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H.R. 28: THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

United States.

HEARING

BEFORE THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

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H.R. 28; FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

TUESDAY, OCTOBER 19, 1993

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

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the committee] presiding.

Present: Chairman Gonzalez, Representatives Neal, LaFalce, Roybal-Allard, Hinchey, Fingerhut, Leach, McCollum, Roukema, Ridge, Roth, McCandless, Nussle, Johnson, Pryce, Knollenberg, Lazio, and Huffington.

The CHAIRMAN. The committee will please come to order.

Today, the Banking Committee begins the third day of hearings on issues involved in the Federal Reserve System Accountability Act of 1993, otherwise known as H.R. 28. I certainly welcome and want to thank the Federal Reserve Chairman of the Board of Governors, Mr. Greenspan, the Federal Reserve Governors, and the presidents of the Federal Reserve Banks.

Chairman Greenspan testified at our last hearing last week that everything proposed in our H.R. 28 was a, quote, major mistake, end of quote. Today, we will hear additional testimony to see if our proposals are needed reforms or major mistakes.

H.R. 28 requires that the Federal Open Market Committee: One, announce changes in its policy 1 week after its meetings and that it; two, make public a complete record of those meetings 60 days after each meeting.

The central issue of today's hearing is simple: Why is the Federal Reserve, among all Federal agencies, exempt from keeping complete and accurate records? If the White House, the Supreme Court, the Defense Department, and every other government agency keep accurate records of what they are doing, why not the Federal Reserve? Are decisions by these parts of our government less sensitive than those made at the Federal Reserve?

You distinguished gentlemen who serve as Federal Reserve presidents did not have to present your credentials and your views to the American public to secure your seats on the FOMC. President Jordan has previously gone through the confirmation process for his seat on the Reagan Council of Economic Advisors. I hope today's hearing will allow the citizens of our country to learn a little bit more about you and how independent your views really are.

I would like each of you to tell me if you think the following information is of sufficient national importance to require recording and publication of minutes of your FOMC meetings.

Last week at these hearings I cited FOMC minutes of two meetings prior to the reelection of President Richard Nixon. Those minutes were released 5 years after the FOMC meetings. Although he was warned that projections were for fast growth, Federal Reserve Chairman Arthur Burns had called for even faster money growth at these meetings. Why shouldn't the historical record reflect the truth that Burns was pursuing an inflationary policy?

The importance of accurate minutes is reflected in the records of a Philadelphia Federal Reserve Bank's board of directors meeting. The minutes reveal a possible coverup by the Federal Reserve related to the Watergate burglary in 1972. Recall the Watergate scandal that began with the break-in of the Democratic National Committee offices in the Watergate office building on June 17, 1972. A dangerous political crisis rocked our country while Congress sought to uncover the facts.

As a matter of fact, this committee had original and first and primary responsibility in June 1972. I recall it vividly, as if it were today. And the committee chairman, the Honorable Wright Patman, was frustrated because we had to have subpoenas, and we had a solid block of the minority resisting, and all they had to do was pick up three of our fellow Democrats, which they did, and we were frustrated in that effort.

Judge Sirica was very much involved in that. What would have happened if this committee had not been frustrated and we had from the very beginning unraveled—I think even President Nixon would have ended up better off. A dangerous political crisis did develop, though, and I think we know the consequences today.

I read now from page 77 of the June 22, 1972, minutes of the Philadelphia Bank's board of directors meeting, and I am quoting:

"Mr. X reported that $6,300 in $100 bills had been found on the persons arrested for breaking into the Democratic National Committee headquarters in Washington. The FBI came to this Bank and said that 10 new 3–C notes, that is, $100 bills, numbered in sequence were among those found. This Bank informed the FBI that they were part of a shipment sent to the Girard Bank on April 3. Mr. X also said that the *Washington Post* had called to verify a rumor that these bills were stolen from this Bank. The *Post* was informed of the CV&D thefts but was told they involved old bills that were ready for destruction.

"Mr. X said that Chairman Burns doesn't want the System to get involved and issued a directive to all Reserve banks on June 21 which said, in effect, that the System was cooperating with law enforcement agencies but should not disclose any information to others."

Three days earlier, Chairman Burns had written the following to the Joint Economic Committee about rumors regarding the sources of funds used to finance the Watergate burglars: "We at the Board have no knowledge of the Federal Reserve Bank which issued those particular notes or of the commercial bank to which they were transferred. Without this information, there is nothing that we can do to comply with your request."

The apparent lie to the *Washington Post* reporter as a result of the directives issues by the Chairman of the Federal Reserve may have been part of a coverup of important information by the Federal Reserve. Did the Federal Reserve ever inform the U.S. Congress about these bills it had traced that were found on the Watergate burglars? If the answer is no, it appears that the Federal Reserve blocked the public and the Congress from a significant part of the investigation of the financing of the Watergate burglars.

The Acting Director of the FBI, who may have been given the information, testified that he burned some Watergate files. The Nixon administration asked him to limit the FBI's investigation of the burglars' financing on the grounds that further inquiry would "uncover CIA assets and sources." Gosh, that sounds familiar. What was the Federal Reserve's role in this coverup? Did the Federal Reserve deliberately obstruct the Congress and the public?

If we only had a formal directive giving the extremely truncated version of these meetings, as the FOMC publishes today, there would not be a historical record of these events. The American public and the Congress are not the barbarians at your gates. These are the people whom you are supposed to be serving.

Our expert witnesses testifying today will tell you that, contrary to what Chairman Greenspan testified about at our last hearing, accurate information does not undermine markets. Partial information and leaked information undermines market efficiency.

I want to highlight the astounding claim in Dr. Anna Schwartz' testimony, and I quote: "The *Wall Street Journal* has reported the contents of the directive within a week of each of 11 out of 34 FOMC meetings that were held between March, 1989, and May, 1993." Since substantial information is already coming out in leaked form, why should we pretend that it is a closely guarded secret? We need a straightforward record with complete and accurate information.

Some claim we have all the information necessary in the formal directive that is issued 5 or 6 weeks after each FOMC meeting. That directive is sometimes called "minutes." However, the FOMC directive is far from a complete record, and it is equivalent to the kind of information we would get if the Supreme Court only announced its decisions and not its opinions. Although the directive does contain the FOMC vote, those who understand the Federal Reserve know the objective in any FOMC meeting is to get a unanimous final vote regardless of any underlying disagreement.

Publishing only the final vote at FOMC meetings is little more information than could be obtained from the Congress if we issued only the vote on adjournment and none of the discussion. In order to obtain a record that establishes individual accountability, there must be a more detailed record. Most of the so-called minutes the Federal Reserve now issues are boilerplate reports on the economy that anyone could copy out of government and newspaper reports.

In 1976, the FOMC members arbitrarily announced that they had stopped taking minutes of their meetings. In response to his inquiries, Congressman Steve Neal, our ranking majority Member, investigated and reported that among the 55 individuals who opposed the FOMC's decision to stop taking minutes were 4 former

Federal Reserve Governors and 2 former presidents of Federal Reserve Banks.

One of the strongest letters was from Jerry L. Jordan, formerly an official at the Federal Reserve Bank of St. Louis, here today as president of the Federal Reserve Bank of Cleveland. His letter of October 21, 1976, said, and I quote from him: "As an economist in the Federal Reserve for over 8 years, I found the memoranda of discussion"—that is the name of the minutes—"to be extremely useful. Even when I attended FOMC meetings I always reviewed the memoranda of previous meetings as part of the preparation for the next meeting."

The President of the St. Louis Federal Reserve Bank was definitely influenced in a very positive way by the existence of a permanent record that would eventually be made public. It helped him and his staff to maintain intellectual honesty, sometimes in the face of great pressure to bend. He knew that even when his views fell on deaf ears in a meeting, consistent analysis of the problem and the recommendation of solutions would be in the record to be viewed with historical perspective.

I want to know why minutes which were clearly helpful up until 1976 suddenly became harmful after 1976. I think it is a reasonable question.

I understand the peculiar position of the distinguished presidents of the Federal Reserve Banks who are testifying today. I understand that, and I am extremely grateful for your presence. I think that goodwill—and, obviously, certainly there is no political advantage—should reflect the seriousness of the intent and motivation and a clear attempt to discharge a prime responsibility that lays upon us who want to be and claim to be representatives of the people in that area that most affects their livelihoods.

I had thought that last week Chairman Greenspan would have emphasized that you serve as independent coequals on the FOMC. However, he contends that the ultimate defense against a bank president is the power by the Board of Governors to remove that person from office. I think this says a great deal about your independence. Nevertheless, be that as it may, I hope our distinguished witnesses will give their honest views today, as I am sure they will, and that they will be perfectly frank while their comments are being recorded. And I certainly look forward to your testimony.

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

The CHAIRMAN. With that, I recognize Mr. Leach.

Mr. LEACH. I thank the distinguished chairman.

Today we hear from 10 presidents of the district banks and 5 Governors of the Federal Reserve Board. Given that these individuals influence the allocation and expansion of credit through the regulation of the banking industry, it is important to note in the context of a hearing on reforming the Federal Reserve System that the American public is served by individuals represented here of distinctive quality and integrity. We welcome them in a spirit of appreciation and trust.

And I personally would like to say, Mr. Chairman, I appreciate your sense of history that you just expounded. It should be clear in the record that Watergate didn't tar the reputation of any of the individuals that we have before us, and that everybody is here voluntarily without any hint of misdoing or misdeeds. In fact, given the brain trust we have before us, it makes me think it would be very appropriate perhaps at some other time to invite all or part of this group before the committee again. Given the regional economic perspective that is here, it might be very helpful to the Congress itself.

At the first two hearings, this committee gave deserved attention to the fact that particular presidents are assigned public responsibility on boards comprised of individuals not only from the private sector but one element of it. In defense of this selection methodology, the Federal Reserve System can properly point to a tradition of independence, quality, and political insulation. Nevertheless, there is an element of unseemliness inherent in a system in which sectors of the public view their interest as distinct from the banking sector and in particular when individuals are asked to regulate the industry while being accountable to boards of directors controlled by members of that industry.

While I have a high regard for the current leadership of the Fed and the direction it is currently moving on the regulatory front, it is useful to point out three areas where the Federal Reserve System in the past has instituted discriminatory regulatory policies.

First, in the late 1970's, early 1980's, the Fed went along in believing that sovereign guarantees were ironclad because governments never go broke and imposed lesser regulation on LDC debt. Second, the Fed has continued to assume that large banks need less capital than smaller banks. Third, it has not required bad loans of large banks to be written off to the same extent required of small banks.

My view is that discriminatory regulation skews the financial landscape and amounts to credit allocation. The irony in regulation being too accommodating, if not cozy, with individual banks is that management becomes misserved. For instance, New York money center banks for decades have been on the cutting edge of wanting to see liberalization of the Douglas amendment and McFadden Act so they could branch interstate. When interstate barriers started to fall, without congressional modification of these laws, many of these banks were in no position to take advantage of it because their capital had been so dramatically depleted. This was due, in part, to lending mistakes which were in effect sanctioned by regulators. If regulators, on a timely basis, had insisted on stronger capital ratios for international lending, domestic as well as foreign, these institutions would be larger and stronger today.

It is instructive to note that Federal regulators, albeit a bit late, forced the Bank of America to restructure and recapitalize approximately 5 years before they served comparable notice on the east coast. Bank of America later credited regulator sternness with its turnaround and the ability to launch an expansionary drive.

One of the lessons of the S&L debacle is that capital moves toward industries which have the weakest regulation.

The problem of regulator-driven deposit skewing was most evident in the 1980's in the thrift industry when institutions were allowed to leverage minimal and in some cases nonexistent capital bases. It is a not inconsequential problem today. The more attention given to risk weighting assets, the less reliance Federal bank regulators are putting on the leverage ratio. Overreliance on risk-based capital standards without use of an adequate ratio leads to competitive inequities in deposit seeking and de facto credit allocation of those deposits. The fact that State bank regulators rely more on leverage ratios means that deposits will flow to national banks rather than State banks, to money center institutions rather than community banks, to bond buying instead of entrepreneurial lending.

Regulatory agencies have a vested interest in the competitive vitality of the institutions they regulate. Hence, if the Fed wants to keep, which I support, a major regulatory function, it must be careful to ensure that conflicts, perceived or otherwise, do not exist, that regional inequities are not allowed to develop, and advantages are not provided one kind of institution over another.

As mentioned earlier, one of the lessons of the S&L crisis was that disparity in regulations skews capital flows. Another was the conclusion by Congress that it had been a mistake to allow the 12 district banks in the Federal Home Loan Bank System, with boards comprised of representatives from regulated institutions, a principal role in the regulatory process. As part of the cleanup, Congress abolished the regulatory function of the Federal Home Loan Bank System and transferred them to an office which has its director publicly appointed.

As we consider regulatory consolidation, there is a case for and against providing continuation of regulatory responsibility for the Federal Reserve System. But if it is to be preserved—and I would stress again I support that prospect—an institutional arrangement must be established which gives no hint of self-regulation, of the fox guarding the foxes. In a country in which process is our most important product, it simply is unacceptable for regulators to be accountable to boards which, in turn, are controlled by the regulated.

I look forward today to the testimony of the witnesses.

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

The CHAIRMAN. The Chair will recognize Mr. Neal. He is our ranking Member on the majority side and also chairman of the fundamental Subcommittee on Financial Institutions. Thank you.

Mr. NEAL. Thank you, sir, very much.

I would like to say briefly, first of all, it is entirely appropriate for the Banking Committee to hold hearings looking into any and every area of its jurisdiction. It is entirely appropriate for us to continue to examine the underpinnings of our system, every aspect of the underpinnings of our system, to constantly try to find ways to do better what it is we try to do.

So I certainly have no objection to our examining the Fed's regulatory structure, the open market operations, every aspect of it. In fact, I think it is very healthy. I think that certainly nothing should be set in stone forever, and that it is very healthy to continue to look at the way we do things.

Having said that, I must say it is also a little strange to me that we are devoting a lot of time to the Fed, especially the Fed's open market operations, at this time because it seems to me that those operations have been very successful, and there has not been a hint of scandal ever.

The Fed's—the most important role, of course, is controlling inflation in the Open Market Committee, which has that responsibility, has done that job very well over recent years, in fact, extraordinarily well under the most difficult circumstances. And every citizen of this country really should be thankful to this group for the current situation. I am talking especially about the fact that young couples now can borrow at the lowest mortgage rates in memory, that banks are lowering the prime rates to the lowest rates in many years, that really the whole banking structure has been strengthened, in fact, saved, by low inflation, low interest rates. The stock market is strong because of low inflation, low interest rates.

So the healthiest aspect of our economy is directly attributable to the fact that this institution has worked well, that it has done its job very, very well. Every American, most importantly the working people of America, the people who must borrow, not the rich people who can handle their finances under all circumstances but the average guy out trying to make it from paycheck to paycheck, is the main beneficiary of this policy that has lowered interest rates and lowered inflation.

