the fault risk and so on.

Mr. LEACH. My time has expired. But I will only conclude, there are other kinds of credit allocations that are not industrially specific. For example, if one region of a country has a weaker standard versus another region, you end up with regional credit allocation. That is what occurred in the S&L circumstance in States like Texas. It also occurs in the banking field when one kind of bank is given less rigorous examination than another kind of bank or one region or State is given less rigorous examination than another region or State.

It is something that is never discussed in terms of credit allocation but that is precisely the way the circumstances are.

Thank you, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Neal.

Mr. NEAL. Thank you, sir.

Mr. Crews, I appreciate your pointing out the error of my ways. I asked for a little help from my staff for research on applicable court cases and that is what I was given. It was clear I owe an apology to my good friend, Henry Reuss.

What would you say, may I ask you, is the appropriate court case in this instance? I don't believe you mentioned it.

Mr. CREWS. There is no case in which any plaintiff has ever succeeded in getting the courts to rule on the specifics of the Federal Open Market Committee.

Now, the general rule of law was, the source of it was correctly identified by Chairman Reuss in his testimony, and in my prepared statement, I discussed it. There are two aspects of the Constitution that are implicated, the appointments clause and various money powers. I said the appointments clause is the easy one. In article 2, section 2——

Mr. NEAL. Excuse me, I have limited time, that is your interpretation of that clause; is there—is it not? I was really asking, if you don't mind, to point me in the direction of a court case that would resolve it.

Mr. CREWS. Sure. This is the case. Yes.

How do you determine who is an officer of the United States? The Supreme Court has given us a very straightforward answer. Now I will quote the Court's exact——

Mr. NEAL. That is the *Buckley* case?

Mr. CREWS. That is the *Buckley case*. We think the term, quote "officers of the United States" close quote, as used in article 2, is a term intended to have substantive meaning. We think its fair import is that any appointee exercising significant authority, pursuant to the laws of the United States, is an officer of the United States, and must therefore be appointed in the manner prescribed by section 2, clause 2 of that article.

Mr. NEAL. I appreciate that and I will go back and do a little more research. I also think that leaves in doubt—I can see how this might leave in doubt the situation as covered by the bill. The clause may be clear to you that these are officers of the government, others may have a different interpretation.

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But anyway, I am glad that you have corrected my earlier assertion.

I was going to say to my distinguished chairman, he said just moments ago that he wants some minimal control over our constitutional responsibility in the area of Fed policy. I would like to suggest to him that we should exercise maximum control and that what we do is establish a very clear policy for the Fed. I think, frankly, that is the responsibility of the Congress.

We have chosen to delegate this to, this responsibility, a responsibility that albeit imprecise, as Mr. Crews has pointed out, because things were different when the Constitution was written, but in any case, it is fairly clear that the Framers wanted us to be responsible for the value of money, and so on, and that ultimately is what the Fed is doing these days. We have consciously delegated that to the Fed but we have not told them exactly what we wanted them to do.

Now, in a similar situation, we delegated to the independent Postal Service the delivery of mail. We took it out of the political process, but in that case, we told them what to do. We told them we wanted the mail delivered efficiently and on time, and so on. Just that we didn't take that other step with the Fed.

Personally, I think we should. Frankly, if we did and did it in the direction, the proper one, we would solve all these problems that both of you have pointed to this morning.

Just to comment on a couple of them, Mr. Crews, again you said someone back in the late 1970's, or early 1980's, when the Fed was engaged in this all-out assault on inflation, that somehow the public should have been notified and the savings, and loan industry should have been notified, and so on.

You know, frankly, there wasn't any opportunity for that. The public was saying: Fight inflation, inflation is out of hand. It is not tolerable. We will not tolerate these levels of inflation, these levels of interest rates. Our government is failing, and stop it. Make it stop. Other consequences were not important.

That was the issue that the public wanted us to do. Then there were side issues.

I would argue the real problem was letting inflation get out of hand in the first place. If we had never had the high inflation, we would never have had the savings and loan problem, never have had the recession of early 1980, so on.

By the way, I don't want to—I have argued and will continue to argue over and over again for low inflation, the lowest possible, zero, if I could have my way, in price stability, because I think that does give us everything else that we want and that is not just my opinion. Every single one of the Fed Governors will tell you exactly the same thing, that the proper policy for this country is the lowest possible inflation because that gives you everything else that you want.

It gives you a maximum sustainable economic growth, maximum job creation, lowest possible interest rates, maximum savings, maximum investment, the proper international relationship of our currency to other currencies. It is just that—it is the proper policy.

Interestingly, there is just no disagreement among those people who have studied this subject the most.

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I just think that has great educational import, value.

I want to—may I just say, and then I will certainly yield—I don't mean to take all of this time. But I just want to go back to this point of the bill about going to these public discussions within the Fed. This is Mr. Greider's main thrust of his testimony, that we would benefit by making all of this public.

I just wonder—I don't mean to get personal or anything—but if we were to listen in on your discussions with your family or close friends or something, would they be the same discussions as if they were kept private? And, of course, the answer is no.

And that is the problem with what you suggest about the Fed. If you let—if you open that up so that the folks deliberating these policies can't speak freely and they can't speak freely if they know that we and the public are listening in.

Are we then going to blame them and hold them specifically accountable for a thing they said on a particular day, a particular twist they put on something, and then put pressure on them to change their policy, because we didn't like just the way something was phrased?

We in elective office are subject to all of that. I can put just the wrong twist on something that I say and get creamed for it. And that is fine. That is part of our system. But to do that to these kinds of deliberations would skew them in a way that we wouldn't get the kind of policy that we want, would be my response to what you are saying; we don't benefit from it. It sounds like we do, but we just wouldn't.

Mr. GREIDER. May I respond? If that is the case, why did not Federal Reserve have such minutes for, I guess, 60 years? They had that.

Mr. NEAL. They had a 5-year delay.

Mr. GREIDER. That is correct. They had a delay.

Mr. NEAL. Is that what you are asking for now, to go back and have minutes and have a 5-year delay? That is what you said they had for 60 years.

Mr. GREIDER. No. I am suggesting to you that if you would read through those minutes, you would find—and I did not read through 60 years but Milton Friedman and Ana Schwartz did—and there is not the sensational content in those.

Mr. NEAL. Of course, it is not that sensational.

Mr. GREIDER. But in terms of understanding the policy, you can't understand the policy if you don't understand the arguments that led up to it, and I mean argument in the general sense, not the abusive sense.

And in that—I mean, as I said in my testimony, I have no doubt that it would change some minor way the tone of conversation at that table.

But, again, I am relying on what Governors and others told me. The tone of conversation at that table is already quite decorous. I have never been inside that room, so I can't guarantee that. But my strong impression is that it is a fairly formal, round-the-table discussion, and then around again, and then the chairman and some others propose various alternatives for policy. And then they break for lunch, and there is a lot of conversation in the hall outside the formal meeting and so forth and so on.

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My answer to your question is, I really do not believe, with two exceptions, you would be compromising their ability to discuss things honestly in any way. And the two exceptions which I mentioned are the mentioning of foreign governments; and they would, of course, want the ability to excise that. And I think this is probably quite rare. But in the instance where a particular enterprise or institution comes up in the discussion, they would want to excise that.

Mr. NEAL. If you want to know what the Fed does, right now it is perfectly transparent because you can see what they do in the marketplace. They are essentially using one tool.

And if you are interested or anyone else is interested, it doesn't take any genius; it doesn't take any—you just look at exactly what they are doing. And they—they change interest rates. That is what they do. There is no huge secret. Nothing is being concealed from you. I am just telling you. It is not.

If you are interested in what they do, look at what they do in the marketplace every day, any day.

Mr. GREIDER. Let's take a very recent episode, which I wrote about in the pages of *Rolling Stone*, and the *New York Times* had a piece a bit later.

The Federal Reserve Chairman was up here in July before the Senate committee, or both, talking vaguely about the possibility that he was going to have to raise interest rates sometime soon. And he talked all around it, and people asked him questions—these are not his precise words—but basically about the threat of inflation recurring and that the signal I am trying to send is that the next move is an interest rate increase.

Now, I was told by a number of sources inside and outside the Federal Reserve after that discussion that that is not really what the Fed is worried about. What the Fed is worried about, as was mentioned this morning, is the possibility of overheated financial markets, particularly the stock market.

And if that turns something ugly, the Federal Reserve just, as it did in 1987, will ultimately be responsible for cleaning up the mess. And so they were trying to signal, albeit in an oblique way, to financial markets to be a little more prudent and to slow down.

Now, I can't prove to you that that was the case. But I was told that by some pretty well informed people who heard it themselves from Governors at dinner. And the story in the *Times* which Senator Sarbanes was complaining about, or Mr. Frank, where two of the Governors said, yeah, there is some worry about that. Now, that is not a change of policy, but it matters a lot to Americans what is on their minds. And I grant their necessity to not come out the door and reveal their discussions instantly. That would be difficult for them.

Mr. NEAL. I am not following your point.

If they are trying to signal——

Mr. GREIDER. You said there is nothing we need to know, that there is nothing being kept from us. And I am saying, yes, there is something that we don't understand that is going on there.

Mr. NEAL. And you are saying that if the Fed is trying to accomplish something——

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Mr. GREIDER. I think actually if they were able to say clearly and directly what they want to see change in the behavior of consumers or investor or business managers or whatever, that would not damage the Fed. In fact, it would enhance its ability to regulate the economy.

And secondarily, I am saying——

Mr. NEAL. I am not following this point at all, I must tell you. If you don't trust what the Fed said publicly about maybe having to raise interest rates a little bit, why would you trust what they said in this other meeting?

Mr. GREIDER. It is not a question of trusting it or not trusting it.

Mr. NEAL. Or believe it. Whatever it is that you are trying to get at. My point is—it is true, by the way, I think, that the Fed might say something like that. Say, well, we may have to raise interest rates in the future, and not wanting to raise them today, as if they might have what they call an announcement effect.

But now, again, I don't see the harm in that. They may not want to change policy today. They may want to see if this so-called announcement effect has some change. And if it does, they may have to change policy.

In other words, it may be a minor thing they are trying to do. Ultimately, there is no mystery about what they are trying to do. What they are trying to do is keep inflation as low as they possibly can, when it gets out of hand, bring it down and deep as low as they possibly can. There is no mystery about that.

And if you doubt that they do what they say, look what they do in the marketplace. These other things are so subtle that, I mean, it doesn't make any difference. And if it does make a difference to a scholar or *Rolling Stone* or something like that, then go after the fact a few months and go study it and do like you did and spend all of this time studying it. My point is that the cost to that—I mean, if you do something like is contemplated here it will greatly inhibit this discussion that can be very useful in making policy, to no avail. There is nothing gained by it.

Mr. GREIDER. Mr. Neal, if you feel, as you do that, the Federal Reserve has only a single goal, which is price inflation.

Mr. NEAL. Primarily, that is their goal.

Mr. GREIDER. If that is all they have to worry about. And it is true, then, the debate becomes very narrow and straightforward. But I disagree profoundly with you, A, that that is a correct goal; but, B, that that is the Federal Reserve's goal.

And I think if you go back over the history of the Federal Reserve, you will find some Governors at the table saying exactly what you are saying, that that is what we ought to concentrate on and we ought to forget all collateral effects, this is the best possible outcome and let's go for this.

And you will find other Governors and bank presidents and I would say usually the majority saying, it ain't that simple; there are countereffects here that we have to take into account.

Mr. NEAL. You are correct if you go back over history.

Mr. GREIDER. I am not taking about past history. I am talking about recent history.

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Mr. NEAL. History in the 1970's, you are 100 percent correct; and the result of that was absolute disaster.

What I was saying is today, if you would poll the Governors and ask them what they think the priority of their policy ought to be, I am quite certain they would tell you that it is price stability; and that, yes, there are times when they do intervene in foreign exchange markets, for example, which I personally would rather they didn't, but they are not real believers in it. But they feel they have to do a little of that from time to time. So that is a subsidiary.

But ultimately and for the long term—and there again what I am arguing for honestly and most importantly, if I might say, is trying to help us achieve a long-term policy objective. Political pressure, the reason for objecting to political pressures is not that political pressures are bad. We live with them every day, and they are great.

But in the interest of achieving a long-term policy goal, they are not useful, because the political pressures are always for a short-term benefit. And that is sort of our challenge, I think, is to try ourselves to overcome that constant pressure to do something for the short term and try to see the long term.

And so in the court system and in the Fed we have tried to do something to help them achieve those long-term goals. And my argument is that the things we are talking about would tend to—they wouldn't be the end of the world—but would tend to force their attention back to the shorter term and subject these conversations which are now private and free flowing and subject them to the same kind of pressures that the chairman and I have to live with. That is, saying something just the wrong way or something like that.

Now they are at least protected from that, and they can speak freely and then hope, given the other things that we have done for this effect, act in the long-term national interests. That is the argument.

Mr. CREWS. Could I respond just very briefly to that, Mr. Chairman.

The CHAIRMAN. Certainly.

Mr. CREWS. I think there is an aspect of this discussion which has been lost. And that is that a full discussion within the Fed is going to bring out the consequences of a given act.

And this 1970's and 1980's business with stopping inflation and the savings and loan is an illustration of the kind of benefit which I think Mr. Greider is trying to call your attention to.

If it had been brought to the attention of the public and this committee that, yes, we are going to follow this policy; and in our judgment, we believe that that is to the greater good, even though it is going to put this intense pressures causing the collapse of many savings and loans.

Congress would, at that point, have been able to say to the savings and loan regulators, you fellows are in for a terrible storm, and we need tighter regulation than normal. And to say to the Appropriations Committee, there is probably going to be some bankruptcies out there, and we are committed to the FSLIC to back it up, and we better get some money ready for it.

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And instead of a multi-hundred-billion dollar fiasco, which it ultimately turned out to be, I think the damage could have been much more limited.

Mr. GREIDER. Let me add just a response to his example, that if people like the chairman and Mr. Leach—and I don't know, perhaps yourself as well—who were warning the Congress, trying to alert the Congress to the savings and loan dimensions long before it exploded, had been backed up by the argumentation of the Federal Reserve, here are the implications—I'm not talking about them revealing any secrets just sort of the same things they know about the implications of their policy—you might very well have gotten a different legislation than what got passed in 1982 and a much more forthright response that Mr. Crews says we don't know what the size of the problem would have been, but we know it would have been a small part of the $200 billion plus.

Mr. NEAL. May I say what everyone knew was that the Fed, after the disastrous high inflation of the late 1970's, the appointment of Mr. Volcker to head the Fed was to fight inflation. Everyone knew that the course had changed. Everyone knew that. All the economists knew it. All the bank economists knew it. All the savings and loan economists knew it. All the academic economists. There was no secret about that. The consequences of that were known by everyone. We all knew. We were driving those rates up in order to control inflation.

Now, there was no secret, I mean, the world knew it, and the world knew the implications of that for unemployment. It drove unemployment up. It couldn't help it. It drove prices of other things up. It influenced energy. I mean there were incredible consequences of fighting inflation. There were consequences for the banking industry, for the savings and loan industry.

It didn't take that little group of people talking about it to signal that. That would have been irrelevant. Other people talked about it. It wouldn't have added anything. What you are essentially saying is that there were millions of people discussing the huge events; and yet, we didn't make the right policy decision because the comments of a few weren't added to that debate.

It just doesn't add up, I must tell you. Everyone knew what their policy decision had been. Everyone.

Mr. GREIDER. Well, I would differ with you again. If you went back to 1982 and 1984, and asked what did people generally understand—I am not talking about people on the streets; I am talking about people in the high offices of government—about the consequences for, for instance, the trade deficit or the savings and loan industry, I think you are mistaken, those were not widely understood.

Mr. NEAL. Well, it was widely understood. There were thousands or millions of economists around the world that comment on such things.

I must say, by the way, I didn't know what the consequences of all of this were. And I think there were differences of opinion on it.

Mr. GREIDER. Right. Members of Congress agreed that they could go ahead and play around with the savings and loan industry and not do anything about it and it would all work out.

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And I am telling you that there were economists inside the Federal Reserve advising the Chairman and the Board that that was not the case.

And I don't think they came up here and told you all that.

Mr. NEAL. Well, you are saying that those voices, those few little voices in that room would have been listened to more than thousands of other economists, when their action, when the consequence of what they said was well known. I just don't buy it.

Mr. LEACH. Would the gentleman yield on one small point?

Of all of the aspects of Federal Reserve policy that struck me as an abdication of responsibility in the 1980's was an answer to a question I asked something in the neighborhood of 8 to 10 times to various Fed Board members and Fed Chairmen: "What is the cost of the S&L circumstance; and what are the ramifications for policy?"

The response was obviously a very careful policy response considered by the Fed of what to reflect to Congress. Informally, you may have gotten a very different response.

But the response was: "All we can tell you is that those charged with responsibility make the following estimates." In other words, deferral to the old Federal Home Loan Bank.

That was a very honest response in the sense that they deferred to other estimates, even though their own judgments were very different.

So what the Federal Reserve Board of the United States did was take a hands off approach, abdication rather than serious inquiry, even though one could argue that despite not being the primary regulator they did have very substantial authority and responsibility over this matter.

And so it was abdication in the 1980's by the Federal Reserve Board. There was one like-minded abdication of accountability that has never been very well presented but it is very comparable. The Treasury of the United States of America in 1988 refused to take responsibility for resolving thrifts in difficulty and, in effect, said to the then Federal Home Loan Bank Board, you make certain decisions, we don't want to be held accountable; you go ahead and do it, but don't tell anyone we agreed.

And that is what led to the December 1988 deals which were, in retrospect, a small billion dollar hit on the Treasury. Maybe $3 or $4 or $5 or $6 billion.

But everyone was saying, we don't want to take responsibility but saying to these other people, go ahead and try this. And sometimes refusing to take responsibility is an act of responsibility of rather substantial proportions.

But the only reason I raise this is, in my memory, I don't think the Fed ever presented a falsehood to this committee. By the same token, the Fed held off taking accountability when they should have.

Mr. GREIDER. And what I am adding to that is only that I know from my reporting that they had their own hard estimates. And I can understand how they would say, well, we are not the Home Loan Bank Board; we can't put this out; but they were guided by that and their own numbers. And I am talking about the best minds on the Federal Reserve Board who anguished over this re-

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peatedly for 4 or 5 years and yet never found a way to go public and say, you people better deal with this.

And Mr. Neal was right, that doesn't guarantee that anything would have changed, but I think the question of responsibility is relevant.

I mean, the sympathetic way of describing the Fed's position now is that they are trapped in this sort of archaic style of operation that doesn't allow them to speak very candidly. That is just not the way the institution functions. It doesn't allow them to sound warnings on what is happening on somebody else's turf, and so forth. And then when the things fall apart they have to hunker down and say, it wasn't us; it was somebody else; we knew about that but, of course, it wasn't our responsibility. That is not a very sound way to run the government.

And I actually—I know people may find this hard to believe because I am a critic of the institution—but I actually believe if they could get to the place where they communicate directly and consistently with the public that it would enhance their ability to produce good results.

And you saw this—we are going to disagree on this I think; but if you go back through the history leading up to 1979 and in the years after, there is just abundant evidence. I read through a stack of speeches this high, and I asked Joe Coyne at the Fed, when we started the book, one of the first things I said was, can you give me the speeches of all the governance. To his astonishment, I really wanted to get them and read through them all and many of them are quite brilliant diagnoses, and so forth.

But you have to be steeped in this stuff to understand what they are saying. And so they were talking to financial groups or, you know, conventions of this group or that group. But for the most part, I have to tell you, it is pretty hard. It took me quite a lot of study before I could understand this.

Mr. NEAL. It is true that the economists have their own language, just like newspaper people have their own language and so on. But that is not to say that they are not saying it and that the people to whom they are saying it do not understand it. They do understand it, and they do go out and make these speeches on international matters and domestic matters and Mr. Greenspan—how many committees did he appear before this year? For a while he was on the TV all the time. He appeared before the Joint Economic Committee and the Ways and Means Committee and took all of these questions from Members of Congress.

I mean I think they are quite open and responsive. And the other Governors talk and testify and so on. Again, I just don't see that they are inhibited in any way.

The CHAIRMAN. If the gentleman will yield to me at this point.

Just when this was getting nice and juicy, and I was turning over in my mind at least 10 vital points that I was going to enlarge on, I have just been notified that Chairman Barney Frank of the International Subcommittee had reserved this hearing room for 2 p.m. So we have no alternative but to close the hearing and, once again, thank the witnesses for their generous help to this committee. I can assure you it has been most helpful.

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There will be some questions in writing, I understand, that will be addressed to you and should be done expeditiously so that by the time you get the transcript of the hearing, you will be able to address it.

But thank you again very much.

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

The CHAIRMAN. This hearing is adjourned.

[Whereupon, at 2 p.m., the hearing was adjourned.]

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APPENDIX

October 7, 1993

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Opening Statement of Chairman Henry B. Gonzalez
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
Hearing on Issues Raised By HR 28, the "Federal Reserve System Accountability Act of 1993"

October 7, 1993

Today, eighty years after the passage of the Federal Reserve Act, the Committee begins the first of a series of hearings on Federal Reserve System reform. This is not a new subject. The Congress reorganized the Federal Reserve in 1935 and the Banking Committee has had important hearings on this subject in the 1930's and in 1964.

The 1935 reorganization occurred after the Federal Reserve miserably failed to carry out its initial function of being the "lender of last resort" to failing banks. In the early 1930's as 1/3 of the commercial banks failed or were merged because of bank runs that drained their cash reserves, the Federal Reserve stood idly by and let the money supply collapse by 1/3. The Federal Reserve's inaction turned a serious recession into our country's worst depression.

Power to manage the money supply was put in the hands of the Federal Open Market Committee, composed of 12 members. Five of the FOMC members are private citizens serving as presidents of the Federal Reserve Banks. The presidents are selected by their individual Bank's board of directors, 2/3 of whom are voted into office by the member commercial banks in each district.

Testifying before the House Banking Committee on April 13, 1938, Federal Reserve Chairman Marriner S. Eccles -- who served as chairman for over 13 years until 1948 -- repeated his strong conviction. He thought the 1935 reorganization of the Federal Reserve was seriously incomplete as long as private citizen Federal Reserve Bank presidents voted on the nation's money supply. He said:

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"As I have said before, I am in favor of placing open-market committee's functions with the Board of Governors, which is a public body appointed by the President and confirmed by the Senate, to represent the public interest. I do not wish to imply that the bank representatives are less conscientious than the Board members or that they do not act in good faith with the best of intentions. But since they are presidents of the Reserve banks and are elected by the directors of those banks, two-thirds of whom are in turn elected by the member banks, their viewpoint necessarily is likely to reflect that of member banks. I feel that a committee which is entrusted with monetary policies as important as those given to this committee should consist entirely of persons representing the public interest."

To illustrate Federal Reserve Chairman Eccles' point, that the Federal Reserve Bank presidents represented banking interests and not the public interest, one has only to look at the pool of bankers and their friends from which nearly all Federal Reserve Bank presidents have been drawn. There has been only one woman and no minority Bank presidents in the Federal Reserve System's 80-year history. I want to take the "bankers and their friends" sign off the door to this exclusive club and open it up to all competent Americans.

Since Federal Reserve Chairman Marriner Eccles spoke, the FOMC including these private citizen Federal Reserve presidents, greatly expanded their authority.

For example, in 1962 the FOMC gave itself authority to intervene in foreign exchange markets to manage the foreign value of the U.S. dollar. At FOMC meetings in 1962 the Vice Chairman of the Federal Reserve, J.L. Robertson, criticized the Federal Reserve's actions, saying its main advantage was to give the Federal Reserve an "unlimited pocketbook." Limited funds had been appropriated by Congress for intervention purposes and placed with the Exchange Stabilization Fund in the Treasury. [FOMC minutes, February 13, 1962, p. 62] Today that so-called "SWAP" fund amounts to $30.1 billion.

And in the Treasury-Federal Reserve accord of March 3, 1951 the U.S. Treasury relinquished its authority to manage the money supply. The Federal Reserve was given complete and sole authority to manage the nation's money supply.

Believe it or not, these twelve people on the FOMC Committee, whom we entrust with these functions crucial to the economic health of our nation, decided in 1976 to stop taking minutes of their meetings so the American public would not know what they are discussing.

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My legislation, HR 28, the "Federal Reserve System Accountability Act of 1993," would require the twelve Federal Reserve presidents who serve, five at a time, on the FOMC to be nominated by the President and confirmed by the Senate. This will enable the public to learn just who it is that is making decisions on monetary policy. HR 28 would also require a record to be made of FOMC meetings that would be made public within 60 days and release of information on policy changes within one week. HR 28 also allows the GAO to investigate the FED's massive interventions in foreign currency markets and daily open market auctions to see if these operations are efficient and secure from leaks of inside information.

The power of the Federal Reserve to operate without public scrutiny and accountability is evidenced in its expenditures. Because it is not subject to the same scrutiny as those agencies that use budgeted funds, the Federal Reserve makes its own rules, some of which involve expenditures that would be illegal for budgeted funds. For example:

1) The Federal Reserve spent $346,000 buying individual memberships in private organizations for many of its employees in 1990, expenditures that are illegal for budgeted funds. Federal Reserve Chairman Alan Greenspan refused to comply with my request for a listing of memberships for 1992 and 1993. Chairman Greenspan wrote to me on September 15, 1993 that since he is changing the policy "a new survey would not be useful and would not justify the cost of collecting the information."

2) The Federal Reserve tells me that although it employs a large army of 730 professionals (economists, statisticians, and research assistants) in its research departments in 1993 it still needs to spend nearly $100,000 a month to pay for outside economists mostly drawn from academia.

Sixty-seven economists received 82 contracts from the Federal Reserve from 1991 to mid-1993 for more than $10,000 each for a total of $2.3 million. This expense does not cover total research costs which I want Chairman Greenspan to reveal to us when he comes before the Committee next week on Wednesday, October 13.

It is interesting to speculate why the Federal Reserve keeps these outside economic consultants on its payroll. Nobel Laureate economist Milton Friedman, commenting on these practices, has said that the Federal Reserve is trying to buy off "its most likely critics" and that few among the academic community are prepared to criticize the Federal Reserve.

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HR 28 would require an independent audit of the FED's budget so that in the future the Federal Reserve could not refuse the Congress' request for information about its spending habits. With a new Administration calling for a streamlined, efficient government, it is essential that all government agencies indicate where the fat is and what could be cut.

The changes I am proposing to the Federal Reserve System are quite modest. There is nothing to fear. I am not seeking to politicize the central bank nor take away its independence. I am not calling for policies that would cause inflation or deflation. My legislation does not require the Federal Reserve to set any particular monetary targets, nor is Congress required to "micro-manage" the central bank. Rather, I am only asking that the central bank be accountable to the American public and abide the Constitution of the United States by requiring those who manage our money supply to present their credentials in Senate confirmation hearings.

I look forward to the testimony of our esteemed panel of witnesses on their ideas for making our central bank more accountable to the nation it serves. We are honored to begin this series of hearings on Federal Reserve reform with such a distinguished panel.

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Representative Lee Hamilton has represented the ninth District of Indiana since 1965. He is Chairman of the Committee on Foreign Affairs, Co-Chairman of the Joint Committee on the Organization of the Congress, and a member of the Joint Economic Committee. He has long been interested in reforming the Federal Reserve and has developed and introduced reform legislation.

Maryland's senior Senator Paul Sarbanes was elected to the House of Representatives in 1970 where he served for six years before going to the Senate in 1976. He is Vice Chairman of the Joint Economic Committee and Chairman of the Housing Subcommittee of the Senate Banking Committee. He has also a leading advocate for reform of the Federal Reserve and has introduced reform legislation.

Senator Byron Dorgan represented North Dakota in the House of Representatives from 1980 to his election in the Senate in 1992. In February he introduced S 212, the "Federal Reserve Reform Act of 1993." He has also joined Senator Sarbanes in introducing the "Monetary Policy Reform Act of 1993."

Henry Reuss served in the House of Representatives from 1955 to 1983 and was the chairman of this Committee from 1975 to 1980. Chairman Reuss developed and promoted the "Federal Reserve Reform Act of 1977" which was aimed at opening the Reserve Banks to the employment of women and minorities. That Act also made conflict of interest laws that applied to government employees applicable to the boards of directors of the Federal Reserve Banks. Chairman Reuss's speech in 1977 in support of reform presented a vivid account of how our central bank used its resources to lead a lobbying effort here in Congress to prevent a GAO audit of all its operations. Chairman Reuss fought the imposition of an amendment to the 1978 "Government in the Sunshine Act" that severely limited the GAO's authority to audit the Federal Reserve.

Congressman Kweisi Mfume of Maryland, who is serving his fourth term, is an active and much appreciated member of this committee. He serves as chairman of Congressional Black Caucus for the 103rd Congress and is a member of the federal government Service Task Force.

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Our next witness is William Greider. He is the author of Secrets of the Temple, How the Federal Reserve Runs the Country, a definitive work which was on The New York Times best seller list. Bill Greider writes about national affairs for Rolling Stone. He was formerly assistant managing editor of The Washington Post.

Grasty Crews II is our final witness. From 1958 to 1970 Mr. Crews worked closely with this Committee and its staff as a member of the Office of the Legislative Counsel of the House and later as a counsel to this Committee. He has also served as an officer in the legal division of the Federal Reserve Board of Governors, and General Counsel for the drug policy office in the Executive of office of the president. He is now engaged in the private practice of law in Virginia and the District of Columbia.

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STATEMENT BY
REPRESENTATIVE JAMES A. LEACH
Before The Committee on Banking, Finance and Urban Affairs
Hearing on Reforming the Federal Reserve System
October 7, 1993

Few institutional issues are more fraught with real and perceived problems than those relating to the structure and accountability of the Federal Reserve System. In the context of today's hearing, it should be clear that what is at stake is **change**, not necessarily **reform**; modest tinkering, not radical reorganization.

Since its inception, the Fed, in effect, has become a quasi- fourth branch of government with authority largely delegated to it by the first branch -- the legislature -- on the assumption that there are aspects of monetary policy and financial services regulation that demand independent, consistent and professional attention that a legislative branch of political generalists is not by nature equipped to provide.

At this time, the Federal Reserve System is well-led and well-respected; its leadership as well as sheer existence has provided an anchor of financial stability in a time of economic uncertainty and world-wide disequilibrium. When we look at things that might have gone disastrously askew with the economy over the last several decades, it is apparent there are a lot of dogs that did not bite and a lot of bites that did not prove contagious, in part because of Fed leadership. One can make a powerful case that a system that is not broken should not be fixed. On the other hand, one can also credibly suggest that the best time to make modest adjustments in policy and structural arrangements is when crises are not at hand.

My sense is that Congress should be chary about pushing radical change at the Fed at any time, but should be open to periodically considering modest adjustments.

Basically, the Federal Reserve has two responsibilities: one is monetary policy; the other is bank regulation, with attendant safety net concerns for individual institutions and the economy at large. Regarding monetary policy, there is an unseemly dimension to the fact that open market decisions affecting interest rates are made, in part, by individuals who are neither chosen by the Executive nor confirmed by the legislature. But like all circumstances there is an implicit counter balancing positive: regional Federal Reserve Bank presidents symbolize the best of decentralized public leadership. While regional Fed presidents are public employees, because of their manner of selection they provide the federal government at a very high level a unique private/public partnership which in political science terms may be awkward, but which through experience has generally proven to be both ethical and effective.

There are two principal approaches on the table affecting open market decisions -- one involves senatorial confirmation of regional Fed presidents; the other involves implicitly giving more authority to current members of the Federal Reserve Board in Washington by simply withdrawing the right to vote -- although not necessarily participation in meetings -- of regional Fed presidents. Of these two approaches, my instinctive preference is for the second. But I am not necessarily convinced of the need, in the first place, to establish a new institutional arrangement.

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On the issue of transparency, the case for a modest increase in openness appears reasonable, but care must be taken not to hamstring the Fed in its traditional decision-making, which demands coordination with and cooperation from foreign governments, and which has significant effects on various financial markets, of which the taxpayer -- through the U.S. Treasury and the Fed -- may be a participant.

Regarding regulation, the Federal Reserve System has major responsibilities, particularly in supervising larger banks, foreign financial institutions operating in the U.S., and sophisticated bank holding company operations.

There are a number of approaches to the reform of the regulatory structure that are being considered in Congress and by the Executive today. My preference, as reflected in legislation I introduced last March (H.R. 1227), is not to move in the direction of a single regulator, but instead to consolidate regulators and the regulation of institutions. In particular, I advocate merging the OCC and the OTS, but keeping the Fed responsible for regulating all of the Nation's larger banks (those with assets over $25 billion) and their holding companies. In addition, I believe the Fed's authority to regulate foreign financial institutions in the U.S. should be retained.