So I do find it a little strange that we are examining the Fed. But, in any case, it is an important subject, and if there is any problem, we ought to uncover it and deal with it.

Just one more point I would like to make. I hope you all, in your testimony this morning, will try to relate the policies that we are examining, the idea of revealing minutes and auditing the Open Market Committee and the other suggestions that are contained in this legislation and in other legislation to your policy.

Somehow, so far, it seems these hearings have considered process divorced from policy. And, frankly, if we were to look at sort of a good government model and that were all we were looking at, we might say, yes, it would be nice to know every word that was spoken and know it that day and maybe show it on the evening news and so on, audit the Open Market Committee and so on. But the fact is that those considerations are not divorced from policy. And the only reason we want an independent Fed is so the Fed can work for the long-term benefit of this country, even in light of the short-term political pressures that would be there were there not the independence.

So I think that point hasn't quite been made when we have talked about how it would be a good idea for every comment made by every person when discussing monetary policy to be made public. It is not a good idea because we want be free, open discussion devoid of political pressure. Because that can help lead to a policy that is best for our people.

When we talk about auditing the Open Market Committee, the reason we don't want to audit the Open Market Committee is we don't want to second-guess and impose a short-term political pressure on the committee that is trying to take a long-term view in the interest of our people.

So, anyway, Mr. Chairman, I appreciate the opportunity to say a few words. I am glad you are holding the hearing. I hope we will just introduce the policy consideration here as it affects these policies that these so-called reforms are talking about. I think it will become clearer why we wouldn't want to pass this bill.

I thank the distinguished chairman.

The CHAIRMAN. I ask unanimous consent that all members have an opportunity to place in the record in writing any preliminary statement they wish to have appear in the transcript of the proceedings. And being that we have such numerous witnesses, we will try to hurry on expeditiously.

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

We will recognize Chairman Greenspan, of course, first. The Chairman has asked for at least 15 minutes.

We will be prepared to place in the record all of the written testimony that has been submitted to us by the diverse presidents and directors and then ask that your oral presentation be as brief as possible following Chairman Greenspan.

Mr. Chairman.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE BOARD AND THE FEDERAL OPEN MARKET COMMITTEE; ACCOMPANIED BY DAVID W. MULLINS, JR., GOVERNOR, FEDERAL RESERVE BOARD; WILLIAM J. McDONOUGH, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK; AND ROBERT T. PARRY, PRESIDENT, FEDERAL RESERVE BANK OF SAN FRANCISCO

Mr. GREENSPAN. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before this committee and to provide my particular views on the appropriate degree of disclosure by the Federal Open Market Committee.

In a democratic society, public policy decisions——

The CHAIRMAN. Will you please yield to me for a moment?

Gentlemen, I hate to bother you, but Congressman Johnson has reported that his view is obstructed. Is there any possible way you can take a shot without obstructing his view?

Congressman, why don't you sit up here?

Thank you, sir. Thank you, Mr. Chairman.

Mr. GREENSPAN. Just to repeat, Mr. Chairman, it is important that we recognize that in a democratic society public policy decisions should be in the open, except where exposure impedes the primary function assigned to an institution by law. Accordingly, the Federal Reserve makes its decisions public immediately, except when doing so could undercut the efficacy of policy or compromise the integrity of the policy process.

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

These minutes, a copy of which for the meeting of February 1993, I have attached to the statement, can run from 15 to more than 30 pages, presenting a comprehensive record of the economic factors and analysis and alternative policy approaches considered in reaching our decisions.

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

It is often the case that the FOMC expresses a predisposition toward a policy change in its directive to the Open Market Desk. Such a predisposition, for example, toward easing, implies that the FOMC is more concerned about developments that would dictate an easing of policy rather than a tightening, and therefore wants to respond relatively promptly to information suggesting the need for such action.

We often express this predisposition without any change in instrument settings in fact resulting. In such circumstances, the release of those directives during the period they are in force would only add to fluctuations in financial markets, moving rates when no immediate change was intended.

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

Holding open meetings of the FOMC or releasing a videotape, audio tape, or transcript of them would so seriously constrain the process of formulating policy as to render those meetings nearly unproductive.

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

Moreover, to avoid creating unnecessary volatility in financial and foreign exchange markets, the FOMC might have to forego explorations of the full range of policy options. Even a lag in releasing a verbatim record of the meetings would not eliminate this problem but only attenuate it.

Mr. Chairman, let me take a moment to describe more fully the process followed at FOMC meetings to reach decisions on monetary policy. After staff presentations of recent developments and emerging economic trends, a roundtable discussion of all 19 participants begins. The Reserve bank presidents describe conditions and developments within their districts, and both they and the members of the Board of Governors go on to evaluate the outlook for the U.S. economy as a whole.

All members bring in, where relevant, international economic and financial considerations. In light of this discussion, we then consider whether the stance of monetary policy needs to be adjusted, either immediately, or possibly in the future under particular circumstances.

A considerable amount of free discussion and probing questioning by the participants of each other and of key FOMC staff members takes place. In the wide-ranging debate, new ideas are often tested, many of which are rejected. Ideas initiated by one participant are frequently built upon by others.

The prevailing views of many participants change as evidence and insights emerge. This process has proven to be a very effective procedure for gaining a consensus around which a directive to the Open Market Desk can be crafted. It could not function effectively if participants had to be concerned that their half-thought-through, but nonetheless potentially valuable, notions would soon be made public.

I fear in such a situation the public record would be a sterile set of bland pronouncements scarcely capturing the necessary debates which are required of monetary policymaking. A tendency would arise for one-on-one premeeting discussions, with public meetings merely announcing already agreed-upon positions or for each participant to enter the meeting with a final position not subject to the views of others. Such a record would be far less informative than the minutes we currently publish.

In both the Freedom of Information Act and the Government in the Sunshine Act, Congress explicitly recognized that there were types of information and kinds of meetings that should be protected from dissemination to the public. Certain exemptions have been provided in FOIA for information that, for example, is of a confidential financial nature and in the Sunshine Act for meetings that would prompt speculation in financial markets.

In the various exempted areas it was determined that release of information would not be in the public interest. For similar reasons, I believe that the consequences of requiring prompt release of a verbatim record of FOMC meetings would most certainly not be in the Nation's best interest.

Mr. Chairman, in your letter of invitation to this hearing, you also posed several specific questions related to the maintenance of notes or records of FOMC meetings and to the premature release of FOMC information. I would like to turn now to the answers to those three questions.

At FOMC meetings, I take very brief, rough notes on the views expressed by participants. These notes assist me in keeping track of committee sentiment as the meeting progresses and thus in judging where a consensus may be reached with respect to monetary policy. After the meeting, the notes are kept in a locked file cabinet along with other FOMC materials.

Others attending the FOMC meetings may also be taking notes, and I am sure they will tell you about them in their own responses. I have suggested to the Reserve bank presidents that they respond to your questions regarding whatever records may be kept at their own banks; I will cover records made by the Board staff and, in particular, by the FOMC secretariat.

Some individual members of the Board staff take handwritten notes and retain them to help them in discharging their responsibilities. The meetings are reported electronically by the FOMC secretariat. These audio tapes are used to assist in the preparation of the minutes that are released to the public following the subsequent meeting. Thereafter, the tapes are recorded over.

In the process of putting together the minutes, an unedited transcript is prepared from the tapes, as are detailed notes on selected topics discussed in the course of the meeting. These materials generally are seen only by the staff involved in preparing the minutes, and the documents are kept under lock and key by the FOMC secretariat.

With regard to your final query on the release of information about FOMC meetings, I would again state my strong view that any unauthorized release of FOMC decisions is a very serious matter. Leaks of FOMC proceedings are clearly unfair to the public, potentially disruptive of the policymaking process, and undoubtedly destructive of public confidence in the Federal Reserve.

Any leaks that may have occurred were most assuredly not orchestrated or directed by the FOMC. A deliberate premature leak of information is repugnant. Our current policies that call for delayed release of information are in place for good reasons, as I indicated previously. They are grounded on the assumption of confidentiality; leaks undermine these policies.

I suspect that, to an extent, what appear to be deliberate leaks may instead represent something quite different. In some cases, FOMC participants who speak to the press may believe they have revealed nothing about recent monetary policy decisions, but they may in fact have inadvertently provided enough of a sense of the policy considerations to allow conclusions to be drawn, especially for experienced reporters speaking to several sources. This puts us in a difficult situation. We should not reveal confidential information about our decisions. At the same time, we cannot and should not wall ourselves off entirely from the media; it is our obligation to explain the broad considerations that motivate monetary policy, to correct certain misimpressions, and to convey as much information as possible, without unsettling markets, creating inequities, or violating the trust of our colleagues.

The FOMC has discussed this issue extensively, and we have taken several steps that we believe will curb any further unauthorized release of information. We have reemphasized the necessity of avoiding contact with the press during the periods surrounding FOMC meetings and of caution at other times. Moreover, it has been made clear that any future leak from an FOMC meeting will be followed up very aggressively—by a full investigation that will include gathering sworn statements from all attendees.

In response to your request as to whether I personally played a part in past leaks of FOMC information, I can assure you, Mr. Chairman, that I have never knowingly released to the press or to other members of the public any information about the results of an FOMC meeting prior to the formal, scheduled release.

I would include one footnote to this statement, however: From time to time, I have briefed members of various administrations about the outcomes of FOMC meetings, because that knowledge could assist them in the formulation of government policies for which they have responsibility. This qualification has not, however, been a relevant one over the past year or so, as the Federal Reserve has not altered its instrument settings.

I trust the problem of leaks is behind us. If I am wrong about this, the FOMC's policy on delayed disclosure of decisions will have to be reevaluated. Should we have to change our policy as a result, it would be unfortunate, for I firmly believe that a shift to prompter disclosure of the substance of our deliberations will adversely affect our discussions and decisions and therefore monetary policy itself.

Thank you very much, Mr. Chairman.

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

The CHAIRMAN. We will recognize Governor Angell first. I understand he has a time problem, and we have listed him here as first to be recognized.

Governor Angell.

STATEMENT OF WAYNE D. ANGELL, GOVERNOR, FEDERAL RESERVE BOARD

Mr. ANGELL. Mr. Chairman and members of the committee, I appreciate this opportunity to give you my views on the accountability of monetary policy. My perspective is of one who throughout his career as an elected and appointed official has been in favor of opening government proceedings to the public and the press. Our democracy demands that the actions of its government be conducted "in the sunshine" to the greatest extent possible. It also demands that government agencies adopt the very best policies. In some cases, there is a tradeoff between these two objectives.

Monetary policy is best formulated within a framework that provides an appropriate degree of insulation from day-to-day political pressures while requiring full accountability.

The Board of Governors is required to report to the Congress on its monetary policy plans and objectives twice each year. Federal Reserve policymakers also testify as requested before this and other congressional committees about monetary policy and other matters of interest, including a detailed accounting of our expenditures.

Beyond the statutory requirements, the Federal Reserve provides significant additional information to the public about the conduct of monetary policy. The Federal Open Market Committee publishes minutes of its meetings. These minutes summarize fully the discussion. Significant decisions taken by the FOMC should always be made on the basis of recorded votes—in accord with an important principle of accountability. Each member of the committee is afforded an opportunity to participate in the preparation of the minutes so that no individual or shared views are omitted. In my view, the minutes present an accurate account of each FOMC meeting.

With regard to timeliness of the release of such minutes; as you know they are published shortly after the following committee meeting. It seems to me that such a lag is appropriate. The immediate release of information on the committee's plans for contingencies could increase market volatility, particularly in circumstances when the contingencies do not eventuate. Such volatility is unnecessary and could be especially counterproductive if concerns about possible volatility deterred some members of the Federal Open Market Committee from discussing such contingencies or drove them to relying on implicit or behind-the-scenes understandings. On balance, the market and the public are better served by more detail and more openness with delayed publication as compared with the realistic alternative of less specificity that would likely accompany earlier publication.

Similarly, I believe that the provisions in H.R. 28 that would require release of videotapes or transcripts of committee meetings would have deleterious consequences. In the context of monetary policy, such provisions likely would cause policymakers to be less willing to conjecture about future economic and financial developments, to explore alternate policies, or to challenge others' views. Under those conditions, discussions during FOMC meetings are less likely to lead to appropriate policy decisions. The willingness of individual members to explore verbally what may seem to be low probability events may be the beginning of a new perspective that elicits more careful watching and continued debate. The process of developing a consensus view through an open contrarian forum is essential if monetary policy is to lead toward monetary stability.

For these reasons, I believe that the relevant provisions of H.R. 28 would do little to make the monetary policy process more transparent and, unfortunately, would do much to make the conduct of monetary policy less effective. In my view, our current procedures regarding disclosure are on the right track. They permit a careful review of alternative policies while allowing the Congress and the public to analyze both the process by which our decisions are reached and their results.

My answers to your specific questions are included in my written statement.

The CHAIRMAN. Thank you very much. As I said before, your full prepared text will be in the record.

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

Our next witness is Governor Kelley.

STATEMENT OF EDWARD W. KELLEY, JR., GOVERNOR, FEDERAL RESERVE BOARD

Mr. KELLEY. Thank you, Mr. Chairman, and thank you for the opportunity to present my views on H.R. 28.

Pursuant to the request in your letter of invitation, I shall first answer, in order, the three specific questions posed therein and then offer my perspectives on the bill in the area of maintaining a record of the Federal Open Market Committee meetings.

First, I have generated rough pencil notes of my own thoughts and summaries of the views of other members, as I understand them, at most meetings. These notes reside in a locked file in my office.

Second, I would assume various persons present at the meetings prepare and keep notes and records of their own, certainly including the FOMC secretariat, but I am unaware of specifically who does what in that regard. Doubtless, others will report on their own activities.

Finally, I have no information whatsoever about unauthorized or premature release of FOMC information.

Let me move on to comment on H.R. 28 which would require, among other things, complete release of FOMC meeting proceedings within 60 days. I must respectfully oppose this proposal.

It seems to me that the issue here is the reconciliation of two basic principles for conducting public business in a democracy. The first is the obvious requirement that public policy be generated to further the public interest in the soundest possible way. The second is that the public has the right to know what its leaders are doing in the conduct of its business, including how and why they are doing it.

While these two principles can often be fully accommodated, there are clear cases wherein the second, fully implemented, can potentially degrade the first. In such cases, the overriding requirement is that public policy must be of the highest possible quality.

The meetings of the FOMC are such a case. In these meetings, 12 voting members, augmented by the 7 additional Reserve Bank presidents, debate and decide important public matters of monetary policy. To work well, such an arrangement must proceed in private, where the participants may freely and easily exchange perspectives and confidential information, dispute, alter viewpoints, and work toward the discovery of common ground. In this manner, responsible public policy is created.