In conclusion, I would like to stress two circumstances. All of us have individual assessments of whether the Fed at various points has conducted too tight or too loose monetary policy. At this time, though, it is impressive how stable the American currency is, especially given the spectacularly loose fiscal policy conducted by Congress. It is hard not to sympathize with the dilemma of Fed policymakers given the constraints that fiscal policy has provided them; and, based on the record, it is impossible not to be skeptical about any approaches which would enhance Congress's role in monetary policy. If Congress's record in fiscal policy is a guide, the danger is very real that any effort by the First Estate to recapture powers reserved by the Constitution to it could lead to a butchering of monetary policy.

In all institutional circumstances, governmental and nongovernmental, there is an element of tradition that goes beyond the drawing of lines of authority relationships on charts. In this context, it deserves to be noted that the Federal Reserve System, at this moment, has developed an expertise of signal dimension and respect, particularly in the financial markets and overseas, far higher than any other institution of the U.S. government. Hence, any change diminishing Fed responsibilities, even of modest dimension, demands a compelling burden of proof not immediately self-evident to this Member.

The country will do just fine if none of the approaches propounded by any of us this morning is adopted. On the other hand, this fact is not sufficient to rationalize a "never change" legislative mantra.

This non-crisis environment may be the most propitious time to consider undertaking small improvements in the system to help ensure that in a time of greater crisis in the future the Fed is not susceptible to challenges of either democratic legitimacy or institutional arrogance or stultification.

Mr. Chairman, with this philosophical framework, I welcome the thoughts and concerns of our distinguished panel of witnesses.

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COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

Hearing on The Federal Reserve Accountability Act of 1993

STATEMENT BY CONGRESSWOMAN LUCILLE ROYBAL-ALLARD

October 7, 1993

MR. CHAIRMAN:

I AM LOOKING FORWARD TO TODAY'S HEARING ON THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993.

IN MY SHORT TENURE IN THE CONGRESS AND AS A MEMBER OF THE HOUSE BANKING COMMITTEE, I HAVE COME TO FULLY UNDERSTAND THE IMPORTANCE AND THE IMMENSE INFLUENCE THAT THE FEDERAL RESERVE HAS OVER THE ECONOMY, EMPLOYMENT RATES, INFLATION AND THE INTERNATIONAL VALUE OF OUR U.S. DOLLAR. FOR THIS REASON, I WOULD LIKE TO COMMEND YOU MR. CHAIRMAN FOR YOUR LEADERSHIP AND VISION DEMONSTRATED BY THIS COMPREHENSIVE MEASURE WHICH GREATLY IMPROVES THE WAY THE FEDERAL RESERVE DOES BUSINESS.

I AM AN ORIGINAL CO-SPONSOR OF CHAIRMAN GONZALEZ' HR 28 FOR A NUMBER OF REASONS. PLEASE LET ME HIGHLIGHT WHAT I CONSIDER THE MOST IMPORTANT PROVISIONS OF THIS BILL:

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FIRST, I WHOLEHEARTEDLY AGREE WITH THE CHAIRMAN THAT WE NEED TO HOLD THE CENTRAL BANK MORE ACCOUNTABLE FOR CRUCIAL DECISIONS ON MONETARY POLICY. RESTRUCTURING THE FEDERAL OPEN MARKET COMMITTEE (FOMC) TO REQUIRE THAT THEY BE APPOINTED BY THE PRESIDENT WITH SENATE CONFIRMATION WILL ALLOW THE GENERAL PUBLIC AND CONGRESS TO BE AWARE OF THEIR POSITIONS ON ISSUES OF IMPORTANCE PRIOR TO BEING APPOINTED.

SECOND, I BELIEVE THAT THE PUBLIC HAS THE RIGHT TO KNOW ABOUT THE IMPORTANT DELIBERATIONS THAT AFFECT THE NATION'S MONETARY POLICY. THE CURRENT PRACTICE OF CLOSED MEETINGS AND NO MINUTES AVAILABLE FOR PUBLIC SCRUTINY MAKE IT IMPOSSIBLE FOR THE PUBLIC TO HOLD THE FEDERAL OPEN MARKET COMMITTEE ACCOUNTABLE FOR ITS DECISIONS AND ACTIONS.

THIRD, THE PUBLIC HAS EVERY RIGHT TO REQUIRE COMPLETE AND THROUGH AUDITS OF ALL OPERATIONS OF THE FEDERAL RESERVE. THIS BILL AUTHORIZES THE GENERAL ACCOUNTING OFFICE TO AUDIT ANY PART OF THE FEDERAL RESERVE.

HOWEVER, ONE OF THE MOST IMPORTANT SHORTCOMINGS THAT I HAVE SEEN WITH THE CURRENT SYSTEM IS THE VIRTUAL LACK OF DIVERSITY IN PERSONNEL. I FIND IT APPALLING THAT THE FEDERAL RESERVE CAN NOT FIND

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QUALIFIED WOMEN AND MINORITIES TO FILL THEIR DECISION-MAKING POSITIONS. I PREFER TO BELIEVE THAT THIS IS NOT BY DESIGN, AND FOR THAT REASON, MY ONLY CONCLUSION IS THAT THE CURRENT SYSTEM FOR THE SELECTION OF THESE INDIVIDUALS IS FLAWED. THIS ISSUE IS VERY IMPORTANT TO ME BECAUSE I DO NOT UNDERSTAND HOW THE FEDERAL RESERVE CAN MONITOR AND REGULATE BANK LENDING DISCRIMINATION BASED ON RACE, GENDER AND INCOME, WHEN THEIR OWN STAFF IS NOT REFLECTIVE OF OUR DIVERSE POPULATION. THE FEDERAL RESERVE MUST INCLUDE A STAFF THAT IS REFLECTIVE OF ALL SEGMENTS OF OUR POPULATION. THE FACT THAT THERE HAS BEEN ONLY ONE WOMAN SERVING AS ONE OF THE 12 FEDERAL RESERVE BANK PRESIDENTS SINCE 1913, AND NO MINORITIES, IS TOTALLY UNACCEPTABLE IN 1993. I COMMEND THE CHAIRMAN FOR HAVING THE FORESIGHT TO DEVELOP AN ALTERNATIVE TO THE CURRENT FEDERAL RESERVE SYSTEM THAT PROVIDES A PROCESS FOR A MORE REPRESENTATIVE POLICY MAKING BODY.

IN CLOSING, I WOULD LIKE TO OFFER MY ASSISTANCE TO YOU, CHAIRMAN GONZALEZ. I LOOK FORWARD TO WORKING WITH YOU ON THIS ISSUE.

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LUIS V. GUTIERREZ
4TH DISTRICT, ILLINOIS

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OPENING STATEMENT
CONGRESSMAN LUIS V. GUTIERREZ
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
OCTOBER 7, 1993

MR. CHAIRMAN, AS YOU ALREADY KNOW, I AM VERY SUPPORTIVE OF H.R. 28, THE FEDERAL RESERVE ACCOUNTABILITY ACT. I WAS AN EARLY CO-SPONSOR OF THIS LEGISLATION; NOT BECAUSE I AM A SCHOLAR OF THE FEDERAL RESERVE, BUT RATHER BECAUSE I BELIEVE THIS COUNTRY WAS FOUNDED AND OWES ITS SUCCESS TO A BASIC DEMOCRATIC PRINCIPLE - GOVERNMENT OF THE PEOPLE AND FOR THE PEOPLE.

THE FEDERAL RESERVE AND THE FEDERAL OPEN MARKET COMMITTEE HAVE ALWAYS PLAYED A CRITICAL ROLE IN OUR NATION YET, ACCORDING TO MUCH OF THE TESTIMONY HERE TODAY, IT HAS NEVER BEEN HELD TO THE SAME LEVEL OF ACCOUNTABILITY AS OTHER SEGMENTS OF OUR GOVERNMENT. I AM INTERESTED TO LEARN MORE ABOUT THE CURRENT SYSTEM AND IT'S PROBLEMS. BUT MORE IMPORTANTLY, I WANT TO ENSURE THAT THE DEMOCRATIC PRINCIPLES FUNDAMENTAL TO OUR VERY EXISTENCE ARE UPHELD AND BELIEVE DISCUSSIONS SUCH AS THE ONE TODAY ARE CRITICAL IF WE ARE TO BE SUCCESSFUL.

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THIS BILL DEALS NOT ONLY WITH THE QUESTION OF ACCESSIBILITY TO INFORMATION, BUT QUESTIONS OF CONSTITUTIONALITY AS WELL. MR. CREWS, IN HIS PREPARED STATEMENT, SERIOUSLY QUESTIONED THE CONSTITUTIONALITY OF OUR PRESENT SYSTEM OF APPOINTING FEDERAL RESERVE BANK PRESIDENTS. AS WE ALL KNOW, CHAIRMAN GONZALEZ HAS ALWAYS WORKED EXTREMELY HARD AND BEEN PARTICULARLY CONSCIENTIOUS ABOUT UPHOLDING AND GUARDING OUR CONSTITUTION. THEREFORE, IT SEEMS ONLY FITTING THAT HE HAS INTRODUCED THIS IMPORTANT PIECE OF LEGISLATION AND IS HOLDING HEARINGS ON H.R. 28 AT THIS TIME.

I WANT TO WELCOME CHAIRMAN HAMILTON, SENATOR SARBANES, CONGRESSMAN MFUME, AND OUR OTHER DISTINGUISHED WITNESSES. I CERTAINLY LOOK FORWARD TO THE OPPORTUNITY TO HEAR MORE ABOUT THE FEDERAL RESERVE AND THE OTHER LEGISLATIVE PROPOSALS REGARDING THE FEDERAL RESERVE.

THANK YOU, MR. CHAIRMAN.

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Embargoed for Release
9:30 a.m., October 7, 1993

STATEMENT
of
CONGRESSMAN LEE H. HAMILTON
before the
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
of the
U.S. HOUSE OF REPRESENTATIVES
on
October 7, 1993

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

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

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

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

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

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Eight years ago, when I introduced my bill on the Federal Reserve's budget, interest rates were in the range of 8.5 to 10.5 percent. Four years ago, when I introduced the broader Federal Reserve Reform bill, interest rates were in the range of 8.5 to 9.5 percent. Today, the Federal Funds rate is 3.0 percent, the lowest level in 30 years, and long-term rates are just over 6 percent, the lowest level in 20 years. The problem of high interest rates is largely behind us. If this were the motive for my bills, there would be no reason for me to be here today.

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

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

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

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

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

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

C. It waits six weeks before releasing policy decisions.

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

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

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

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

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

FEDERAL RESERVE REFORM ACT

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

I. Consultation with the Administration

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

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

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

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

II. Term of the Federal Reserve Chairman

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

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

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

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

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

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

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

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

This is almost precisely what my bill would do.

III. Disclosure of Monetary Policy Decisions

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

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

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

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

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

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

IV. GAO Audits

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

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

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

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

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V. Federal Reserve Budget

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

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

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

MONETARY POLICY REFORM ACT

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

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

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

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

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

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

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

The argument is that "If it ain't broke, don't fix it." This objection assumes that the effect of these bills will be to force the Federal Reserve to alter its conduct of monetary policy, which would harm the economy of the United States. This is essentially the position taken by President Clinton in his September 20 letter to you.

This fear is based on a misreading of these bills. Nothing in them would affect the conduct of monetary policy. There is no provision in either bill that would give Congress or the President any control over monetary policy. If someone wanted to politicize monetary policy, these bills would not be the way to do it.

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Nonetheless, my bills do address a problem that does need to be fixed, the complex problem of Federal Reserve accountability in a democratic society. The bills would do that without jeopardizing the Federal Reserve's independence or injecting politics into monetary policy. Congress should not wait until a monetary crisis to reform the Federal Reserve. These bills take advantage of a period of high regard for the Fed, and a moment of economic calm, to bring Fed procedures up to date. If we wait to make the necessary adjustments until a time of economic turbulence and controversy, the results may be far less measured.

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

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STATEMENT OF

Senator PAUL S. SARBANES

VICE CHAIRMAN
JOINT ECONOMIC COMMITTEE

ON

FEDERAL RESERVE REFORM

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 7, 1993

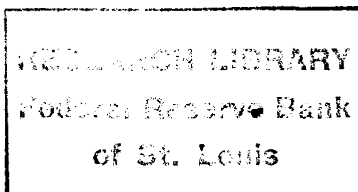
Mr. Chairman and members of the Committee, thank you for this opportunity to testify on the issue of reforming the structure of the Federal Reserve System. In this country and around the world, in the public sector and in the private sector, we are living in an era of institutional reform. Everywhere you turn, people are trying to restructure their institutions to make them more effective and more accountable.

Eighty years ago the Congress created the Federal Reserve System and in 1935 the Congress created its structure for monetary policy, the Federal Open Market Committee (FOMC). Although the FOMC plays a role in today's economy that could not have been imagined in 1935, the Congress has left its structure unchanged.

To address a major aspect of the current Fed structure, I have introduced the Monetary Policy Reform Act. This act would make responsibility for monetary policy decisions rest solely with those who have been nominated by the President and confirmed by the Senate. It would end the anomaly that individuals selected by private interests cast almost half of the votes on the body that sets the nation's monetary policy.

BACKGROUND ON DECISION-MAKING AT THE FEDERAL RESERVE

The Federal Reserve System consists of the Board of Governors in Washington and the twelve regional Federal Reserve Banks. The Board of Governors has seven members, who are appointed by the President and confirmed by the Senate to 14-year terms. The Governors of the Federal Reserve are thus duly-appointed public officials who are responsible to the President and Congress, and through them to the American people, for their conduct in office.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The twelve Federal Reserve Bank presidents, in contrast, are selected for five year terms by the board of directors of each regional Bank. By law, the commercial banks in each region directly select six of the nine members on the regional Bank board of directors, three from among bankers and three from among non-bankers in the region. The other three members of the board are chosen by the Federal Reserve Board of Governors.

Neither the President nor Congress has any role in selecting the presidents of the Federal Reserve Banks. Some of the Bank presidents are career employees, others have backgrounds in banking, business and academics; none are duly-appointed public officials. Nonetheless, they participate in monetary policy decisions through their membership on the Federal Reserve's Open Market Committee (FOMC), where they cast five of the twelve votes that determine monetary policy and interest rates.

An article in the *Wall Street Journal*, "Fed Banks' Presidents Hold Private Positions But Major Public Role" (August 1, 1991) described the role of a regional Bank president this way:

> ...he straddles an odd but awesome combination of public and private power. He is paid like a private banker--$175,600 a year. His shareholders are private banks. His board members are private citizens. His budget is free of congressional scrutiny. He works in a spacious corner office atop a striking skyscraper with a fine view. Once every six weeks, [he] abandons these comforts and goes to Washington, where he assumes the role of powerful government official.

Although most government agencies -- including the Fed -- make extensive use of private citizens as advisers, in no other agency is actual decision-making power vested in individuals who are formally accountable to private parties instead of to the public.

LEGISLATIVE HISTORY

1913 Federal Reserve Act

The legislative history of the Federal Reserve Act and later amendments suggest that the Bank presidents are members of the FOMC because of political compromises necessary to unify the nation's monetary policy. There has never been a conscious decision that the public is best served by having almost half the votes on monetary policy cast by people not publicly accountable.

The role of the Bank presidents in the conduct of monetary policy has always been a controversial issue. Neither Woodrow Wilson, who was President at the time the Fed was created, nor Franklin Delano Roosevelt, who was President when the banking laws were rewritten during the 1930s, found any justification for having private interests controlling votes on government bodies.

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In 1913, as Congress was drafting the Federal Reserve Act, Rep. Carter Glass, who was then Chairman of the House Banking Committee, proposed in his draft of the Federal Reserve Act to give the nation's banks significant representation on the Federal Reserve Board. Senator Owen, Chairman of the Senate Banking Committee, strongly opposed this and held instead that the government should appoint all the members of the proposed Board. Glass's compromise position was to have four members chosen by the government and three by the banks. Owen and Glass met with President Wilson on this issue. According to Owen (see Congressional Record, Vol. 50):

> After a discussion of two hours, approximately, the President coincided with my contention that the Government should control every member of the Board on the ground that it was the function of the government to supervise this system, and no individual, however respectable should be on the Board representing private interests.

According to Glass' 1927 book, *Adventures in Constructive Finance*, when a group of bankers went to the White House to protest Wilson's decision, the President turned to the bankers and said:

> Will one of you gentlemen tell me in what civilized country of the Earth there are important government boards of control on which private interests are represented?

After what Glass tells us was a "painful silence," President Wilson inquired:

> Which of you gentlemen thinks that railroads should select members of the Interstate Commerce Commission?

As a compromise, Wilson suggested that, while the banks should not be on the Board, the bill should include a Federal Advisory Council, which would let representatives of the banks meet with the Federal Reserve Board periodically in an advisory capacity. Since Glass decided there could have been no convincing reply to either of Wilson's questions, he thereafter gave Wilson's approach "his very cordial support."

Wilson's views were reflected in the Report of the Senate Banking Committee on the 1913 act, which stated:

> The function of the Federal Reserve Board in supervising the banking system is a governmental function in which private persons or private interests have no right to representation, except through the Government itself.

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Development of the Federal Open Market Committee

One of the most serious omissions from the Federal Reserve Act of 1913 was any Federal Reserve organ to guide open market operations. Instead, such decisions were left up to the individual Federal Reserve Banks.

During the early years, the Banks, which received no appropriations from Congress for operating expenses, frequently made open market purchases of Treasury bills and other financial instruments in order to gain earning assets to fund salaries and other Bank expenses. Since each Bank did this separately and at its own convenience, open market operations occasionally had a disruptive influence on Treasury markets.

In 1922, under pressure from the Treasury, the Governors (as the Bank presidents were called before 1935) of the Banks of New York, Boston, Chicago, Cleveland and Philadelphia formed what came to be called the Open Market Investment Committee, to work out an orderly method of buying and selling government securities. The individual Federal Reserve Banks, however, were not required to obey this Committee; each Bank decided on its own whether to follow the approved policy. The Federal Reserve Board in these early days had no statutory role in open market operations.

At the outset of the Great Depression in 1929, the nation's monetary policy was conducted by twelve separate regional banks with poor coordination and sometimes severe undercapitalization. Economic historians still debate the importance of various events that may have caused the economy to contract by one third over the next four years. But many hold the view that the lack of coordination of monetary policy among the twelve separate Federal Reserve banks, combined with the undercapitalization of some Reserve banks, was a contributing factor to its depth.

The Banking Acts of 1933 and 1935

The Banking Act of 1933 gave the Open Market Committee statutory recognition and expanded it to include one representative of each Federal Reserve District. But it did little to enhance the role of the Federal Reserve Board. The Board could not initiate open market operations; it could only approve or disapprove decisions of the Open Market Committee.

When President Roosevelt appointed Marriner Eccles to head the Federal Reserve Board in 1934, Eccles proposed to give the Board increased control over monetary policy by making it, rather than the FOMC, responsible for open market operations.

The House version of the Banking Act of 1935 followed this plan by limiting membership in the Open Market Committee to Federal Reserve Board members. The bill did include a provision under which the Board would consult periodically with five representatives of the Federal Reserve Banks. After consultation, however, the Board would be free to follow its own judgement on monetary policy. Some Members of Congress resisted this plan and insisted that the power be shared with the Federal

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Reserve Banks. The final version of the Act compromised on this issue by creating an FOMC which included as voting members the 7 Members of the Board of Governors and a rotating group of 5 Federal Reserve Bank presidents. As part of the legislation, the FOMC's policy on open market operations was made binding on the Federal Reserve Banks. Authority and responsibility for monetary policy was thus centralized in the FOMC, though not in the Federal Reserve Board.

MONETARY POLICY IN OTHER COUNTRIES

This arrangement of giving formal power in the conduct of monetary policy to individuals selected by private industry does not find a parallel among major central banks abroad. A study prepared for the Joint Economic Committee on central bank-government relations in the major industrialized countries found that central bank officials who make monetary policy decisions elsewhere are duly-appointed public officials who are accountable to the public and not to private interests.

Where central bank officials that are not directly appointed by the government have a role, as in Italy, it is usually advisory; ultimate policy control still rests with government appointees. Even in Germany, which some believe to have the most independence of all central banks, the 11 Land Bank presidents who participate in monetary policy decisions are all appointed by the upper house of the German parliament.

THE MONETARY POLICY REFORM ACT OF 1993

The Monetary Policy Reform Act of 1993 would do two things. First, the FOMC as presently constituted would be dissolved and its responsibilities would be taken over by the Board of Governors. Second, a Federal Open Market Advisory Council would be created, composed of the presidents of the 12 Federal Reserve Banks. Through this Federal Open Market Advisory Council, the Bank presidents would have an important consultative role on monetary policy, but would not have a vote. The Fed would still have the benefit of the Bank presidents' advice, but monetary policy decisions would be the responsibility of accountable public officials.

Public power without public accountability does not fit the American system of democracy. The Monetary Policy Reform Act of 1993 would apply this democratic principle of public accountability to the Federal Reserve.

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OTHER REFORM PROPOSALS

You have convened this series of hearings to consider not just the composition of the FOMC, but also a number of other proposals to reform the Federal Reserve system.

We need to look for better ways to coordinate monetary and fiscal policy. At minimum, this requires better communication of the Fed with the Administration and Congress. Obviously, the Federal Reserve chairman provides a key communications link. Yet the four year term of the Federal Reserve chairman now comes up very late during the President's term. The proposal to make the term of the Federal Reserve chairman coincide more closely with the term of the President is worth consideration.

Communication between the Fed and the Congress also has problems. The Humphrey Hawkins act of fifteen years ago is based on the assumption that twice a year the Fed would inform Congress of goals for monetary aggregates that would have clear policy implications. For several years the Fed has been downplaying its monetary targets; in July the Fed reported that it has no confidence in the meaning of the monetary aggregates for policy. When this issue was raised with Nobel prize-winning economist James Tobin at a Joint Economic Committee hearing earlier this year, he made the following statement:

> ... it is more important to have the Federal Reserve come to the Congress and express its goals for macroeconomic performance on things that really matter, and that is growth of GNP, what happens to employment and unemployment, investment and foreign balance and inflation and talk about their appreciation of the macroeconomic circumstances in which they are making policy and the general directions in which they hope to move the economy in the coming six months or the coming year ....
>
> ... those goals could be discussed between the Congress and the administration and the Federal Reserve so there is [a] coherent macroeconomic plan on fiscal [and] monetary policy ....

It seems to me that Professor Tobin's suggestion is worthy of consideration.

Mr. Chairman and Members of the committee, I believe that this is an important series of hearings that you have launched today and I will follow them with interest. I understand that you plan to devote two hearings to witnesses from the Federal Reserve itself. We will all benefit from a thorough airing of the arguments for and against each proposal.

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TESTIMONY OF
SENATOR BYRON L. DORGAN
BEFORE THE HOUSE BANKING COMMITTEE

October 7, 1993

Mr. Chairman and members of the House Banking Committee, I appreciate the opportunity to talk with you about the Federal Reserve Board and the extraordinary power it has given to private bankers in managing the economy of this country.

These private bankers, who actually sit and vote on Board decisions regarding the nation's money supply and interest rates, are not appointed by the President or confirmed by Congress. They are not accountable to anyone but their own shareholders.

This is not how a democracy is supposed to work and it is not even how the framers of the original Federal Reserve Act intended it to work. The role of private bankers in the policy decisions of the Board is, by contrast, a financial coup that we should not tolerate just because it took place in the Board's imposing marble structure, rather than on the streets.

This is why I have joined Senator Sarbanes and others on legislation to change a Fed system which Congress and the President never authorized in the first place. This legislation is not radical. It would not cause disruption of the Board nor turmoil in the financial markets.

Rather, the legislation would simply restore and limit control of the nation's monetary policy to the officials of the Federal Reserve Board, as the founders of the Federal Reserve intended. It would get private bankers, who are accountable only to their shareholders, out of their current policy-making role.

We all know that the Federal Reserve Board is not exactly a hot political topic. It cloaks itself in ecclesiastical gravity, speaks in mind-numbing technicality, and is treated in the media with great reverence and awe. Yet this Board makes critical decisions about money that are crucial to our economy, to large and small businesses, to farmers and ultimately to every single American. How much money will circulate in our economy? What will interest rates be?

That's pretty basic policy. Arguably, it is the single most important thing the government does concerning our economy. Even though the Fed can't control the money supply and interest rates with the precision it once did -- the world economy is just too complex -- the Federal Reserve still exerts more direct control over economic policy than nearly any other institution in this country.

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Today, the Fed exercises this power primarily through its so-called Federal Open Market Committee (FOMC), which consists of the seven members of the Board of Governors plus the twelve regional bank presidents in the Federal Reserve System. These regional presidents are private bankers, not public officials. They serve their own shareholders, not the interest of the general public. Yet they get five votes, on a rotating basis, on some of the most important economic policy decisions in this country.

Stripped of the pomp and majesty, this is a pretty raw deal for our farmers and small businesses and for the American people generally. Bankers are in the business of lending money. The money supply is their stock in trade, the inventory on their shelves. By controlling the creation of this money, through the Fed's Open Market Committee, they get to manipulate the inventory to their own advantage. If this were any other part of the economy, an arrangement like this would prompt the interest of the Antitrust lawyers at the Justice Department. It would be seen as a money cartel.

But because it is the Federal Reserve Board, we are supposed to kneel on our prayer blankets and bow towards Twentieth Street and Constitution Avenue instead.

If ordinary business people can't sit on the Open Market Committee, then there's no reason that private bankers should sit there either. That's what the Sarbanes bill would accomplish. It would do away with the Open Market Committee and replace it with an Open Market Advisory Committee. The regional bank presidents could sit on this Advisory Committee. They could advise until they're exhausted. But they would no longer vote on policy. The only people who would vote on policy would be the members of the Board of Governors, whom the President nominates and the Congress confirms.

As I said, this is hardly a radical step. Few if any other countries give private bankers the kind of power over the nation's monetary policy, that the Federal Reserve does. It can't be stressed enough that the lawmakers who crafted the Federal Reserve never intended for private bankers to have this power in the first place. President Woodrow Wilson spoke over and over again of the need to keep the conduct of monetary policy open and public.

That's all this bill would do. It would not change the Federal Reserve; it would simply restore the Fed to the structure the framers intended.

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There's also a need to diminish the secrecy in which the Fed now operates. If the Federal Reserve Board is a public agency -- if it belongs ultimately to the people of this country -- then the people ought to be able to know what is going on there. That's the purpose of the "Federal Reserve Reform Act of 1993" which I have introduced. Congressman Lee Hamilton of Indiana has introduced a companion bill in the House. Chairman Gonzalez has introduced a more comprehensive Fed reform bill touching upon many critical reform items such as expanded Fed audits and public information disclosures.

Today, despite its central role in our economy, the Federal Reserve dwells only in the shadows of public debate. It does not make its decisions public in a timely manner. It releases very little information on its budget. There are not even any formal channels through which the Fed can coordinate its policy goals with the President and Congress. As a result, the nation's economic policy is like an army with two generals. The framers of the Constitution never intended the government to work this way. Experience does not suggest that it works very well.

My bill would address this lapse. It's important to be clear up front on what the bill would not do. It would not reduce the independence of the Fed as the architects of the institution conceived it. The bill would not enable Congress to meddle in Fed decisions. Certainly, the bill would not guarantee an end to policy mistakes.

But my bill would reduce the likelihood of those mistakes. It would establish a formal channel of communication between the Fed and the elected representatives of the people -- the Congress and the President. It would also give the public more information about the monetary policies that weigh so heavily on their economic prospects.

Specifically:

First, the President's top economic advisers would be required to meet three times a year with the Federal Open Market Committee. This includes the Secretary of the Treasury, the Chairman of the Council of Economic Advisors, and the Director of the Office of Management and Budget.

Second, the President would be empowered to appoint a new Chairman of the Federal Reserve near the beginning of his term rather than toward the end. The Fed is crucial to the success of any economic policy and the President should have the opportunity to appoint a chairman of the Fed near the beginning of the Presidential term.

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October 7, 1993

Third, the Fed would be required to disclose immediately any changes in its targets for the money supply. This would provide all investors, large and small, with equal and timely information about monetary policy decisions. Today only the larger firms, which have the financial ability to hire sophisticated "Fed watchers", can get a jump on the future direction of monetary policy. Such firms get an unfair advantage over small businesses and investors who can't afford to employ experts to monitor Fed activities.

Fourth, the Comptroller General would be permitted to conduct more thorough audits of Fed operations, including policy procedures and processes. For many years the Fed was totally exempt from any such audits to uncover misdoing or waste. Today the General Accounting Office (GAO) is prohibited from auditing many of the Fed' operations including actions on monetary policy and transactions made under the direction of the Federal Open Market Committee (FOMC). This bill will remove many of these restrictions.

Fifth, the Fed would be required to publish its budget in the budget of the United States government. Today the Federal Reserve budget is secret; it reveals nothing about its operations to what it considers the unwashed masses. But no governmental agency should take in and spend billions of dollars without making its budget open to the public.

These modest steps will inject fresh air and light into the making of monetary policy without impairing the independence of the Fed. The legislation will require that those who make monetary policy and those who make fiscal policy at least understand what each is doing

Once again, I commend Chairman Gonzalez for holding these important hearings; and I urge the House Banking Committee to pass Fed Reserve reform legislation in the near future.

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For release on delivery
9:30 a.m., EDT
October 7, 1993

Statement by

The Honorable Kweisi Mfume

Member, Committee on Banking, Finance and Urban Affairs

before the

Committee on Banking Finance and Urban Affairs

U.S. House of Representatives

October 7, 1993

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Mr. Chairman, I am here this morning to discuss concerns about the Federal Reserve and issues involving H.R. 28, "the Federal Reserve System Accountability Act of 1993." As a co-sponsor of this act, and as a Member of this Committee, I am honored to have the opportunity to share my specific concerns with my colleagues.

The accountability of the Federal Reserve and the constitutionality of allowing private citizens to vote on the nation's money supply are very important questions before us today.

H.R. 28 is designed to make the Federal Reserve, the nation's central bank, more accountable to the public it is there to serve. The Federal Reserve exerts immense influence over the economy because of its ability to influence interest rates, employment, inflation and the international value of the U.S. Dollar. As such, its role is not to be taken lightly.

H.R. 28 requires that members of the Federal Open Market Committee (FOMC), the Federal Reserve's decision-making Committee, who vote on our money supply, be appointed by the President and have their views examined publicly during Senate confirmation proceedings. This way we can know exactly where the FOMC members stand on issues of importance to the public.

In addition, the President must include representatives of agriculture, small business, labor, consumer and community groups, women and minorities, among his nominees. Bringing more

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diverse representation to Federal Reserve decision-making roles is a reasonable and desirable objective for any policy making entity.

The reforms embodied in H.R. 28 are modest and simple. During today's discussion, I wish to focus specifically on the issue of diversity.

H.R. 28 contains language which will help end the Federal Reserve's discrimination against women and minorities. The legislation requires that the Federal Reserve abide by the Civil Rights Act of 1964, which guarantees employees' basic civil rights, including the ability to pursue the Federal Reserve for discrimination. A quick review of the history of diversity issues with the Federal Reserve will show that holding the central bank more accountable legislatively is the only course of action left for us to take.

The record clearly shows that women and minorities have little or no say in the conduct of our nation's monetary policy or bank regulation. In 1977, the House Banking Committee issued a report noting "the virtual exclusion of women, black, and representatives of labor unions, consumer interest organizations, non-managerial and non-producer interest groups," in policy making positions regarding our money supply.

In response, the Congress passed the Federal Reserve Reform Act of 1977 which required that all Federal Reserve bank directors be chosen "without discrimination on the basis of race, creed, color, sex, or national origin."

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Then, at the beginning of 1978, it was thought that diversity would begin to occur when the 12 Federal Reserve banks had 37 directorships vacant--12 were in class A, 12 in class B and 13 in class C. Of the first 21 that were filled with new persons, 7 were in each class. There was no increase in diversification at all in class A directors; there was one non-minority woman appointed to a class B directorship; and, one non-minority woman was appointed in class C.

In defense of that action, which violated the spirit of the 1977 Act, the Federal Reserve pointed out that the Federal Reserve Reform Act was not passed until November 1977, and therefore there was not a great deal of time to turn around the situation.

Thirteen years after enactment of the 1977 act, in 1990, an intensive study entitled Racial, Gender, and Background Profiles of the Directors of the Federal Reserve Banks and Branches, revealed that diversity had still not occurred as specified in the law and showed continuing indifference on the part of the Federal Reserve.

According to the report, among the 72 class A and B directors who are chosen by private member banks in the 12 Federal Reserve districts, there was one African-American, no Hispanic-Americans, and only three women. Of the 36 class C directors chosen by the members of the Board of Governors--which are supposed to "represent the public"--50 percent were former bank directors and none worked for consumer or labor

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organizations.