To expose this process to public scrutiny would, in my view, very clearly introduce an atmosphere that would be detrimental to the final result. The quality of the final result, sound monetary policy to undergird and support our economy, is the most important of the interests in question. I believe H.R. 28 would be counterproductive in this respect.

The requirement remains that the public be as informed as possible in these matters and that those involved in the process be accountable. I believe that the existing procedures for release of FOMC decisions are responsive to the public's right to be informed.

Concerning accountability, FOMC decisions are the result of the votes of the participating members, and each participant's vote is recorded and made public. Affirmative votes are explained in the minutes as released, and dissenting votes are accompanied by individual explanations. Thus, there is complete accountability for results.

In summary, I feel that the public's interest in this matter is best served by maintaining a system wherein the process is confidential and the policy results are made public in appropriate ways, with personal and group accountability for such results.

Thank you, sir.

The CHAIRMAN. Thank you.

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

The CHAIRMAN. Our next witness is our long-time friend, a man who has spent a considerable number of minutes, maybe hours, before this committee, and we are grateful.

Governor LaWare.

STATEMENT OF JOHN P. LAWARE, GOVERNOR, FEDERAL RESERVE BOARD

Mr. LAWARE. Mr. Chairman and members of the committee, I am here with my Federal Open Market Committee colleagues to comment on the proposed requirements in H.R. 28 for full and timely accounting of each FOMC meeting.

I would strongly urge the committee to continue, as in the past, to concentrate its oversight efforts on the substance of monetary policy rather than on the procedures by which it is determined. The Humphrey-Hawkins testimony provides a full description of policy moves, historic economic performance, and future objectives for policy. It is the fullest public accounting of monetary policy provided by any central bank in the world.

I see no purpose in the publication of a verbatim transcript of the Federal Open Market Committee's deliberations and less purpose in a videotape record of the proceedings. A verbatim transcript or a videotape recording of the meetings of the Open Market Committee might significantly inhibit the members from the free exchange of ideas which presently characterizes our meetings. We all have a certain amount of self-consciousness about being on stage, as we would certainly be under the suggested protocol, and the problem would be aggravated by the knowledge that the matters under discussion are highly sensitive for financial markets.

Consultation in camera, rather than on camera, gives the members of the Open Market Committee the same privileges of open communication and free exchange enjoyed by juries. Importantly, it also gives the committee members the same right to change their minds as jurors enjoy. I am sure the quality of jury decisions would be significantly changed if their deliberations were published. I am equally sure the process of developing monetary policy would suffer under a regime of public performance.

I am less concerned that the quality of policy decisions would be adversely affected by a memorandum of discussion carefully edited to delete market-sensitive information provided on a confidential basis and released on some delayed schedule, perhaps 1 year after the meeting it described.

The issue of the timely release of the directive for open market operations is a difficult one. On the one hand, the market knows at 11:30 or so the morning after the FOMC meetings whether there has been a policy shift. That is discernible from the way the Desk at the New York Reserve Bank enters the market. From that perspective, there is little to be gained or lost from the publication of FOMC decisions within a week, as proposed in H.R. 28.

On the other hand, immediate release would discourage the use of asymmetric language because asymmetry reflects the tilt of the committee either toward ease or tightening. Markets might react impulsively on such news, to no one's best interest except speculators. And, internally, such a stricture against asymmetric language would inhibit quick intermeeting response to changing market conditions.

As to the three specific questions raised: Number one, I make no notes at FOMC meetings other than brief bullet points to outline my own comments to assure coherence. These, together with all the analytical materials supplied by the staff prior to the meeting, are given by me to my executive assistant for destruction as soon as the FOMC meeting adjourns.

Two, I have no knowledge of what notes or records are made by or retained by other members of the committee.

Three, I have no knowledge of the source of the notorious leaks of FOMC information. Such leaks are irresponsible and reprehensible. If they are unintentional, they reflect a naivete which should not be allowed to lurk anywhere near the FOMC. If they are intentional, they should be punished to the full extent of whatever remedies are available, no matter whom the culprit may be.

I appreciate the opportunity to participate in this hearing and look forward to answering any further questions the committee may have, Mr. Chairman.

The CHAIRMAN. Thank you very much, Governor. Again, we thank you for your prepared text that we had an opportunity to review before the meeting.

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

The next witness is also our friend, Governor Lindsey, whom I happen to have had the pleasure of meeting in San Antonio. It wasn't quite in my district. The hotel wasn't in my district, Governor, but it was close enough.

STATEMENT OF LAWRENCE B. LINDSEY, GOVERNOR, FEDERAL RESERVE BOARD

Mr. LINDSEY. Thank you, Mr. Chairman and members of the committee. I appreciate this opportunity to comment on provisions of the Federal Reserve System Accountability Act that pertain to the release of information on monetary policy.

I point out that the Federal Reserve currently provides a great deal of information to the public about the monetary policymaking process both formally and informally. We report to the Congress in a formal sense semiannually on our objectives and plans for monetary policy, and we provide additional testimony on request. We publish a considerable volume of timely data on our monetary policy actions.

In addition, we publish minutes of each FOMC meeting shortly after the following meeting. These minutes are often many pages in length and fully summarize the discussion at the committee meetings, and I think are provided in a timely fashion. Federal Reserve officials frequently discuss the economic situation and monetary policy in informal contacts with Members of the Congress, members of the administration and their staffs.

I would also point out, Mr. Chairman, and you mentioned my trip to San Antonio, that part of our responsibility is to explain to the public what our positions are, and we, therefore, often speak out through speeches and other forums, not just on monetary policy but on economic policy more generally. We go into communities across the Nation, partly to understand the economic circumstances and concerns of all Americans, but also to articulate the Federal Reserve's position on the economy.

And I have had the pleasure of going to San Antonio twice as a Governor during the last 23 months. I have met with citizens from all walks of life there to listen to their needs and explain our mission. In fact, in virtually every city to which I have traveled, over 30 since becoming a Governor, I have met with local business people, bankers, and citizens to discuss the economy and its direct impact on their businesses and daily lives. I consider the process of carrying on a public dialog to be central to my responsibilities. There are no mysteries regarding my position or thinking. And I believe the same is true of my colleagues.

In my view, the provisions of the proposed legislation directed at increasing the availability of monetary policy information probably would suffer from the law of unintended consequences. Videotaping FOMC meetings would likely reduce the usefulness of these meetings considerably. Participants would hesitate to use hypothetical or speculative examples to explain points, because these examples could be easily misinterpreted and cause unnecessary volatility in financial markets. Information learned from meetings and travels is often proprietary or private in nature and thus could not be shared if the meetings were taped. More generally, the give and take in the discussion among policymakers would be sharply reduced.

I think Governor LaWare's analogy to a jury is quite apt.

Policy discussions, I believe, would then tend to take place outside of committee meetings, and members of the Board and Reserve bank presidents would come to the FOMC with preconceived notions. The ideas that arise in the current process of open, candid discussion would no longer be produced in committee meetings and thus would not be reported in the FOMC minutes. Their loss would limit the flexibility and give and take of the policy process and, in so doing, produce the unintended consequence of actually reducing the net amount of publicly available, informed debate on monetary policy.

I am also skeptical that, on balance, immediate release of the directive would be useful. While there may be some advantages, there are also costs. Under current procedures, market participants and others are able to recognize an actual shift in the Federal Reserve's policy stance on the morning that the change is implemented. Thus, an immediate verbal statement on policy changes would provide no additional information to the market.

A requirement to publish information could be damaging in cases where policy contingencies are part of the FOMC directive. In fact, increased market volatility could potentially result due to market speculation. Moreover, such a requirement could diminish the committee's ability to provide instructions to the Federal Reserve Bank of New York to respond to such contingencies, potentially hobbling the Federal Reserve's ability to resolve financial crises.

Let me turn next to the three specific questions that you posed in your letter.

First, I do take very sketchy—and I would emphasize the words very sketchy—notes during FOMC meetings to help organize my own comments. I discard these notes at the end of each meeting.

Second, I believe others will be describing their own note taking, and the Chairman will describe the note-taking process of the FOMC secretariat.

Finally, I have no information for the committee on any premature release of FOMC confidential material.

In summary, Mr. Chairman, I believe there will always be a tension between the benefits of an open and ongoing public debate on economic policy and the benefits of confidentiality. Although the current system is imperfect, it is probably better than resolving the current tension in favor of either fuller openness or greater confidentiality.

Thank you.

The CHAIRMAN. Thank you, sir.

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

The CHAIRMAN. Governor Phillips.

STATEMENT OF SUSAN M. PHILLIPS, GOVERNOR, FEDERAL RESERVE BOARD

Ms. PHILLIPS. Thank you very much.

Mr. Chairman and members of the committee, I am pleased to have the opportunity to appear before this committee to present my views on the reporting of Federal Open Market Committee actions. I am the newest member of the Federal Reserve Board.

Since joining the Board, I have been impressed by the care and the attention given throughout the System to seeking a broad range of viewpoints as monetary policy is formulated and conducted. This comes about through various advisory committees, studies, reports, meetings, and certainly also through the boards of the individual Reserve banks.

I believe that the System receives considerable cooperation in this enormous task of economic monitoring, precisely because of the serious and confidential manner in which business and economic information is treated by members of the FOMC. Releasing a literal transcription or videotape of FOMC meetings would likely inhibit members' abilities to obtain and relate confidential information because of its potential market sensitivity.

In addition, a literal transcript or videotape of FOMC meetings may make many members feel constrained to speak only from prepared statements. We will likely lose the analytical approach now used in building upon each other's observations in a truly deliberative process. There may also be reduced capability to reach a consensus, since many members' initial statements may limit their flexibility to adjust their positions.

We all have an opportunity to edit the minutes before the next meeting to assure our views are adequately reflected in the minutes. To assist in this process I take sporadic, personal notes during some parts of the FOMC meetings. Those handwritten notes are retained in my personal confidential files, shared with no one. I also know of no one who shares any of the FOMC materials with the public or the press prior to its official release.

With respect to the question of earlier release of the minutes or very rapid release of the committee's decisions or directives, such a change in procedure would, I believe, curtail the committee's flexibility and perhaps even its market effectiveness. Those directives frequently contain longer range strategies the committee wishes to adopt. No major market participant, public or private, could announce its future strategy without that having an impact on the market itself. Such announcements, I believe, would be self-defeating and limit the Federal Reserve's ability to affect the market as intended.

I hope these comments are helpful to the committee in its deliberations. I have confined my comments to the issues that were raised in your letter. Nevertheless, I would be pleased to respond to additional questions along with my colleagues. Thank you.

The CHAIRMAN. Thank you very much.

[The prepared statement of Ms. Phillips can be found in the appendix.]

President Boehne.

STATEMENT OF EDWARD G. BOEHNE, PRESIDENT, FEDERAL RESERVE BANK OF PHILADELPHIA

Mr. BOEHNE. Thank you very much for inviting me here. I spend a great deal of time speaking with citizens all across my district, which is the Philadelphia district, and it is especially nice to be meeting with you this morning.

Let me begin by saying that I take very seriously my role in FOMC proceedings and have a natural bias toward public disclosure and personal accountability. I also take seriously the collective responsibility of the FOMC to formulate the best possible monetary policy.

An essential ingredient in formulating the best possible monetary policy is an effective deliberative process—one that fosters the free flow of information, the ability to speculate about the effects of alternative policies, the general give and take among members and the ability to reach a consensus.

I believe the FOMC's existing procedures generally provide a workable balance between the need for effective policy deliberations and the need for public disclosure and accountability.

You have my full comments, but let me comment very briefly on some of the specific provisions of the bill. I believe the FOMC already complies with the provision of H.R. 28 that requires that a written copy of the minutes of each FOMC meeting be made available to the public within 60 days of it.

For those who read the minutes completely and regularly, the minutes are typically available within 60 days and are indeed comprehensive. The minutes include information about current and prospective economic and financial conditions, the pros and cons of alternative policy actions, the reasons the majority favored a particular action, plus comments, by name, of those members dissenting.

The minutes the committee now releases are not as detailed as the memorandum of discussion that was released prior to 1976. But, in my view, the old memorandum had some disadvantages that hindered the deliberative process.

I attended FOMC meetings during some of the years when the memorandum was still being prepared. At those meetings, as I recall, members of the committee tended to stick more to their prepared statements, and there was less give and take about alternative views of the economy and policy actions.

The current arrangement of releasing comprehensive minutes of FOMC meetings more promptly than the old memorandum in my judgment better serves both the need for disclosure that is of practical use to the public and the need for an effective, deliberative process.

Mr. Chairman, you also requested my comments specifically on three areas.

First, during my tenure as president of the Philadelphia Reserve Bank, which began in 1981, I have not taken notes during FOMC meetings. My economic adviser usually takes handwritten notes, which are then kept in a locked file cabinet with other materials prepared for each FOMC meeting. He uses these notes to identify issues that should be explored in future pre-FOMC briefings.

Finally, I am aware, of course, of news stories that have discussed the premature release of information about FOMC meetings. I deplore such leaks in the strongest possible terms. Security of FOMC information is taken very seriously at the Philadelphia Reserve Bank, and I do not have any direct knowledge about how such leaks occurred.

Thank you.

The CHAIRMAN. Thank you, sir.

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

President Broaddus.

STATEMENT OF J. ALFRED BROADDUS, JR., PRESIDENT, FEDERAL RESERVE BANK OF RICHMOND

Mr. BROADDUS. Thank you. I am pleased to be here today to discuss the procedures FOMC follows in recording policy information and releasing it to the public.

My views in these areas are based on two principles. First, these procedures should enable us to make the best possible policy decisions.

Second, in general, we should release as much information to the public on our policy decision as promptly as possible, provided such release does not impair our ability to make sound decisions.

Currently, the directive for a particular FOMC meeting is released immediately following the next meeting, along with a record of policy actions.

I think it is worth emphasizing here today what that record of policy actions is and is not. It is not a brief summary. Instead, it is a lengthy and, in my view, very thorough description of the discussion leading up to the committee's policy decisions. It indicates in considerable detail the views of those supporting the decision and contains a full explanation of any dissenting votes.

As a long-time attendee at FOMC meetings, I can attest that the record of policy actions always conveys the content and flavor of the committee's deliberations as well as its specific decisions completely and accurately. In my view, the record fully satisfies the need for the committee to be accountable to the public.

H.R. 28 would change these procedures in two ways. First, it would require that videotapes of FOMC meetings be made and released along with a verbatim transcript within 60 days.

My views on releasing videotapes and verbatim transcripts of FOMC meetings have not changed, Mr. Chairman, since I responded to your letter on this issue earlier this year. I believe the prospect of a literal record in any form, even if released after a long period of time, would restrain committee members in debate and very seriously inhibit the flow and restrict the flow of information and ideas. This, in turn, would undermine the deliberative process and therefore risk lowering the quality of monetary policy decisions.