The upper echelons of the Federal Reserve's management--consisting of the top staff at the Board of Governors, the 12 presidents of the Reserve Banks and the 7 members of the Board of Governors--have been and continue to be practically devoid of women and minorities.

Since 1913, there has only been one woman and no minorities serving as one of the 12 Federal Reserve Bank Presidents.

In reviewing Federal Reserve staff salary compensation, of the 34 staff members of the Board of Governors earning <u>over</u> $125,000 in 1993, only one is a woman and one is listed as "non-white." The 12 Federal Reserve Banks have 82 staff employees earning <u>over</u> $125,000 per year of which 14 are female and 3 are listed as "non-white."

To reiterate, women and minorities have little or no say in the conduct of our nation's monetary policy and in bank regulation. This lack of female and minority representation alienates tens of millions of Americans from representation and influence. And this is unfortunately typical for all bank regulatory agencies.

Chairman Gonzalez has allowed me to use some of the data from his 1993 study of diversity in hiring in the Federal Reserve System. This study has not yet been made public. I want to thank you, Chairman Gonzalez, for undertaking this study and for making part of it available to me today.

Let us look at the results of the study. The Board of

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Governors employs 1,683 people with salaries amounting to $88 million. The 12 Federal Reserve Banks employ 24,286 people with total basic salaries of $1.14 billion. Let us examine the distribution of this billion dollar payroll.

I would like to submit for the record two charts for each of the 12 Federal Reserve Banks and for the Board of Governors (attached). One chart shows the distribution of jobs for the highest paid ten percent of employees and the other chart shows the distribution for the lowest paid ten percent.

These charts clearly show than women and minorities are significantly underrepresented at the highest paying positions in the Federal Reserve System. At the lower level of employees, the ten percent lowest paid employees, minorities and women, in most cases make up more than the majority.

This is a blatant blueprint of discriminatory hiring practices. The truth is there are many qualified minority persons and women. Our country has a large number of qualified minority and women lawyers, accountants, and academics who are well qualified for employment in upper level jobs at the Federal Reserve. These people must fight the battle against discrimination in employment in many parts of the private sector. Why should they be fighting this battle with our central bank, which should be a role model for the banking system.

African-Americans have a particularly high stake in how monetary policy effects our economy. A Wall Street Journal analysis of Equal Employment Opportunity Commission records

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revealed that tha last recession sariously eroded aqual opportunity for African-American workers. In fact, African-Americans were the only racial group to suffer a net job loss during the 1990-91 economic downturn. The computer aided study shows that some of the nation's largest corporations shed black employees at the most disproportionate rate. Overall, African-Americans' share of jobs at companies dropped--in 36 states and in six of nine major industry groups--for the first time in nine years, wiping out three years of gains.

Regarding the issue of access to credit, since 1990, the Congress has been requiring the federal bank regulators to track bank lending according to race, gender and income. The results have shown a disturbing pattern of discrimination in bank lending. The Federal Reserve itself recently reported extensive bias against minorities in bank lending--something that Community Reinvestment Act supporters have fought hard to counter for years.

The fact that this lending discrimination reappears year after year leads one to wonder whether bank regulators such as the Federal Reserve would move more vigorously to eradicate this discrimination if they, themselves, were composed of personnel more reflective of the country's diversity and thus sensitive to the borrowing needs of all Americans. The fact of matter is that minorities are just as under-represented on the boards of the 4,623 state and nationally chartered banks that are currently members of the Federal Reserve System, as they are under-

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represented on the boards of the Federal Reserve Banks.

The central bank may be a starting point to remedy this problem. Banks cannot take seriously the federal government's commitment to eradicate discrimination as long as agencies like the Federal Reserve remain as exclusive as ever.

Increasing the number of women and minorities in decision-making positions at our nation's banks will have the positive effect of creating a lending atmosphere cognizant of the needs of creditworthy borrowers, regardless of their race or sex or place of residence. Such action would help address what some would call a "disconnect" between Federal Reserve policy makers and what ordinary Americans are faced with in their day to day lives.

It is imperative, also, that the Federal Reserve be made to understand that diversity and competence can go hand-in-hand. Federal Reserve Chairman Alan Greenspan visited with me earlier this year regarding diversity issues and expressed concern about qualified and competent candidates. I was informed that the Federal Reserve had been having difficulty in building the pipeline which would allow for diversity in policy-making due mainly to the highly specialized nature of the Board's work and the qualifications needed to fill positions.

In supporting the need for reform of the Federal Reserve, I belive the following changes, as recommended in the 1990 study and as incorporated into H.R. 28, are necessary to effect diversification:

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RECOMMENDATIONS

1.) The Federal Reserve Board's and Federal Reserve Banks' exemption from Title VII of the Civil Rights Act of 1964 should be repealed.

2.) Nomination of the 12 Federal Reserve Bank presidents should be by the President of the United States with confirmation by the Senate.

3.) Six of the nine directors of each board of directors should be appointed by the Board of Governors in Washington (instead of the present three of nine). The members should include a wider representation of United States citizens (largely stipulated previously in the Federal Reserve Reform Act of 1977).

4.) There should be authorization of an 18-month Federal Reserve Reform Commission to examine a number of areas, including the effect of the regulations of the Board and the operations of the Board and the Federal reserve banks on low- and moderate-income families, including the effect on availability and cost of financial services and credit.

5.) The Federal Reserve Act should contain a definition of the term "public." A comprehensive definition would make it difficult for the Federal Reserve to abrogate the intent of Congress regarding Director diversity.

6.) An individual that has been an officer, director or employee of a bank within the preceding three year

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period should be ineligible to hold a "public" Director slot.

7.) The qualifications of Branch Directors should be defined in legislation. At present the Federal Reserve determines Branch Director qualifications.

8.) Each district should be required to establish consumer, labor and small business advisory councils.

Further, in identifying eligible women and minority candidates, the Federal Reserve should utilize the U.S. Treasury's nationwide list of minority-owned banks participating in the minority bank deposit program and work with trade organizations like the National Bankers Association which represents minority- and women-owned banks and has been operating for 65 years. The Federal Reserve should also enter into an agreement and establish a plan involving Historically Black Colleges and Universities, as well as the United Negro College Fund, in order to support and track eligible candidates for the pipeline.

Again, thank you for allowing me to speak before you today.

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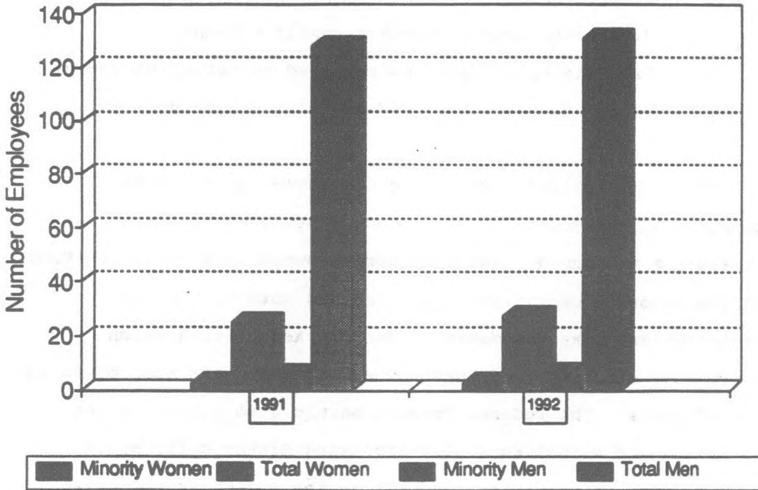
Federal Reserve Board
Highest Ten Percent Paid Employees



Prepared by the House of Representatives Committees on Banking, Finance and Urban Affairs

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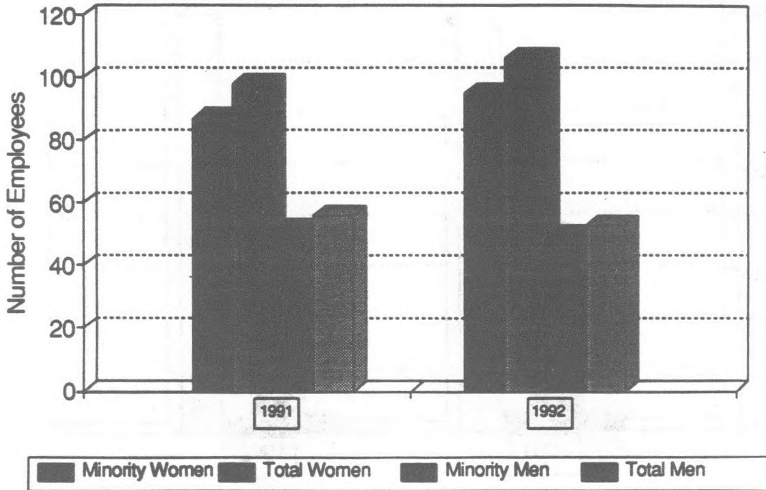
Federal Reserve Board
Lowest Ten Percent Paid Employees



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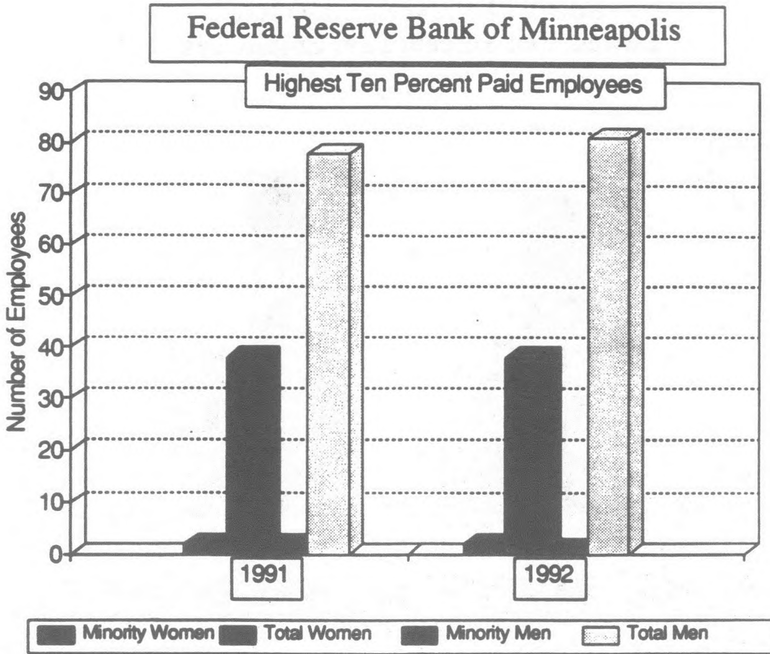

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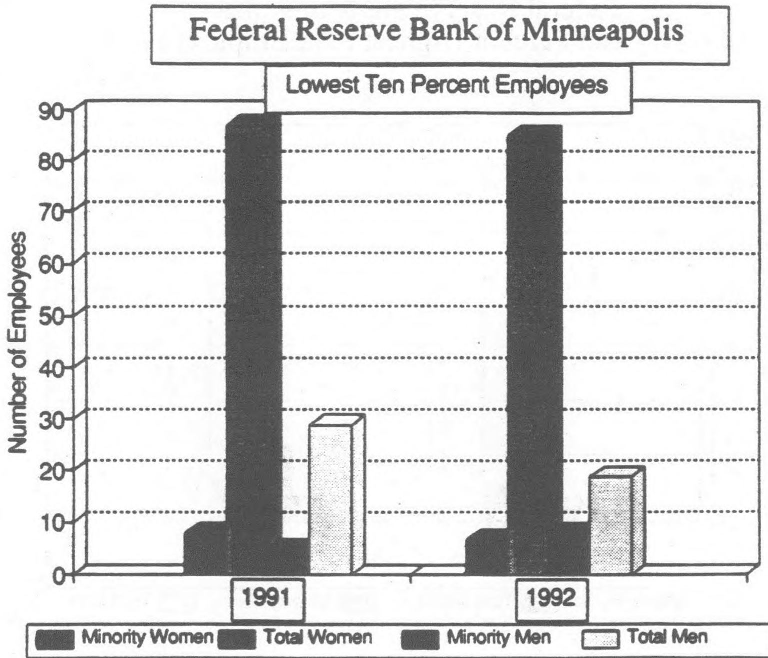

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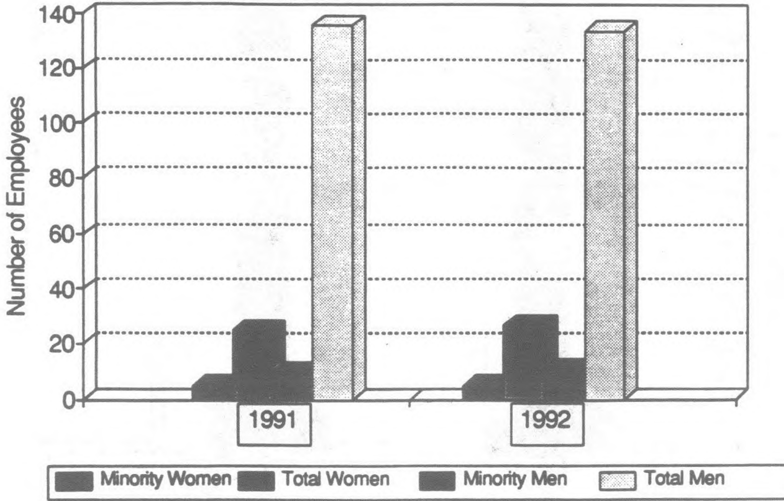

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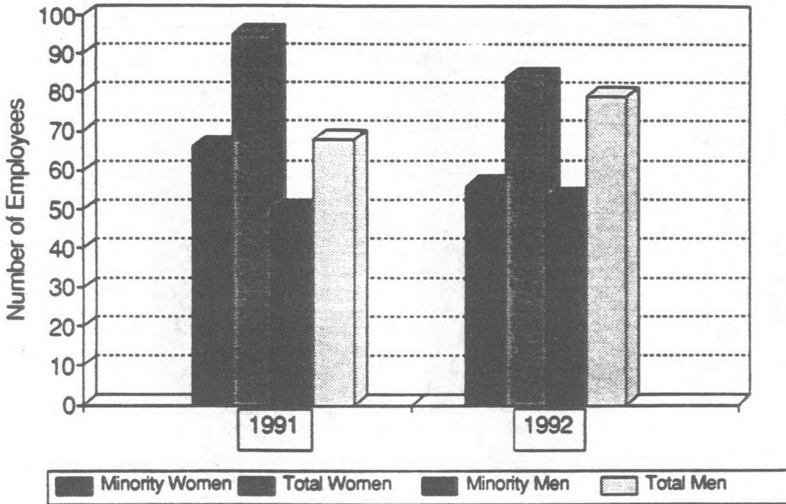

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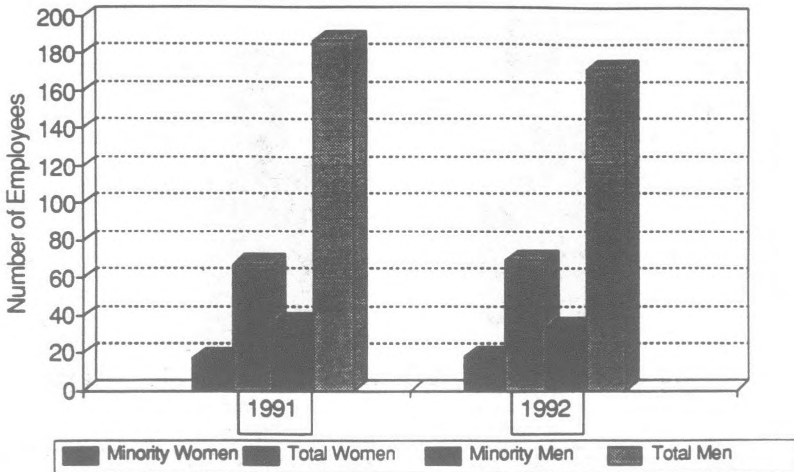

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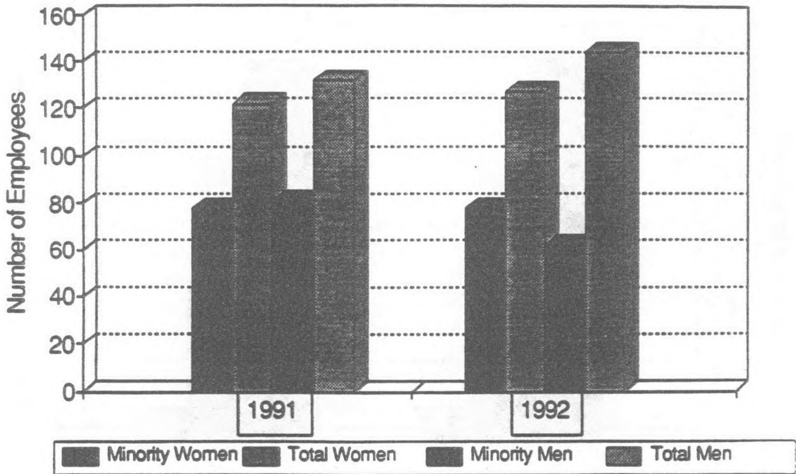

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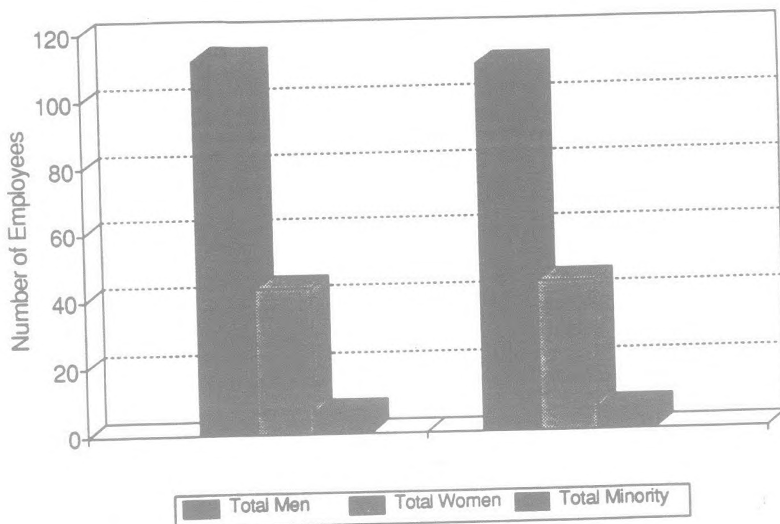

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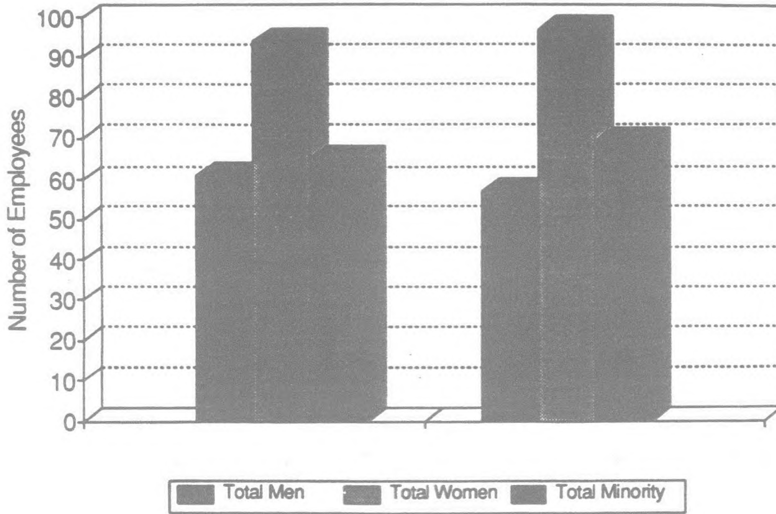

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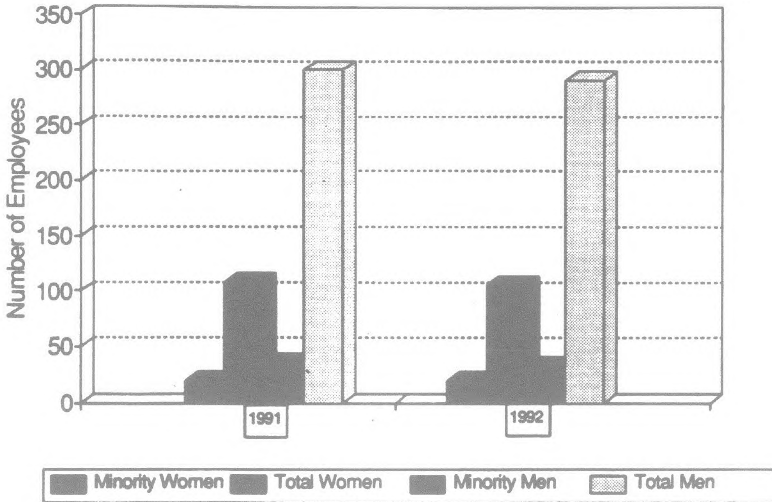

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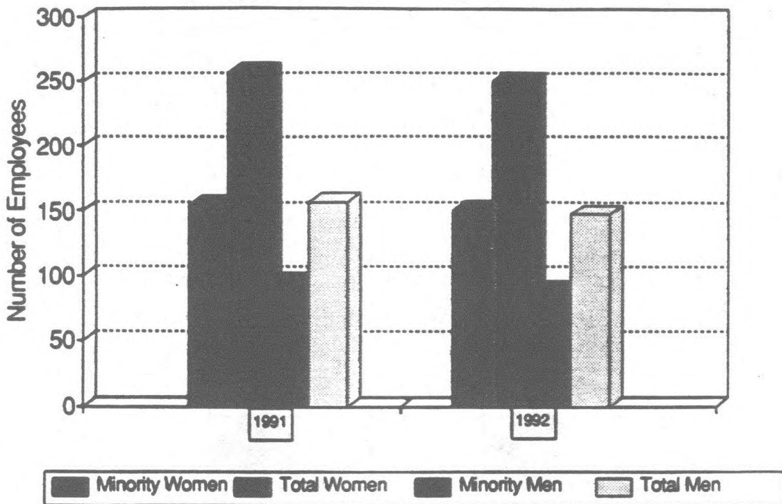

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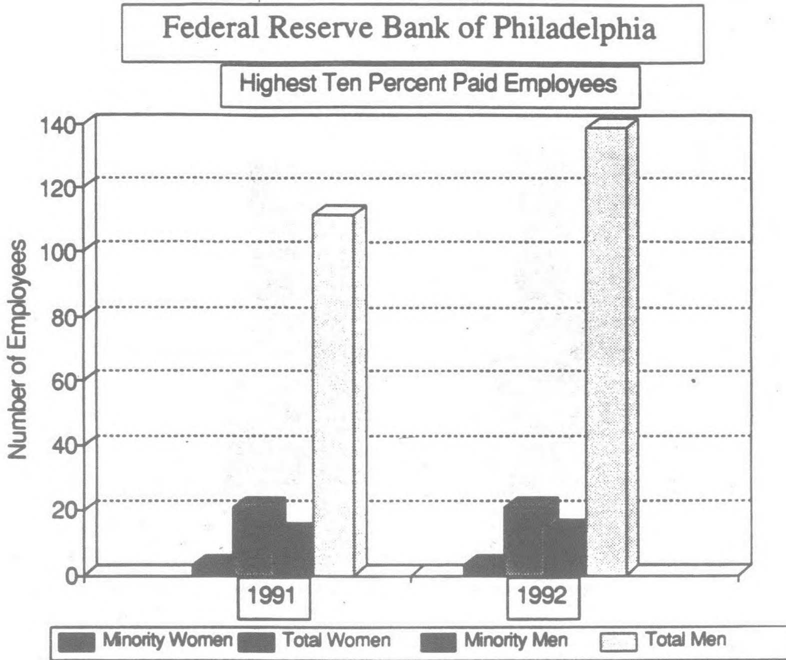

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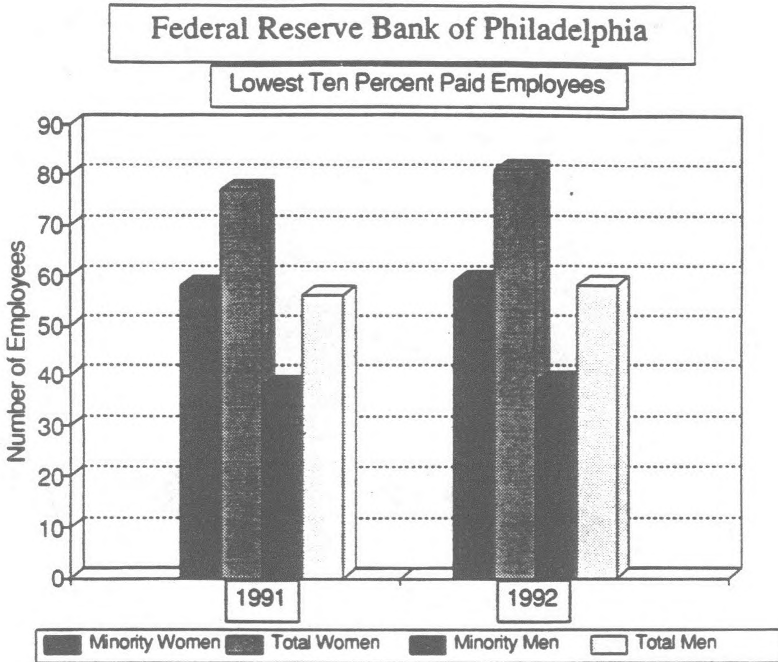

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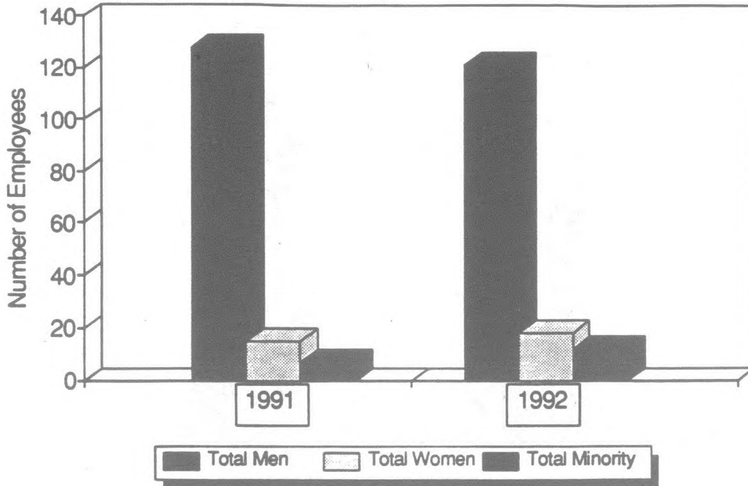

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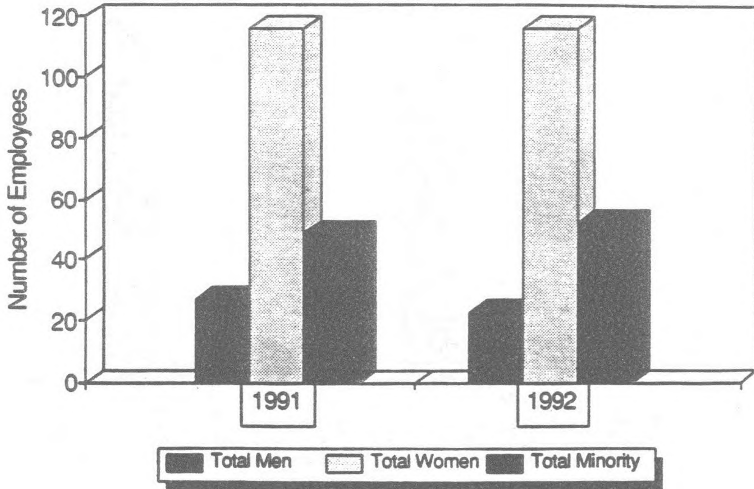

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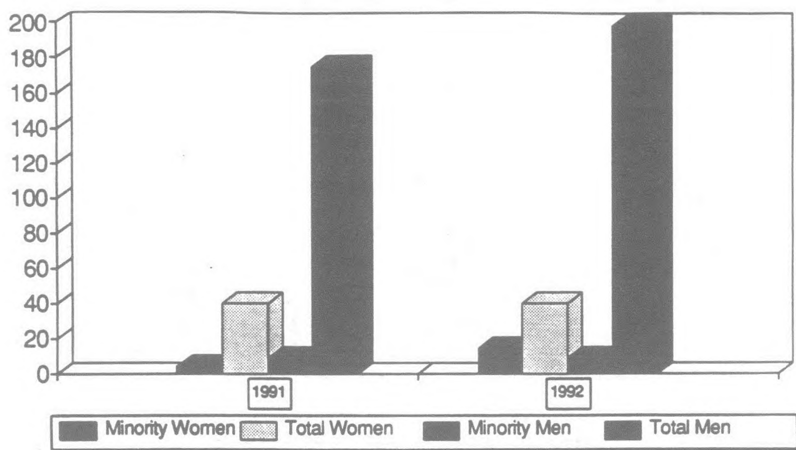

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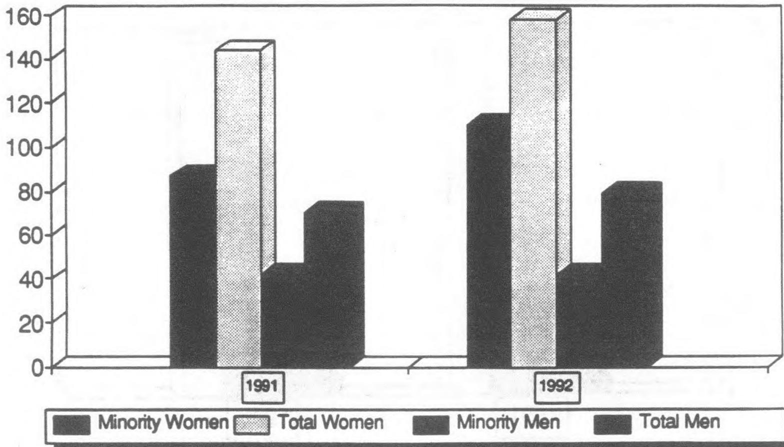

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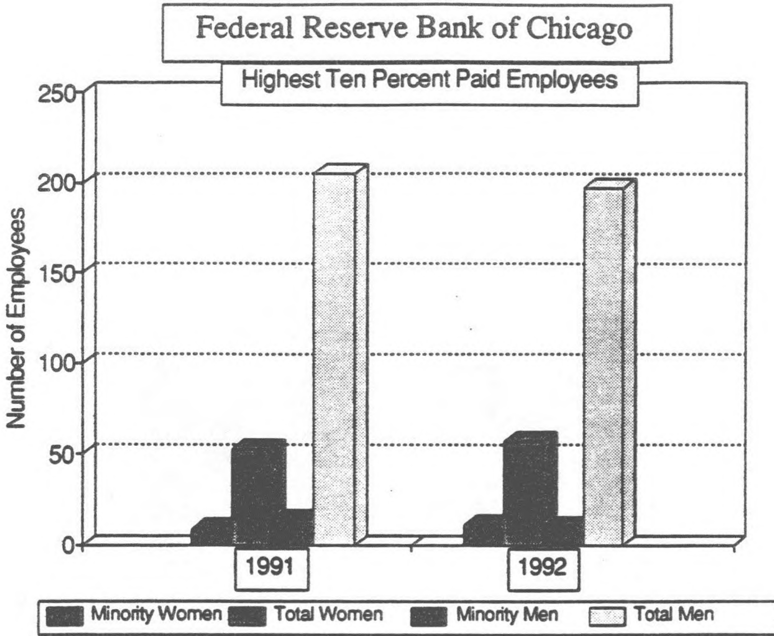

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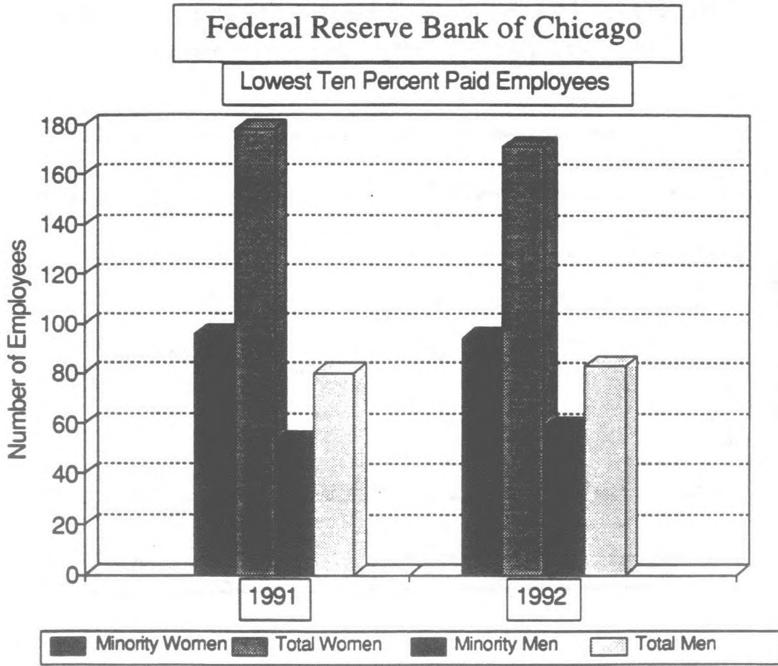

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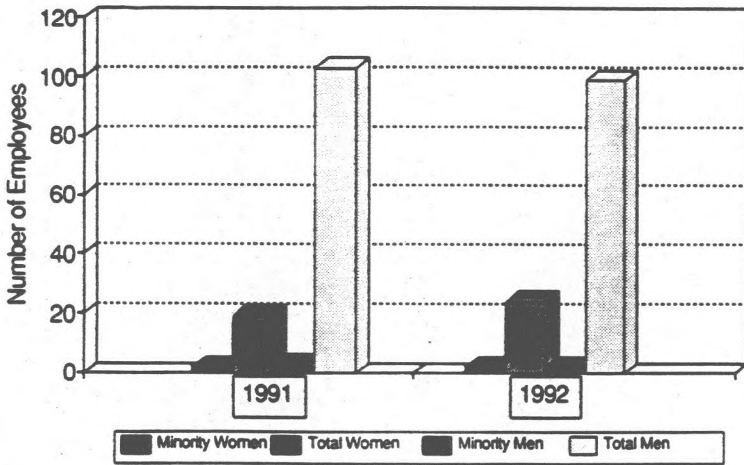

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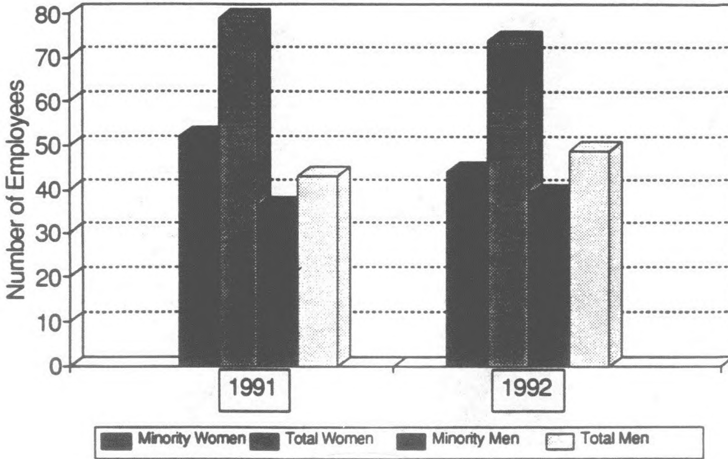

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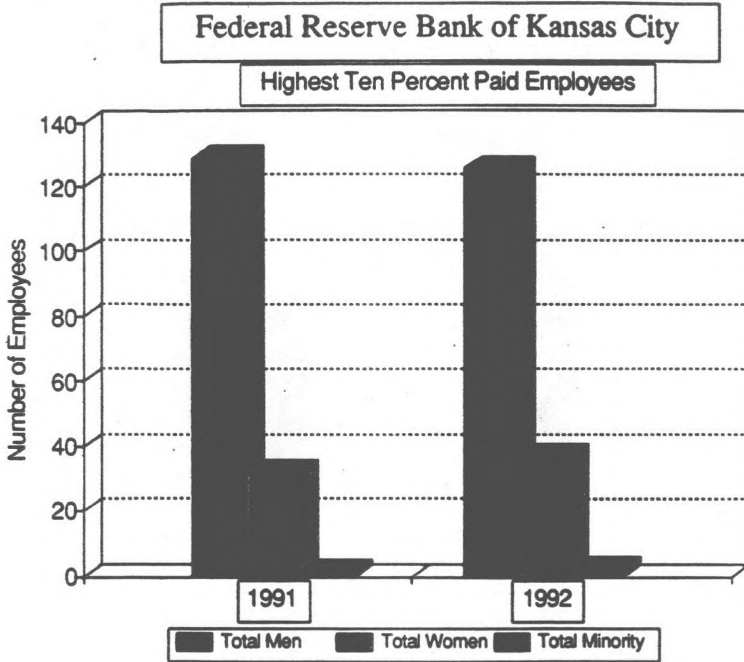

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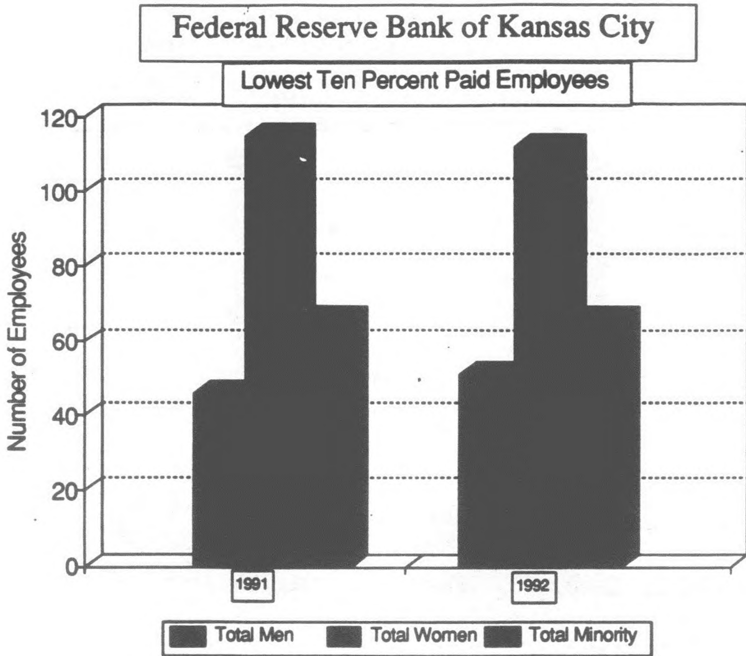

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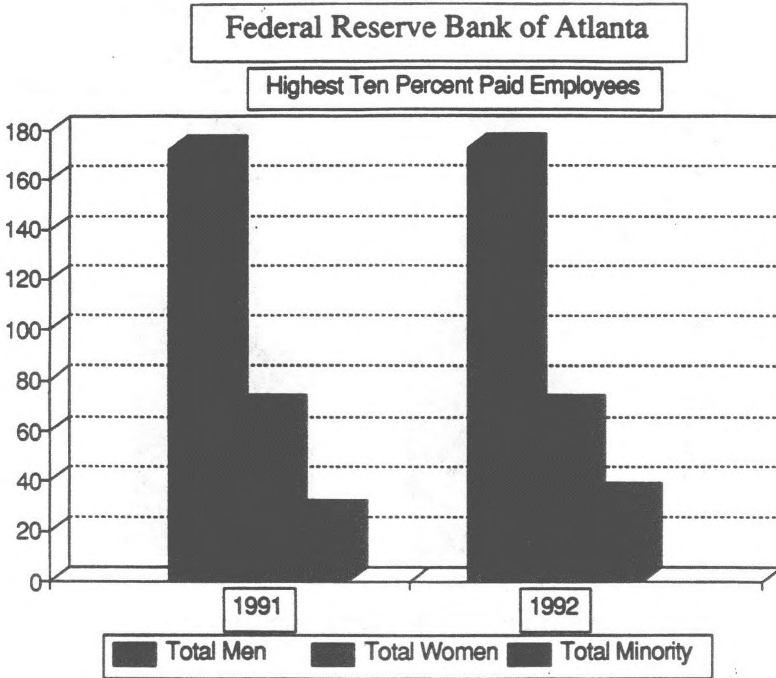

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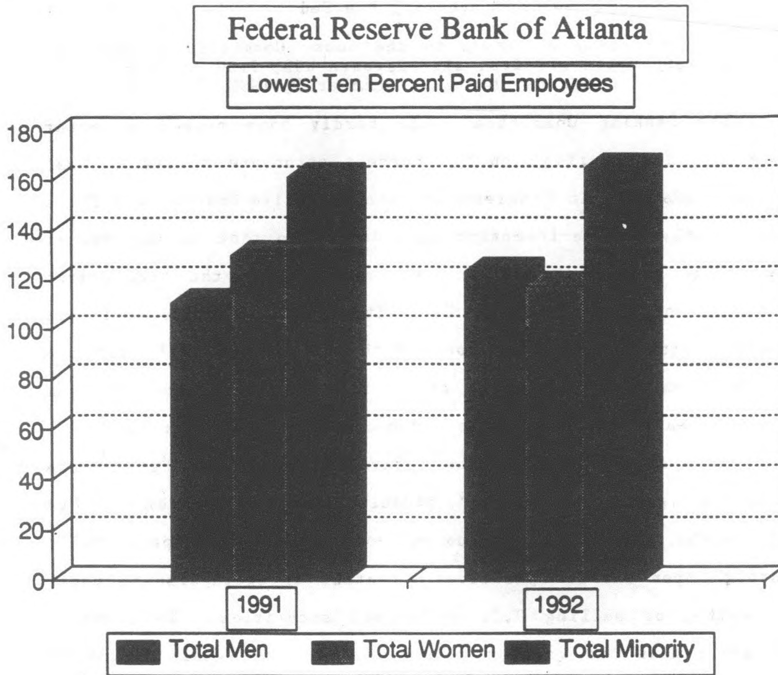

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Re-inventing the Fed

Statement by Henry S. Reuss to the House Committee on Banking, Finance, and Urban Affairs, 2128 Rayburn HOB, 9:30 o'clock Thursday morning, October 7, 1993

The Banking Committee could hardly have picked a better time for its hearings on the current structure of the Federal Reserve System. In Congress and the Executive Branch, the focus is properly on "re-inventing government" so that it may better serve the people. In Europe, all eyes are on the "democratic deficit" of the European Community, whose institutions are charged with having lost touch with the citizen. All over the world, from South Africa to Japan, from Hungary to Mexico, from South Korea to the Middle East, democracy is on the march.

So must it be with the Federal Reserve. The Fed is the monetary agent of Congress' constitutional responsibility "to coin money, regulate the value thereof". This it does principally through open market operations--creating or extinguishing money by buying or selling U.S. government securities. No function of government has greater consequence for the weal or woe of its citizens.

But ironically, this great governmental power is vested not in officers of the government but in something called the Federal Open Market Committee. The FOMC's 12 members consist of the 7 members of the Board of Governors, who are indeed appointed by the President and confirmed by the Senate, plus five presidents (or vice-presidents) of the 12 Federal Reserve District Banks, private citizens who have been selected by their boards of directors who are themselves two-thirds composed of

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representatives of the commercial banks in the district.

If the members of the FOMC may be selected by the bankers, why not have the Treasury Secretary named by the NAM, the Secretary of State by the Council on Foreign Relations, and the President by the AFL-CIO?

This private exercise of public power is made worse by the capricious way in which the five rotating private members of the FOMC are selected--one member, all the time, from the New York district; one every other year from Cleveland and Chicago; and one every third year from "those lesser breeds without the law", Boston, Philadelphia, Richmond, Atlanta, Dallas, St. Louis, Minneapolis, Kansas City, and San Francisco. How can any one defend this nonsensical disproportion?

The remedy is to consolidate the governmental open market power in public officers, the governors of the Federal Reserve. The advisory voice of the 12 District presidents can be obtained through a revision of the Federal Advisory Council which would require their presence and their voice--but not their vote--at open market meetings.

Mandating that the money power shall be conducted by public officers rather than by private persons is not only dictated by principles of good government. It is required by the Constitution. Article II, Section 2, Clause 2 provides that "officers of the United States" must be appointed by the President by and with the advice and consent of the Senate. In Buckley v. Valeo, 424 U.S. 1 (1976), the Supreme Court unanimously struck down a statute providing that commissioners

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of the Federal Election Commission should be appointed, in part, by the House and Senate. If an election commissioner is an "officer", within the meaning of the Constitution, how much more an "officer" is one charged with conducting the nation's monetary policy?

Restricting the FOMC to "officers of the United States", as the Constitution requires, should be the Congress' first order of business. Pending legislation sponsored by Senator Sarbanes(S. 219) and by Representatives Gonzalez (H.R. 28) and Hamilton (H.R. 586, 587) would do just that.

That done, there are other anomalies of the Fed structure demanding attention.

The Fed's basic law provides that member banks must hold 6 percent preferred stock in the Fed, amounting today to some $3 billion. The 1980 Federal Reserve reform legislation, by requiring banks to post reserves whether or not they were Fed members, made membership in the Fed irrelevant. The preferred stock arrangement is thus a pleasant fiction, that the Fed is somehow owned by the banks. The credit crunch is still with us, and the banks dearly need additional capital on which to base expanded lending. Why not endow them with some $3 billion of additional capital by requiring that the preferred stock be redeemed?

Another piece of Fed structure crying for attention is the requirement of <u>seven</u> Fed governors. Seven is simply too many. Who among us today can name the incumbents of these powerful positions? How can the public fix responsibility when

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it is divided among so many? The number of governors could well be reduced to five, like the FTC or the FCC, or even three, like the CEA or the SEC.

Reducing the number of governors would make it fiscally and politically easier to pay governors an adequate salary. The Fed's governors are now paid $123,100 ---less than the $161,800 paid top Fed staff, less than the $250,000 paid the N.Y. district bank president, less than the $148,000 paid cabinet officers. Fed governors are important government officers, and they should be compensated accordingly.

One final, and perhaps heretical, thought. What is it that the 12 district Feds, and their numerous branches and centers, are supposed to be doing? Their principle function, check-clearing and currency-moving, is steadily diminishing in our increasingly "checkless society". Could not these functions be carried out more economically by privatization?

We ought to find out. If they can, the only remaining function of the district Feds, as set forth in the pamphlet of one of them, is "to provide System officials with considerable 'grass roots' information on business conditions." As Professor Galbraith has observed of this "function" of the District Feds in his 1975 classic "Money": "The roads (being) good, the telephone service excellent, and its newspapers readily available if wished, the volume of such information otherwise unavailable in Washington cannot be great."

Forecasters predict that the present glut of office space in our great American cities is likely to end toward the turn

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of the century, just when the problem of the federal budget deficit, temporarily solved by this year's Budget Act, will again rear its head. Selling off the Fed's redundant office space at a fair price would be a piece of down-sizing that would do wonders for the fiscal 2000 budget. It's worth thinking about.

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EMBARGOED UNTIL
9:30 A.M.

William Greider
Testimony, House Banking Committee
October 7, 1993

Reforming the Federal Reserve

The Federal Reserve and its conduct of monetary policy involve daunting complexities, but the most important thing to understand is really quite simple: **the Federal Reserve is a political institution.**

That is not how the Fed is generally perceived or depicted. By tradition and design, the conventional wisdom describes our central bank as a kind of cloistered sanctuary where disinterested experts make authoritative calculations about the future of the economy. The governors are said to be "above" politics -- protected from the messy claims of special interests that surround the Congress and the President. The extraordinary secrecy surrounding the Fed's decision-making supposedly insures that crass political motives will not intrude on its difficult deliberations.

The veil of secrecy certainly does enhance the mystique surrounding the Fed -- and the general ignorance about it. Otherwise confident and intelligent people -- including members of Congress -- defer to the Fed's wisdom mainly because they do not understand it. They are understandably intimidated by its mystery and power.

What I found behind the veil is an agency of mortal men and women -- smart, dedicated and exceptionally well-educated people who are empowered to decide some of the largest questions of how the federal government manages the economy. In my many interviews, the one theme that governors, Federal Reserve Bank presidents and other senior officials repeatedly emphasized was their own fallibility. Monetary policy is filled with large uncertainties, squishy facts and unpleasant trade-off's between competing goals. The Fed deliberates at length, but it must also decide things on the run -- since neither financial markets nor the broader economy of commerce will stop and wait for its judgments.

And, as every governor freely acknowledged to me, the Fed also makes mistakes -- just like the rest of us mortals. The difference is that the Fed's mistakes can have devastating impact on the lives and fortunes of millions. It can sink viable business enterprises and force debtors to the wall and put millions of people out of jobs. It can reward some investors and

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punish others. It can literally reverse the tide of economic growth or, in other circumstances, ignite the economic energies of the nation, not to mention the world.

Given these vast powers, it is fatuous to pretend that the Federal Reserve can somehow be insulated from politics. And, indeed, it is not. As any candid governor will tell you, the institution is bombarded constantly with pleas and demands and unsolicited advice from selected interests. As a matter of style, lobbying the Fed is done more delicately and discreetly than, say, lobbying Congress or the White House, but the private and semi-private dialogues surrounding monetary policy go on continuously -- between the Fed and financial markets, banks and brokerages and other major players, both foreign and domestic.

The only players who are left out of this conversation are the American people and, to a large extent, their elected representatives. Instead, they are provided a frustrating stream of evasive euphemisms and opacque jargon and platitudinous generalities and, sometimes, even downright deception. As more than one Federal Reserve governor confided to me, it would be very difficult -- perhaps impossible -- for the Fed to have an honest discussion of monetary policy with Congress or the public because the level of ignorance (and the potential for misunderstanding) is so profound.

In other words, if you are serious about reforming the Federal Reserve, you will necessarily have to think about changing more than the institutional behavior of the Fed. The lack of accountability is not simply a function of Fed mystique. Among elected politicians, there is also a widespread willingness not to know or understand. In fairness to Congress, the news media encourages this deference by promoting the conventional wisdom about the institution. Any politician who dares to become a critic can count upon damaging attacks from both editorial writers and news reporters, accusing him or her of "political meddling" with the non-political Federal Reserve.

I want to be very clear about what I mean by "political institution." I am not arguing that the Federal Reserve plays partisan favorites at election time or that it secretly obeys the incumbent President's whispered commands. Those are the standard complaints of Fed critics, but I found them refuted again and again by the actual history of the central bank's performance. If the Fed was dedicated to punishing Democrats and rewarding Republicans, then George Bush might still be President and Richard Nixon would certainly have defeated John F. Kennedy in 1960. If the Fed faithfully took instruction from the White House, Jimmy Carter might have enjoyed a second term.

I am using "politics" in its generic sense: the Federal Reserve makes large and potent public decisions backed by the

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force of government power -- yet there are no reliable mechanisms for political accountability or even for achieving a decent public understanding of what has been decided in the people's name. The Fed's power over the daily lives of ordinary Americans -- not mention the largest enterprises of commerce and finance -- is at least as great as the President's or Congress and, in most instances, more immediate. It takes many months or years to enact new legislation or to redirect the priorities of fiscal policy. Monetary policy can turn winners into losers overnight. And vice versa.

In the opening pages of my book, I called the Federal Reserve a "crucial anomaly at the core of representative democracy, an uncomfortable contradiction." That word "anomaly" was suggested to me by the former president of a Federal Reserve Bank. It is a nice way of saying the Fed's unaccountable power doesn't fit with our idea of self-government.

The Fed never has to face reelection. It was designed that way, of course, in order to resist the transient storms of popular opinion or narrow partisan ambitions. The actual result, I think, is a very skewed political process in which some citizens have a large voice and most citizens have none. Bankers are consulted regularly and intimately, but labor unions and farmers, home builders and independent oil drillers are not. The bankers have their own private policy meeting with the Board of Governors four times a year -- try getting a transcript of those discussions.

My point is not that the Fed is "captured" by the bankers and bondholders, as some critics claim. The reality is more complicated. My complaint is that the Federal Reserve, given its own institutional biases, is preoccupied with a narrow version of economic reality while other competing versions are excluded from the inside debate. If we could actually hear the inside debate at the Fed, I think this distortion would become clear to most everyone.

Frankly, the Fed does not even have to confront intelligent scrutiny from those the people have elected to represent them. That is, the Congress. In my experience, congressional oversight hearings are usually a dispiriting mixture of posturing and bile and trick questions that Federal Reserve governors find quite easy to fend off. It is hard to take most of the congressional questioning seriously and not surprising that many at the Federal Reserve do not.

Meanwhile, important decisions are made in private and only the most sophisticated observers can read the portents. Wall Street spends big money on its "Fed watchers" because it needs to understand what the Fed will be doing to interest rates and the supply of credit and, therefore, to economic activity across

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every sector.

The public, meanwhile, is regularly blindsided by these government decisions because nobody will give them an intelligible explanation of what's coming and why. In fact, nobody looks backward in a patient manner and asks the most obvious question: was the Federal Reserve right in its decision? Or did the governors misunderstand the economic forces and choose the wrong objective? Did it make another large mistake?

In financial markets, investors speak of "transparency" and they insist upon it before they will buy a company's stock. They need to be able to see inside the company -- beyond its rhetorical claims -- in order to judge the logic of the company's business strategy and the reality of its performance. The Federal Reserve lacks "transparency." There is no earthly way that an average citizen can parse meaning out of the Fed's dense pronouncements. Actually, there is no practical way for any member of Congress to begin to exercize accountability. To understand the policy, we need to be able to see the arguments that produced it.

This is not an unreasonable standard. Every other institution of government -- except perhaps the Central Intelligence Agency -- is required to reveal itself in just these terms. A President or any Executive Branch agency must provide exhaustive documentation and rationale for decisions. Every member of Congress must literally contribute to a public record of argument and deliberation. That's the basis of how you are held accountable.

That is I why think the chairman's proposal is so important. It is a necessary first step -- no more than that -- toward developing a more mature understanding of monetary policy and, therefore, a reliable sense of accountability. The chairman's bill is actually quite modest in scope. It does not compromise the Federal Reserve's established independence in any way. It does not try to change the institutional structure of the Federal Reserve System (as Senator Sarbanes and others propose).

It simply asks a very basic question of a powerful government agency; tell us what happened at your meeting. Let us hear what you said in plain English. Let us see why you made these decisions, what you were thinking you would achieve, what the economic conditions looked like to you at the time. Given that information, then we might be able to judge more coherently whether you are doing a good job or not, whether the trade off's you chose seemed reasonable, given all the interlocking complexities. Or whether the Fed has made a large mistake and ought to correct it.

Let me offer two quick reactions to the other reform

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proposals:

First, the measure to reform the status of the regional bank presidents is a worthy idea but a very old one. The late Wright Patman, who was chairman of this committee, once called the Federal Reserve System a "pretty queer duck" and he introduced that same measure and numerous others year after year, trying to straighten out the tangled anomalies in the institution's structure. Congress never got up the nerve to enact any of these. Of course I agree with the objective, but I'm not sure it would accomplish all that much in terms of altering the Fed's fundamental behavior. Federal Reserve governors, after all, are still going to consult closely with bankers on monetary policy. It would be odd if they didn't.

Second, some have proposed that the Federal Open Market Committee be required to announce its policy decisions on the same day they are made rather than releasing a summary statement six weeks later. The Federal Reserve has always argued against immediate release on the grounds that it would weaken its ability to conduct monetary policy. I think the Fed is right about that. The Federal Reserve is an active daily participant in the credit markets -- the largest participant -- and, like every other player, it develops its own trading strategy for the weeks or months ahead. That is the essence of the FOMC policy directives to the open-market desk in New York. It makes no sense to compel the Fed to reveal its trading strategy in advance so that other traders can use the information to adjust their own portfolios. The bond traders might like that, but it wouldn't do a thing for the general public or for the Fed's effectiveness.

A reasonable requirement, I believe, is to tell the Federal Reserve to publish a transcript of FOMC deliberations two or three months after the fact. That is a long enough delay to avoid any complications for the Fed's open-market desk, but it is still timely enough so that outsiders can find the information relevant to the larger economic debate. The old reporting system -- unilaterally abolished by Arthur Burns in the mid-1970's -- provided only a secretary's rough minutes of the FOMC debate and it wasn't made public until five years after the fact -- too late to be of any use to any but the most arcane scholars. I would even let the Fed delete any references to specific foreign countries or particular financial institutions if they come up in the deliberations -- in the interest of securing the Fed's cooperation.

If Congress adopted this modest reform, what would the public get? A hard slog through very turgid stuff, believe me. Based on my interviews with governors recounting the internal debates and on reading through several years of the old FOMC minutes, I don't think anyone will be taking this book to the beach.

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We would be required to read a long, earnest, genteel and quite dense argument over economics. No name calling. No secret political plots. No heavy oratory. Once in awhile, perhaps, we might find a remark that sounds like one governor heckling another governor for some prior misjudgment, but even the internal criticisms are usually quite subtle. The Federal Reserve is a decorous institution -- even behind closed doors.

The grist of these private discussions is about the competing analyses of the economy held by the people at the table -- arguments over what is happening and how monetary policy will affect everything from bank lending and manufacturing to unemployment and retail sales. The material, in other words, is not not likely to yield sensational headlines.

But it would be extremely useful to serious people who are willing to spend some time and effort tracking the monetary debate, month after month, and then asking some intelligent questions about it. This starts with Congress, presumably, but it might also include the wide array of economic sectors that are not in banking or finance but who do feel the impact of monetary policy, from farmers to home builders.

In short, this is a modest step toward public education and accountability. Might it lead eventually to more substantial reforms that democratize the Federal Reserve and reduce its independence? Maybe. But not necessarily. History certainly argues against the prospect of such reforms. It depends on how the Fed behaves and whether people are shocked or reassured by what they read in the FOMC minutes.

Would it change the FOMC conversations around the big long table? Sure, at least a little. Any public official who knows his words are recorded -- not to mention videotaped -- is likely to talk a bit differently that he might in private. But so what? The content of the debate inside the Federal Reserve can be its own educational tool, just as members of Congress use the floor debate for broader purposes than persuading colleagues. That's valuable in a democracy.

Would it change Fed decisions? Maybe. If it makes the people at the table more sensitive to the competing trade off's and to the wider variety of economic interests that will be affected by their decisions, that is a valuable result too. But it won't reduce the daunting complexities and uncertainties that Fed governors must confront. That is the nature of monetary policy and no one can repeal it.

So why then do I think this modest reform would be so significant?

Believe it or not, I actually think the simple step of

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casting some sunshine on monetary policy might make the Federal Reserve a more effective institution of government. It would certainly raise the level of the economic debate in this country. It could actually enhance the Fed's credibility with the general public, as people get a better grasp of the hard choices, and at least put to rest some of the spookier conspiracy theories that are now so popular.

It would also encourage Federal Reserve governors to share the premise of their decisions with the people at large in terms that ordinary people can understand. The Fed is often in the posture of warning folks to slow down, telling business or consumers or investors to temper their appetites and behave more prudently. That message can be communicated with more effective results if people know what the Fed knows, if people can grasp what the Fed is trying to tell them.

The larger consequence of this reform, however, should affect other government decision makers far beyond the Federal Reserve -- perhaps even including Congress. Making monetary policy more visible and legible ought to improve the government's overall management of the economy -- not to mention the quality of our democracy -- because it would make visible contradictions that at present no one has to face.

Wright Patman once referred to the existing arrangment as "a car with two drivers." One driver has a foot on the gas, the other on the brake. He meant that the fiscal policy of spending and taxation is controlled by Congress and the Executive, while the money and credit policy is controlled by the central bank. These two levers interact powerfully with another -- sometimes with contradictory results.

Yet, believe it or not, there is absolutely no requirement in the law that the two levers must be coordinated with one another. There is not even an intelligent process by which monetary policy and fiscal policy can be viewed together as pieces of an overall economic strategy. We hope that there are private conversations between the Fed and the White House and the budget leaders of Congress. They certainly don't match notes in public and their plans are often in conflict.

Instead, each side is free to go its own way, regardless of the other. I suspect that, down deep, both sides like it like that: neither Congress nor the Federal Reserve wishes to coordinate policy, even in the most limited fashion, because that might crimp the ability to do their own thing. Forget the larger fallout.

I have been talking abstractly. Now let me give some tangible examples of what I mean:

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In 1981, when Congress passed the Reagan economic program, the massive tax cuts and defense build-up were powerfully stimulative to the economy. But the Federal Reserve was simultaneously embarked on the opposite course: suppressing economic growth with extraordinarily high interest rates in order to squeeze out price inflation. Let's leave aside the argument over who was right and who was wrong. The stark fact is that the government was pushing the national economy in opposite directions at once. The car with two drivers wound up in a ditch -- first deep recession, then an awesome accumulation of debt -- and we are effectively still in it.

After the 1981-82 recession, though it never said so in public, the Federal Reserve privately resolved that it must continue to check the stimulus provided by the Reagan program in order to prevent inflation from recurring. In order to do that, the Fed held interest rates very high throughout the 1980's -- the highest rates of this century in real terms -- and that produced many collateral consequences. Let me name some of them:

1. The savings and loan crisis was dramatically worsened by the Fed's high interest rates. Fed Vice Chairman Preston Martin, who argued repeatedly and unsuccessfully for an easier policy to help salvage the S&Ls, told me: "We just threw them to the wolves."

2. The U.S. trade deficit ballooned from 1980 to 1985 because the Fed's tough monetary policy sent the value of the dollar soaring against foreign currencies. Privately, Paul Volcker anguished over this, but he did not change the policy. Lee Iacocca complained that once foreign producers grabbed market shares, it would be very difficult for American manufacturers to get them back. He was right. The trade deficit is with us still, despite a much weaker dollar.

3. The collapse of Third World debt in August 1982 was directly triggered by the punishing interest rates -- a connection denied at the time but now widely acknowledged by global financial authorities. Once the debt crisis put major American banks in peril, the Fed had no choice but to come to their rescue. Our trade relations with Mexico and the current debate over NAFTA are directly tied to what the Federal Reserve decided ten years. Does anyone in Congress examine the connection?

4. The farm crisis of the middle 1980s -- and the debt liquidation of tens of thousands of family farms -- was also linked to the Fed policy. The Fed, of course, did not set out to achieve this, but it was an inescapable side effect. My point is that, given the Fed's secrecy, neither farmers nor other debtors were given fair warning of what the government was doing to their financial condition. Indeed, long after the Fed had begun its

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campaign, various federal agencies were still making and guaranteeing small-business and farm loans that were literally doomed to fail by the Fed's monetary policy. The central bank didn't give the farmers a clear warning, but it didn't tell the Department of Agriculture or the Small Business Administration either.

I could go on with a variety of other examples. My point is not to blame the Fed for every bad thing that happened and certainly not to argue that Reaganomics was right while the monetary policy was wrong. My point is that Federal Reserve policy makers faced excruciating trade-off's and usually had to choose between two bad outcomes. Yet these stark trade-off's were not generally known or understood, much less openly debated by the elected representatives. This great collision between monetary policy and fiscal policy unfolded in broad daylight, but only the most sophisticated citizens even understood that it was happening.

An economist from the Minneapolis Federal Reserve Bank wrote that it was like a "game of chicken" between the two halves of government, fiscal policy and monetary policy. Is that anyway to manage the largest economy on earth?

I will offer one other example that is closer to the present. In the presidential campaign of 1988, both candidates naturally promised voters that they would deliver expanding economic growth and abundant jobs. Meanwhile, Chairman Alan Greenspan and the Federal Open Market Committee were pursuing the opposite objective: slowing down the economy, suppressing consumption and increasing unemployment. Right in the middle of the campaign, the Fed started ratcheting up interest rates and continued to do so for the next year or so. When short-term rates were pushed higher than long-term rates, the Fed was flirting with recession. I don't know if that is what the Fed intended -- maybe not -- but that is what the country got.

Question: did Congress know the Fed's tightening monetary policy was pushing the economy into a full-blown contraction? Evidently not. Just as the recession was taking hold, Congress adopted the famous deficit-reduction deal of 1990 -- raising taxes in the face of recession and thereby deepening the pain and destruction.

By the way, this is not a judgment made in hindsight. I wrote as much at the time in the pages of Rolling Stone: first, that the Federal Reserve was inducing a recession and later that the 1990 budget deal would thus make things worse -- including make the federal deficit worse. My analysis was based on what financial sources in Wall Street told me was happening and on a very straightforward observation: every recession since World War II has been preceded by similar behavior from the Fed. When

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the central bank pushes short-term rates above long-term rates and holds them there -- the so-called inverted yield curve -- a recession follows.

Question: would Congress have changed its budget decisions in 1990 if members had understood what the Fed was doing? At the time, as I recall, the chairman was urging passage of the budget accord and assuring everyone that recession was not at hand. As I said, the Fed is not infallible either.

In summary, reforming the Fed should have two goals:

First: to foster a more coherent and rational coordination between monetary and fiscal policy.

Second: to open up the cloistered debate so that many more voices can be heard.

If I were asked to design the reforms, I would no doubt propose changes much more radical than the measures before this committee. But the political realities make it pointless to discuss such ideas. Having thought about this for many years, I concluded that the first step toward reform requires public education, not changing the institution. Over time, if elected political leaders develop a better grasp of the subject, they might be willing to examine the deeper power relations and consider changing them.