While I cannot support release of a videotape or other verbatim transcript of the FOMC meetings, I believe there might be benefits from releasing a nonliteral but relatively complete record of FOMC proceedings similar to the old memorandum of discussion that we prepared until 1976, if and only if there were a long and enforceable delay of release, such as the 5-year period in the case of the memorandum of discussion. Early release of even a nonliteral record could inhibit FOMC discussion and reduce the quality of monetary policy decisions. Consequently, I think it is essential that any reinstitution of something like the memorandum be accompanied by a legislative guarantee that it would not be released prematurely.

The second change proposed in H.R. 28 is to release the directive 1 week after an FOMC meeting. Arguments can be made both for and against this proposal. An early release would be consistent with the general principle that we should inform the public of policy decisions as soon as possible. At the same time, I believe early release could well have announcement effects that could create unnecessary volatility in interest rates in some situations for reasons I indicate in my written statement.

Let me respond now to the specific questions raised in Chairman Gonzalez' letter regarding my knowledge of notes made at FOMC meetings. As I indicated earlier, I have attended FOMC meetings for a number of years, mostly as the adviser to my predecessor as president of the Richmond Reserve Bank. While in this advisory position I took notes in order to serve my predecessor effectively. The notes were handwritten, were never transcribed to typewritten, or any other form, and were not distributed to anyone. I have always kept these notes in locked confidential files.

I should add I have taken only partial notes since assuming my current position at the beginning of the year. I now rely on notes taken by my adviser who follows the same exact procedures I did.

I have only limited knowledge of records made by other FOMC participants, and I have not read or used any such notes.

Finally, I personally do not know of any information that has been released by anyone at the Federal Reserve Bank of Richmond or elsewhere in the Federal Reserve System to persons outside the Federal Reserve prior to its official release.

I would like to add one additional comment not in my written statement, but it probably should be. I certainly agree that the FOMC should be accountable for its actions. Basically, I think we already are. However, full and effective accountability for any institution requires that everyone understand clearly exactly what the institution is accountable for.

With this in mind, I would respectfully suggest that one of the most positive things Congress could do to raise our already high level of accountability even higher would be to pass Congressman Neal's amendment which would mandate that we achieve and maintain a stable price level over time.

Thank you, sir.

The CHAIRMAN. Thank you.

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

The CHAIRMAN. President Hoenig.

STATEMENT OF THOMAS M. HOENIG, PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY

Mr. HOENIG. Thank you, Mr. Chairman.

Good morning. I am very pleased to have this opportunity on behalf of Federal Reserve Bank of Kansas City to express my views on the disclosure of information of the FOMC meetings. I will tell you that our district is composed of agriculture, energy, and a lot of small manufacturing and, therefore, is diverse. I do spend a fair amount of time within the region listening to and speaking out on economic policy matters.

As to your purpose of this hearing, let me begin by saying that I, like others, feel strongly that the Federal Reserve must be accountable for its actions and has an obligation to disclose as much information as possible about its deliberations and decisions subject, in terms of balance, to maintaining the highest possible level of policy effectiveness. It is my belief that the Federal Reserve's current disclosure policies achieve these ends and this balance.

These policies provide a detailed accounting of FOMC deliberations and decisions. The minutes of FOMC meetings I think are comprehensive. They are detailed. They document the information considered during the meeting and the decisions of each voting member. Moreover, the minutes provide the rationale for the majority's decisions and include statements filed by members who dissent from the majority.

In addition, the Federal Reserve reports regularly and frequently to Congress, ensuring further that we are accountable for our monetary policy actions, that they are explained.

Current procedures foster an environment of open and candid discussion among the members of the FOMC. Valuable information from a variety of sources is brought to the discussion, some of it is provided with the understanding that it be kept confidential.

The give and take among members provides an opportunity to clarify issues, allows the FOMC to synthesize a range of views. Any proposals that would impair this deliberative process, given current procedures that I believe ensure accountability, I think would compromise the quality and effectiveness of policy without a significant offsetting benefit.

Current procedures, in my opinion, also strike—and importantly strike—an effective balance between timely disclosure and the need for flexibility in the conduct of policy. These procedures, which provide release of the minutes shortly after the subsequent meeting, about 6 weeks usually, allow the FOMC to respond flexibly to various contingencies over the intermeeting period. Earlier release of the minutes, I think, would restrict this flexibility and could have the unintended effect of contributing to market volatility.

With regard to the questions posed in your September 24 letter: One, I make brief notes for my personal use during FOMC meetings, and our bank's research director also occasionally takes notes. These notes are kept in locked files, as is other FOMC material.

Two, I have observed other participants taking notes during the FOMC meetings, but I have no knowledge of their content or disposition.

And, three, I have no information about the release of information by anyone employed at the Federal Reserve about FOMC meetings prior to the official release of that information by the Federal Reserve.

In closing, let me reiterate that I believe the FOMC must be accountable for its actions. At the same time, it must be permitted to pursue effective policy and allow for dialog among its members. Current procedures provide, I think, the best balance toward achieving these ends.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

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

President Jordan.

STATEMENT OF JERRY L. JORDAN, PRESIDENT, FEDERAL RESERVE BANK OF CLEVELAND

Mr. JORDAN. Thank you, Mr. Chairman, members of the committee.

It seems to me this series of hearings and various proposals for legislation, various ideas, center on two questions. One is, what information should be released and when? And the second is, who should participate in the deliberations and the formulation of monetary policy actions?

I think that those two questions ought to be addressed in the context of three main issues. One is the objectives of monetary policy. I think that can only be the highest standard of living that we can achieve with our resources, with our labor force, and so on. I know that fiscal policies and regulatory policies have other objectives at times, including redistribution, but I think that monetary policy can only be used to try to maintain the highest growth of income and the lowest sustainable rate of unemployment.

Second, the strategy to do that, I am convinced, is maintaining price stability. I think that the Congress intended—what really the Constitution intended in maintaining the purchasing power of the currency, so that the dollar is a stable standard of value over time.

And the third issue is whether or not independence furthers that strategy to achieve the ultimate objective.

If these questions of what information we release and when, and who participates can be addressed in that context, I think we can clarify the issues involved.

I believe that currently we are releasing the information that is necessary to make it clear to people what it is we are trying to do, what our strategy is and that we have the right people participating in that deliberation.

Regarding your specific questions about notes, I took some notes the first few meetings of Open Market Committee meetings starting in March 1992 with regard to research topics I wanted to go back and get my staff to work on. I don't find it necessary to take those notes anymore, so I don't take any at all.

I don't know what kind of notes are kept by other people. I am learning here today what notes are taken by my colleagues at the meeting and what they do with them.

On the subject of leaks, I deplore it, as others have indicated. We are the central bank. Central banks don't leak.

The CHAIRMAN. Thank you.

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

President Keehn.

STATEMENT OF SILAS KEEHN, PRESIDENT, FEDERAL RESERVE BANK OF CHICAGO

Mr. KEEHN. Thank you, Mr. Chairman and members of the committee.

As requested, let me briefly summarize my views on the question of the appropriate recordkeeping and public release of the deliberations of the FOMC.

As I stated in my letter of January 13 of this year to you, Mr. Chairman, I fully support Chairman Greenspan's previously stated position on the various proposals for maintaining and releasing a more detailed record of the FOMC's deliberations. In my view, the minutes of the FOMC, as they are currently written, provide the right level of reporting and detail necessary to communicate the current policy concerns and actions of the committee. The minutes explicitly document the full range of policy arguments made during the discussion, and when a member of the committee disagrees with the resulting consensus, that member's dissent becomes an integral part of the public policy record.

Based on my participation in FOMC deliberations, I believe that releasing more detailed minutes, most especially a verbatim transcript of the meeting, without a significant delay would be counterproductive and would impede the development of sound monetary policy—first, by limiting the free flow of necessary information into the policy process and second, by hindering the consensus process so essential if policy is to adequately reflect economic conditions in all regions of the country.

As president of the Federal Reserve Bank of Chicago, I have an important responsibility to convey to the FOMC the economic conditions of the Seventh Federal Reserve District. To meet this responsibility, I and other senior members of our staff maintain extensive contacts with district businesses, both large and small, community groups, and State and local government officials. From these individuals we are able to gather a wide array of highly significant information about the district that cannot be derived from public data sources—information not only about current economic conditions, but about changes in business practices, future production, labor negotiations, investment and hiring plans, and a host of other issues that have important value to the policy process.

This type of information is particularly important at the present time. The economy is going through a very different phase than any that we have experienced in the past. Many of the economic indicators that have been useful guideposts in developing policy in the past are now proving unreliable. In such an environment, I find the regional information derived from local contacts, both about the Seventh Federal Reserve District and elsewhere in the country, essential to the policy process. In the context of these hearings, it is important to understand that much of the information that these contacts provide is highly proprietary and very confidential in nature. I have absolutely assured these contacts that the source and nature of the data will not be divulged in a way that they would find compromising. I have never had anyone decline to speak with me about their activities. If I could not provide such assurances, then much of this significant information would not be forthcoming and the development of monetary policy would be impeded.

It is precisely this type of information about local businesses, communities, and financial institutions that demonstrates the value of the regional structure of the Federal Reserve System and district representation on the FOMC. The impact of releasing such information as part of the written record of the FOMC without a significant delay would only result in the exclusion of this vital information from the FOMC policy discussion. In my view, this would not be in the public interest, especially when the current system of disclosure is able to convey an accurate description of the key issues and arguments underlying the FOMC's decisions, as well as record individual votes and dissenting positions.

As to the specific questions that you asked me to address: I prepare an outline of economic conditions in the district which forms the basis for my remarks at each meeting of the FOMC. After the meeting, these notes are kept secured in my office until the next meeting at which time I destroy them. I do not maintain notes on the discussion that takes place at the meeting itself, and Chairman Greenspan has described the records that are kept by the FOMC secretariat.

As to the premature release of information from the FOMC meetings, I have not talked to the press or other outside contacts, nor to other Federal Reserve officials who do not have authorized access to FOMC information and my only direct knowledge of such premature releases arises from articles I have seen in various newspapers. I completely concur with Chairman Greenspan that premature releases of this type of information are highly inappropriate and totally unacceptable.

Thank you.

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

The CHAIRMAN. President McTeer.

STATEMENT OF ROBERT D. McTEER, PRESIDENT, FEDERAL RESERVE BANK OF DALLAS

Mr. MCTEER. Thank you, Mr. Chairman, for your invitation to testify on H.R. 28. I will limit my testimony to the issue of FOMC records, although I do have opinions on other parts of the H.R. 28, especially the part that puts me out of work.

I became president of the Dallas Fed in February 1991, so I am a relative newcomer, both to the FOMC and to your great State of Texas, Mr. Chairman, and also Congressman Johnson's. As the bumper sticker says, "I wasn't born in Texas, but I got there as soon as I could."

Prior to moving to Texas 2½ years ago, I was with the Federal Reserve Bank of Richmond for 23 years, the last 11 of which I served as manager of its Baltimore branch. I have participated in FOMC meetings since 1991, but did not vote until this year.

In your letter you asked us to respond to three specific questions regarding note taking in FOMC meetings. Regarding my own practice, I don't take notes of the type I assume you mean. I do a lot of reading and homework prior to the meeting and I go into the meeting with some tentative ideas in mind. I doodle during our discussions and occasionally write down a word or phrase for reference when I speak. I don't write down decisions because they are simple and easy to remember, and normally come at the end of the meeting.

My doodles and notes all mixed up would be of no use to traders or journalists. I destroy them after the meeting and rely only on official documents for future reference.

Regarding your second question, notes kept by others, my impression is that most other members and staff probably follow a pattern similar to my own since all who are present presumably have access to the official records and documents. At least, I have no knowledge to the contrary.

In answer to your third question, I have no information about the premature release of FOMC information by anyone at the Federal Reserve. Let me add that, in my opinion, if someone wanted to leak valuable information about the committee's decisions, such notes would not be necessary nor even very helpful. While the decision process may be difficult, while the debate may be difficult, the decisions themselves are very simple and easy to remember without notes.

Let me comment briefly on other aspects of meeting records. As a former economist, I have some sympathy for the idea of immediate release of the directive or decision. Immediate release of the decision would eliminate any question of leaks or the appearance of leaks.

The practical problem with immediate release of the directive is that not all decisions are clear-cut decisions to ease, tighten, or remain unchanged. On occasion, the committee votes to hold steady, pending further information or developments, and wishes to give the chairman extra leeway to act on his own prior to the next scheduled meeting. More often than not, I believe, these asymmetric directives are not acted on, but occasionally they are.

To announce a decision of no change without the proviso would be misleading to the public, and to announce it with the proviso would likely cause the markets to react in a way not necessarily warranted by subsequent information.

Given this dilemma, I believe the current arrangement is best. Markets are able to discern the immediate decision by watching the Federal funds rate the following morning, and we retain maximum flexibility to react to incoming data and changing circumstances without misleading anyone. Then as soon as another meeting is behind us, we release the directive that includes the prevailing circumstances, the rationale for the decision, and the identity of any dissenters and their reasons for dissenting.

I personally have a greater problem with videotaping and verbatim transcripts of discussions than with the prompt release of decisions. I believe that videotaping or verbatim transcripts, no matter how they are released to the public, would diminish the quality of our deliberations. My colleagues and I are willing to listen to each other and adjust our initial leanings in the interest of consensus-building.

We currently don't posture for the record or for the camera. There is no winning or losing the debate. There is no playing to the gallery or to the folks back home. This, I am afraid, would all change with videotaping or its equivalent.

I would much prefer present arrangements even with more detail added, as long as the detail involves the substance of the discussions and the decisions rather than the language used. I would also have no objection to detailed minutes, not a verbatim transcript, being released after a lengthy period of several years, as long as the legal obstacles to such a delay could be overcome. Thank you.

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

The CHAIRMAN. Thank you very much.

President Melzer.

STATEMENT OF THOMAS C. MELZER, PRESIDENT, FEDERAL RESERVE BANK OF ST. LOUIS

Mr. MELZER. Thank you, Mr. Chairman. I am pleased to appear before the committee today to testify on the prompt public disclosure of Open Market Committee meetings. As a creation of Congress, the Federal Reserve System is fully accountable to the public for its monetary policy actions. One way we ensure this accountability is by releasing information about our policy decisions. The Federal Open Market Committee provides a full accounting of its actions in its minutes of the Federal Open Market Committee.

The minutes, as has been mentioned earlier, contain all important information about FOMC decisions, including the policy directive agreed upon by the majority and the reasons underlying the policy decisions. Any significant differences among those voting with the majority, as well as the views of any dissenting members, are included in the document. The minutes are released upon their approval by committee members at the next FOMC meeting. The public record thus contains the outcome of FOMC deliberations and the policy views of each member of the committee.

I am not in favor of producing a further detailed account of FOMC deliberations, either in the form of an edited transcript, such as the memorandum of discussion, verbatim minutes, or an audio or videotape. Such a release, in my judgment, would impede the deliberative process and thereby impair policymaking.