The Federal Reserve will naturally oppose both of those goals. As a political institution, it has been quite skillful over 80 years in mobilizing its constituencies to oppose any intrusion on the mystique. Right at this moment, bankers are busy heckling members of Congress, warning them about the dire implications of these hearings. Guess who asked them to do that.

I know the political resistance to even modest reform is enormous and I am well familiar with all the traditional arguments for keeping the Federal Reserve as secretive and mysterious as possible. It takes courage for a congressman to stand up to financiers and tell them that America needs more democracy, not less.

In 1913, the Federal Reserve seemed like the grand compromise and both political parties supported it. Both parties have stood by it ever since.

In 1993, we are on new ground. The Fed is both more influential than it pretends but also less powerful in the global economy than it once was. If this country is ever going to come to grips with the new global economic realities threatening our long-term prosperity, we need to hear a lot of honest arguments about how the government manages the economy. That is impossible

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so long as half the story remains fogged from view.

If citizens of the United States ever decide that they must lead the world in reforming the global economy, they will first have to educate themselves about the real terms of debate.

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EMBARGOED UNTIL
9:30 A.M.

Statement of Grasty Crews, II
Prepared for Presentation at the Hearings of the
Committee on Banking, Finance, and Urban Affairs,
United State House of Representatives,
on H.R. 28,
"The Federal Reserve System Accountability Act of 1993"
October 7, 1993

Mr. Chairman, Members of the Committee, I most sincerely appreciate this opportunity to appear before you. It is a very special pleasure to me, because I was here and I remember vividly when Wright Patman introduced his colleague and fellow Texan Henry Gonzalez as the newest member of the Banking Committee. I have long since forgotten what that meeting was about, but I'll never forget the shy smile of the young congressman as he acknowledged the introduction and took his seat.

You have asked me to testify on the constitutionality of allowing private citizen Federal Reserve Bank presidents to vote on the nation's money supply." There are two areas of the constitution which are implicated. One of them is very easy to deal with. I'll take that up first, but I won't waste your time belaboring the obvious.

The easy one is the Appointments Clause. In Article II, Section 2, the Constitution provides:

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> The President . . . shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . Officers of the United States . . . .

Now, how do you determine who is an "Officer of the United States" ? The Supreme Court has given us a very straightforward answer. The Court has said:

> We think that the term "Officers of the United States" as used in Article II . . . is a term intended to have substantive meaning. We think its fair import is that any appointee exercising significant authority pursuant to the laws of the United States is an Officer of the United States, and must, therefore, be appointed in the manner prescribed by § 2, cl. 2 of that Article.

I do not see how anyone can reasonably argue that the members of the Federal Open Market Committee do not fall within that definition. In a guarded understatement, the Federal Reserve Board itself has said--

> The Federal Open Market Committee is the most important monetary policy-making body of the Federal Reserve System. It . . . makes key decisions regarding the conduct of open market operations - purchases and sales of U.S. Government and Federal Agency securities - which affect the provision of reserves to depository institutions and, in turn, the cost and availability of money and credit in the U.S. economy. The FOMC also directs system operations in foreign currencies.

Mr. Chairman, for the benefit of those who may wish a more detailed, technical explanation of this issue, with citations to the relevant cases, statutes, and constitutional provisions, I would like permission to put into the record a copy of the brief for the appellant in the United States Court of Appeals for the District of Columbia Circuit in the case of *Melcher v. Federal Open Market Committee*. The decision of the Court of Appeals in that case was to vacate the judgment of the District Court, which had ruled that the members of the FOMC are not officers of the United States. The Court of Appeals then dismissed the case on

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the ground that the plaintiff did not have "standing," that is, a legal right to require the Federal courts to rule on the issue, thus leaving the existing structure of the FOMC neither constitutionally vindicated nor, in the light of other cases, subject to challenge in judicial proceedings. The Supreme Court declined to hear the case.

Even without the authority of a judicial opinion, however, I think it is easy to see that the present structure of the FOMC directly conflicts with the Appointments Clause of the Constitution. So why is there such a controversy? The controversy grows out of other constitutional provisions which, taken together and in their historical context, contemplate a monetary system which, in my judgment, simply can not be made to work in the world in which we now live.

Section 8 confers on Congress, in so many words, the power "To coin money, regulate the value thereof, and of foreign coin . . ." Section 10 explicitly withdraws the coinage power from the States, and implicitly mandates a precious metal standard as the means by which Congress is to regulate the value of money.

Specifically, Section 10 provides, "No State shall . . . coin Money; emit Bills of Credit [that's an eighteenth century way of saying issue paper money]; [or] make any Thing but gold and silver Coin a Tender in payment of debts . . . ."

Why would such a system be perfectly sensible in the 18th century, yet perfect nonsense as we approach the 21st century? The answer to that question is implicit in the work of Milton Friedman. If I may put it in the vernacular, what he taught us is this: In a stable economic system with a given total output of goods and services, the value of any given unit of money will depend on how many such units there are to go around. When you stop to think about it, it's only common sense. In whatever economic universe you are considering, you have on one side all the shoes and ships and sealing wax, yes and all the services that people perform for one another, and on the other side you have all the money that there is in the system, and for which the various participants in the system compete. Intuitively, one

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senses that the two sides have to balance out. Dr. Friedman's more precise formulation and scholarly validation of this idea made him one of America's Nobel prize winners.

This testimony is no place to get into the mechanics of the operation of a precious-metal based monetary system, but the essential principle of such a system is very simple and highly relevant. That principle is that the metal and the money are so freely interconvertible that to all intents and purposes the metal *is* the only true money, all other instruments being mere credit, or obligations to pay money.

Under such a system, the constitutional power and duty to "regulate the value" of money is discharged simply by specifying the quantity of precious metal which is to be contained in a coin of a given denomination. In a series of steps, some giant, some tiny, taken by the world's industrial nations in the aftermath of the first and second World Wars, that system was abandoned not only by the United States, but throughout the world.

The winds of change now blow not only too hard but too erratically for the price or value of any commodity to be expected to stay in step with the needs of a worldwide economy. Even apart from the waxing and waning of speculative fervor, technological changes affecting the production and consumption of precious metals would surely destroy any illusion of inherent and immutable stability.

This leaves us in a place where the very foundation of the monetary system assumed and intended by the Framers of the Constitution has been swept away. Gradually and, I believe, without a full public understanding of what we were doing, we have put in its place the discretion of a Federal agency, and that agency is the Federal Open Market Committee. As we know all too well from recent history, Federal agencies in general are not immune to efforts by members of Congress to influence management in ways not necessarily consistent with the mission of the agency as defined in law.

The Federal Reserve System, however, enjoys a special kind of immunity from that kind of pressure. Its immunity derives

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from its exemption from the appropriations process, an exemption which effectively protects its mission and responsibilities from becoming just another bargaining chip in the hardball negotiations which inevitably take place around the complex issues of taxing and spending. Knowing how seriously the Federal Home Loan Bank Board was weakened, not just in the recent past but decades ago, by such pressures and the threat of such pressures, I would say that the continuation of the Fed's exemption from the appropriations process is in the interest of the integrity of its monetary operations. There is no doubt in my mind that much of the intensity of the opposition to acknowledging that all members of the FOMC should be subject to the Appointments Clause of the Constitution derives from fear that such a step would lead to the loss of that exemption.

I, myself, am living, breathing evidence of the independence of the Fed. With many misgivings, because I know how easily my testimony could be misunderstood, quoted out of context, or otherwise misused, I am nevertheless going to lay my experience before you as briefly as I can, because I think it is relevant to some of the most important issues raised in these hearings.

In the fall of 1969, I became involved in a project for a Democratic member of this Committee, Tom Rees of California, which ultimately brought me into conflict with a man who was probably the most powerful nonMember that the House of Representatives has ever had: Lewis Deschler, who served as Parliamentarian for nearly half a century. I want to emphasize that I do not question his motives or the motives of any of the people involved in that controversy, which had nothing to do with anything under the jurisdiction of this Committee.

When, several months into the project, the likelihood of conflict with Mr. Deschler began to emerge, I had to deal not only with what could be seen as a conflict of institutional loyalties, but also with my very practical responsibilities as family breadwinner. For that reason, I visited Vice Chairman J. L. Robertson at the Fed, and in substance, this is what I said:

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Over the years that I have worked with the Fed on behalf of the Legislative Branch, it's been suggested to me on several occasions that there might be a job for me here.

At this time, I'm working on something having nothing to do with banking or the Fed which may get me fired from Capitol Hill with such enthusiasm that I won't even stop skidding until I get to 20th & Constitution.

If that happens, would I still have a shot at employment here?

He said that I would, so I went back to Capitol Hill and resumed work on Tom Rees's amendment to a bill that was to become the Legislation Reorganization Act of 1970. It came to the floor of the House that summer. I will never forget the day I happened to be in the office of a Republican Member--a Member whose counsel had been sought, and given, as the Rees Amendment was being developed. Returning from the floor, he burst in and exclaimed, "Boy, you better back off from that amendment! Deschler is furious!"

When I reported this to Rees, he offered to withdraw the amendment. I told him no, I didn't think that was any way to run the legislative process, and he should stick to his guns. Predictably, the President's signature on the final enactment was scarcely dry before I was out. Without a break in service, I was signed on at the Fed, first as a consultant and three months later as an officer in the legal Division.

Now the point of that story is simply this: I don't believe there is any other agency of government that could or would have knowingly risked hiring me under those circumstances. I was very happy at the Fed, and had every expectation of staying. The manner of my leaving was yet another demonstration of the independence of that institution. The President's Special Consultant for Narcotics and Dangerous Drugs, Dr. Jerome H. Jaffe, wrote a letter to Chairman Burns asking that I be granted a leave of absence to assist in the establishment of the Special Action

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Office for Drug Abuse Prevention in the Executive Office of the President. Realization of the seriousness of the drug problem had hit the White House rather hard and suddenly, and in the interest of a quick start, such requests for personnel on a leave of absence basis were made of several agencies. I do not know of any others that were turned down. Dr. Burns, however, responded with a polite but firm No. He said the Board needed me in connection with the implementation of the newly enacted Bank Holding Company Act Amendments. He added that he appreciated the importance to the nation of Dr. Jaffe's work, and that should I decide to make the change, he would certainly find that understandable. As things worked out, by the time the Special Action Office came to the end of its statutory life in the summer of 1975, Mr. Deschler had retired, and so I was able to return to Capitol Hill.

I think I understand, perhaps better than most, the intensity of feeling that many people have about the independence of the Federal Reserve. They tend to view any change as an encroachment which, however harmless in appearance, may turn out to be the first step down a slippery slope. The irony of the situation is that as I look back across the panorama of monetary history since the enactment of the Banking Act of 1935, it seems to me that in an effort to avoid major controversies which might lead to calls for curbs on its independence, the FOMC and its individual members have sometimes abjured that independence just as effectively as if it had been removed by statute.

It is hard for me to escape the conclusion that the accommodations which the FOMC made to the needs of first a Democratic and then a Republican administration to simultaneously finance a war in East Asia and urgently needed social programs here at home contributed to a subsequent acceleration in the rise of prices, especially in real estate.

At the end of the seventies, efforts to counteract the effect of those accommodations led to a rate of change in interest rates far in excess of anything that many depository institutions specializing in longterm real estate loans could reasonably

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be expected to adjust to. As a result, they quite predictably went broke in droves. Although I think a strong case can be made for the proposition that the Fed's action was necessary to break an ingrained expectation that price rises would continually outpace interest rates, I think the Fed had a responsibility to warn what else was going to be broken in the process, especially when that something else was something that the Government itself was pledged to fix.

If we can't go back to the method of regulating the value of money that was contemplated by the Framers--and I an convinced that we cannot--then we must think anew how we shall achieve the objective they sought, but by means which are available to us in our time. In the not quite 60 years since the enactment of the Banking Act of 1935, which established the FOMC in essentially its present form, we have seen a devaluation of the dollar of more than 90%. My first job was as a minimum-wage laborer at 40¢ an hour, but that 40¢ would buy more than the minimum wage will now. There is no way that we as a nation can feel satisfied with that record. I think it's obvious that institutional changes have to be made, because if we could do better with the existing institutional structure, we would already have done it.

So far as the Constitution is concerned, the point of all this is simply that independence, in the sense of immunity to meddling by either legislative or executive officers, is not enough to enable us to achieve the price stability that the Framers of the Constitution so clearly intended. They had seen what happened to the unbacked paper currency issued by the Continental Congress. The derisive phrase "Not worth a continental" is a monument that lingers to this day.

I would like to conclude by urging all three of my former employers--the Executive Branch, the Federal Reserve, and this Committee--to approach the issues raised by H.R. 28 as an opportunity for dialogue, for genuine communication and problem-solving, and not as a challenge to a power struggle. It is my deep conviction that the appointment of all members of the FOMC in accordance with the Constitution would strengthen, not weaken,

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the legitimate independence of this vitally important arm of government.

In and of itself, such a change would certainly not solve the central dilemma of monetary policy, which is how best to balance short-term and long-term considerations in the context of an ever-changing global economy. It may be that until we can devise a true global currency--a function that gold once appeared to fulfill--we may simply have to muddle through with substitutes that don't work very well. Even so, I think the muddling will be more successful and the discussion more enlightening if it is illuminated by a candid acknowledgment by the FOMC of its function, and by timely and candid disclosures of the reasoning behind its decisions. I think the essential thrust of H.R. 28 is an effort to foster those objectives, and I hope it will be considered in that light.

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The Congressional Black Caucus

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MFUME RELEASES NEW FEDERAL RESERVE HIRING DATA

DIVERSITY AT ISSUE FOR CBC

(Washington, D.C., October 7, 1993) Congressman Kweisi Mfume (D-MD), Chairman of the Congressional Black Caucus (CBC) and a member of the House Banking Committee, testified today at a Congressional hearing reviewing proposed reforms of the Federal Reserve System. Today's hearing marked the first of a planned series of four hearings to be held by Henry B. Gonzalez, Chairman of the House Banking, Finance and Urban Affairs Committee to review the Federal Reserve's accountability to the public.

Congressman Mfume released new data, from a 1993 study about to be made public, detailing the status of women and minorities within the Federal Reserve System. The data suggests that the two groups have little or no say in the conduct of our nation's monetary policy or bank regulation. Noting that the Federal Reserve Reform Act of 1977 attempted to address the issue of diversity by addressing discrimination on the basis of race, creed, color, sex, or national origin, Mfume stated, "the continued lack of female and minority representation in policy-making positions within the Federal Reserve System alienates tens of millions of Americans from representation and influence. And this is unfortunately typical for all bank regulatory agencies." **(See Charts On Reverse)**

The CBC has a keen interest in reforming the Federal Reserve because African-Americans have a particularly high stake in how monetary policy affects our economy. A recent Wall Street Journal analysis of Equal Employment Opportunity Commission records revealed that the last recession seriously eroded equal opportunity for African-American workers. In fact, African-Americans were the only racial group to suffer a net job loss during the 1990-91 economic downturn. Overall, African-Americans' share of jobs at companies dropped--in 36 states and in six of nine major industry groups--for the first time in nine years, wiping out three years of gains. Also, regarding the issue of access to credit, the Federal Reserve has reported extensive bias against minorities in bank lending. The CBC feels that bank regulators such as the Federal Reserve would move more vigorously to eradicate this discrimination if they, themselves, were composed of decision-making personnel more reflective of the country's diversity.

Chairman Mfume delivered eight recommendations on behalf of the Congressional Black Caucus for reforming the Federal Reserve. Major recommendations include:

- *The Federal Reserve Board's and Federal Reserve Banks' exemption from Title VII of the Civil Rights Act of 1964 should be repealed.*
- *Nomination of the 12 Federal Reserve Bank presidents should be by the President of the United States with confirmation by the Senate.*
- *Six of the nine directors of each board of directors should be appointed by the Board of Governors in Washington and the members should include a wider representation of the United States citizens.*
- *A Federal Reserve Reform Commission should be authorized to examine a number of areas including the effect of the regulations of the Board and the operations of the Board and the Federal reserve banks on low- and moderate-income families, including the effect on availability and costs of financial services and credit.*

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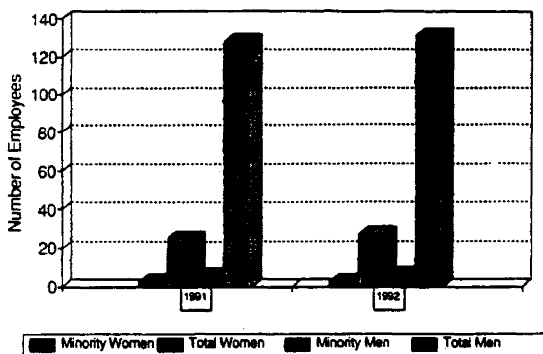
Federal Reserve Board
Highest Ten Percent Paid Employees



Federal Reserve Board
Lowest Ten Percent Paid Employees

Prepared by the House of Representatives Committee on Banking, Finance and Urban Affairs

(Charts were also released for the 12 Federal Reserve Banks)

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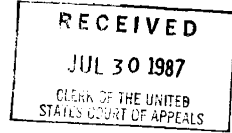
Set for Argument October 5, 1987

IN THE UNITED STATES COURT OF APPEALS
for the
DISTRICT OF COLUMBIA CIRCUIT



No. 86-5692

JOHN MELCHER, Member, United States Senate,
Appellant,

v.

FEDERAL OPEN MARKET COMMITTEE, *et al.*,
Appellees.

On Appeal from the United States District Court
For the District of Columbia

BRIEF FOR APPELLANT

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IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOHN MELCHER, Appellant,	)	
v.	)	No. 86-5692
FEDERAL OPEN MARKET COMMITTEE et al. Appellees.	)	

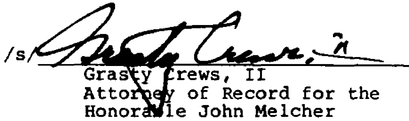
Certificate Required by Rule 8(c) of the General Rules of the United States Court of Appeals for the District of Columbia Circuit

The undersigned, counsel of record for the Honorable John Melcher, Member, United States Senate, certifies that the following listed parties, and no amici, appeared below:

Plaintiff: Hon. John Melcher, Member, United States Senate.

Defendants: Federal Open Market Committee, Anthony M. Solomon, Thomas M. Timlen, Edward G. Boehne, Robert P. Black, Karen N. Horn, Silas Keehn, E. Gerald Corrigan, John J. Balles, Robert H. Boykin, Robert P. Forrestal.

These representations are made in order that judges of this Court, inter alia, may evaluate possible disqualification or recusal.



/s/ Grasty Crews, II
Attorney of Record for the
Honorable John Melcher

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STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether section 12A of the Federal Reserve Act (12 U.S.C. § 263) confers on the members of the Federal Open Market Committee such authority as to bring them within the holding of Buckley v. Valeo, 424 U.S. 1 at 125 (1976)--

> that any appointee exercising significant authority pursuant to the laws of the United States is an Officer of the United States and must, therefore, be appointed in the manner prescribed by § 2, cl. 2 of [Article II of the Constitution].

Statement Pursuant to General Rule 8(b)

This case was previously before this Court under the title of In re: Federal Open Market Committee, et al., No. 86-5374. By order filed June 24, 1986, this Court granted the defendants' request for expedited consideration, denied the defendants' petition for a writ of mandamus, and dismissed the defendants' emergency motion for stay as moot.

Counsel is not aware of any other related cases presently pending in this or any other court.

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References to Parties and Rulings

Senator Melcher has appealed from (1) the order of the District Court filed September 25, 1986, which denied the plaintiff's motion for summary judgment, granted the defendants' motion for summary judgment, and dismissed the action; and (2) the order of the District Court filed November 18, 1986, which denied the plaintiff's motion to alter or amend the judgment entered September 25, 1986.

The opinion of the District Court filed September 25, 1986, made reference to the earlier opinion and order filed June 5, 1986, denying the defendants' motion to dismiss. The opinion supporting that ruling is relevant to the orders appealed from and was published together with the September 25 opinion at 644 Federal Supplement, beginning on page 510. Beginning on page 20 of the Joint Appendix, these opinions are reproduced as they appeared in the Federal Supplement advance sheets. No opinion was filed in support of the November 18 order.

Senator Melcher's complaint, filed and served on April 30, 1984, and reproduced beginning at J.A. 9, lists as defendants Anthony M. Solomon, Edward G. Boehne, Karen N. Horn, E. Gerald Corrigan, and Robert H. Boykin, identifying them as Members of the Federal Open Market Committee, and lists as defendants Thomas M. Timlen, Robert P. Black, Silas Keehn, John J. Balles, and Robert P. Forrestal, identifying them as alternate members.

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In view of the District Court's holding, 644 F. Supp. at 520, J.A. 30, that the named individuals are "private individuals selected by the Reserve banks," the present status of some of them as parties to this litigation is not clear, but the question does not seem to have any practical significance. If Senator Melcher obtains an injunction against the Federal Open Market Committee, it will afford him the relief he seeks regardless of the identity or status of the other defendants; if the defendants prevail, the issue of who (other than the FOMC) appeared and how will likewise be moot.

If a person can be "a public officer" within the meaning of Rule 25(d) of the Federal Rules of Civil Procedure and Rule 43(c) of the Federal Rules of Appellate Procedure, but at the same time be neither an "Officer" nor an "inferior Officer" within the meaning of Art. II, § 2, cl. 2 of the Constitution, then by the operation of those rules the following public officers are now parties to this litigation: E. Gerald Corrigan, Edward G. Boehne, Silas Keehn, Gary H. Stern, and Robert H. Boykin as members of the FOMC, and Thomas M. Timlen, Robert P. Black, Robert T. Parry, and Robert P. Forrestal as alternate members. There is at this writing (July 24, 1987) one vacancy among the alternate members.

If the persons named in the complaint as defendants are not public officers within the meaning of the rules cited, then they are presumably still the individual defendants, and the only individual defendants, in this litigation, as their attorneys have never filed any motions to dismiss as moot or to substitute successors.

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STATEMENT OF THE CASE

> The Federal Open Market Committee (FOMC) is the most important monetary policy-making body of the Federal Reserve System. It is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments. The FOMC makes key decisions regarding the conduct of open market operations - purchases and sales of U.S. Government and Federal Agency securities - which affect the provision of reserves to depository institutions and, in turn, the cost and availability of money and credit in the U.S. economy. The FOMC also directs System operations in foreign currencies.[1]

Thus does the Board of Governors of the Federal Reserve System acknowledge and describe the dominant role of the Federal Open Market Committee in the critically important function of formulating the monetary policy of the United States Government.

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1. This is the opening paragraph, set in boldface type, of a pamphlet entitled "The Federal Open Market Committee," which is the second in a series on the structure of the Federal Reserve System. As an official publication of the Board of Governors, it has been reviewed and approved by the Publications Committee, consisting of the senior Assistant to the Board in the Office of Board Members, the General Counsel (who is also General Counsel to the FOMC and appeared of counsel for the defendants in the court below), the Staff Director for Management, the Director of the Division of Consumer and Community Affairs, the Director of the Division of Research and Statistics (who is also listed as "Economist" on the staff of the FOMC), and the Director of the Division of International Finance (who is also listed as "Economist (International)" on the staff of the FOMC). The names of the members of the Publications Committee are listed on the title page of the monthly Federal Reserve Bulletin. Their official positions on the staff of the Board of Governors and their positions, if any, on the separate staff of the Federal Open Market Committee are shown at the end of the statistical section (whose page numbers are prefixed with the letter "A") at the end of the Bulletin.

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The FOMC has itself described its independence of the Board of Governors as follows:[2]

> The Federal Open Market Committee ("FOMC") is a separate and independent statutory body within the Federal Reserve System. In no respect is it an agent or "subdivision" of the Board of Governors of the Federal Reserve System . . . .

Of its twelve members, seven are the members of the Board of Governors,[3] all of whom are officers of the United States who are appointed by the President, subject to Senate confirmation, in accordance with section 10 of the Federal Reserve Act (12 U.S.C. § 241).

The other five members are elected for a term of one year by the boards of directors of the twelve regional Federal Reserve Banks from among the 24 persons who, at any given time, are the presidents and first vice presidents of such banks.[4] There is no power in the the Board of Governors or any other agency or officer of the United States to determine who, among those eligible, will be elected to the FOMC. For each elective member, an alter-

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2. 12 CFR § 282.1

3. Section 205 of the Banking Act of 1935, 49 Stat. 705, amended section 12A of the Federal Reserve Act to provide for the present composition and powers of the Federal Open Market Committee. Codified at 12 U.S.C. § 263, the section has since been amended only once, in 1942, 56 Stat. 647, to limit eligibility for election to the FOMC to the presidents and first vice presidents of the Federal Reserve Banks.

4. As provided in section 12A(a) of the Federal Reserve Act (12 U.S.C. § 263(a)), one member is elected by the board of directors of the Federal Reserve Bank of New York; one by the boards of the Boston, Philadelphia, and Richmond banks; one by the boards of the Cleveland and Chicago banks; one by the boards of the Atlanta, Dallas, and St. Louis banks; and one by the boards of the Minneapolis, Kansas City, and San Francisco banks.

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nate to serve in his absence is also elected in the same way from the same pool of eligible bank officers.

The Federal Reserve Banks are, in form, banking corporations chartered by the Comptroller of the Currency under authority of the first three paragraphs of section 4 of the Federal Reserve Act (38 Stat. 254; not in U.S. Code). Their so-called "stock," however, has no exact counterpart among the types of securities issued by corporations in the private sector. It is very different from the "capital stock" of an ordinary corporation having but one class of stock outstanding. Its closest analogue would be a nonparticipating preferred stock constituting an extremely small fraction of total capitalization and carrying limited voting rights not amounting to ownership or control of the issuing corporation. It cannot be transferred or hypothecated. It must be purchased as a condition of membership in the Federal Reserve System, which is compulsory for national banks (commercial banks chartered under authority of the Federal government), and optional for state banks (commercial banks chartered under authority of state governments). In either case the amount held at any given time must bear a fixed ratio of 3% to the capital and surplus of the member bank.[5]

It conveys no financial interest beyond the right to receive back its cost if and when it is surrendered to the Federal Re-

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5. Section 5 of the Federal Reserve Act (12 U.S.C. § 287) requires member banks to "subscribe" for stock in the Federal Reserve Bank in whose district they are located in an amount equal to 6% of the member bank's capital and surplus, but as the Act has been administered ever since its enactment in 1913, only one-half of the subscription is actually purchased.

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serve Bank which issued it, and a right to a statutorily fixed dividend of 6% per annum. In recent years, these dividends have amounted to less than 1% of the earnings of the Federal Reserve Banks, more than 98% of which have been paid immediately and directly into the United States Treasury. The remaining fraction of one percent of earnings has been added to surplus, all of which would be also be paid into the Treasury should the Reserve Banks be liquidated, and is available for transfer to the Treasury at any earlier time by direction of the Board of Governors.[6]

Except for the election of six of the nine members of the board of directors, the so-called stockholders have no right to vote on any of the affairs of the Reserve Banks. The kinds of actions which in the case of corporations in the private sector would typically be taken by or subject to the approval of the stockholders are controlled by statute or by the Board of Governors. The three directors not elected by the stockholders are appointed by the Board of Governors, which designates one of its appointees as chairman and one as vice chairman.[7]

The statute provides that the president of a Federal Reserve Bank shall be its chief executive officer, and shall be appointed by its board of directors, with the approval of the Board of Governors, for a term of five years. The first vice president is to

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6. See the discussion <u>infra</u> at pages 25 through 32.

7. Sections 4 and 5 of the Federal Reserve Act (12 U.S.C. §§ 302 and 305).

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be appointed in the same manner, and for the same term.[8] The salaries within each bank are set by its board of directors, subject to the approval of the Board of Governors.[9]

On April 30, 1984, Senator John Melcher of Montana filed an action in the District Court seeking an injunction prohibiting the five members of the FOMC elected by the boards of directors of the Federal Reserve Banks from voting or serving as chairman or vice chairman of the Committee,[10] contending that he is being deprived of his constitutional role in the appointment process as long as they perform these functions[11] because when they do, they are in fact acting as officers of the United States for whose appointment the advice and consent of the Senate must be obtained in accordance with Art. II, § 2, cl. 2 of the Constitution.

The injunction sought by the plaintiff would permit the FOMC to continue to function without diminution of its jurisdiction or authority. The only change would be that the five Reserve Bank representatives would be reduced to nonvoting status.

The defendants are the Federal Open Market Committee, the five private-citizen members, and their five alternates. They filed a motion to dismiss on June 29, 1984, arguing that Riegle v. Federal Open Market Committee, 656 F.2d 873, cert. denied, 454 U.S. 1082 (1981) requires that the case be dismissed in the exercise of equitable discretion.

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8. Section 4 of the Federal Reserve Act (12 U.S.C. § 341, paragraph "Fifth.")

9. Section 5 of the Federal Reserve Act (12 U.S.C. § 307).

10. Complaint, Prayer for Relief, J.A. 9.

11. Complaint, ¶¶ 26, 27, J.A. 8, 9.

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On July 30, 1984, Senator Melcher filed a motion for summary judgment, but on September 28, 1984, the District Court, sua sponte, filed an order staying the action pending the decision of this Court in Committee for Monetary Reform v. Board of Governors of the Federal Reserve System, 766 F.2d 538 (D.C. Cir. 1985).

In response to the District Court's June 5, 1986 denial of their motion to dismiss, the defendants sought certification of the question of justiciability for interlocutory appeal. When that was denied, the defendants then filed a petition for mandamus seeking review of the District Court's denial of their motion to dismiss. The petition was denied, In re Federal Open Market Committee, No. 86-5374 (June 24, 1986).

On July 3, 1986, the defendants filed a motion in which they asked (1) for summary judgment and (2) in the alternative that the action be dismissed for failure to state a cause of action and on the ground that the plaintiff lacked standing.

The District Court granted summary judgment to the defendants, and after the denial of his motion to alter or amend the judgment, Senator Melcher filed this appeal.

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SUMMARY OF ARGUMENT

Employing the traditional language of administrative law, section 12A of the Federal Reserve Act (12 U.S.C. § 263) grants to the Federal Open Market Committee plenary authority over the open market operations of Federal Reserve Banks. Since the agency is under the control of its members, the authority conferred on it is necessarily conferred on them. The rule enunciated in Buckley v. Valeo, 424 U.S. 1 (1976) at 125, "that any appointee exercising significant authority pursuant to the laws of the United States is an Officer of the United States, and must, therefore be appointed in the manner prescribed by [the Appointments Clause]," is therefore applicable to the members of the FOMC.

Part I of the appellant's Argument presents this analysis of the case. The inferences which, as a matter of legal theory, would be expected to flow from the language of the statute are shown to have been fully exemplified in practice. Specific actions taken and announcements made by the FOMC, beginning with its first meeting after its establishment under the Banking Act of 1935, are shown to be not only consistent with the theory that it is a government agency acting as such, but inconsistent with any other theory. The same is true of specific actions taken and arguments advanced by the Department of Justice.

The District Court based its decision on the premise that the FOMC can be viewed not as a government agency, but as a vehicle for effectuating a "balance" of control as between public and

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private elements. Even if the premise is accepted, however, that Congress could theoretically construct such a balance, the Buckley rule still applies in this case, because both elements of the so-called balance are governmental, and there is therefore no escape from the conclusion that the actions of the Committee represent an exercise of "significant authority pursuant to the laws of the United States," regardless of whether the FOMC fits the traditional mold of a government agency. In Part II of the Argument, it is shown that the Federal Reserve Banks (the "private" element in the District Court's analysis) are owned by the Federal government, not their so-called stockholders, and in Part III, it is shown that the primary function of these banks, and the one which is directly controlled by the FOMC, is an exercise of sovereignty and not a commercial activity.

Part IV of the Argument contrasts the differing applications of the ripeness doctrine in Reuss and Synar, and argues that the difference is attributable to a changing understanding of the doctrine of separation of powers that militates strongly in favor of the plaintiff in the case at bar.

Part V concludes the Argument with a demonstration that the relief sought by the plaintiff will fully remedy the injury of which he complains, and will do so without in any way trenching upon the prerogatives of the legislature or impairing the ability of the FOMC to function pending such further changes, if any, as the legislature may see fit to make.

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ARGUMENT

I. THE BUCKLEY RULE

A. Introduction

The Supreme Court has prescribed a functional test to determine whether the holder of any given position is an officer of the United States who must be appointed in accordance with the relevant constitutional procedure. The court was explicit, Buckley v. Valeo, 424 U.S. 1 (1976) at 125 and 126:

> We think that the term "Officers of the United States" as used in Art. II, defined to include "all persons who can be said to hold an office under the government" in United States v. Germaine, supra, is a term intended to have substantive meaning. We think its fair import is that any appointee exercising significant authority pursuant to the laws of the United States is an Officer of the United States, and must, therefore, be appointed in the manner prescribed by § 2, cl. 2 of that Article.