Arriving at appropriate policy often involves considerable give and take, consensus-building and debate of alternative actions. Because of the possibility that a particular statement might be misunderstood or taken out of context, FOMC members would be reticent to engage in the kind of open discussion that leads to good policymaking if they knew that all of their statements would be in the public record. Furthermore, the release of verbatim minutes or any other detailed record of deliberations would discourage other parties from supplying the FOMC with confidential information that is useful in determining appropriate policy.

Turning to the timing of the release of the FOMC policy directive, I believe that immediate release of the outcome of FOMC deliberations would interfere with the deliberative process and would lessen the flexibility with which the Federal Reserve can respond to changing economic conditions. If directives were released immediately, the FOMC might be reluctant, even if economic conditions warranted, to take a timely subsequent action because of concern that such action would add to the uncertainty in financial markets.

In addition, the FOMC would be less inclined to bias its directives toward ease or restraint, in effect limiting its policy options. Consequently, reaching a consensus among FOMC members would be difficult, which might delay policy actions and add uncertainty to financial markets.

Finally, let me turn to the three specific questions raised in your letter, Mr. Chairman, of September 24. I have included answers in my statement submitted for the record.

To sum up, then, the Federal Open Market Committee is committed to informing the public of its policies, which ultimately must be judged by their results. Minutes of the Federal Open Market Committee convey fully the relevant information about FOMC decisions and do so in a timely manner. Thus, in my view, there is little to be gained by providing detailed minutes or mechanical reproductions of FOMC deliberations, while the adverse consequences of doing so are potentially very great.

In addition, the benefits of immediate release of the policy directive would not seem to outweigh the potential cost of doing so.

By inhibiting the frank exchange of views and possibly reducing the willingness of the FOMC to take timely actions, public release of the details of committee deliberations or immediate release of the policy directive could harm the policymaking process. Although intending to increase the accountability of FOMC members, the proposed changes in H.R. 28 may thus impede monetary policy performance.

Thank you.

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

The CHAIRMAN. Thank you.

President Parry.

STATEMENT OF ROBERT T. PARRY, PRESIDENT, FEDERAL RESERVE BANK OF SAN FRANCISCO

Mr. PARRY. Thank you, Mr. Chairman and members of the committee. As president of the Federal Reserve Bank of San Francisco, one of my jobs is to contribute to Federal monetary policy deliberations with information and ideas from my district. The 12th Federal Reserve district is highly diverse. It is made up of the nine western States which at present include three of the more robust State economies in the country: Utah, Idaho, and Nevada, and one of the weakest, California. In fact, California has seen employment fall by 592,000 jobs since mid-1990.

With that introduction, I would like to express my appreciation for this opportunity to discuss the disclosure of information about Federal Open Market Committee meetings. As I stated in my letter of January 13, 1993, I believe that there should be a presumption that Fed deliberations should be fully disclosed unless there is a compelling reason not to do so.

In the case of FOMC deliberations, such a compelling reason exists. As discussed in my written testimony, I am concerned that verbatim records or videotapes would inhibit the free flow of comments at our meetings, and thus the process limit the effectiveness of our policy discussions.

Now, I will turn to the specific questions raised in your letter to me dated September 24. I do not take notes of what is said at FOMC meetings. However, I do take into the meetings notes concerning the comments I plan to make about the national and 12th district economies, about monetary policy, and occasionally about special topics that are on the agenda for a particular meeting.

These talking points are stored in locked files at the Federal Reserve Bank of San Francisco, in accordance with FOMC security procedures. My actual statements often divert somewhat from my notes, and I also make impromptu comments at each meeting for which I have no notes.

I also take into FOMC meetings a briefing book prepared by the research department at the bank. This book contains analyses and forecasts of developments in the U.S. economy, analysis of developments in the 12th district, occasionally discussions of special topics related to FOMC issues, and analysis of monetary policy issues and recommendations by my staff.

The director of research at the bank, and occasionally his alternate, take handwritten notes of comments made at FOMC meetings when they attend as my adviser. These notes are for their own use in directing FOMC policy analysis within the research department. They are stored in their locked files at the bank in accordance with FOMC security procedures.

Finally, with respect to your question about leaks of confidential FOMC information, I have never knowingly divulged any FOMC information to unauthorized persons prior to the official release date, and I have no information concerning anyone else doing so.

Thank you, Mr. Chairman.

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

The CHAIRMAN. Thank you.

President Stern.

STATEMENT OF GARY H. STERN, PRESIDENT, FEDERAL RESERVE BANK OF MINNEAPOLIS

Mr. STERN. Thank you. Mr. Chairman and members of the committee, I appreciate this opportunity to discuss issues related to maintaining a record of Federal Open Market Committee meetings and procedures followed at the Federal Reserve Bank of Minneapolis to handle confidential monetary policy material. These are indeed significant matters.

As indicated in my January correspondence, I am convinced there is considerable value in our current report of FOMC proceed-

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ings. As you know, we release extensive minutes of each FOMC meeting shortly after the subsequent meeting. The minutes describe the discussion and the votes of individual members. More specifically, they include an assessment of business conditions here and abroad, price developments, and performance of financial markets and monetary aggregates.

They report the committee's views of prospects for the economy, frequently including information gleaned from personal contacts in individual Federal Reserve districts. The minutes also report the discussions of monetary policy options as well as the decision ultimately reached by the committee, including dissents, if any, and the logic underpinning the dissents.

This amounts to a good deal of information in my view, and I do not find merit in suggestions to prepare and release at any time a literal record of FOMC deliberations through videotaping or other vehicles. Three issues in particular concern me.

First, given the gravity of our responsibilities, I believe it is imperative that the quality of our deliberations be maintained. Open discussion of ideas, of policy alternatives, and of significant potential risks to the economy are critical to sound policymaking.

Second, some of the information we discuss is voluntarily provided on a confidential basis. We have an obligation to maintain that confidentiality.

Third, I believe our procedures carefully balance the need to provide information to the public with the necessities of effective monetary policy. Even small changes carry the considerable risk that they will disturb, perhaps unknowingly and unintentionally, this balance, with adverse consequences for financial markets and economic performance.

As indicated in my earlier correspondence, I believe there could be some merit to reintroduction of something like the memorandum of discussion, a very detailed, although edited, accounting of FOMC discussions, provided that the confidentiality of such material is assured for several years. As I see it, such a document could be useful to historians and students of monetary policy when they investigate the broad context of policy decisions and the evolution of the policymaking process.

Finally, in response to your specific inquiries about confidentiality, I am unaware of any unauthorized release of monetary policy information ever emanating from the Federal Reserve Bank of Minneapolis. My economic adviser and I leave highly confidential material at the Board of Governors and do not return with it to Minneapolis. I take limited notes during the meeting, as does my adviser. All notes or other materials are handled according to strict guidelines, and I attached a copy of those guidelines with my prepared statement. Thank you.

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

The CHAIRMAN. Thank you, sir.

President Syron.

STATEMENT OF RICHARD F. SYRON, PRESIDENT, FEDERAL RESERVE BANK OF BOSTON

Mr. SYRON. Thank you, Mr. Chairman. In the interests of time, I will try to be very short. Being involved in making monetary policy is something that is a great responsibility and enormous honor. Thus, from a purely personal perspective, I would welcome my views being made more public. However, as others have said, the key issue to me is what will provide the best policy for the people of the United States, and in my case for the 1st district.

In this regard I believe there are difficult tradeoffs between openness and the effectiveness of the deliberations that lead to the development of monetary policy. Because we work for you as creatures of the Congress, these tradeoffs are a valid reason to have this discussion today. But we need to think a lot about what is involved.

I am concerned that a highly detailed accounting of FOMC deliberations, unless its release were accompanied by a delay of several years, would impair the ability of the FOMC to obtain and discuss confidential information essential to developing monetary policy. It would impact what I do personally. I literally never go anywhere on a personal or professional basis without asking people about what is happening in the economy.

As others have said, being able to assure people that information they give you is confidential is an important part to being able to get that information. I believe the value of this process is demonstrated by New England's experience in the most recent recession.

The recession began earlier in New England than it did in other parts of the country, and proportionately many more jobs were lost. As a consequence some of our banks developed serious problems. These difficulties contributed to a credit crunch. The credit crunch was the subject of hearings held by this committee.

These problems were discussed extensively at FOMC meetings. It wouldn't have been possible to convey the seriousness of this problem without discussing individual lenders and individual firms and how it affected their employment plans, investment plans, and other business decisions.

But, if the people from whom we gathered this information knew it would become public, they certainly, in their own interest, wouldn't have volunteered it, and our understanding of the problems would have been greatly constrained.

Again, I think tradeoffs are involved. The more specific are the references in the record of FOMC deliberations, the longer would be the time lag required before disclosure if access to valuable, confidential information is to be maintained.

If confidentiality could be assured and there were sufficient lags, I would have some sympathy for resubmitting the memorandum of discussion mentioned by others today. However, a second tradeoff is that much of the discussion and economic information subsequently disclosed in FOMC meetings pertains to the valuation of assets, value changes that can have a substantial impact on world financial markets.

Fluctuations in asset values can have significant impact on the jobs of workers, and the incomes of investors. Public disclosure of preliminary and exploratory discussions could generate unintended value changes that could lead to adverse and unnecessary reactions in the economy.

In summary, the ultimate objective of monetary policy is to promote the highest sustainable standard of living possible for Americans. The policymaking process should be as open as it can be, consistent with that objective, and that is what we are here to explore this morning.

My formal answer to the three questions you asked, Mr. Chairman, are contained in my written statement.

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

The CHAIRMAN. Thank you very much. May I take this opportunity to thank you for the graciousness with which you met the committee in Boston when we were there for a hearing on CRA and with your good work with respect to CRA.

Well, it looks like we don't have a consensus on H.R. 28 yet, but we are working up to it and hope springs eternal. At least we made a dent on Chairman Greenspan's total unacceptability. There are some indications there is a little glimmer there for some hopeful change.

I have a couple of questions. In the questions that I had directed, I did ask and each one of you responded, as to their notes or records that you are aware of. But today's testimony by Chairman Greenspan reveals to me, at least, that the FOMC meetings are tape-recorded.

As far as I know, I had not been aware of that, or know of anybody else that had been aware of that. I don't think we had been previously informed that there were these tape-recordings. What I am going to ask is if any of you knew or know about these recordings being made when you submitted your written testimony for today's hearing, or are you unaware that tape-recordings of FOMC meetings are customarily being made.

Can you tell me exactly of any tapes of FOMC meetings now in existence that you do know about? I would be glad to hear from any of you.

Mr. GREENSPAN. Mr. Chairman, may I clarify that?

The CHAIRMAN. Certainly.

Mr. GREENSPAN. In my remarks, what I indicated was that the FOMC staff, in the preparation of the minutes, takes a recording for purposes of getting a rough transcript, but the tapes are taped over. In other words, we don't keep the actual tapes themselves. We do not have electronic recordings of the meetings.

The CHAIRMAN. I am a little bit confused here. In other words, you have no tape-recordings of the actual proceedings.

Mr. GREENSPAN. We have them only—as far as I know, what the staff does is, in order to assist its presentation and preparation of the minutes, it takes recordings but then tapes over them so they are not available thereafter.

The CHAIRMAN. Well, I am glad my staff doesn't. Of course, I don't know that I would grant that much blanket authority. Anyway, the second question, about the so-called leaks, in your testimony, Chairman Greenspan, you say, and I quote, "From time to time I have briefed members of various administrations about the outcomes of FOMC meetings."

Now, you also say that you have not done it in the last 1½ years. Now, what I am really wondering about, how do each of you decide who to approve for the Chairman's disbursal of confidential FOMC information? Is it just a coincidence that the official leaks went to the Bush administration, but not to the Clinton administration? If monetary policy changes again, who will receive those?

Mr. GREENSPAN. Mr. Chairman, let me just say, as I indicated in my prepared text, what I do is try to communicate as best I can to the administration, whomever it may be, what the underlying monetary policy of the Federal Reserve is, and most importantly, to try to convey to them, those relevant individuals, why we are doing what we are doing and why we may do something else.

In other words, I try to convey the substance of our deliberations, because it is important for individuals within the administration to know what we are doing so that they can do what they are doing better.

In other words, we in previous testimonies have discussed the question of the interaction of monetary and fiscal policy and the necessity of communicating, and that is precisely what I was referring to. The notation I made with respect to the last year did not have to do with an ending of communication.

On the contrary, I communicate more now than I have ever done. I was merely suggesting that an occasion to stipulate to them that we actually changed policy has not been necessary. But as I have suggested to you previously, the contacts I have personally with the individual key policymakers of the administration is exceptionally extensive and works very well.

The CHAIRMAN. Thank you very much.

Mr. Leach.

Mr. LEACH. I thank the chairman. It has been an extraordinary hearing, and I have the sense that all of us are learning from each other. Let me just ask, first of all, in the area that I am most interested in many ways is how the regional bank presidents are selected. There are basically three ideas that have been discussed in Congress.

One relates to whether the regional bank presidents ought to be designated by the President with the advice and consent of the Senate. The second is whether regional bank presidents should participate in the Federal Open Market Committee. The third is whether the regional bank presidents should be designated by the Chairman of the Federal Reserve Board. All three relate to the political science dilemma regarding regional bank presidents being designated by boards, the majority of which are composed of people whom they regulate, which is an awkward circumstance; or have as one of their responsibilities regulation; as well as the political science dilemma of representing only one industrial sector in Open Market Committee meetings.

And so what I would like to ask, first, of the regional bank presidents, of these three approaches, if there were change, recognizing that perhaps no change is preferred, which of the three would you find most reasonable? Maybe I should start at this end.

Mr. SYRON. Mr. Leach, I would like to make one comment about the regulatory concern. I understand the point that you are raising, in that there is an appearance of a problem. With regard to regulation the Federal Reserve Act makes clear that at the district level the presidents act as agents of the Board. Thus I, and I am sure this is true of my colleagues, never discuss a regulatory matter on a specific institution at a Board of Directors meeting. We talk about banking conditions overall, but we absolutely never discuss specific cases that are pending.

Mr. LEACH. But you are selected by the Board and you are accountable to the Board.

Mr. SYRON. That is right. In response to your specific question, as you might expect, I think the present system has worked quite well, and thus of the three choices you present, if I had to choose I would prefer the one that represents the least change, which is the suggestion to have the presidents designated by the Federal Reserve Board.

Mr. LEACH. Sure.

Mr. Stern, would you agree with that?

Mr. STERN. I think I would agree with that, but I would emphasize that the selection of Reserve bank presidents, ultimately those appointments have to be approved by the Board of Governors, so they are not made simply in isolation in the Reserve districts.

Mr. LEACH. Fair enough.

Mr. Parry.

Mr. PARRY. I think the Chairman already has—and the Governors have tremendous influence on the selection of the presidents at the present time.

Mr. LEACH. But of those three changes, which would you prefer?