The statute at issue in this litigation vests in the FOMC authority which is not merely significant, but total, over the open market operations of Federal Reserve banks. Section 12A(b) of the Federal Reserve Act (12 U.S.C. § 263(b)) provides as follows:

> (b) No Federal Reserve bank shall engage or decline to engage in open-market operations under section 14 of this Act except in accordance with the direction of and regulations adopted by the Committee. . . . .

Despite this plain statutory statement, the District Court declined to apply the Buckley rule, relying on quotations from Committee for Monetary Reform and Buckley itself, which we will discuss in that order.

The District Court stated in note 26, 644 F. Supp. at 523 (J.A. 33)--

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> Moreover, as the Court of Appeals has said, the FOMC "in no way exercise[s] direct governmental authority." [citation omitted]

With all due respect, we do not believe that the District Court's quotation does justice to this Court's opinion. After discussing Buckley as it pertains to standing to sue, the only issue before this Court in Committee for Monetary Reform, this Court said, 766 F.2d at 543-44--

> Consequently, we conclude that litigants have standing to challenge the authority of an agency on separation-of-powers grounds only where they are directly subject to the authority of the agency, whether such authority is regulatory, administrative, or adjudicative in nature.[footnote omitted] In the present case, it is clear that the FOMC and the Federal Reserve System in no way exercise direct governmental authority over the appellants. We therefore conclude that the Buckley principle fails to support the appellants' standing in the present case.

It is obvious from the words of the statute that within the narrow but vitally important field of its own jurisdiction, the FOMC exercises administrative authority over the Federal Reserve banks, and it is equally obvious from a fair quotation from Committee for Monetary Reform that this Court said nothing to the contrary in that case.

In apparent recognition of the weakness of the argument that the defendants are not "exercising significant authority pursuant to the laws of the United States," the defendants argue, and the District Court seems to agree, that Buckley limits the ambit of the Appointments Clause to those officers whose "regulatory, administrative, or adjudicative" authority is such as to give rise to standing to sue on the part of persons in the private

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sector who are directly affected by its exercise. In note 10, 644 F. Supp. at 520, J.A. 30, the District Court said--

> However, in Buckley v. Valeo, supra, 424 U.S. at 139, 96 S.Ct. 691, the Supreme Court noted that when a function is "sufficiently removed" from the administration and enforcement of the public law, the person performing it need not be an officer of the United States.

Like the excerpt from this Court's Committee for Monetary Reform opinion noted supra, the "sufficiently removed" quotation from Buckley is truncated and out-of-context. It appears in the Supreme Court's discussion of those functions of the Federal Elections Commission which simply provide information to the Congress. The court was making clear that those functions could be performed by persons who were not "Officers." There was no suggestion that the other duties of the FEC defined the outer limits of the requirements of the Appointments Clause.

The Appointments Clause itself makes clear that this is not the case. The first officers it mentions are "Ambassadors." It would be unusual in the twentieth century and probably impossible in the eighteenth for an ambassador to do anything which would bring his office within the class to which the defendants contend the Appointments Clause is limited. Neither in the debates of the Constitutional Convention nor anywhere else is there the slightest support for that position.

To justify its refusal to apply the Buckley rule, the District Court's opinion repeatedly asserts that there is nothing inherently or exclusively governmental about the conduct of open-market operations, but this assertion confuses two distinct issues. One is whether the conduct of a given function is consti-

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tutionally committed to the government, and the other is whether the regulation of that function involves the exercise of "significant governmental authority." Whether or not the open market operations of Federal Reserve banks are an inseparable part of a purely governmental function, the regulation of those operations is a governmental function because Congress has made it so. In the remainder of Part I of this argument, we will demonstrate not only that the defendants have actually exercised governmental authority, but also that they and the Department of Justice have been very much aware that they have done so.

B. Oath of Office

The consciousness of the members of the FOMC of the nature of their authority was evident at their very first meeting after the effective date of the Banking Act of 1935.[12] At the time when they were most freshly aware of the understanding and intent of the Congress, they unanimously adopted the following by-law:

> Section 3. Oath--Each member of the Federal Open Market Committee and each alternate shall take the same oath of office as that required by the Constitution for officers of the United States.

The minutes of that meeting further state[13] that before the day was out--

> The form of oath of office as required by Section 3 of Article I of the by-laws was executed by each member of the Federal Open Market Committee present and filed with the Secretary.

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12. The relevant portion of the minutes of that meeting is reproduced at 1A2 infra.

13. Id.

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The same requirement is now embodied in section 3 of the FOMC'S Rules of Organization:[14]

> (c) Oath of Office.-- Each member of the Committee and each alternate take the same oath of office as that prescribed by statute to be taken by officers of the United States.

C. Treasury Bills Policy

In 1946, Congress enacted the Administrative Procedure Act, section 3 of which required agencies to publish "substantive rules adopted as authorized by law and statements of general policy or interpretations formulated and adopted by the agency for the guidance of the public." 60 Stat. 238. In obedience to this requirement, the FOMC published at page 4543 of the Federal Register for July 10, 1947, a notice which in its entirety read as follows:

> TITLE 12--BANKS AND BANKING
> Chapter II--Federal Reserve System
> Subchapter B--Federal Open Market Committee
> Part 281--Statements of Policy
> Purchase of Treasury Bills
>
> The following statement of policy was issued by the Federal Open Market Committee on July 2, 1947:
>
> § 281.1 Purchase of Treasury bills. The Federal Open Market Committee of the Federal Reserve System has directed the Federal Reserve Banks to terminate the policy of buying all Treasury bills offered to them at a fixed rate of 3/8 per cent per annum and to terminate the repurchase option privilege on Treasury bills. The new policy will apply to bills issued on or after July 10, 1947. Existing policy will continue to apply to bills issued prior to that date. (Sec. 205, 49 Stat. 705, as amended by sec. 1, 56 Stat. 647; 12 U.S.C. and Sup. 263).
>
> FEDERAL OPEN MARKET COMMITTEE,
> S. R. Carpenter,
> Assistant Secretary.

14. Not published in the Code of Federal Regulations.

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The foregoing policy statement, which by its own terms was issued under authority of section 12A of the Federal Reserve Act (12 U.S.C. § 263), is now carried at 12 CFR § 281.1. While it represented an extremely important change in Federal monetary policy, one does not have to appreciate or even understand the economic basis and impact of that change to recognize it as an exercise of administrative authority. Before the change was made, any holder of Treasury bills could present them to a Federal Reserve bank for purchase at a price which was readily determinable. After the change, Federal Reserve banks could no longer offer that option. The change was mandatory, and it was imposed by governmental authority.

D. Regulations Relating to Open Market Operations

In 1966, the Administrative Procedure Act, as such, was repealed, and the substance of its provisions was incorporated into the then-new positive-law version of Title 5, U.S. Code, at §§ 551 et seq. and 701 et seq. Beginning at page 2753 of the Federal Register of January 30, 1973, the FOMC published a set of regulations which began--

> REGULATIONS RELATING TO OPEN MARKET
> OPERATIONS OF FEDERAL RESERVE BANKS
>
> **§ 270.1 Authority.**
>
> This part is issued by the Federal Open Market Committee (the "Committee") pursuant to authority conferred upon it by sections 12A and 14 of the Federal Reserve Act (12 U.S.C. 263, 355).

The regulations go on to define the terms used, and to set forth the governing principles under which the Committee intends to formulate specific directives. The Committee then asserts its total, statutory control over open market operations as follows:

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§ 270.4 **Transactions in obligations.**

(a) Each Federal Reserve bank shall engage in open market operations under section 14 of the Federal Reserve Act only in accordance with this part and with the authorizations and directives issued by the Committee from time to time, and no Reserve bank shall decline to engage in open market operations as directed by the Committee.

The full text of "this part," 12 CFR Part 270, requiring participation in the "System Open Market Account" and setting forth the mechanisms for FOMC control, is reproduced infra at 2A3 et seq. It is a classic exercise of substantive administrative rulemaking authority. There is no question that the FOMC continuously utilizes the levers of control thus placed in its hands by statute and regulation.[15] There is no rational basis for the defendants' argument that the FOMC's authority is not governmental.

E. The Position of the Attorney General

There is little doubt that in the successive challenges to their authority which have been mounted in Federal courts,[16] the defendants have benefited greatly from the prestige attaching to legal representation which purports to subordinate the parochial

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15. Holland affidavit, J.A. 35-41; Auerbach declaration, J.A. 42-46.

16. Bryan v. FOMC, 235 F. Supp. 877 (D. Mont. 1964); Reuss v. Balles, 584 F.2d 461 (D.C. Cir.), cert. denied, 439 U.S. 997 (1978); Riegle v. FOMC, 656 F.2d 873 (D.C. Cir.), cert. denied 454 U.S. 1082 (1981); Committee for Monetary Reform v. Board of Governors of the Federal Reserve System, 766 F.2d 538 (D.C. Cir. 1985); and the case at bar, 644 F. Supp. 510, J.A. 20.

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interests of the particular agency or officer appearing in the litigation to the interests of the government as a whole.[17]

At page 33 of their brief in this Court in Riegle v. FOMC, 656 F.2d 873 (D.C. Circ.), cert. denied, 454 U.S. 1082 (1981), a case which the Department of Justice later asserted was identical to the case at bar,[18] the defendants, by their Department of Justice counsel, "conceded that the members of the FOMC exercise significant governmental authority," and at pages 37 and 38 of the same brief, they reiterated this concession as follows:

> As noted above, we have no quarrel with the Senator's contention that the members of the FOMC exercise significant governmental authority. They are, therefore, "officers" whose appointments are subject to the provisions of the Appointments Clause. [emphasis added]

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17. In the case at bar, the position taken by the Department of Justice is aligned with (1) the institutional interest which the Federal Reserve has in strengthening its political position with the regulated industry (a not uncommon interest of regulatory agencies) and (2) the financial interest which privately-owned commercial banks that are members of the Federal Reserve have in by-passing the constitutionally-ordained political process to influence governmental policy directly in the critically important areas of money and credit. Such banks are estimated to have over 60,000 directors, of a high average economic and social status, strategically placed in virtually every Congressional district. Their alignment with the Fed and the Department of Justice produces a kind of power for which, in the political arena, a mere black-letter command in the Constitution is no match. That is why we have judicial review.

18. At page 9 of the Defendants' Memorandum of Points and Authorities in Support of their Motion to Dismiss, filed June 29, 1984, in the case at bar.

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Nor was Riegle the first case in which the defendants and the Department of Justice had taken this position. Although the merits were never reached in Reuss v. Balles, 584 F.2d 461 (D.C. Cir.), cert. denied, 439 U.S. 996 (1978), at the very threshold of that case, the Attorney General necessarily made a determination as to the governmental character of the only defendants in that case, which were the Federal Reserve Banks and their representatives on the FOMC.[19] The suit was brought by the Chairman of the Committee on Banking, Currency and Housing of the House of Representatives, and was bound to have received high-level attention. At its inception, neither the Attorney General nor the U.S. Attorney was served with process, and in accordance with 28 U.S.C. § 2403, Judge Barrington D. Parker promptly notified Attorney General Edward H. Levi of the pendency of the action, by letter dated 13 days prior to any appearance on behalf of the defendants.[20] Given the Attorney General's clear power to intervene pursuant to section 2403, if it had been his position that the defendants were private, he was probably under a duty not to devote the resources of the Department to their defense, particularly in view of their power under section 4 of the

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19. A copy of the Reuss complaint as originally filed is included in the record of the case at bar as an appendix to the plaintiff's reply memorandum filed October 30, 1986.

20. A copy of this letter dated June 24, 1976 was filed as an appendix to the plaintiff's reply memorandum filed October 30, 1986. The District Court docket entries in Reuss show July 7, 1976 as the date of the defendants' first appearance.

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Federal Reserve Act (12 U.S.C. § 341) to appear in litigation without the Attorney General's authority or representation.[21]

Thus when the defendants filed their motion for summary judgment on July 3, 1986, proclaiming themselves to be private citizens whose oath of office was empty ceremony, that proclamation was a radical repudiation of their own historical and repeatedly reaffirmed position. The District Court's briefing schedule[22] allowed the plaintiff only eight calendar days, of which only four were business days, in which to prepare and file an opposition to the defendant's motion for summary judgment, even though the defendants had been allowed, over the plaintiff's strenuous objections, more than 23 months before they were required to file any response at all to the plaintiff's motion for summary judgment.

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21. The authority of the Department of Justice to appear as counsel would have been questionable unless the individual defendants, in serving on the FOMC, were acting as officers of the United States, and unless the banks, in carrying out the directives of the Committee, were acting as agencies of the United States, because these were the only acts of which the plaintiff complained. The basic principles governing the appearance in litigation by the Attorney General and his subordinates in the Department of Justice are well established. As indicated in the marginal notes beside sections 359 and 361 of the Revised Statutes, 18 Stat. 61, they have been in effect for more than a century. Now embodied in 28 U.S.C. § 519 and 5 U.S.C. § 3106, they authorize the Department of Justice to conduct all litigation on behalf of the United States and its departments, agencies, officers, and employees, and prohibit other representation except in narrowly defined classes of cases not relevant here. See also 28 CFR §§ 50.15 and 50.16 (Department of Justice policies limiting representation of officers and employees to cases in which they are sued in their capacity as such); and 57 Comp. Gen. 444 (1978) (no authority to provide or pay for representation for persons sued for acts outside scope of their official duties as officers or employees of the United States Government).

22. By order filed June 10, 1986.

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F. Conclusion

The District Court's rationale for its acceptance of the defendants' new position, and the theme underlying the whole of its decision on the merits, was its stated belief that the present structure of the FOMC represents a balance between "public" (i.e., the Board of Governors) and "private" (i.e., the Federal Reserve Banks) control of open market operations. We believe that what we have already presented demonstrates that whatever its motives may have been, Congress clearly exceeded its power when it authorized what the District Court called "private individuals selected by the Reserve banks"[23] to serve as members of the FOMC.

Appellant cannot, however, prudently rest his case with that demonstration. There is no assurance that the defendants will not once again reverse their position, repudiate the rationale they advanced in the District Court, and urge this Court to validate the Reserve bank representatives as "inferior Officers." We think that an examination of the ownership of Federal Reserve banks and the functions they perform that are relevant to this litigation will demonstrate not only that they are so completely governmental in nature that there is no validity to the "balance" theory, but also that the functions in question are of such gravity that under no reasonable construction of the Appointments Clause can their control be entrusted to inferior officers.

23. 644 F. Supp. at 520, J.A. 30. The statute makes a distinction between the banks and their boards of directors, and authorizes the latter, not the former, to make the selection. There is no basis for the contention that this meets the formal requirements for the appointment of inferior officers.

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II. THE OWNERSHIP OF FEDERAL RESERVE BANKS

A. Introduction

As we noted at the conclusion of Part I, *supra*, the District Court's decision is expressly predicated on the theory that the Federal Open Market Committee represents a "balance" between governmental and private components. In Part I, we sought to demonstrate that if it were the congressional purpose to structure such a balance, that purpose was executed by means which are prohibited under the Constitution. In this Part II, we will examine the question whether, quite apart from the design of the scales in which this balancing is said to be done, there is really anything of substance on the side which is labelled "private."

No principle of constitutional adjudication is more firmly established than that it is the duty of the court to look beyond superficial formalities to examine the underlying reality. That principle is especially important in the present context.

Corporations which are genuinely a part of the private sector are subject to important disciplines as a result of that status. In order to stay in business, they must produce a product or service for which there is a real demand, they must produce it at a price which is low enough to be competitive, and they must charge a price which is high enough to cover their costs. These disciplines are not imposed simply by pasting private sector labels like "stock" and "vice president" and "earnings" on components of an institution which functions within the government. To do so may be to achieve the worst of both worlds: an institution

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or officer functioning outside the disciplines of both our free enterprise economic system and the control of the people as expressed through our system of constitutional government. When the individuals functioning in this way nevertheless retain ties to profit oriented-enterprises in the same segment of the economy to which their governmental powers and duties relate, the potential for irresponsible policymaking,[24] not to speak of outright abuse, is as obvious as it is enormous.

B. Federal Reserve Bank "Stock"

The attributes of control and of financial interest--that is to say, an interest or share in profits, losses, and net worth, as opposed to a mere creditor's right to payments--are what distinguish stock from bonds, debentures, and other financial obligations. The possession of control and financial interest in an enterprise by private persons, as opposed to a government, is what distinguishes such an enterprise as "private". If the enterprise in question is a corporation, the corporate stock is the means by which control and financial interest are allocated among the owners.

The Federal Reserve's own publications are candid in their admission that the so-called "stock" of Federal Reserve Banks is

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24. One of America's, and indeed the world's, most respected authorities on money and banking has long maintained that the policy blunders of the Federal Reserve were in large measure responsible for the depth, duration, and tragic human cost of the Great Depression. See Chapter 7, "The Great Contraction, 1929-33," in A Monetary History of the United States, 1867-1960, by Milton Friedman and Anna Schwartz (Princeton University Press, 1963).

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at variance with the commonly understood definition of that term. In The Federal Reserve System: Purposes & Functions, 7th Ed. (1984), published by the Board of Governors, it is stated at page 10:

> However, ownership of [Federal Reserve Bank] stock does not carry with it the usual attributes of control and financial interest.

The absence of the key attributes of control and financial interest is reiterated in greater detail at page 50:

> These shares, unlike ordinary stock in private banks or corporations, do not carry voting power to control the policies of the Reserve Banks. Member institutions are entitled by statute to a cumulative dividend of 6 percent per annum on the value of their paid-in stock. Ownership of Reserve Bank stock may not be transferred, nor may the owning institution use its shares as collateral for loans.

Lest there be any misapprehension that a holder of the so-called stock might at least be acquiring a hidden equity which could be realized upon liquidation, it is stated at page 9:

> Earnings of Federal Reserve Banks are allocated first to the payment of expenses (including assessments by the Board of Governors to defray its expenses), the statutory 6 percent dividend on Federal Reserve Bank stock that member institutions are legally required to purchase, and any additions to surplus necessary to maintain each Reserve Bank's surplus equal to its paid-in capital stock. Remaining earnings are then paid into the U.S. Treasury. About 95 percent of the Reserve Banks' net earnings have been paid into the Treasury since the Federal Reserve System was established. ... Should a Reserve Bank be liquidated, its surplus--after all obligations had been met--would become the property of the U.S. government. [emphasis added]

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Similarly, if a member bank withdraws from membership, it receives in redemption of its Federal Reserve Bank stock exactly what it paid for it, "with interest at the rate of one-half of one per cent per month [the same as the statutory "dividend" rate] from the date of the last dividend...." (Federal Reserve Act, section 9, 12 U.S.C. §328). The tenor of this provision is more consonant with a subordinated debt obligation than with any kind of equity interest.

The statutory basis for the foregoing statements in respect of financial interest is found in sections 5, 6, 7, and 9 of the Federal Reserve Act (12 U.S.C. §§ 287, 288, 289, 290, 323, 327, and 328); the statements in respect of control are derived from the Act *passim*. From them, it is clear that in any meaningful usage of financial and legal terminology, the thin sliver of the capitalization of Federal Reserve Banks represented by their so-called stock would have to be denominated as something like "qualifying nonparticipating preferred stock." The ownership of such stock is one of the necessary qualifications for membership in the Federal Reserve System, and entitles the holder to a fixed return subject only to the availability of income, but it carries no significant equity interest.

If the stockholders are not the owners, where does the ownership interest lie? As we noted in the Statement of the Case, it is obvious that the United States Government, by legislation and otherwise, exerts the kind of broad, ultimate control over these institutions that stockholders have over private-sector enter-

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prises. From an examination of sections 7 and 16 of the Federal Reserve Act as they have been amended and administered over the life of the Federal Reserve System, it will similarly be clear that the financial interest of the United States government is also that of ownership.

C. Distribution of Earnings

As originally enacted, 38 Stat. at 258, section 7 of the Federal Reserve Act read as follows (emphasis added):

> Sec. 7. After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, all the net earnings shall be paid to the United States as a franchise tax, except that one-half of such net earnings shall be paid into a surplus fund until it shall amount to forty per centum of the paid-in capital stock of such bank.
>
> The net earnings derived by the United States from Federal Reserve Banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal Reserve bank be dissolved or go into liquidation, any surplus remaining after payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied.
>
> Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.

The limitation of the interest of the so-called stockholders to the amount which they actually paid for their stock, plus the

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statutory 6% dividend, has never been changed. Thus they are at best, as we have noted supra, holders of an issue of preferred stock constituting a minuscule fraction of the total equity capital of these institutions. There have been only two direct amendments to section 7. In 1919, the franchise tax was reduced,[25] and in 1933 it was removed altogether,[26] but under neither amendment were the holders of the so-called stock given any interest in the surplus, either immediate or residual.

Federal Reserve Bank earnings vaulted upward after the close of World War II. In 1947, for the first time, they made payments to the Treasury denominated as "Interest on Federal Reserve Notes."[27] The statutory authority for such payments is contained in section 16 of the Federal Reserve Act, and it is to that section that we now turn our attention. Its first paragraph (12 U.S.C. § 411) provides--

> The said notes shall be obligations of the United States . . . .

and its fourth paragraph (12 U.S.C. § 414) provides that each Federal Reserve Bank through which Federal Reserve notes are issued--

> shall be charged with the amount of such notes issued to it and shall pay such rate of interest as may be

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25. Act of March 3, 1919, 40 Stat. 1314.
26. Act of June 16, 1933, 48 Stat. 163. The purpose behind the 1933 amendment was to increase the capital of the Federal Reserve Banks to encourage them to expand their lending in an economy devastated by the Great Depression.
27. Table 9.9, "Earnings and Expenses of Federal Reserve Banks - A. Summary: Cumulative 1914-70, and Annually 1942-70" at page 501 of Banking and Monetary Statistics 1941-70, published by the Board of Governors of the Federal Reserve System (1976).

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> established by the Board of Governors of the Federal Reserve System on only that amount of such notes which equals the amount of its Federal Reserve notes outstanding less the amount of gold certificates held by the Federal Reserve agent as collateral security. Federal Reserve notes issued to any such bank shall, upon delivery, together with such notes of such Federal Reserve Bank as may be issued under section 18 of this Act upon security of United States 2 per centum Government bonds, become a first and paramount lien on all the assets of such bank.

At first blush, this seems very confusing. Interest is ordinarily paid by, not to, an obligor, yet despite the declaration in the first paragraph of section 16 that Federal Reserve notes are obligations of the United States, the fourth paragraph provides (by necessary implication) for the payment of interest to the United States. Moreover, such notes are not shown as any part of the Federal debt (whether or not subject to the debt ceiling) in the accounts of either the Treasury or the Federal Reserve. They are, however, shown as liabilities of the Federal Reserve Banks,[28] which is consistent with the provision in the fourth paragraph making them "a first and paramount lien on all the assets" of the bank through which they are issued, as well as a necessary consequence of their convertibility to and from deposits held in Federal Reserve Banks.[29]

The explanation for these apparent contradictions is that the liability imposed on the United States by 12 U.S.C. § 411 is

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28. See any statement of condition of Federal Reserve Banks. Table 1.18 carried in the statistical section of the monthly Federal Reserve Bulletin is one of many published sources.

29. See the discussion infra at pages 43 and 44.

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only a contingent liability, and since Federal Reserve notes now _are_ money,[30] rather than an obligation to pay money, the possibility that the contingency will ever arise as a result of a holder of the notes appearing and demanding payment has become absolutely nonexistent. Moreover, throughout the period when the holder of such notes could actually do this, no interest was ever charged.

Why? It is clear that even then, the government had the sole residual proprietary interest in the earnings of the Federal Reserve Banks. Under sections 7 and 16 as originally enacted, as long as a Federal Reserve bank had earnings in excess of the modest additions to surplus authorized by statute, it made absolutely no difference whether the transfer of the remainder of those earnings was labelled as payment of a "franchise tax" or as a payment of "interest," because all of that income would be transferred to the government in any event.[31]

Because of prevailing economic conditions and Federal policy at the time of the repeal of the franchise tax, and for a number of years thereafter, the issue of how to transfer the earnings to the Treasury was moot. When conditions changed, the policy changed, and the "interest" provision of section 16 (12 U.S.C. § 414) began to be used.

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30. Auerbach declaration dated July 9, 1986, J.A. 47; see the discussion _infra_ at pages 40 and 41.

31. This point is made by the Federal Reserve Board itself in its announcement of April 24, 1947, published in the May, 1947 _Federal Reserve Bulletin_ at pages 518 and 519.

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The statement of the Board of Governors of the Federal Reserve System issued upon the occasion of the first use of this provision makes it crystal clear that this was in no sense a charge for interest as that term is understood in law, economics, or financial accounting.[32] There was not so much as a nod in the direction of risk, maturity, market conditions, or any other factor which is taken into consideration in the establishment of any bona fide interest rate. It was purely and simply a vehicle for the transfer of money from one pocket of the Federal government to another. After reviewing the then-recent earnings history of the banks, the Board said:[33]

> Under the circumstances, the Board concluded that it would be appropriate for the Federal Reserve Banks to pay to the Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend. In effect, this will involve paying currently to the Treasury funds which, under existing law, would come to it only in the event of the liquidation of the Federal Reserve Banks. The Federal Reserve Act still provides that, in case of liquidation of a Federal Reserve Bank, any surplus remaining after the payment of all claims shall be paid to the Treasury. It is expected that the present payments will be made at quarterly intervals. By invoking its authority under Section 16 of the Federal Reserve Act, the Board is able to accomplish the same results as were accomplished by the payment of a franchise tax, i.e., the transfer of excess earnings to the Government. The payments can thus be reflected in current revenues and taken into account in the Government's budget without further legislation.

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32. Announcement made by the Board of Governors of the Federal Reserve System under date of April 24, 1947, as published in the May, 1947 Federal Reserve Bulletin at pages 518 and 519.

33. Id.

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From the first use of the section 16 authority announced in the foregoing quotation down to the present day, the accounting treatment accorded such payments by both the Board and the banks has been inconsistent with their characterization as "interest." For any business enterprise, interest paid is a cost, and is deducted from revenues before, not after, net earnings are determined. It is only after all costs have been taken into account that the resultant net earnings are distributed internally to various accounts such as earned surplus, or externally by way of dividends or similar payments to the owners of the enterprise. The so-called interest charged under section 16 has never been treated in this way: it has uniformly been accounted for not as an element of costs, but as a distribution of earnings, and has always been so labelled not only in the formal accounts[34] but also in the Board's narrative explanations of how the system operates.[35]

Since issuing its initial statement in 1947, the Board has twice revised its determination of what level of earnings would be considered "excess" and thus transferable to the Treasury. Prior to 1959, the Board had deemed that an appropriate level of surplus for the Reserve Banks would be 100% of their "subscribed" capital, plus whatever level would be achieved by adding approximately 10 percent of the annual net earnings. At page 24 of the January 1960 Federal Reserve Bulletin, the Board explained the

34. E.g., note 27 supra.
35. E.g., note 32 supra.

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upward leap of nearly 80% (from $879,685,000 in 1958 to $1,582,119,000 in 1959) in "interest" payments to the Treasury as follows:

> The 1959 payments to the Treasury reflect a conclusion reached by the Board, after consultation with the Federal Reserve Banks, that the maintenance of a surplus at the level of subscribed capital would be appropriate in the light of present circumstances. It was therefore decided to change the recent practice of adding approximately 10 per cent of the annual net earnings of the Federal Reserve Banks to the surplus accounts, and to pay to the Treasury the amounts by which the surplus accounts exceeded subscribed capital.

In other words, the accumulation of a number of years' additions to surplus resulting from the retention of 10% of earnings was simply paid over to the Treasury, and the Reserve Banks were instructed that in future any such accumulation was to be avoided by immediately paying over to the Treasury the entire earnings in excess of those required to maintain the surplus at the level of subscribed capital.

In its next announcement[36] regarding the computation of "interest" on Federal Reserve notes, the Board of Governors determined that maintaining the Reserve banks' surplus at a level equal to paid-in capital, rather than subscribed capital, would be adequate. This had the effect of cutting in half the amount of earnings to be retained by the banks for transfer to the surplus account. Accordingly, it directed a one-time payment of over half a billion dollars to the Treasury in 1965, in addition

36. Announcement published in the January 1965 (Volume 51) Federal Reserve Bulletin at page 113.

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to the more than one billion which would otherwise have been paid in that year, and further directed that in future, all earnings above a level necessary to maintain surplus equal to paid-in capital be paid directly to the Treasury. No further changes have been announced. The result, as documented <u>infra</u> at 32 and 33 and the sources therein cited, is that the government immediately and directly receives more than 98% of the earnings of the Federal Reserve Banks, now running at some $17 to $18 billion a year.

What is abundantly, overpoweringly clear from the foregoing is that these actions by the government, through the agency of the Board of Governors, were not those of a creditor or guarantor receiving payments of interest, nor even of a sovereign exercising regulatory power over the payment of interest. They were, rather, the actions of an owner. If <u>any</u> governmental agency attempted to take actions like these against <u>any</u> private corporation, there would be a political and constitutional uproar of historic proportions.[37] As it was, these actions passed virtually unnoticed save by the handful of people professionally involved in Federal budgetary and monetary affairs, because there was no substantial private ownership interest in either the funds in question or the banks in which they were generated.

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37. See, e.g., the extensive media coverage, speeches in Congress, and the historic decision of the Supreme Court, <u>Youngstown Sheet & Tube Co. v. Sawyer</u>, 343 U.S. 579 (1952), in which it granted certiorari before judgment in this Court, all of which ensued from President Truman's attempted seizure of the steel mills during the Korean War.

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This is no abstract, academic discussion. The sums generated by the open market operations whose control is at stake in this litigation are immense. As indicated in Table 17 at pages 6e-32 and 6e-33 of the Budget of the United States Government, Fiscal Year 1987, reproduced *infra* at 1A5, it is estimated that in 1987 the deposit of earnings from the Federal Reserve will exceed the grand total of all alcohol taxes, all tobacco taxes, and all other non-trust fund excise taxes combined.

Perhaps an even better appreciation of what the government's ownership of Federal Reserve banks means in financial terms can be gained by comparing its receipts from them with items on the expenditure side of the ledger. Again referring to the Budget, the discussion and tables at pages 5-139 through 5-148 show that the total of all expenditures for the administration of justice, that is, the entire outlays of the Judicial Branch of the government, plus the entire outlays of the Department of Justice, plus the outlays of all other law enforcement agencies such as Customs and the Secret Service, were estimated for 1986 at $6.788 billion. The entire outlays of the Legislative Branch of the government ($1.522 billion), plus all other functions discussed in the Budget under the heading of general government, were estimated for 1986 at $6.270 billion. If all of these expenditures, totalling $13.058 billion, had been funded exclusively from receipts from the Federal Reserve System,[38] the government would still have had $3.474 billion left over.

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38. These receipts are virtually all generated by open market operations; other sources of income to the Federal Reserve banks are small by comparison, and largely offset by associated costs.

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And the return to the "stockholders" ? $110 million[39] - barely over six-tenths of one per cent of earnings. The government cannot seriously contend that the Federal Reserve Banks are private corporations.

III. THE SOVEREIGN FUNCTION OF FEDERAL RESERVE BANKS

A. Introduction

Contemplation of the enormous revenues which the Federal government derives from Federal Reserve banks leads naturally to inquiry as to how these huge sums are generated. If we examine the table entitled "Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1985 and 1986" at the top of page 213 of the current Annual Report,[40] we find that in 1986, current income before any deduction for expenses was approximately $17.465 billion, while the total of all current expenses, plus assessments for the support of the Board of Governors and the cost of currency, was only $1.435 billion. If we look at the consolidated balance sheet (Statement of Condition of All Federal Reserve Banks Combined) in Table 1 at pages 222 and 223 of the same report, we find that the net earnings of the Federal Reserve banks were derived from a total capital and surplus of only $3.747 billion. Net earnings were thus more than 10 times total expenses, and more than four times capital and surplus.

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39. March 1987 Federal Reserve Bulletin, page 209.

40. Seventy-Third Annual Report of the Board of Governors of the Federal Reserve System, transmitted to the Speaker of the House of Representatives May 18, 1987.

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Is it possible that private corporations have achieved these fantastic financial ratios? Is it by Miracles of Modern Management? Have the Gnomes of Zurich finally met their match? Have these banks discovered a latter-day Philosopher's Stone whereby not lead but paper may be transmuted into gold?

Sad to relate, the answers to the above are No, No, No, and No. They are not private corporations. Neither administrative expertise nor market astuteness can account for these results. The First Law of Economics[41] has not been repealed. As we shall demonstrate in this part of our argument, the open market operations of Federal Reserve banks are an exercise of sovereignty, conducted pursuant to law. Because of this, the direction of such operations is, clearly, an exercise of "significant authority pursuant to the laws of the United States," regardless of whether that exercise takes the form of rules and orders directed to those who must ultimately bear the economic burdens thus imposed.[42]

---

41. "There is no free lunch."