Mr. PARRY. I would prefer the third.

The CHAIRMAN. Mr. Melzer.

Mr. MELZER. I just wanted to add a little to what Dick Syron was saying, if I could. I think with respect to the composition of the boards, as you know there are only three bank directors, and they come from three different groups of banks within the district. In other words, banks are broken down by size according to capital, so that it is impossible, for example, for large banks to dominate a Reserve bank board. Second, with respect to the other three directors who they nominate and elect, it is my experience that those directors are anything but pawns of the bankers. They can't be bank officers; they can't be bank directors. There may be an appearance problem, but as a practical matter, from firsthand experience, I have not seen any of those individuals to be what could be described as pawns of the bankers.

And, third, in connection with the appointment of presidents, again, based on the experience at our bank, the search committee for a president would be chaired by either the Chairman or Deputy Chairman, a Class C director, one of the three public directors. There may be one bank director on a search committee, but it would not be dominated by so-called banker directors.

And, finally, as has been noted, the appointment of a Reserve bank president must be approved by the Board of Governors, so that there is a already a very important public role in connection with that.

Mr. LEACH. Which of the three would you prefer?

Mr. MELZER. It is difficult for me to say. I guess on the theory that your suggestion is the least change, perhaps that one. But I think, as Chairman Greenspan noted the other day, that would have a significant impact, in my judgment, in terms of the role of regional Reserve bank boards of directors and the great benefit that we get from their input. I think that is why the Federal Reserve operates as efficiently as it does, because in effect we are applying, and have been for many years, private sector management concepts to the operation of our activities.

Mr. LEACH. I appreciate that. My problem is my time has expired. Let me ask briefly, would anyone differ with what has been said?

Mr. JORDAN. I differ, because it would destroy the Federal Reserve Bank System.

Mr. LEACH. Would you prefer that, would you rather have the President appoint——

Mr. JORDAN. I would not prefer any of those.

Mr. LEACH. Would you prefer to have the district Governors not on the Federal Market Committee?

Mr. JORDAN. These are not acceptable choices. Making the presidents nonvoting members, appointment by the President and confirmation by the Senate, or appointment by the Board of Governors, would alter the Federal Reserve substantially, and in a very harmful way. It would not be a job I would want——

Mr. LEACH. Of those three which would you find most——

Mr. JORDAN. I would not be a part of the system if you made any one of those three decisions.

Mr. LEACH. That is intellectually irrational. Let me pin you down, Mr. Jordan.

Recognizing you might prefer not to serve under any of them, which is the least appealing?

Mr. JORDAN. I think it wouldn't come to that because you don't have a regional diversified decentralized system of Reserve banks if you make any one of those changes. You have a system of branches across the country. That outcome was considered by Congress in 1913 and rejected. It would destroy the system.

Mr. LEACH. President Hoenig.

Mr. HOENIG. Obviously, the preference is with the current. But I would make a slight change in what you are saying. The three Class C directors are appointed by the Board of Governors, and rather then having it appointed by the Board, I would suggest you have the three Class C directors do that with input from the other directors with the same veto power that is with the Board of Governors. That way you have it with those appointed by the Board of Governors, not from this elected group as such, but you have input from them, and yet you have those three that are not elected actually making the appointment, and you still have the Board of Governors who can veto that.

That is, I think, a better option than perhaps your third.

Mr. LEACH. Does anyone else wish to comment?

Mr. BROADDUS. If I were forced to choose, I would choose the third alternative, but very reluctantly. It would change what is now a Federal Reserve System to a central reserve system. I went through this process last year and I can tell you the Board of Governors played an important role in reviewing my appointment and also the search committee that selected me included two Class C directors.

The CHAIRMAN. Let me suggest that since the time has expired that any other comment be submitted in writing.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. You said a minute ago you didn't think we had a consensus on this bill. I want to point out I think we, frankly, did. I did not find any support for the idea of the bill at all among any of our witnesses. I read that as a pretty solid consensus. And I think that is important, because our witnesses are the country's premier experts on this subject.

And so their opinion is important, and their opinion in regard to Congressman Leach's ideas also is important. And again, I think there was consensus. They don't think we ought to inhibit what is now a very broad-based system.

I want to ask these witnesses' opinion on another subject, because I think ultimately you and Mr. Leach, in fact all of us, want accountability. It just seems to me we are going about it in a little different way. I think there is a possible solution here, and I want to make a stab at it. It may work; it may not.

But as President Broaddus mentioned, I want to say this to the witnesses. You already may know, I have introduced legislation which would in effect require 100 percent accountability, because it would say that the Fed should require, over time, over whatever time it takes to avoid recession, a particular policy, and that policy is zero inflation or price stability, as the economists like to say, we mean the same thing. I want us to achieve and maintain this as zero inflation, price stability, because I am convinced it is the essential policy necessary for us to achieve everything else it is that we want for the economy.

It will allow us to achieve and maintain the lowest sustainable long-term interest rates, the highest sustainable levels of economic growth, the highest sustainable levels of employment, the highest levels of savings, and therefore investment, productivity, growth, the highest levels of efficiency in our economy, everything we want, the highest level of prosperity for all of our people.

So, since I think we do know what is the best possible policy for the Fed, I would just like to ask our witnesses if they agree that this is the best policy or not, and if not, what they would say about it, and if they agree it is the best policy, do they think they should be held accountable to it, which is to say, would they support passage of our legislation, which would in effect require the Fed to achieve and maintain over a period of time, not overnight, but over a period of time, price stability?

So just briefly, if I could, ask each of you to comment. Let me start at the left.

Mr. KELLEY. Mr. Neal, I fully support your suggestion and have done so over the years. The Federal Reserve is a creature of the Congress, and the Federal Reserve should endeavor to try to fulfill the will of Congress as its boss, if you will.

In order to achieve what the boss wants, it is necessary for the organization to understand just what that is. Very frankly, now there are various voices that come to us from the Congress. I know of no one who has advocated inflation per se, but on the other hand, there are suggestions that come forth that could very easily lead in that direction, and in short, our mandate is unclear.

I think it would be very helpful if it were clear. As things are now, I think it is somewhat confusing to the markets. I think it is confusing to other central banks and to other governments, as to just what our mandate is from the Congress. And I think we would appreciate very much having that much more clear.

Mr. NEAL. I know I am going to run out of time, so if I may just ask each of you to comment as briefly as you can. I would love to hear in great detail from all of you, but I know we are going to run out of time.

Mr. LAWARE. I certainly agree that the primary focus of monetary policy should be price stability tempered by the additional responsibilities for sustained economic growth and as full a level of employment as is consistent with those two conditions.

Mr. LINDSEY. I agree with your objective completely, Mr. Neal. I would just caution you that perhaps binding the Federal Reserve, the Congress might find, binds itself with regard to fiscal policy decisions. For example, one could imagine a value-added tax being passed by the Congress. I am not recommending it, but you would want to think long and hard about binding the Federal Reserve in the face of maintaining price stability.

Mr. PHILLIPS. I do agree with your objective in terms of that it should have as its goal the achievement of real sustainable economic growth in an environment of stable prices. I think that is what we are trying to achieve.

Granted, we may disagree at times as to how to get there, and that is one of the very constructive parts of this assembly in the give-and-take process.

Mr. BOEHNE. I would state the goal somewhat more broadly. I think, Congressman, that the goal of the Fed and indeed all economic policy is economic growth, producing jobs, and higher standards of living. I think over the longer pull, the most significant contribution that a central bank can make is low inflation. But I think we always need to keep that in the context that that is a means to an end, and the end is growth, jobs, and higher standards of living.

And I think clearly from experience we know we do a lot better with low inflation rates rather than high inflation rates in pursuing those ultimate objectives.

Mr. BROADDUS. I strongly, vigorously support the amendment specifically because I think it would enable the Federal Reserve, the Open Market Committee to make its maximum contribution to sustained employment and growth.

The CHAIRMAN. I will suggest that any additional comments be submitted in writing, since the time has expired. In fact, we have gone over just about equal to the time we allowed Mr. Leach.

Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman. Mr. Chairman, I came here this morning asking myself, you know, what kind of a testimony are we going to hear today? What is our chairman after today? But I must say I was a little shaken by the testimony today.

The reason I say that is, when I look at these hearings, I always ask myself, how is it perceived by the general public, because here in our country we are really facing a severe problem of public trust and confidence in our institutions.

We, as Congressmen, when we go home, we find that all the time. That is a big issue when we are at our town hall meetings. So for the American people, the Federal Reserve is really sort of a big question mark. What kind of powers do they have, and it is like a hidden hand in our economy.

I think you ladies and gentlemen are aware of that. When I hear testimony of leaks and tapes erased and notes hidden away in storage boxes, the public perception is, there is something going on there that shouldn't be going on there. So I think the question I would have is, why shouldn't the public question what goes on at the Fed?

Mr. BOEHNE. I think, indeed, the public does have more than a right. I think it has an obligation to question what goes on at the Fed. I think that comes through in a variety of ways when we meet directly with the public and through you as their representatives.

Speaking for myself, I want to be as completely open, no secrets, as possible in the conduct of monetary policy. However, I think that we all realize that there is a tradeoff sometimes in public policy between openness and the quality of the product, the quality of monetary policy. We are trying to find the right tradeoff.

Mr. ROTH. Let me phrase the question this way. All the testimony I have heard this morning could be capsulized as: Videotaping and verbatim transcripts, no matter when they are released to the public, would decrease the quality of the deliberations. I think that is basically what everybody has said. So you make monetary policy, but Congress makes fiscal policy. Your arguments are the same arguments we heard before Congress was televised. But do you think that Congress, and we make the fiscal policy, do you think that Congress has been less well served because we have been televised?

Mr. BOEHNE. I am reluctant to comment on the quality of fiscal policy.

Mr. ROTH. But seriously, I think that is the question, I think, that basically is what we are wrestling with.

Mr. SYRON. Congressman, I think that is a relevant point, but fiscal policy that is made in a more episodic sense. It is made not on a continuous basis, where monetary policy is. Monetary policy is reported to the Congress twice a year in Humphrey-Hawkins hearings. While I am not opposed to having the degree of openness that is necessary, monetary policy does require input from confidential sources. It would be impossible to get confidential information from financial markets, companies, and other parts of the private sector.

Mr. ROTH. Mr. Syron, what goes on at these meetings that is so confidential that is going to hurt the public or the Congress if 60 days after the meeting Congress or the public read the transcript?

Mr. SYRON. I think it depends on what is discussed at the meetings. I will give you a specific example. I come to a FOMC meeting talking about the credit crunch issue and I mention a specific company in one of the States in the New England district.

I give the company's name, and say I am concerned that it is going to go out of business, this is what the employment effect is going to be, depending upon its capital flow over the next 90 days and what its bank does. That company is not going to give me that information if it is going to be included in a publicly available transcript in 60 days.

Mr. ROTH. Mr. Syron, that happens to us all the time. We get all kinds of cases, where people write to us, and we use that on the floor of Congress without giving their names.

Mr. SYRON. They give you that information because they want to make a specific point and they are writing to you of their volition. We are going out seeking the information from them. I am talking about a process where we are continuously and appropriately asking people in our districts for confidential information. I am afraid that in an open, or videotaped session, you would dramatically alter our potential of getting that information.

Mr. ROTH. I appreciate your comment.

Mr. Chairman, I want to make this comment in closing. There is no one on this committee that is a better friend of yourselves than I am. But I just want to say this. In the climate we are living through today, where there is so much public distrust and a lack of confidence in our public trust, I think we are coming to the point where all these things are going to have to be brought out in the open whether we like it or not, because I think the public is going to demand that. Thank you very much.

The CHAIRMAN. Mr. Hinchey.

Mr. HINCHEY. Thank you, Mr. Chairman. First of all, you are a very impressive group of Americans and I very much appreciate your being here and the opportunity to be with you. I express my appreciation to you, Mr. Chairman, for providing these gentlemen here.

First, with regard to the question that the chairman asked of Mr. Greenspan earlier, I just want to see if I understood the answer. As I understand it, there are tape-recordings taken of the meeting by staff. Those tape-recordings serve as the basis for the preparation of the minutes that are released a month or so later after the next meeting. And in the interim, those tapes are then taped over so that no permanent record exists in that way. Is that correct?

Mr. GREENSPAN. There is no permanent electronic record, that is correct. We obviously have rough notes——

Mr. HINCHEY. You do make recordings, but the recording is taped over?

Mr. GREENSPAN. That is correct.

Mr. HINCHEY. After the staff then prepares the minutes in preparation for their release at a subsequent date, a month or so later, between that time, the time that the staff prepares the minutes and their release, do the members then have an opportunity to review those minutes?

Mr. GREENSPAN. Yes. The minutes are drafted by the staff in some detail, circulated to the individual members to make certain that they capture the substance of what went on. There are changes that are made, corrections that are made. There are a number of suggestions to clarify certain points. Then we have a final set of minutes which are those minutes which are released to the public 6 weeks, generally, after the meeting itself.

Mr. HINCHEY. So the members in attendance then have an opportunity to edit the minutes before they are released?

Mr. GREENSPAN. That is correct.

Mr. HINCHEY. With regard to the memorandum of understanding or memorandum of discussion, rather, that was available prior to 1976 or 1977, precisely what did that memorandum contain? Was that a verbatim release of what took place? Was it rough minutes? How would you describe it?

Mr. GREENSPAN. It was a fairly detailed memorandum. In fact, maybe it would be better if I asked President Boehne, who was actually present at those times, to describe exactly what they are, and he could probably do it better from memory than I can from nonexperience.

Mr. BOEHNE. It would be hard to top your ability to do that sort of thing, Mr. Chairman, but let me try. What those memoranda were, they are not verbatim, but they went through and described the individual positions in a sequential way, and they were perhaps—I am really guessing now, but I would guess they would run maybe 150 pages or something like that for a typical meeting and they were released with a 5-year lag, although there were a number of things that were taken out, particularly involving relationships with foreign central banks and other kinds of information that might damage individual firms or companies or banks or that sort of thing.

Mr. HINCHEY. Even after 5 years there was a danger that that might occur?

Mr. BOEHNE. In terms of some of the ongoing relationships, particularly in the foreign area, I think that was the judgment at the time.

Mr. GREENSPAN. In my comment that—minutes are not made available by other central banks, and that the Bundesbank, for example, makes its minutes available, I believe, 30 years after the actual event. So the amount of disclosure which occurs by the Federal Reserve is far above any disclosures made by other central banks amongst the industrial countries.

Mr. HINCHEY. But it is less so than it was prior to 1976 and 1977?

Mr. GREENSPAN. In the sense that we make—I would suspect that our actual minutes now are more inclusive than they used to be, and far more representative of the substance of the discussion. But they are not as long and detailed as the memoranda of discussion that existed 15 or 17 years ago and earlier.

Frankly, I would suspect the person who wanted to find out what happened at an FOMC meeting would learn far more from the minutes we produce today than having to plow through one of those memoranda of discussion of an earlier period.