42. Some economists maintain that these profits are properly identified as "seigniorage." While it is unnecessary for the purposes of this case to take a position on the correct terminology to be used, it is surely pertinent to observe that these profits do represent a transfer of wealth from the private to the public sector. That is not to say that this particular means of transfer is unconstitutional or even unwise, but neither as a government nor as a society can we rationally address the issue unless we are willing to recognize it for what it is. See, e.g., "Monetary Policy's Payoff to the Treasury," by Professor Richard H. Timberlake of the University of Georgia, which appeared on page 18 of the December 22, 1986 Wall Street Journal.

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B. "Money" vs. "money supply"

The District Court's decision from which this appeal was taken rests on the proposition that coining money is not an exclusively governmental function, but one that can be vested in, or at least shared by, persons and institutions in the private sector. This proposition rests in turn on the following syllogism:

> The first and second Banks of the United States influenced the money supply in their time.
>
> The first and second Banks of the United States, when acting to influence the money supply, were under the control of boards of directors composed of persons in private life, and such control was constitutional.
>
> The open market operations of Federal Reserve Banks influence the money supply in our time.
>
> Such operations are under the control of a body, the FOMC, composed in part of persons in private life.
>
> The participation of private persons in the decisions of the FOMC is therefore constitutional.

The fallacy in the syllogism is that "Money," as used in the Constitution, does not have the same meaning as "money" or "money supply," which are terms of art in modern macroeconomic analysis. We need not concern ourselves with the technical aspects of the various definitions of "money" or "money supply;" it is enough to note that even under the most restrictive definition, those terms include checks and drafts, instruments which were well known at the time the Constitution was written.

In pertinent part, Clause 5 of Section 8 of Article I provides--

> The Congress shall have Power . . .
>
> * * * * * * *
>
> To coin Money, regulate the Value thereof, and of foreign Coin . . . .

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while Clause 1 of Section 10 of the very same Article provides--

> No State shall . . . coin Money; emit Bills of Credit; [or] make any Thing but gold and silver Coin a Tender in Payment of Debts . . . .

If "Money" as used in Article I has a meaning broad enough to support the defendants' contention and the District Court's holding, one is led to the result that the states are forbidden to issue checks and drafts. That is obviously absurd. It is equally absurd to think that the Framers had the slightest intention to countenance the exercise by persons in private life of a power so sensitive, so central to sovereignty, that it was unequivocally, unconditionally forbidden to the states. Since the gold and silver coinage of which the Constitution speaks no longer exists, we are left with the problem how to apply the provisions of § 8, cl. 5 in the context of the monetary system that we have today.

C. Legal Tender

Whatever other attributes it may have, "Money" within the meaning of that provision of the Constitution must have the quality of legal tender, and that is a quality which the sovereign, and only the sovereign, can impress upon it. This notion was expressed forcefully and unambiguously by the Supreme Court in *Juilliard v. Greenman*, 110 U.S. 421 at 447 (1884) as follows:

> The power, as incident to the power of borrowing money and issuing bills or notes of the government for money borrowed, of impressing upon those bills or notes the quality of being a legal tender for the payment of private debts, *was a power universally understood to belong to sovereignty*, in Europe and America, at the time of the framing and adoption of the Constitution of the United States. [emphasis added]

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From the discussions carried on in the Constitutional Convention in regard to that provision,[43] there can be no doubt that the framers of the Constitution understood the difference between "Money" issued by the sovereign and having the quality of legal tender, whether or not backed by precious metal, and other payment instruments which might be employed in any given transaction by agreement of the parties.

The same understanding that only the sovereign can issue money in a legal or constitutional sense was expressed in the report to the House of Representatives by Alexander Hamilton as Secretary of the Treasury, recommending the establishment of what became known as the first Bank of the United States.[44] Hamilton urged the creation of the Bank of the United States because he believed that credit extended by an organization in the private sector could adequately substitute for money in facilitating many business and commercial transactions, and thereby relieve pressure on the government to increase the supply of "Money" either by reducing its content of precious metal, or by "emitting Bills of Credit" as the government does today through the Federal Reserve Banks.

The citation of the first and second Banks of the United States as precedents for the Federal Reserve System thus stands

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43. II Farrand, Records of the Federal Convention of 1787, at 308-310 (Yale University Press, 1911).

44. Reprinted in 3 Works of Alexander Hamilton 388 et seq. (H. Lodge ed. 1903), and in I Krooss, Documentary History of Banking and Currency in the United States 230 et seq. (McGraw-Hill, 1969).

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history on its head and reflects a total misunderstanding of Hamilton's position. His report to the Congress recommending the chartering of a bank is a veritable polemic against the system we have today, under which the supply of "Money" is determined by open market operations of the Federal Reserve Banks acting under the direction of the Federal Open Market Committee.

D. Banknotes vs. "Money"

The first and second Banks of the United States had the power to issue circulating notes, but these notes were not "Money". They were not legal tender. They were not issued by, nor were they obligations, whether contingent or direct, of the government. They were simply promises to pay, in "Money", the sums stated. The fact that a modern economist would consider them part of the "money supply" is irrelevant to the question whether the institutions which issued them can be considered as constitutional precedents for the modern Federal Reserve Banks. The fact that the institutions which issued those notes could and did influence the "money supply" by demanding (or refraining from demanding) payment of circulating notes issued by state-chartered banks is equally irrelevant. That part of the "money supply" which they could control had no effect on the supply of "Money" in the constitutional sense, of which the only equivalent in our present-day system is the supply of reserves under the control of the FOMC. That control and that equivalence are documented in the affidavit of Robert C. Holland, J.A. 35, and the declarations of Robert D. Auerbach, J.A. 42 and 47. In paragraph 2 of the last of these, Auerbach states at J.A. 47 (emphasis added):

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> 2. The monetary base referred to in paragraph 2 and subsequent paragraphs of my June 19, 1986 declaration is the nearest present-day equivalent of the "Money" the Constitution authorized the Congress to coin and regulate the value of. Federal Reserve notes, together with a small vestigial issue of circulating U.S. notes and the coins minted by the Treasury, constitute the coin and currency in circulation in the United States today. Federal Reserve notes and deposits in Federal Reserve Banks are equivalent forms of money in terms of their economic significance, and in our present-day monetary system, they cannot be "paid" or "redeemed" by exchange for any more basic medium. <u>Among professional economists, I know of no responsible dissent from these propositions</u>.

The same point is made at pages 33 and 34 of <u>The Federal Reserve System: Purposes & Functions</u> (7th ed., 1984, published by the Board of Governors):

> A Federal Reserve security transaction changes the reserve base of the banking or depository system: a purchase adds to nonborrowed reserves, and a sale reduces them. In contrast, the same transaction between financial institutions, business firms, or individuals simply redistributes reserves within the depository system without changing the reserve base.
>
> When the Federal Reserve purchases securities from any seller, it pays, in effect, by issuing a check on itself. The seller's bank, on receipt of the check, presents the check to the Federal Reserve for payment; and the Federal Reserve, in turn, honors the check by increasing the reserve account at the Federal Reserve Bank of the seller's bank. The reserves of the seller's bank rise with no offsetting decline in reserves elsewhere; consequently, the total volume of reserves increases. Just the opposite occurs when the Federal Reserve sells securities: the payment results in a reduction of the reserve account of the seller's bank at the Federal Reserve Bank with no offsetting increase in the reserves of any other bank. The total reserves of the banking system decline in this case.

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> It is this characteristic of Federal Reserve purchases and sales of assets - the dollar for dollar change in the reserves of the banking system - that makes open market operations so important. Through these operations the Federal Reserve can change the amount of reserves available to depositary institutions and thus influence the rate of growth of money and, at the margin, conditions in credit markets.

E. The Sovereign Power of Money Creation

We are now at last in a position to understand how the immense profits described in Part II, supra, are generated, and why the government treats them as its own. They result from the critical difference between open-market purchases by Federal Reserve Banks, and such purchases by any other type of financial institution. When a private institution makes a purchase, it must either raise the money to do so by drawing down or selling existing assets, thereby reducing or eliminating its income from them, or arrange for some other form of financing, financing which for an organization in the private sector inevitably involves the assumption of carrying costs of some kind, normally the payment of interest or dividends.

By contrast, when a Federal Reserve bank makes a purchase, it simply creates the money and incurs no carrying costs whatever, and thus the entire income generated by the asset so acquired is added to the Reserve bank's earnings. Moreover, unlike a private enterprise, its power to acquire additional assets in the same way remains undiminished. By virtue of the sovereign power of the United States government, and only by virtue of that power, the payment it makes in the form of the reserve deposit

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which it writes to the credit of the seller (or the seller's commercial bank) is the ultimate monetary asset in our monetary system, with neither the necessity nor the possibility that the Reserve bank will ever be called upon to redeem it by the payment of any more basic or fundamental unit of exchange. That is the reason, and the only reason, that Federal Reserve Banks can produce, at no cost to themselves, an asset which can be exchanged for income producing securities. It is also why, in our present-day monetary system, the direction of Federal Reserve open-market operations inherently involves the exercise of "significant governmental authority," quite independently of our contention that the regulatory authority conferred on the FOMC would come within the rule of Buckley v. Valeo even if it were privately-owned corporations rather than Federal Reserve Banks that were subject to that authority.

F. The Contrast with the Bank of the United States

The first and second Banks of the United States had exactly the same kind of influence over the credit component of the "money supply" that large private-sector banking institutions have today. That influence is an important factor in the economy, but it did not then and it does not now provide control of the coinage or supply of "Money" in a constitutional sense. The only "influence" it has in that regard depends entirely on how much attention the FOMC chooses to pay to it.

The contrast between those early banks and the modern Federal Reserve Banks is dramatically illustrated by comparing their notes. The notes issued by the first and second Banks of the

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United States were nothing more than demand promissory notes of privately-owned depository institutions. The Smithsonian Institution photographs of these notes reproduced <u>infra</u> at 1A1 were included in the record of the case below, together with a copy of the letter of transmittal, as an exhibit with the plaintiff's reply memorandum filed October 30, 1986.

The early banknotes can be reproduced in this brief, whereas Federal Reserve notes cannot, because 18 U.S.C. § 474 prohibits the reproduction of obligations of the United States, and the banknotes issued by neither the first nor the second Bank of the United States fall in that category. On their face, as required by 12 U.S.C. § 413, Federal Reserve notes identify the particular Federal Reserve bank which put them into circulation and on whose books they appear as a liability, but they also bear numerous and conspicuous indicia of their governmental character: the legend "The United States of America" across the top and "This note is legal tender for all debts public and private" just beneath it to the left; the seal of the Department of the Treasury on the right; and the signatures of the Secretary of the Treasury and the Treasurer of the United States along the bottom.

Under our monetary system as it existed throughout the periods of the existences of the first and second Banks of the United States, the nominal supply of "Money," that is, the number of dollars of constitutional "Money" available to the economy, depended on two factors. The directors of those banks had absolutely no control over either factor. One was the physical stock of precious metal, which was thought to change so slowly as to be a giv-

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en, and the other was the conversion ratio set by Congress under Art. I, § 8, cl. 5. Today, by contrast, as Dr. Auerbach's unopposed declaration attests, apart from coins and vestigial currencies that are principally of numismatic interest, Federal Reserve Bank deposits and Federal Reserve notes are the only things we have which correspond to the "Money" of which the Constitution speaks. They are, in the aggregate, absolutely subject to the control of the FOMC.

Each of these forms of Federal Reserve credit - Federal Reserve deposits and Federal Reserve notes - is readily convertible into the other. The role of the Federal Reserve Board in the issuance of Federal Reserve notes has no more policy significance than that of the engraver who makes them or the truck driver who delivers them. The Board's own book, The Federal Reserve System: Purposes & Functions, does not even mention Federal Reserve note issuance among the policy functions of the Board.

The extent to which Reserve Bank credit appears as Federal Reserve notes as opposed to Reserve Bank deposits is simply a reflection of public demand. People allocate their funds as between currency and deposits in depositary institutions on the basis of considerations of convenience, economy, security, and anonymity. The demand for currency is thus the product of two factors: one is the total amount of funds in the hands of the public, and the other is the fraction of that total which the public prefers to keep in the form of currency. As The Federal Reserve System: Purposes and Functions explains at page 105 in Chapter 7, Federal Reserve Bank Services:

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An important function of the Federal Reserve System is to ensure that the economy has enough currency and coin to meet the public's demand. Currency and coin are put into or retired from circulation by the Federal Reserve Banks, which use depository institutions as the channel of distribution. When banks and other depository institutions need to replenish their supply of currency and coin - for example when the public's need for cash rises around holiday shopping periods - they order cash from the Federal Reserve Bank or Branch in their area, and the face value of that cash is charged to their accounts at the Federal Reserve. When the public's need for currency and coin declines, and depository institutions return excess cash to a Federal Reserve Bank, its value is credited to the account of the depository institution.

Virtually all currency in circulation is in the form of Federal Reserve notes, which are printed by the Bureau of Engraving and Printing of the U.S. Treasury. Before being issued to the public, notes must be secured by legally authorized collateral, most of which is in the form of U.S. government and federal agency securities held by the Federal Reserve Banks.

When the Federal Reserve notes are delivered to the private-sector depositary institutions, the note liabilities of the Federal Reserve Banks go up, and their liabilities for deposits are correspondingly reduced. When the notes are turned back in to the Reserve Banks, the deposit liabilities are increased, and note liabilities reduced. The role of the Federal Reserve Board in this process, like that of the Bureau of Engraving and Printing, is the purely ministerial one of assuring that an adequate supply of notes is physically available and properly accounted for. It is the Federal Open Market Committee, not the Federal Reserve Board, that makes the policy decisions which determine the supply of reserve bank credit (the present-day equivalent of the Constitution's "Money") of which the public then withdraws a

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portion in the form of Federal Reserve notes. It is the FOMC, not the Board, that controls the Reserve banks' holdings of the "legally authorized collateral . . . in the form of U.S. government and federal agency securities" referred to in the passage quoted above.

The power to determine the size of the monetary base was never remotely possessed by the directors of either the first or the second Bank of the United States. While a comparison of their enabling legislation with that of the Federal Reserve banks is a more tedious exercise than comparing their respective notes, it yields exactly the same conclusion. In contrast to that of the Federal Reserve banks, the stock of the first and second Bank of the United States represented a genuine equity interest. Just as in the case of any private corporation today, the shareholders received a return on their investment not at some fixed statutory rate, but in the form of dividends determined in the discretion of the directors and paid out of actual earnings,[45] and in the form of the increase in the value of their shares if the business grew and prospered. Upon the liquidation of the bank, they would receive their proportionate share of whatever equity had been built up. The share of the Federal government in profits, and its exposure to risk of loss, was, like that of any other shareholder, strictly in proportion to its actual investment.

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45. Paragraph XIV of section 7 of the Act of Feb. 25, 1791, 1 Stat. 191 at 195; and paragraph Thirteenth of section 11 of the Act of April 10, 1816, 3 Stat. 266 at 273.

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Even the provision for presidential appointment, subject to Senate confirmation, of five of the directors of the second bank is not the evidence of sovereign involvement that it might appear to be. The total number of directors was 25,[46] and the government held one-fifth of the total stock outstanding.[47] Because the voting rights otherwise specified for the stock were geared to individual rather than institutional ownership,[48] it was necessary to make special provision for the government in order to afford it proportional representation on the board.

In short, the government had a proprietary interest in commercial ventures whose success Congress thought would be beneficial to the national economy. Congress sought to foster their development by granting them national charters and immunity from most forms of state taxation, as well as by making a modest investment in their capital stock. Congress also gave them what we would today call a preferred position in marketing financial services to the government. The existence of these factors, however, in no way converted the operation of these banks, created to avoid government involvement in credit as opposed to money, into exercises of sovereign power.

The first and second Banks of the United States provided important precedents for our present-day national banks, Federal savings and loan associations, and other corporate enterprises organized and operating under Federal as opposed to state law. Their relevance to the present controversy, however, is exactly the opposite of what the defendants contend.

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46. Act of April 10, 1816, § 8, 3 Stat. 269.
47. Id., § 6.
48. Id., paragraph 1 of § 11, 3 Stat. 271.

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IV. JUSTICIABILITY

In view of our agreement with the District Court's analysis of the issue of justiciability, 644 F. Supp. 510-17, J.A. 20-27, and the fact that this case is on all fours with Riegle on the issue of standing, we believe that a rather abbreviated treatment is appropriate. A few observations, however, may be in order.

Almost ten years have elapsed since Reuss v. Balles[49] was argued before this Court. The doctrinal development which has taken place since then, and was epitomized last year in both the district court and Supreme Court opinions in Synar,[50] suggests that the anxiety about legislators' claims which afflicted the Reuss court, and was the theme of the law review article[51] so heavily relied upon in Riegle, may have been exaggerated. Representative Reuss claimed that the peculiar method of appointment at issue cast a cloud over his power of impeachment with respect to the elected members of the FOMC.[52] At least one Federal judge would now say that that was a gross understatement: under the holding of the District Court in the case at bar, the power of impeachment as it relates to these defendants is not just impaired, it has been destroyed. Yet the Reuss court, refusing to recognize the obvious weakening of the impeachment power posed

49. 584 F.2d 461 (D.C. Cir.), cert. denied 439 U.S. 997 (1978).

50. Synar v. United States, 626 F. Supp. 1374 (three-judge court, D. D.C.), affirmed sub nom. Bowsher v. Synar, ___ U.S. ___, 106 S. Ct. 3181, 92 L. Ed.2d 583 (1986).

51. Hon. Carl McGowan, "Congressmen in Court: The New Plaintiffs," 15 Ga. L. Rev. 241 (1981).

52. Reuss v. Balles, 584 F.2d. 461 at 467.

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by the potential for a claim by the Reserve Bank representatives that they are not "Officers," held that Henry Reuss's claim of injury was not ripe for adjudication, and would not be, until a Reserve Bank representative on the FOMC had successfully used in an actual impeachment proceeding against him the very defense which the defendants have raised in the case at bar.[53]

The contrast with Synar is glaring. Responding to a claim that the mere existence of a never-used power of removal conferred by a 1921 Act rendered the Comptroller General impermissibly subservient to Congress, the courts did not hesitate to strike down the key mechanism embodied in Gramm-Rudman-Hollings. Had the Reuss approach been favored, the ripeness doctrine could have been used in any of a number of ways to avoid a decision on the merits.

The difference is a greater receptiveness to, and a better understanding of, the doctrine of separation of powers. It is ironic that in their ceaseless invocation of that doctrine, the defendants ignore its most fundamental aspect, which is the separation of powers as between the government and the people. By this we mean the integrity of the political process by which free citizens maintain their control over the government which must ultimately be their servant, not their master. That process is obviously compromised when powers of government, be they executive, legislative, or judicial in nature, are placed in the hands of those who are neither elected by the people, nor responsible within the executive hierarchy, nor selected and screened as the Constitution requires.

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53. Id. at 468.

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V. CONCLUSION--THE PRECISE RELIEF SOUGHT

Since it is neither the powers of the individual defendants nor their method of selection which, standing alone, raises a constitutional question, but rather the presence of the two in combination, Senator Melcher has properly sought that relief which is least disruptive to the legislative scheme. The government abounds with commissions, councils, and committees comprised in whole or part of officials who have not been appointed as officers of the United States. This Court has held in Metcalf v. National Petroleum Council[54] that even a biased selection of the members of such a body does not result in a legally cognizable injury to the legislature where their duties are advisory only.

In applying the doctrine of severability, whether as an implicit judicial power or in implementation of a statutory grant such as section 30 of the Federal Reserve Act,[55] the courts are certainly not limited to blocking out particular words in the manner of a military censor. Voting is but one, albeit an important one, of the functions of the Reserve bank representatives. As the chief executive officers of the regional banks, they may be in a unique position to bring to the Committee first-hand knowledge of conditions in their respective districts. With a statutory right to present that knowledge to the Committee at the very time that decision-making deliberations are being conducted, they are in a position to do so with vastly greater effectiveness than

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54. 553 F.2d 176 (D.C. Cir. 1978).

55. 38 Stat. 275; not in U.S. Code.

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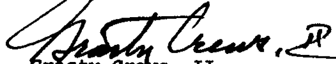
if their presence at these deliberations were a matter of grace. Whether viewed as "interpretation"[56] or as "repair,"[57] we respectfully suggest that the most appropriate judicial response to the existing statutory scheme is to excise only those implicit functions of the Reserve bank representatives that exceed constitutional limitations, and leave the rest intact. That is exactly the result which would be achieved by the injunctive relief prayed for in the complaint[58] and hereby sought in this Court.

Accordingly, Senator Melcher respectfully submits that the decision and order of the District Court should be reversed, and the case remanded with instructions to enter an order enjoining the individual defendants and their successors in office from voting as members of the Federal Open Market Committee or serving as its chairman or vice chairman, and enjoining the Federal Open Market Committee from permitting them so to vote or serve.

Respectfully submitted,



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56. Crowell v. Benson, 285 U.S. 22 at 62 (1932).

57. Hon. Ruth Bader Ginsburg, "Some Thoughts on Judicial Authority to Repair Unconstitutional Legislation," 28 Cleveland State L. Rev. 301 (1979).

58. J.A. 17.

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APPENDIX 1 -- MISCELLANEOUS MATERIALS

Smithsonian Institution photographs of circulating banknotes issued by the first and second Banks of the United States . 1A1

Excerpt from minutes of first meeting of Federal Open Market Committee as constituted by the Banking Act of 1935 . . . . 1A2

Announcement of first use of authority in section 16 of the Federal Reserve Act to transfer earnings to the Treasury . 1A3

Pages 6e-32 and 6e-33 of the Budget of the United States Government, Fiscal Year 1987, showing receipts from the Federal Reserve in comparison with other sources of Federal revenue 1A5

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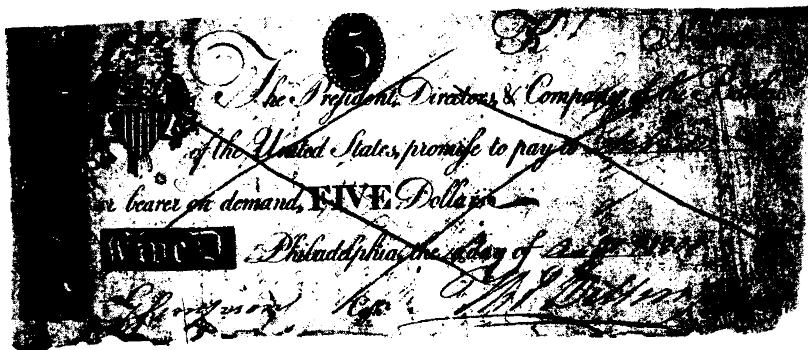

CENTIMETERS

SMITHSONIAN INSTITUTION Photograph No. 86-12753

CENTIMETERS

SMITHSONIAN INSTITUTION Photograph No. 86-12752

Smithsonian Institution photographs of circulating banknotes issued by the first (upper) and second (lower) Bank of the United States.

These photographs, together with the letter of transmittal from the Smithsonian Institution, were included in the record of the case below as exhibits with the plaintiff's reply memorandum filed October 30, 1986.

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EXCERPT FROM THE MINUTES OF THE FIRST MEETING OF THE FEDERAL OPEN MARKET COMMITTEE AS CONSTITUTED BY THE BANKING ACT OF 1935 AS REPORTED IN THE FIRST VOLUME OF THE SERIES ENTITLED "MINUTES OF THE FEDERAL OPEN MARKET COMMITTEE" PUBLISHED BY THE COMMITTEE

Chairman Eccles stated that this meeting of the Federal Open Market Committee, which was the first meeting of the Committee as constituted by Section 12A of the Federal Reserve Act as amended by the Banking Act of 1935, had been called for the adoption of by-laws, the adoption of regulations required by Section 12A of the Federal Reserve Act to be issued by the Committee, and such other action as might be found to be desirable.

* * * * * * *

The Committee then took up for discussion a tentative draft of proposed by-laws which was read and discussed paragraph by paragraph.

At the conclusion of the discussion, upon motion duly made and seconded, and by unanimous vote, the by-laws were adopted in the following form:

"ARTICLE I. MEMBERS

* * * * * * *

"Section 3. Oath--Each member of the Federal Open Market Committee and each alternate shall take the same oath of office as that required by the Constitution for officers of the United States."

* * * * * * *

The meeting then recessed and reconvened at 2:40 p.m. with the same attendance as at the morning session.

The form of oath of office as required by Section 3 of Article I of the by-laws was executed by each member of the Federal Open Market Committee present and filed with the Secretary.

* * * * * * *

/s/ Chester Morrill
Secretary

Approved: M.S. Eccles
Chairman

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TRANSFER TO TREASURY OF EXCESS EARNINGS OF FEDERAL RESERVE BANKS

The Board of Governors of the Federal Reserve System, under date of April 24, 1947, made the following announcement:

As a result of operations essential to Government financing during and since the war, and operations required by the needs of business and the public for credit and currency, earnings of the twelve Federal Reserve Banks have been at relatively high levels. On the basis of present estimates, it is expected that net earnings of the Federal Reserve Banks for 1947, after payment of the statutory dividends to member banks, will aggregate more than 60 million dollars. In view of these facts, and of the fact that at the end of 1946 the surplus of each Federal Reserve Bank was equal to its subscribed capital, the Board has decided to invoke the authority, granted to it under Section 16 of the Federal Reserve Act, to levy an interest charge on Federal Reserve notes issued by the Federal Reserve Banks. The purpose of this interest charge is to pay into the Treasury approximately 90 per cent of the net earnings of the Federal Reserve Banks for 1947.

This action will add about 60 million dollars to the receipts of the Government for this calendar year. The initial payment covering the first quarter of 1947 will be made on April 24, and will amount to approximately $15,269,000.

Section 16, paragraph 4, of the Federal Reserve Act provides that each Federal Reserve Bank shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on the amount of its outstanding notes less the amount of gold certificates held by the Federal Reserve Agent as collateral security. The Board has now decided to establish such rates of interest as will make it possible to transmit to the Treasury approximately 90 per cent of the net earnings after dividends of each of the Federal Reserve Banks for 1947.

The authority to levy an interest charge on Federal Reserve notes not covered by gold certificates has not been used previously, chiefly because of the existence, prior to 1933, of so-called franchise tax provisions of the law which had a similar effect; that is, of transferring excess earnings of the Reserve Banks to the Treasury. Under these provisions, which were repealed in 1933, each Federal Reserve Bank was required to pay a franchise tax to the Government equal to 90 per cent of its net earnings after it had accumulated a surplus equal to its subscribed capital. To the end of 1932, the Federal Reserve Banks had paid franchise taxes to the United States Treasury amounting to 149 million dollars, and at that time the Federal Reserve Banks had accumulated surplus accounts of 278 million dollars, as compared with subscribed capital aggregating 302 million. In the amendment of the Federal Reserve Act, contained in the Banking Act of 1933, providing for the establishment of the Federal Deposit Insurance Corporation, Congress required each Federal Reserve Bank to pay an amount equal to one-half of its surplus on January 1, 1933, as a subscription to the capital stock of the FDIC on which no dividends would be paid. These stock subscriptions amounted to 139 million dollars and reduced the surplus of the Federal Reserve Banks to an equivalent figure, or considerably less than one-half of their subscribed capital. Congress, therefore, eliminated the franchise tax in order to permit the Federal Reserve Banks to restore their surplus accounts from future earnings.

Net earnings for the next ten years were relatively small, and at the end of 1944 the combined surplus accounts of the Federal Reserve Banks were less than 75 per cent of their subscribed capital. During the next two years, however, net earnings increased substantially, due primarily to large holdings of Government securities accumulated through open market operations. This made possible transfers to surplus accounts which increased the combined surplus of the Federal Reserve Banks to $439,823,000 at the end of 1946, as compared with subscribed capital of $373,660,000.

Under the circumstances, the Board concluded that it would be appropriate for the Federal Reserve Banks to pay to the Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend. In effect, this will involve paying currently to the Treasury funds which,

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under existing law, would otherwise come to it only in the event of liquidation of the Federal Reserve Banks. The Federal Reserve Act still provides that, in case of liquidation of a Federal Reserve Bank, any surplus remaining after the payment of all claims shall be paid to the Treasury. It is expected that the present payments will be made at quarterly intervals. By invoking its authority under Section 16 of the Federal Reserve Act, the Board is able to accomplish the same results as were accomplished by the payment of a franchise tax, i.e., the transfer of excess earnings to the Government. The payments can thus be reflected in current revenues and taken into account in the Government's budget without further legislation.

In the event of restoration of a franchise tax by the Congress, the Board would, of course, withdraw the requirement that Federal Reserve Banks pay interest on Federal Reserve notes, as there would be no justification for utilizing both means of accomplishing the same purpose—namely, payment of excess earnings of the Federal Reserve Banks to the Treasury.

In his Budget Message for 1948 the President recommended that Congress authorize the Federal Deposit Insurance Corporation to repay the 139 million dollars of capital furnished by the Federal Reserve Banks, and accepted the proposal of the Board of Governors that Congress at the same time authorize the payment of this sum to the Treasury instead of to the Reserve Banks. Similarly, the President in his Budget Message concurred in the Board's further recommendation that Congress release to the Treasury general fund approximately 139 million dollars earmarked for payments to the Reserve Banks to enable them to make loans to industry under Section 13b of the Federal Reserve Act. Legislation has been introduced in Congress to repeal Section 13b and to substitute therefor authority for the Reserve Banks, upon request of any commercial bank, to guarantee in part loans made by such bank to business enterprises.[1] If this legislation be enacted, the Federal Reserve Banks would rely upon their own surplus funds for this purpose, without resort to Government funds.

[1] A statement by Chairman Eccles to the Senate Banking and Currency Committee regarding this legislation appears on p. 521 of this BULLETIN.

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Table 17. RECEIPTS BY SOURCE, 1977–87

(In millions of dollars)

Source	Actual									Estimate	
	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Individual income taxes	157,626	180,988	217,841	244,069	285,917	297,744	288,938	298,415	334,531	353,738	385,984
Corporation income taxes	54,892	59,952	65,877	64,600	61,137	49,207	37,022	56,893	61,331	70,865	86,729
Social insurance taxes and contributions (trust funds):											
Employment taxes and contributions:											
Old-age and survivors insurance (off-budget)	68,032	73,141	83,410	96,581	117,757	122,840	128,972	150,312	169,822	180,574	195,474
Disability insurance (off-budget)	8,786	12,250	14,584	16,628	12,418	20,626	18,348	15,763	16,348	17,364	18,801
Hospital insurance	13,474	16,668	19,874	23,217	30,340	34,301	35,641	40,262	44,871	50,641	55,737
Railroad retirement	1,908	1,822	2,190	2,323	2,457	2,917	2,805	3,321	3,605	3,535	3,729
Total employment taxes and contributions	92,199	103,881	120,058	138,748	162,973	180,686	185,766	209,658	234,646	252,114	273,741
Unemployment insurance	11,312	13,850	15,387	15,336	15,763	16,600	18,799	25,138	25,758	23,581	23,415
Other retirement contributions:											
Federal employees' retirement—employee contributions	2,915	3,174	3,428	3,660	3,908	4,140	4,351	4,494	4,672	4,653	5,532
Contributions for non-Federal employees	59	62	66	59	76	72	78	86	87	90	116
Total other retirement contributions	2,974	3,237	3,494	3,719	3,984	4,212	4,429	4,580	4,759	4,743	5,648
Total social insurance taxes and contributions	106,485	120,967	138,939	157,803	182,720	201,498	208,994	239,376	265,163	280,438	302,804
Excise taxes:											
Federal funds:											
Alcohol	5,295	5,492	5,531	5,601	5,606	5,382	5,557	5,315	5,562	5,888	5,901
Tobacco	2,393	2,444	2,492	2,443	2,581	2,537	4,136	4,660	4,779	4,594	4,600
Windfall profit tax[1]	.....	.....	.....	6,934	23,252	18,407	12,135	8,906	6,348	4,085	2,761
Other	1,960	2,116	1,785	585	2,689	2,344	2,258	3,398	2,408	2,859	2,971
Total Federal fund excise taxes	9,648	10,054	9,808	15,563	34,128	28,670	24,086	22,279	19,097	17,426	16,233
Trust funds:											
Highway	6,709	6,904	7,189	6,620	6,305	6,744	8,297	11,743	13,015	13,022	13,814
Airport and airway	1,191	1,326	1,526	1,874	21	133	2,165	2,499	2,851	2,954	3,247
Other	.....	92	222	272	385	765	753	827	1,027	1,227	1,909
Total trust fund excise taxes	7,900	8,323	8,937	8,766	6,711	7,641	11,214	15,082	16,894	17,202	18,970
Total excise taxes	17,548	18,376	18,745	24,329	40,839	36,311	35,300	37,361	35,992	34,628	35,203
Estate and gift taxes	7,327	5,285	5,411	6,389	6,787	7,991	6,053	6,010	6,422	6,073	5,661
Custom duties	5,150	6,753	7,439	7,174	8,083	8,854	8,655	11,370	12,079	12,404	12,937
Miscellaneous receipts:											
Deposit of earnings by Federal Reserve System	5,908	6,641	8,327	11,767	12,834	15,186	14,492	15,684	17,059	16,532	16,560
Other miscellaneous receipts	623	778	925	981	956	975	1,108	1,347	1,480	2,461	4,494
Total miscellaneous receipts[2]	6,531	7,420	9,252	12,748	13,790	16,161	15,601	17,031	18,539	18,993	21,054
Total receipts	355,559	399,561	463,302	517,112	599,272	617,766	600,562	666,457	734,057	777,139	850,372
On-budget	(278,741)	(314,169)	(365,309)	(403,903)	(469,097)	(474,299)	(453,242)	(500,382)	(547,886)	(579,201)	(636,097)
Off-budget	(76,817)	(85,391)	(97,994)	(113,209)	(130,176)	(143,467)	(147,320)	(166,075)	(186,171)	(197,938)	(214,275)
MEMORANDUM											
On-budget:											
Federal funds	241,312	270,490	316,366	350,856	410,422	409,253	382,432	420,370	459,488	485,155	533,293
Trust funds	70,341	76,873	85,983	94,679	106,037	122,111	147,290	157,521	197,749	207,196	216,689
Interfund transactions	−32,912	−33,194	−37,041	−41,632	−47,362	−57,065	−76,480	−77,509	−109,532	−113,199	−113,884
Total on-budget	278,741	314,169	365,309	403,903	469,097	474,299	453,242	500,382	547,886	579,201	636,097
Off-budget (trust funds)	76,817	85,391	97,994	113,209	130,176	143,467	147,320	166,075	186,171	197,938	214,275
Total	355,559	399,561	463,302	517,112	599,272	617,766	600,562	666,457	734,057	777,139	850,372

[1] Net of refunds.
[2] Includes both Federal and trust funds.