It is probably useful for scholars who are very interested in the extreme detail of the deliberations, but I will tell you, if the purpose is to find out what happened, that is not the best way to do it.

Mr. HINCHEY. So, Mr. Chairman, is it true, then, that as a means perhaps in part to compensate for the elimination of the detailed memorandum of discussion, the elimination of that in part, the rationale—since that was done—let me rephrase the question. Since that was done at some point in 1976 or 1977, in order to compensate for that absence now, the minutes that are produced on a monthly basis are more detailed than they would have been prior to that?

Mr. GREENSPAN. I think that is true.

Mr. BOEHNE. That is correct. What is now put out is more detailed than was put out pre-1976, and also is released more promptly. And I think in a much more usable fashion. If one wants to go back and look at what happened at a particular policy meeting, I, for one, would prefer to read the minutes that we now produce than to plow through those old memoranda of discussion, just in terms of practical——

Mr. HINCHEY. Might I ask just one more brief question? I notice that in the minutes you provided, as appended to your testimony, Mr. Chairman, there is some discussion about events that took place and various things that are said, but it doesn't attribute the statements to any particular member. What is the reason for that?

Mr. GREENSPAN. There is a good reason for that. First of all, let me say there are two positions one takes at these meetings. You are either in favor of the final result, meaning you are part of the majority, or you are in the minority. We try to explain in some detail the rationale that has been developed during the meeting by those who eventually voted for it. So in that sense, each member of the majority is essentially subscribing to the views that are involved in that decision.

Those who dissent, for whatever reason, write special dissents specifically. The reason why we emphasize the overall view of the committee is that this by statute is a committee, not a group of individuals, and that we have responsibilities as a committee and are held responsible to the Congress for what it is we do as a committee, not as individuals.

Mr. HINCHEY. But isn't it true the committee is influenced or may be by statements that are made by individual members of the committee? That is the purpose of the discussion, and although one sees the vote, those who voted for and against, those who voted for, particularly, for example, with regard to the discussion of M1, M2, and M3 that took place at the meeting that is reported in the February meeting, certain people may have been influenced by statements made by others at that meeting and they may have voted on the basis of those statements.

Isn't it instructive to know who is influencing people to vote a certain way?

Mr. GREENSPAN. That is difficult to do even in the memorandum of discussion, because what it is that creates changes in points of view or why people come out in certain ways is not always that clear. Sometimes in the discussion somebody will say, I agree with that or I don't agree with that, or I see what you mean or something of that nature. What we would actually need is a different type of set of minutes that would not express what the committee is doing, and in that regard we have discussed this and looked at it at great length and have concluded that it is important that we emphasize what the consensus of the committee is, because that is where the action and the directive comes from, and for which we are held responsible as a group.

And I think that if we endeavor to start to separate this group into individuals, we would lose the strain of the importance of being a committee as differentiated from the individual members themselves.

Mr. HINCHEY. Thank you, Mr. Chairman.

The CHAIRMAN. May I just add one thing here, to clarify, with respect to the Bundesbank, they report to the press immediately after their meeting regarding their decisions.

Mr. GREENSPAN. They report their decisions, but they do not report their deliberations.

The CHAIRMAN. Well, no, we are not talking about the same thing, though. Unlike the case of the Open Market Committee, you are not saying their decisions are reported immediately.

Mr. GREENSPAN. I am basically saying you don't know what the vote of the Bundesbank Council is for a very long period of time. They don't say who voted for what. All you get is the final conclusion.

The CHAIRMAN. I don't want to go into it, but there is a vast difference between the culture and the historical association of that class of banker in a country like Germany and ours. The bankers in a country like Germany look upon themselves as part of the officialdom of the administration. And I don't think we have that tradition in our country. But I don't want to get into that.

I want to thank you for giving me the opportunity to interject. Mr. Ridge.

Mr. RIDGE. Thank you very much, Mr. Chairman. Chairman Greenspan, obviously from the comments of some of my colleagues and some of the legislative initiatives, there is some concern about the mystique surrounding the environment with which the Open Market Committee operates. As my colleague at the left was concerned about, an increasing interest in the body politic of more sunshine, greater disclosure, that is the political side of the discussion.

The policy side of the discussion, I think, recognizes the legitimate need to keep the different contingencies that you had discussed, some of the confidential information you glean from those involved in the economy within the region that helps you come to the conclusions or certainly enables you to draw on information in the marketplace to deliberate and then make some decisions. So we are trying to balance the public's right to know with your need to make some fundamental monetary policy decisions. And I understand that, but I am very interested from your perspective in learning whether or not the manner in which you deal with the question of public access to monetary policy decisions differs from other central banks.

And to the extent that it differs, are there any lessons to be drawn from the experience of other central banks where they may have provided either by design or unintentionally earlier access to the information involving your deliberations or accidental access as it affects monetary policy or minimizing inflation?

Can we look to the central banks in other industrialized democracies and draw any conclusion if the manner of dealing with this differs from ours?

Mr. GREENSPAN. We are so far ahead in the issue of disclosure and indicating to the public what we do and why we do it and who votes what on various different directives, that there is almost no comparison. The general culture of central banking outside the United States has far, far less elements of openness than we have. It is part of their culture, as the chairman says. So I don't necessarily think that we should be endeavoring to view essentially what others do as a model for what we do. We have a different type of culture. It is a far more open one.

And that is reflected in our central bank as well. The trouble, unfortunately, is that central banking by its nature cannot be open, fully open, without undermining our capability to implement our role as described by the law. It is a terrible dilemma that we have, and I personally, in fact, all of my colleagues believe that we would like to have everything out in the open. The only trouble is were we to do that we wouldn't be able to do our jobs. So it is a very delicate and difficult balance that we believe that we at the central bank in conjunction with the Congress over the years have accomplished—a fairly reasonable balance that I think balances our culture on the one hand, and the necessity of operating in markets on the other.

I don't think that tradeoff even remotely resembles that which exists in any other industrial country.

Mr. RIDGE. Are there any examples of which you are aware where the public or the marketplace in any of the industrial countries may have gained access, not through appropriate public disclosure, but through leaks of the sort that had an adverse impact on the marketplace?

Mr. GREENSPAN. I assume they go on from time to time. Any institution which has got large numbers of people will tend to do that. The difference, however, is that in many of those institutions there is a single Governor and a Deputy Governor and very few people who are involved in the process, and hence the probability of leaks are much lower than where you have a large number of people involved.

Mr. RIDGE. I appreciate that, I guess, and I apologize for being late. As I gleaned through some of your testimony and listened to the few witnesses that I had an opportunity to hear, the contingencies, the economic contingencies that you discuss and the information that you share and the dialog with which you engage and challenge one another, it is your collective opinion that the public disclosure of those contingencies or that confidential information, and I suspect engaged dialog, in your judgment, would bring volatility, far more volatility to the marketplace to outweigh the need for us to see immediately the entire course of your deliberations?

Mr. GREENSPAN. That is the judgment of this committee, and I believe it is unanimous, unless I hear those who wish to dissent from that, because we have discussed this issue at very considerable length. We have no vested interest in not disclosing what we are doing as quickly as we can and as broadly as we can. The sole reason why we choose not to is because we believe that the implementation of policy would be impaired.

Mr. RIDGE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. Fingerhut.

Mr. FINGERHUT. Thank you, Mr. Chairman. Mr. Chairman, I do have an opening statement I would like to submit for the record, with your permission.

The CHAIRMAN. Certainly.

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

Mr. FINGERHUT. I would say that based on what I had heard at the beginning of these hearings, I would associate myself with some of Mr. Neal's opening comments, both with respect to the subject of the hearing and also his other resolutions.

I have enjoyed these hearings, Mr. Chairman, and I appreciate you calling them, because it is an extraordinary opportunity for someone new to this committee both to have an exchange with the Chairman of the Federal Reserve and now to do so with all the members of the Federal Open Market Committee.

Last week, Chairman Greenspan, we talked about the coordination of fiscal and monetary policy, and you, on the record, and I appreciate it, were very open about the extent to which you do meet with the relevant persons in the administration who are charged with developing fiscal policy. And I, in fact, commend you and the administration because we have seen a coordination between fiscal and monetary policy over the last period of months that is better than some of the times in our history.

Having the rest of the members of the committee here today, though, prompts me to take the question a step further. While we tend to report our economic results on a nationwide basis, we know that we are, in fact, a very diverse nation, and that often the results that make the headlines in the *Wall Street Journal* are a compendium where, in fact, some areas are doing very well and some areas are not doing as well as they should be.

I would be interested in any comments, and I will just turn my time over to the panel, as to how we do and how we can improve our coordination of technical fiscal and monetary policy, and indeed the broader range of actions we take here in the Congress on a regional level, so the sustained growth we all are seeking is one that is spread equally throughout the country.

Mr. SYRON. May I try answering that question? I think your question is a very apt one particularly at this point in time, because we all collect data on what happens in our regions. Actually, if you look at this recession's recovery period, you'll notice that the variance in regional economic performance is very, very dramatic.

In some places you would hardly know there had been a recession. In some cases, which unfortunately, includes my district, you would hardly know there has been a recovery. This type of transitional situation underscores one of the great values of the system, when published information is not adequate, we have the ability to gather information on an anecdotal basis and get a better feel for what is happening.

While the most important determinant of what happens to any part of the country is the national economy as a whole, another value of the regional system that it is completely consistent with the Federal system of government we have, is the input of all parts of the country in deciding what melded policy on a crudely average basis is best for the Nation as a whole.

Other countries have had policies of different kinds to deal with distressed versus nondistressed regions. The history of success of that approach is mixed at best. Our approach of establishing a common national policy, taking into consideration regional differences, has really worked out quite well in an overall sense.

Mr. MCTEER. Can I just add a footnote to that? To tie together your comments about regional differences in the country, a district, and the question of release of information, we do what they call a beige book, which is the result of a very extensive set of interviews with various sources by each Federal Reserve Bank and we actually publish all of that material that goes into the beige book prior to the FOMC meeting so the public has that even before we get together, to me, just a footnote.

Mr. HOENIG. I think bringing regions to the meetings is very, very important in terms of bringing the differences that occur around the country together and forming monetary policy. As far as the coordination with fiscal policy, though, you do not want 12 regions trying to coordinate fiscal policy with people.

I think that is why you bring it to the Open Market Committee, and why it goes to the Chairman, who then has the best means of informing and so forth in the right context.

So it is important we bring it together, but how we coordinate, I think, has to be done very, very carefully.

Mr. FINGERHUT. I appreciate all of the answers.

The CHAIRMAN. The time of the gentleman has expired. We have another panel following.

Mr. KNOLLENBERG. Thank you, Mr. Chairman. I must be the last one, looking around. I appreciate the testimony of this panel, especially Chairman Greenspan. You have been here a number times and it is a pleasure to see you come back each time.

There are proposals that are being tossed about regarding more closely tying the FOMC and the Fed to each administration, and we have heard some comment about you folks being the foxes that guard the chicken house, I don't especially believe that.

In fact, if you look, the chickens seem to be in pretty good shape, so I would say you are doing your job very adequately. As I have said before, you are probably the envy of the rest of the world.

There is a lurking feeling out there, and it has been talked about by a couple of my colleagues, as to getting things out in the open, the sunshine. Congress seems to, of course, hear a lot about that of late. The 14-year terms are one thing I hear about from my constituency. Is there anything magic about 14 years? This is addressed to you, Chairman Greenspan, in the time that remains, but is there anything magic about those 14 years?

Could it be shortened to 4 years or 6 years? Would that, in fact, do anything to alter the process, and your success rate?

Mr. GREENSPAN. Well, let me say, Congressman, that the 14-year term was something that was compromised out in the original act in 1913 in an endeavor to insulate the members of the Federal Reserve Board from political—from short-term political pressures, and to effectively spread out the appointment process of each individual

President of the United States. So in that sense, is there a magic element involved? Obviously not.

Clearly, it could be shorter or it could be longer. That is a judgment that the Congress has to make. As a practical matter, few of us actually serve the 14 years. So it is not a practical issue. It is an issue more of statute than it is for implementation.

I call on my other colleagues to make other statements they would like to make.

Mr. KNOLLENBERG. Before you get to that, would you have any—I assume, and I shouldn't assume, I guess, but I assume you would feel differently about appointing the Fed Chairman at the commencement of a President's term.

Mr. GREENSPAN. I must admit I go back and forth on this particular question, because there are pluses and minuses as to when the Chairman and the Vice Chairman of the Federal Reserve Board are chosen. And it is very rare that I don't have an opinion strongly on one side or another. But the weight of evidence on both sides of this argument are as balanced as I remember any particular public policy issue getting.

Mr. KNOLLENBERG. In the time remaining, anybody else want to chime in and offer a comment? I assume you speak for the group. Then in that case I will conclude my questioning and I thank you, Mr. Chairman, for bringing these folks in. Thank you very much.

The CHAIRMAN. Thank you.

Mr. GREENSPAN. Mr. Chairman, one of my staff has informed me, and I would correct this for the record, the 14-year term goes back to the 1930's, not to 1913. So I amend my statement accordingly.

Mr. KNOLLENBERG. You stand corrected.

The CHAIRMAN. Gentlemen, thank you. Mr. Leach has requested 1 minute for, I guess, a summation.

Mr. LEACH. Not a summation, but in our booklets we have a statement from David Mullins, and I would like to ask unanimous consent that it be presented for the record as well.

The CHAIRMAN. Without objection.

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

Mr. LEACH. Second, I want to respond from a personal perspective on the Open Market Committee issue. There has been a very emotive response from one of the Federal Reserve Bank presidents, but let me as carefully as I can say that the policies of the Federal Reserve Board of the United States of America, when it comes to regulation, have had multi-billion-dollar implications for the fiscal policy of the United States; that is, the LDC lending circumstance which was partly regulatory-oriented decisionmaking, has caused us to write off billions of dollars of public debt.

I raise this because we have a circumstance in America today that for the first time in the last 50 years, Federal Reserve Board regulated institutions have lower—lower, I repeat—capital ratios required than State-regulated institutions. By historical perspective, I think it very important that the Congress of the United States note that the independence of the Federal Reserve System is the tradition and the history of 20th century America. The Federal Reserve Board has a marvelous record which this Congress must honor. But not all aspects of this record have been or are perfect.

The CHAIRMAN. Thank you very much. Mr. Neal is recognized for unanimous consent request.

Mr. NEAL. I just wanted to ask that the rest of you, if you would, comment to me and for the record on these two questions; whether or not you agree that price stability is the best policy for the Fed, and whether or not you think the Fed should be held accountable for achieving and maintaining that policy by legislation.

The CHAIRMAN. Mr. Neal, the Chair had indicated that when we recognized you, your time was up; and any additional participation by any Member be submitted in writing for the record. Also, every member of the committee, both present and absent, is given unanimous consent to submit written questions to the members of this panel, provided they do so by the time you receive the transcript of the proceedings.