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APPENDIX 2 - CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS

The Constitution - Art. I, § 8, cl. 2; Art. I, § 10;
Art. II, § 2, cl. 2; Art VI, cl. 3 . . . . 2A1

Federal Reserve Act, §§ 4 and 12A (12 U.S.C. §§ 341 and 263) 2A2

Code of Federal Regulations, Title 12, Chapter II,
Subchapter B -- Federal Open Market Committee
(12 CFR §§ 270.1-281.2) 2A3

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CONSTITUTION OF THE UNITED STATES

ARTICLE. I.

* * * * *

Section 8. The Congress shall have power . . . .

* * * * *

To coin Money, regulate the Value thereof, and of foreign coin . . . .

* * * * *

Section 10. No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

* * * * *

ARTICLE. II.

* * * * *

Section 2. . . . .

He [the President] . . . shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such infereior Officers, as they think proper, in the Courts of Law, or in the Heads of Departments.

* * * * *

ARTICLE. VI.

* * * * *

The Senators and Representatives before mentioned, and the Members of the several State Legislatures, and all executive and judicial Officers, both of the United States and of the several States, shall be bound by Oath or Affirmation, to support this Constitution; but no religious test shall ever be required as a Qualification to any Office or public Trust under the United States.

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THE FEDERAL RESERVE ACT

* * * * *

Federal Reserve Banks

Sec. 4. * * * *
The president shall be the chief executive officer of the bank and shall be appointed by the board of directors, with the approval of the Board of Governors of the Federal Reserve System, for a term of five years; and all other executive officers and all employees of the bank shall be directly responsible to him. The first vice president of the bank shall be appointed in the same manner and for the same term as the president, and shall, in the absence or disability of the president or during a vacancy in the office of the president, serve as chief executive officer of the bank. . . . .
(49 Stat. 703; 12 U.S.C. § 341.)

* * * * *

Federal Open Market Committee

Sec. 12A. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the "Committee"), which shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected as hereinafter provided. Such representatives shall be presidents or first vice presidents of Federal Reserve banks and, beginning with the election for the term commencing March 1, 1943, shall be elected annually as follows: One by the board of directors of the Federal Reserve Bank of New York, one by the boards of directors of the Federal Reserve Banks of Boston, Philadelphia, and Richmond, one by the boards of directors of the Federal Reserve Banks of Cleveland and Chicago, one by the boards of directors of the Federal Reserve Banks of Atlanta, Dallas, and St. Louis, and one by the boards of directors of the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco. In such elections each board of directors shall have one vote; and the details of such elections may be governed by regulations prescribed by the committee, which may be amended from time to time. An alternate to serve in the absence of each such representative shall likewise be a president or first vice president of the Federal Reserve bank and shall be elected annually in the same manner. The meetings of said committee shall be held at Washington, District of Columbia, at least four times each year upon the call of the Chairman of the Board of Governors of the Federal Reserve System or at the request of any three members of the Committee.

(b) No Federal Reserve bank shall engage or decline to engage in open-market operations under section 14 of this Act except in accordance with the direction and regulations adopted by the Committee. The Committee shall consider, adopt, and transmit to the several Federal Reserve banks, regulations relating to the open-market transactions of such banks.

(c) The time, character, and volume of all purchases and sales of paper described in section 14 of this Act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.
(49 Stat. 705, as amended, 56 Stat. 647; 12 U.S.C. § 263.)

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SUBCHAPTER B—FEDERAL OPEN MARKET COMMITTEE

PART 270—OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

REGULATIONS RELATING TO OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

Sec.
270.1 Authority.
270.2 Definitions.
270.3 Governing principles.
270.4 Transactions in obligations.

AUTHORITY: Sec. 8, 48 Stat. 168, as amended (12 U.S.C. 263).

SOURCE: 38 FR 2753, Jan. 30, 1973, unless otherwise noted.

REGULATIONS RELATING TO OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

§ 270.1 Authority.

This part is issued by the Federal Open Market Committee (the "Committee") pursuant to authority conferred upon it by sections 12A and 14 of the Federal Reserve Act (12 U.S.C. 263, 355).

§ 270.2 Definitions.

(a) The term "obligations" means Government securities, U.S. agency securities, bankers' acceptances, bills of exchange, cable transfers, bonds, notes, warrants, debentures, and other obligations that Federal Reserve banks are authorized by law to purchase and sell.

(b) The term "Government securities" means direct obligations of the United States (i.e., U.S. bonds, notes, certificates of indebtedness, and Treasury bills) and obligations fully guaranteed as to principal and interest by the United States.

(c) The term "U.S. agency securities" means obligations that are direct obligations of, or are fully guaranteed as to principal and interest by, any agency of the United States.

(d) The term "System Open Market Account" means the obligations acquired pursuant to authorizations and directives issued by the Committee and held on behalf of all Federal Reserve banks.

§ 270.3 Governing principles.

As required by section 12A of the Federal Reserve Act, the time, character, and volume of all purchases and sales of obligations in the open market by Federal Reserve banks are governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

§ 270.4 Transactions in obligations.

(a) Each Federal Reserve bank shall engage in open market operations under section 14 of the Federal Reserve Act only in accordance with this part and with the authorizations and directives issued by the Committee from time to time, and no Reserve bank shall decline to engage in open market operations as directed by the Committee.

(b) Transactions for the System Open Market Account shall be executed by a Federal Reserve bank selected by the Committee. The participations of the several Federal Reserve banks in such account and in the profits and losses on transactions for the account shall be allocated in accordance with principles determined by the Committee from time to time.

(c) In accordance with such limitations, terms, and conditions as are prescribed by law and in authorizations and directives issued by the Committee, the Reserve bank selected by the Committee is authorized and directed—

(1) To buy and sell Government securities and U.S. agency securities in the open market for the System Open Market Account, and to exchange maturing securities with the issuer;

(2) To buy and sell banker's acceptances in the open market for its own account;

(3) To buy Government securities, U.S. agency securities, and banker's acceptances of the kinds described above, under agreements for repurchase of such obligations, in the open market for its own account; and

(4) To buy and sell foreign currencies in the form of cable transfers in

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the open market for the System Open Market Account and to maintain for such account reciprocal currency arrangements with foreign banks among those designated by the Board of Governors of the Federal Reserve System under § 214.5 of this chapter (Regulation N).

(d) The Federal Reserve banks are authorized and directed to engage in such other operations as the Committee may from time to time determine to be reasonably necessary to the effective conduct of open market operations and the effectuation of open market policies.

[38 FR 2753, Jan. 30, 1973, as amended at 39 FR 11873, Apr. 1, 1974; 48 FR 32336, July 15, 1983]

PART 271—RULES REGARDING AVAILABILITY OF INFORMATION

Sec.

271.1 Authority.
271.2 Definitions.
271.3 Published information.
271.4 Records available to the public on request.
271.5 Deferment of availability of certain information.
271.6 Information not disclosed.
271.7 Subpoenas.

AUTHORITY: 5 U.S.C. 552.

§ 271.1 Authority.

This part is issued by the Federal Open Market Committee (the "Committee") pursuant to the requirement of section 552 of Title 5 of the United States Code that every agency shall publish in the FEDERAL REGISTER for the guidance of the public descriptions of the established places at which, the officers from whom, and the methods whereby, the public may obtain information, make submittals or requests, or obtain decisions.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973]

§ 271.2 Definitions.

(a) *"Information of the Committee".* For purposes of this part, the term "information of the Committee" means all information coming into the possession of the Committee or of any member thereof or of any officer, employee, or agent of the Committee, the Board, or any Federal Reserve bank, in the performance of duties for, or pursuant to the direction of, the Committee.

(b) *"Records of the Committee".* For purposes of this part, the term "records of the Committee" means rules, statements, opinions, orders, memoranda, letters, reports, accounts, and other papers containing information of the Committee that constitute a part of the Committee's official files.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973]

§ 271.3 Published information.

(a) *Federal Register.* To the extent required by sections 552 and 553 of Title 5 of the United States Code, and subject to the provisions of §§ 271.5 and 271.6, the Committee publishes in the FEDERAL REGISTER, in addition to this part,

(1) A description of its organization;

(2) Statements of the general course and method by which its functions are channeled and determined;

(3) Rules of procedure;

(4) Substantive rules of general applicability, and statements of general policy and interpretations of general applicability formulated and adopted by the Committee;

(5) Every amendment, revision, or repeal of the foregoing; and

(6) General notices of proposed rule making.

(b) *Policy record.* In accordance with section 10 of the Federal Reserve Act (12 U.S.C. 247a), each annual report made to Congress by the Board includes a complete record of the actions taken by the Committee during the preceding year upon all matters of policy relating to open market operations, showing the votes taken and the reasons underlying such actions.

(c) *Other published information.* From time to time, other information relating to open market operations of the Federal Reserve Banks is published in the Federal Reserve Bulletin, issued monthly by the Board, in such Board's annual report to Congress, and in announcements and statements released to the press. Copies of issues of the Bulletin and of annual reports

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of the Board may be obtained upon request.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973]

§ 271.4 Records available to the public on request.

(a) *Records available.* Records of the Committee are made available to any person, upon request, for inspection or copying in accordance with the provisions of this section and subject to the limitations stated in §§ 271.5 and 271.6. Records falling within the exemptions from disclosure set forth in section 552(b) of Title 5 of the United States Code and in § 271.6 may nevertheless be made available in accordance with this section to the fullest extent consistent, in the Committee's judgment, with the effective performance of the Committee's statutory responsibilities and with the avoidance of injury to a public or private interest intended to be protected by such exemptions.

(b) *Place and time.* In general, the records of the Committee are held in the custody of the Board, but certain of such records, or copies thereof, are held in the custody of one or more of the Federal Reserve Banks. Any such records subject to this section will be made available for inspection or copying during regular business hours at the offices of the Board in the Federal Reserve Building, 20th and Constitution Avenue, Washington, D.C. 20551, or, in certain instances as provided in paragraph (c) of this section, at the offices of one or more designated Federal Reserve Banks.

(c) *Obtaining access to records.* Any person requesting access to records of the Committee shall submit such request in writing to the Secretary of the Committee. In any case in which the records requested, or copies thereof, are available at a Federal Reserve Bank, the Secretary of the Committee may so advise the person requesting access to the records. Every request for access to records of the Committee shall state the full name and address of the person requesting them and shall describe such records in a manner reasonably sufficient to permit their identification without undue difficulty. The Secretary of the Committee shall determine within ten working days after receipt of a request for access to records of the Committee whether to comply with such request; and he shall immediately notify the requesting party of his decision, of the reasons therefor, and of the right of the requesting party to appeal to the Committee any refusal to make available the requested records of the Committee.

(d) *Appeal of denial of access to records of the Committee.* Any person who is denied access to the records of the Committee, properly requested in accordance with paragraph (c) of this section, may file, with the Secretary of the Committee, within ten days of notification of such denial, a written request for review of such denial. The Committee, or such member or members of the Committee may designate (pursuant to § 272.4(c) of its Rules of Procedure) shall make a determination with respect to any such appeal within 20 working days of its receipt, and shall immediately notify the appealing party of the decision on the appeal and of the right to seek court review of any decision which upholds, in whole or in part, the refusal of the Secretary of the Committee to make available the requested records.

(e) *Extension of time requirements in unusual circumstances.* In unusual circumstances as provided in 5 U.S.C. 552(a)(6)(b), the time limitation imposed upon the Secretary of the Committee or the Committee or its designated representative(s) in paragraphs (c) and (d) of this section may be extended by written notice to the requesting party for a period of time not to exceed a total of ten working days.

(f) *Fee schedule.* A person requesting access to or copies of particular records shall pay the costs of searching and copying such records at the rate of $10 per hour for searching and 10 cents per standard page for copying. With respect to information obtainable only by processing through a computer or other information systems program, a person requesting such information shall pay a fee not to exceed the direct and reasonable cost of retrieval and production of the information requested. Detailed schedules of such charges are available upon request from the Secretary of

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the Committee. Documents may be furnished without charge or at a reduced charge where the Secretary of the Committee or such person as he may designate determines that waiver or reduction of the fee is in the public interest because furnishing the information can be considered as primarily benefiting the general public, or where total charges are less than $2.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973; 40 FR 7897, Feb. 24, 1975]

§ 271.5 Deferment of availability of certain information.

(a) *Deferred availability of information.* In some instances, certain types of information of the Committee are not published in the FEDERAL REGISTER or made available for public inspection or copying until after such period of time as the Committee may determine to be reasonably necessary to avoid the effects described in paragraph (b) of this section or as may otherwise be necessary to prevent impairment of the effective discharge of the Committee's statutory responsibilities.

(b) *Reasons for deferment of availability.* Publication of, or access to, certain information of the Committee may be deferred because earlier disclosure of such information would:

(1) Interfere with the orderly execution of policies adopted by the Committee in the performance of its statutory functions;

(2) Permit speculators and others to gain unfair profits or to obtain unfair advantages by speculative trading in securities, foreign exchange, or otherwise;

(3) Result in unnecessary or unwarranted disturbances in the securities market;

(4) Make open market operations more costly;

(5) Interfere with the orderly execution of the objectives or policies of other Government agencies concerned with domestic or foreign economic or fiscal matters; or

(6) Interfere with, or impair the effectiveness of, financial transactions with foreign banks, bankers, or countries that may influence the flow of gold and of dollar balances to or from foreign countries.

[32 FR 9518, July 1, 1967, as amended at 40 FR 13204, Mar. 25, 1975; 41 FR 22261, June 2, 1976]

§ 271.6 Information not disclosed.

Except as may be authorized by the Committee, information of the Committee that is not available to the public through other sources will not be published or made available for inspection, examination, or copying by any person if such information:

(a) Is specifically exempted from disclosure by statute (other than section 552b of Title 5, United States Code), provided that such statute (1) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (2) establishes particular criteria for withholding or refers to particular types of matters to be withheld; or is specifically authorized under criteria established by an executive order to be kept secret in the interests of national defense or foreign policy and is in fact properly classified pursuant to such executive order;

(b) Relates solely to internal personnel rules or practices or other internal practices of the Committee;

(c) Relates to trade secrets or commercial or financial information obtained from any person and privileged or confidential;

(d) Is contained in interagency or intraagency memoranda or letters, including records of deliberations and discussions at meetings of the Committee and reports and documents filed by members or staff of the Committee that would not be routinely available to a private party in litigation with the Committee;

(e) Is contained in personnel, medical, or similar files (including financial files) the disclosure of which would constitute a clearly unwarranted invasion of personal privacy; or

(f) Is contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of any agency responsible for the regulation or supervision of financial institutions.

Except as provided by or pursuant to this part, no person shall disclose, or permit the disclosure of, any informa-

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tion of the Committee to any person, whether by giving out or furnishing such information or copy thereof, by allowing any person to inspect, examine, or reproduce such information or copy thereof, or by any other means, whether the information is located at the offices of the Board, any Federal Reserve bank, or elsewhere, unless such disclosure is required in the performance of duties for, or pursuant to the direction of, the Committee.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973; 42 FR 13299, Mar. 10, 1977]

§ 271.7 Subpoenas.

(a) *Advice by person served.* If any person, whether or not an officer or employee of the Committee, of the Board of Governors of the Federal Reserve System, or of a Federal Reserve Bank, has information of the Committee that may not be disclosed by reason of § 271.5 or § 271.6 and in connection therewith is served with a subpoena, order, or other process requiring his personal attendance as a witness or the production of documents or information upon any proceeding, he should promptly inform the Secretary of the Committee of such service and of all relevant facts, including the documents and information requested and any facts that may be of assistance in determining whether such documents or information should be made available; and he should take action at the appropriate time to inform the court or tribunal that issued the process, and the attorney for the party at whose instance the process was issued, if known, of the substance of this part.

(b) *Appearance by person served.* Except as disclosure of the relevant information is authorized pursuant to this part, any person who has information of the Committee and is required to respond to a subpoena or other legal process shall attend at the time and place therein mentioned and decline to disclose such information or give any testimony with respect thereto, basing his refusal upon this part. If, notwithstanding, the court or other body orders the disclosure of such information, or the giving of such testimony, the person having such information of the Committee shall continue to decline to disclose such information and shall promptly report the facts to the Committee for such action as the Committee may deem appropriate.

[32 FR 9518, July 1, 1967, as amended at 38 FR 2754, Jan. 30, 1973]

PART 272—RULES OF PROCEDURE

Sec.
272.1 Authority.
272.2 Functions of the Committee.
272.3 Meetings.
272.4 Committee actions.
272.5 Notice and public procedure.

AUTHORITY: 5 U.S.C. 552.

SOURCE: 38 FR 2754, Jan. 30, 1973, unless otherwise noted.

§ 272.1 Authority.

This part is issued by the Federal Open Market Committee (the Committee) pursuant to the requirement of section 552 of title 5 of the United States Code that every agency shall publish in the FEDERAL REGISTER its rules of procedure.

§ 272.2 Functions of the Committee.

The procedures followed by the Committee are designed to facilitate the effective performance of the Committee's statutory functions with respect to the regulation and direction of open market operations conducted by the Federal Reserve banks and with respect to certain direct transactions between the Reserve banks and the United States. In determining the policies to be followed in such operations, the Committee considers information regarding business and credit conditions and domestic and international economic and financial developments, and other pertinent information gathered and submitted by its staff and the staffs of the Board of Governors of the Federal Reserve System (the Board) and the Federal Reserve banks. Against the background of such information, the Committee takes actions from time-to-time to regulate and direct the open market operations of the Reserve banks. Such policy actions ordinarily are taken through the adoption and transmission to the Federal Reserve banks of

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regulations, authorizations, and directives.

§ 272.3 Meetings.

(a) *Place and frequency.* The Committee meets in Washington, D.C., at least four times each year and oftener if deemed necessary. Meetings are held upon the call of the Chairman of the Board or at the request of any three members of the Committee. Notices of calls by the Chairman of the Board to other members are given by the Secretary of the Committee in writing or by telegram. Requests of any three members for the calling of a meeting shall state the time therefor and shall be filed in writing or by telegram with the Secretary who shall forthwith notify all members of the Committee in writing or by telegram. When the Secretary has sent notices to all members of the Committee that a meeting has been requested by three members and of the time therefor, a meeting is deemed to have been called. If, in the judgment of the Chairman, circumstances require that a meeting be called at such short notice that one or more members cannot be present in Washington, such members may participate in the meeting by telephone conference arrangements.

(b) *Alternates.* Whenever any member of the Committee representing Federal Reserve banks shall find that he will be unable to attend a meeting of the Committee, he shall promptly notify his alternate and the Secretary of the Committee in writing or by telegram, and upon receipt of such notice the alternate shall advise the Secretary whether he will attend such meeting.

(c) *Quorum.* Seven members (including alternates present and acting in the absence of members) constitute a quorum for the transaction of business; but less than a quorum may adjourn from time to time until a quorum is in attendance.

(d) *Attendance at meetings.* Attendance at Committee meetings is restricted to members and alternate members of the Committee, the Presidents of Federal Reserve Banks who are not at the time members or alternates, staff officers of the Committee, the Managers, and such other advisers as the Committee may invite from time to time.

(e) *Meeting agendas.* The Secretary, in consultation with the Chairman, prepares an agenda of matters to be discussed at each meeting and the Secretary transmits the agenda to the members of the Committee within a reasonable time in advance of such meeting. In general, the agendas include approval of minutes of actions; reports by the Managers on open market operations since the previous meeting, and ratification by the Committee of such operations; reports by Economists on, and Committee discussion of, the economic and financial situation and outlook; Committee discussion of monetary policy and action with respect thereto; and such other matters as may be considered necessary.

[38 FR 2754, Jan. 30, 1973, as amended at 44 FR 52823, Sept. 11, 1979]

§ 272.4 Committee actions.

(a) *Actions at meetings.* Actions are taken at meetings of the Committee except as described below.

(b) *Actions between meetings.* Special circumstances may make it desirable in the public interest for Committee members to consider an action to modify an outstanding Committee authorization or directive at a time when it is not feasible to call a meeting. Whenever, in the judgment of the Chairman, such circumstances have arisen, the relevant information and recommendations for action are transmitted to the members by the Secretary, and the members communicate their votes to the Secretary. If the action is approved by a majority of the members, advice to that effect is promptly given by the Secretary to the members of the Committee and to the Reserve bank selected to execute transactions for the System Open Market Account. All communications of recommended actions and votes under this paragraph shall be in writing or by telegram; provided that, in exceptional cases when that is not feasible, such communications may be made orally, either in person or by telephone, and the Secretary shall cause a written record to be made

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without delay. An action taken between meetings has the force and effect of an action at a meeting: *Provided, however,* That if a meeting is held before the execution of any operations pursuant to the action, the action is null and void unless it is ratified and confirmed by the Committee at such meeting.

(c) *Delegations of authority.* In special circumstances, the Committee may delegate authority to take an action, subject to such instructions or guidelines as the Committee deems proper. Such delegations of authority may be made to the Chairman; to a subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board (or in the absence of the Chairman or of the Vice Chairman of the Board the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate); or to any other member or members of the Committee. An action taken pursuant to such a delegation of authority has the force and effect of an action taken by the Committee.

(d) *Effective date.* Committee action ordinarily is made effective as of the time it is taken because the nature of the subject matter and the action taken is such that the public interest and the proper discharge of the Committee's responsibilities so require. Occasionally, however, the Committee may specify that an action is to be effective at some different time.

§ 272.5 Notice and public procedure.

There ordinarily is no published notice of proposed action by the Committee or public procedure thereon, as described in section 553 of title 5 of the United States Code, because such notice and procedure are impracticable, unnecessary, or contrary to the public interest.

PART 281—STATEMENTS OF POLICY

Sec.
281.1 Purchase of Treasury bills.
281.2 Policy regarding the Government in the Sunshine Act.

§ 281.1 Purchase of Treasury bills.

The Federal Open Market Committee of the Federal Reserve System has directed the Federal Reserve Banks to terminate the policy of buying all Treasury bills offered to them at a fixed rate of ⅜ per cent per annum and to terminate the repurchase option privilege on Treasury bills. The new policy will apply to bills issued on or after July 10, 1947. Existing policy will continue to apply to bills issued prior to that date.

(Sec. 12A, 48 Stat. 168, as amended; 12 U.S.C. 263)

[12 FR 4543, July 10, 1947]

§ 281.2 Policy regarding the Government in the Sunshine Act.

On September 13, 1976, there was enacted into law the Government in the Sunshine Act, Pub. L. No. 94–409, 90 Stat. 1241 ("Sunshine Act"), established for the purpose of providing the public with the "fullest practicable information regarding the decision-making processes of the Federal Government * * * while protecting the rights of individuals and the ability of the Government to carry out its responsibilities."[1] The Sunshine Act applies only to those Federal agencies that are defined in section 552(e) of Title 5 of the United States Code and "headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate, and any subdivision thereof authorized to act on behalf of the agency."[2]

The Federal Open Market Committee ("FOMC") is a separate and independent statutory body within the Federal Reserve System. In no respect is it an agent or "subdivision" of the Board of Governors of the Federal Reserve System ("Board of Governors"). It was originally established by the Banking Act of 1933 and restructured in its present form by the Banking Act of 1935 and subsequent legislation in 1942 (generally see 12 U.S.C. 263(a)). The FOMC's membership is composed of the seven members of the Board of Governors and five representatives of the Federal Reserve Banks who are selected annually in accordance with the procedures set forth in Section 12A of the Federal Reserve Act, 12 U.S.C. 263(a). Members of the Board of Governors serve in an ex officio capacity on the FOMC by

[1] Government in the Sunshine Act, Pub. L. 94-409, sec. 2, 90 Stat. 1241 (1976).

[2] Government in the Sunshine Act, Pub. L. 94–409, sec. 3(a), 90 Stat. 1241 (1976).

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reason of their appointment as Members of the Board of Governors, not as a result of an appointment "to such position" (the FOMC) by the President. Representatives of the Reserve Banks serve on the FOMC not as a result of an appointment "to such position" by the President, but rather by virtue of their positions with the Reserve Banks and their selection pursuant to Section 12A of the Federal Reserve Act. It is clear therefore that the FOMC does not fall within the scope of an "agency" or "subdivision" as defined in the Sunshine Act and consequently is not subject to the provisions of that Act.

As explained below, the Act would not require the FOMC to hold its meetings in open session even if the FOMC were covered by the Act. However, despite the conclusion reached that the Sunshine Act does not apply to the FOMC, the FOMC has determined that its procedures and timing of public disclosure already are conducted in accordance with the spirit of the Sunshine Act, as that Act would apply to deliberations of the nature engaged in by the FOMC.

In the foregoing regard, the FOMC has noted that while the Act calls generally for open meetings of multi-member Federal agencies, 10 specific exemptions from the open meeting requirement are provided to assure the ability of the Government to carry out its responsibilities. Among the exemptions provided is that which authorizes any agency operating under the Act to conduct closed meetings where the subject of a meeting involves information "the premature disclosure of which would—in the case of an agency which regulates currencies, securities, commodities, or financial institutions, be likely to lead to significant financial speculation in currencies, securities, or commodities."[1]

As to meetings closed under such exemption, the Act requires the maintenance of either a transcript, electronic recording or minutes and sets forth specified, detailed requirements as to the contents and timing of disclosure of certain portions or all of such minutes. The Act permits the withholding from the public of the minutes where disclosure would be likely to produce adverse consequences of the nature described in the relevant exemptions.

The FOMC has reviewed the agenda of its monthly meetings for the past three years and has determined that all such meetings could have been closed pursuant to the exemption dealing with finanical speculation or other exemptions set forth in the Sunshine Act. The FOMC has further determined that virtually all of its substantive deliberations could have been preserved pursuant to the Act's minutes requirements and that such minutes could similarly have been protected against premature disclosure under the provisions of the Act.

The FOMC's deliberations are currently reported by means of a document entitled "Record of Policy Actions" which is released to the public approximately one month after the meeting to which it relates. The Record of Policy Actions complies with the Act's minutes requirements in that it contains a full and accurate report of all matters of policy discussed and views presented, clearly sets forth all policy actions taken by the FOMC and the reasons therefor, and includes the votes by individual members on each policy action. The timing of release of the Record of Policy Actions is fully consistent with the Act's provisions assuring against premature release of any item of discussion in an agency's minutes that contains information of a sensitive financial nature. In fact, by releasing the comprehensive Record of Policy Actions to the public approximately a month after each meeting, the FOMC exceeds the publication requirements that would be mandated by the letter of the Sunshine Act.

Recognizing the Congressional purpose underlying the enactment of the Sunshine Act, the FOMC has determined to continue its current practice and timing of public disclosures in the conviction that its operations thus conducted are consistent with the intent and spirit of the Sunshine Act.

(Pub. L. 94-409, 90 Stat. 1241-1242)
[42 FR 13300, Mar. 10, 1977]

[1]Government in the Sunshine Act, Pub. L. 94-409, sec. 3(a), 90 Stat. 1242 (1976).

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FEDERAL RESERVE press release

For use in AMs of Thursday
September 30, 1993

September 29, 1993

The Federal Reserve Board today announced the appointment of Chairmen and Deputy Chairmen of the 12 Federal Reserve Banks for 1994.

Each Reserve Bank has a Board of Directors of nine members. The Board of Governors in Washington appoints three of these directors and designates one of its appointees as Chairman and a second as Deputy Chairman.

Following are the names of the Chairmen and Deputy Chairmen appointed by the Board for next year:

Boston -- Jerome H. Grossman, Chairman of the Board and Chief Executive Officer, New England Medical Center, Inc., Boston, renamed Chairman.

Warren B. Rudman, Esq., Sheehan, Phinney, Bass, and Green, Manchester, N.H., renamed Deputy Chairman.

New York -- Maurice R. Greenberg, Chairman and Chief Executive Officer, American International Group, Inc., New York City, Chairman.

A Deputy Chairman will be selected later.

Philadelphia -- James M. Mead, President, Capital Blue Cross, Harrisburg, Pa., Chairman.

Donald J. Kennedy, Business Manager, International Brotherhood of Electrical Workers, Local Union No. 269, Trenton, N.J.. Deputy Chairman.

Cleveland -- A. William Reynolds, Chairman and Chief Executive Officer, GenCorp, Fairlawn, Ohio, renamed Chairman.

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G. Watts Humphrey, Jr., President, GWH Holdings, Inc., Pittsburgh, Pa., renamed Deputy Chairman.

Richmond -- Henry J. Faison, President, Faison Associates, Charlotte, N.C., Chairman.

Claudine B. Malone, President, Financial and Management Consulting, McLean, Va., Deputy Chairman.

Atlanta -- Leo Benatar, Chairman of the Board and President, Engraph, Inc., Atlanta, Ga., Chairman.

Hugh M. Brown, President and Chief Executive Officer, BAMSI, Inc., Titusville, Fla., Deputy Chairman.

Chicago -- Richard G. Cline, Chairman, President and Chief Executive Officer, NICOR, Inc., Naperville, Ill., renamed Chairman.

Robert M. Healey, President, Chicago Federation of Labor and Industrial Union Council, AFL-CIO, Chicago, Ill., renamed Deputy Chairman.

St. Louis -- Robert H. Quenon, Mining Consultant, St. Louis, Mo., renamed Chairman.

John F. McDonnell, Chairman and Chief Executive Officer, McDonnell Douglas Corp., St. Louis, Mo., Deputy Chairman.

Minneapolis -- Gerald A. Rauenhorst, Chairman of the Board and Chief Executive Officer, Opus Corp., Minneapolis, Minn., Chairman.

Jean D. Kinsey, Professor, Consumption and Consumer Economics, Department of Agricultural and Applied Economics, University of Minnesota, St. Paul, Minn., Deputy Chairman.

Kansas City -- Burton A. Dole, Jr., Chairman of the Board and President, Puritan-Bennett Corp., Overland Park, Kan., renamed Chairman.

Herman Cain, President and Chief Executive Officer, Godfather's Pizza, Inc., Omaha, Neb., renamed Deputy Chairman.

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Dallas — Cece Smith, General Partner, Phillips-Smith Specialty Retail Group, Dallas, Tex., Chairman.

Roger R. Hemminghaus, Chairman, President and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Tex., Deputy Chairman.

San Francisco -- James A. Vohs, Chairman and Chief Executive Officer (Retired), Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, Cal., renamed Chairman.

Judith M. Runstad, Co. Managing Partner, Foster Pepper and Shefelman, Seattle, Wash., renamed Deputy Chairman.

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DEPUTY CHAIRMAN, NEW YORK

DAVID HAMBURG
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