Gentlemen, thank you very much, and lady. Thank you very, very much.

We have another panel, and I must apologize for the time they have had to sit all morning long, but it is a very important panel, and one to which I want to offer my profound personal thanks for their constant cooperation with us.

It consists of the famous and internationally known Anna Schwartz of the National Bureau of Economic Research; Mr. James Meigs, economist for the First Interstate Bank Corp., and Mr. Robert Craven, Fixed Income Management Group. Thank you very much.

Dr. Schwartz, I particularly want to thank you for your constant help to the committee and some subcommittees. I understand you have a time problem, and I can appreciate that, given the length of time you have had to sit here this morning.

STATEMENT OF ANNA SCHWARTZ, RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH

Dr. SCHWARTZ. Thank you, Mr. Chairman. I am here to comment on two provisions in section 4 of H.R. 28 relating to prompt public disclosure of Federal Open Market Committee meetings. One provision would require the Federal Reserve to videotape and transcribe FOMC meetings and to make the videotape and transcription public within 60 days after a meeting. Another provision would require the Federal Reserve to make public within a week of an FOMC meeting the domestic policy directive voted upon and issued to the trading desk in New York after each FOMC meeting.

Let me first discuss the provision regarding the maintenance of detailed records of Federal Open Market Committee deliberations and their public disclosure.

To gain some perspective on this provision, it is helpful to trace historical developments on the availability to the public of information on the Federal Reserve's conduct of monetary policy through its purchases and sales of open market securities. Three subperiods may be distinguished on this matter in the Federal Reserve's history.

The first period was before 1936. The second period was from 1936 through March 1975. And the final period is the one since March 1975.

In the period before 1936, abbreviated minutes of Open Market Committee meetings beginning in 1922 were maintained, but restricted to internal use. Information on the Federal Reserve's activities is, however, available in two sources; one, the Library of Congress for the diaries of Charles Hamlin, a member of the Federal Reserve Board from 1914 to 1936, and Columbia University for the papers of George Harrison, a Governor and then president of the New York Fed from 1928 to 1940.

Charles Hamlin recorded his observations on the views of important Federal Reserve personalities and on the pressure of events on the decisions reached by the Board. The Harrison papers contain a wealth of documentary evidence, including the minutes of Open Market Committee meetings, official correspondence, memoranda exchanged in connection with those meetings, minutes of the meetings of the board of directors of the New York Fed at which system policy was analyzed, and a full record of Harrison's conversations with leading figures in the system.

In the second period, March 1936 through March 1976, detailed minutes or memoranda of discussion were prepared for each FOMC meeting. Before 1965 these records were held to be confidential documents. In 1964 the FOMC adopted a policy to release minutes of each meeting held through 1960 and for the release of minutes for subsequent meetings with a 5-year lag after the calendar year in which the minutes were taken.

This action by the FOMC was a response to congressional requests in the early 1960's for FOMC minutes and the publication in 1963 of a monetary history of the United States, from 1867 to 1960, of which Milton Friedman and I were coauthors. While the book was in draft, we sought but were denied access to the minutes of the FOMC by the Federal Reserve at that time. We had to substitute the Hamlin diaries and the Harrison papers for the period they covered.

By 1964, despite its refusal 2 years earlier to let us see minutes of meetings, the FOMC apparently decided that disclosure of the minutes after a 5-year lag posed no threat to the Fed.

In May 1976, the FOMC announced that after the March 15–16 meeting, memoranda of discussion would be discontinued, and the views of individual participants expressed at FOMC meetings would no longer be documented. The announcement apparently was inspired by the adoption of the Freedom of Information Act and the Sunshine Act that made it difficult for the Federal Reserve to maintain confidential and secret information.

The March 1975 meeting of the FOMC is the last one to date of which minutes have been made public.

I favor reinstatement by the FOMC of its former practice of maintaining detailed minutes of its meetings and publication of the record after a fixed period of time to protect the Federal Reserve against premature disclosure of ongoing, unsettled issues. The record should be verbatim. A videotape is neither essential nor desirable. The record should be verbatim subject to correction within a brief period by the participants for inadvertently misspeaking.

If the Federal Reserve regards 60 days as to short a delay for publication, I would not object to lengthening the delay to 1 year for a full record of the minutes of a meeting.

Absence of the minutes of meetings since March 1975 has deprived scholars of information on the formation of monetary policy and limits research. I am familiar with a recent proposal by a well-known scholar to study Federal Reserve performance in recent decades. That scholar intends to resort to interviews with former Federal Reserve officials as a substitute for the unavailable minutes since 1975. The better course would be for the Federal Reserve to publish whatever documentation it has maintained for each meeting in the period since 1976.

Let me now discuss the question of the appropriate length of delay of the release of the FOMC domestic policy directive. Current practice, which began in 1976, is for directives to be released after financial markets close on the Friday after the subsequent FOMC meeting. This is a lag of approximately 45 days after the meeting at which the directive was adopted and after another directive has been adopted. The directive that is released is always an outdated one.

The position of the Federal Reserve is that early release would harm its ability to conduct monetary policy and the government's commercial interests. It has asserted that prompt release of the directive would have an announcement effect on financial markets. Market participants would hasten to realize gains in anticipation of the Federal Open Market Committee's purchases or sales of securities that would lead to substantial additional costs for the government's debt financing.

The Federal Reserve argument boils down to the claim that prompt release would cause increased interest rate volatility that would raise the average level of interest rates. Is there evidence to support these claims?

Although official release of the directive is delayed for approximately 45 days, the *Wall Street Journal* has reported the contents of the directive within a week of each of 11 FOMC meetings out of the 34 meetings that took place between March 1989 and May 1993. These are leaks that the newspaper attributes to, quote, "government officials," or "people familiar with the Fed's deliberations." The newspaper articles correspond closely with the FOMC directives that were later published.

Prof. Michael T. Belongia of the University of Mississippi and his coauthor, Kevin Kliesen, have analyzed the 11 leaks as if they represented the immediate release of the directive. The authors examine changes in the Treasury bill rate on each of 5 days before and 5 days after the *Wall Street Journal* story appeared to see if the T-bill rate changes support the Federal Reserve's argument that the early release of the content of the directive would be associated with increased volatility in short-term interest rates.

The authors find that any such effect was negligible even when the directive contradicted expectations based on current market rates. Moreover, even if there were large responses of interest rates to each of the 34 directives since 1989 on the assumption that they contained news different from existing market expectations, the increase in variance was numerically small.

Belongia and Kliesen also raised doubts that increased volatility of the limited magnitude they find around the dates of leaks would raise the average level of interest rates on all other days.

I reach two conclusions. One is that the Fed would be better advised to release the directive promptly instead of selectively leaking its content. Market participants scrutinize every scrap of information on prospective Federal Reserve actions. The market will perform better if the scrutiny is based on the actual directive, however Delphic its content, rather than on rumors and conjectures about the directive. It is hard to accept the view that markets perform better the less information they have.

My second conclusion is that the Fed is needlessly concerned about the supposed disturbing effects of prompt release of the directive on volatility and the level of interest rates.

If FOMC meetings were held on Thursday and Friday and participants had an opportunity over the weekend to review the verbatim record to correct instances in which they misspoke, the Fed could then release the domestic policy record and this abbreviated information record on Monday morning when U.S. markets opened.

Finally, let me say that these hearings are devoted to peripheral aspects of Federal Reserve operations. The hearings do not touch on the substantive questions: What are the Fed's objectives? How effective are the operating procedures it follows to achieve its objectives?

So I applaud the legislation that Congressman Neal is proposing that price level stability should be the sole Fed objective. Thank you.

The CHAIRMAN. Mr. Meigs.

STATEMENT OF JAMES MEIGS, SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, FIRST INTERSTATE BANK CORP.

Mr. MEIGS. Mr. Chairman, members of the committee, it is an honor for me to appear before you to express my views on this important matter. I am familiar with the materials we have been discussing, the policy record, and the proceedings, because I used them for many years in three capacities: One, as an economist at the Federal Reserve Bank, where we were providing analytical support for the president of our bank in preparing for meetings of the Open Market Committee; second, as a researcher, writing and lecturing on money and banking, monetary policy, and world financial markets; and third, as an economist or consultant for banks, securities firms, savings and loan associations, and other institutions.

I have had no experience in the oversight role implied by Congress' power to coin money and regulate the value thereof, in article 1, section 8, clause 5, of the U.S. Constitution. However, I think my recommendations may be helpful to you in that function.

I have three recommendations. One, the Federal Reserve should publish the policy record of the Federal Open Market Committee within 1 or 2 days after each meeting of the committee. The policy record should clearly state any changes in policy and the reasons for the changes.

Second, the FOMC should resume the practice discontinued in 1976 of having the committee secretary prepare a memorandum of discussion for each meeting, the minutes. The memorandum of discussion should be released to the public after no more than 1 year.

The third recommendation is that the Congress should provide a clear mandate for the Federal Reserve to pursue a stable price level for the U.S. economy, that is, to regulate the value of money. This Banking Committee then could concentrate on holding the Federal Reserve accountable for how it carries out that delegated responsibility.

In the rest of the statement, I plan to state some of the reasons for these arguments. On the policy record, at the end of my statement for hearings of this committee on September 11, 1973, I said, "My one additional suggestion is to eliminate the secrecy that now cloaks the processes and decisions of the Board of Governors and the Open Market Committee. I see no reason why policy directives of the Open Market Committee should not be publicly announced immediately after each meeting of the committee, preferably with a discussion of the reasons for policy decisions. Ending the secrecy would not only facilitate the monitoring of System actions by the President and the Congress, but it would greatly reduce uncertainty among the general public."

At the time I wrote that, I was advising clients at banks and other financial firms. My inability to provide them with more nearly current information on Federal Reserve policies was extremely frustrating. Now, 20 years later, I am even more firmly convinced that the policy record should be released immediately after each meeting.

Participants in United States and world financial markets are as skittish as gazelles drinking from a river infested with crocodiles. Over the last 20 years, they have invested vast resources in equipment and techniques designed to shorten the time they need to react to new information about economic policies and prospects. They especially would like to know what the FOMC decides about policy at each meeting and what circumstances might lead to a change at future meetings or in the period between meetings. The slightest hint of a change in U.S. monetary policies can affect securities prices and exchange rates around the world within minutes.

These well-known facts about financial markets' sensitivity to changes in the Federal Reserve policy have been used in arguing for delay in releasing the policy record in order to avoid destabilizing financial markets. I believe to the contrary that the effects of reducing the delay in releasing the policy record would be in the other direction. Immediate or early release would exert a stabilizing influence on financial markets by reducing uncertainty. That does not necessarily mean the markets would not jump when a new issue of the policy record announces a policy change. People with their own or client's money at risk adjust quickly to any announced or suspected policy change.

Market jumps in reaction to early policy record releases might embarrass the policymakers, especially when interest rates or exchange rates shift in an unpopular direction. But the markets would be more likely to jump in a direction that would be consistent with Federal Reserve policy objectives than when the markets react to rumors, leaks, innuendo, or conjectures which later prove to be unfounded. It would be better to provide the markets with the truth—whether potentially disturbing or not—and let them sort it out.

Early release of the policy record would have the further virtue of leveling the playing field. Some market players now are believed to have better access to information on Federal Reserve policy than others do. This obviously causes hard feelings or worse at times when some institutions believe competitors receive valuable information from Federal Reserve sources sooner than they do. The policy record should be thrown on the table for everybody at once as soon as the facts are in, like a crop report.

The memoranda of discussion are the minutes we have talked about quite a bit this morning. The memoranda of discussion that were discontinued in 1976 provided fascinating insights into FOMC policymaking procedures, although with an intolerably long delay. A new series of minutes or memoranda of discussion released with less delay would be extremely useful to future policymakers, researchers and market practitioners.

Chairman Arthur Burns told the Subcommittee on Domestic Monetary Policy in 1977 that he thought a bill to require the FOMC to maintain detailed minutes and to publish them after 3 years was "clearly motivated by a concern for the interests of scholars and others who may have occasion to do historical research in the area of monetary policy."

Numerous other researchers and I had written to the committee to express various degrees of anguish over losing the memoranda of discussion. So he thought he was replying to the scholars out there, of whom there were very few. Chairman Burns conceded that the newly revised and expanded policy record "does not preserve a historical record as detailed as that contained in the earlier memoranda of discussion." While expressing his regret over no longer producing FOMC minutes for scholars to mull over, Chairman Burns slighted a much more important group of readers.

He hardly mentioned members and staff of the Open Market Committee and innumerable people throughout the system who have to interpret, explain, and carry out monetary policy. For example, at the Federal Reserve Bank of St. Louis, we used the draft minutes of each meeting to help our president prepare for the next meeting. One reason was that the economist who accompanied the president to FOMC meetings seldom could take enough notes to tell the rest of us who said what and why in a meeting of 12 Reserve Bank presidents, 7 board members, and several staff advisers.

The point of this anecdote is that Federal Reserve views on how monetary policy should be formulated and carried out, were evolving then at a rapid rate, as they still must be evolving now. There was no clear manual of procedure for dealing with policy problems. The FOMC was adapting to changing economic institutions, changing financial institutions, and changing doctrines in monetary economics. Because the membership of the committee was continually changing, the FOMC needed an institutional memory to organize and to preserve this learning experience for future generations of policymakers inside the Fed itself.

The memoranda of discussion provided a fine vehicle and repository for the FOMC institutional memory. The memorandum for each meeting recording the discussion was reviewed by the participants to guard against errors in transcription or wording and was locked up in final form for posterity at the next meeting, usually 1 month later. As Dr. Schwartz said, years of such records of experience are now lacking, never to be retrieved, and these are years of the most sweeping changes and conditions of monetary policy.

Keeping and publishing detailed minutes of FOMC meetings would help answer three overriding questions. One, how do members of the Federal Open Market Committee learn to exercise the awesome powers delegated to them?

Two, how does a corporate body made up of ever-changing individual members remember and employ what it learns from its mistakes and successes?

Three, how can the government that delegated those powers oversee the performance of their stewards?

Former Reserve Board member and Vice Chairman J.L. Robertson summed up these issues in a letter to the chairman of the Subcommittee on Domestic Monetary Policy in 1976, Chairman Neal at that time. He said—and he was a very outstanding and articulate Governor—"In my view, the formulation of monetary policy by the Open Market Committee is one of the most important factors influencing the economy. Hence, it should be mandatory that there be kept a detailed record, to be made available to Congress and the public, after a lapse of appropriate time."

He went on to say, "If minutes of the meetings are not kept and eventually made available, there would be no possible way for the Congress or members of the public to appraise the contribution of any member of the committee to the formulation of monetary policy. Such appraisals are essential to any study of how to improve the system."

Governor Robertson also answered the question which came up over and over and over and over again this morning, of whether knowing they were on public record would inhibit members willingness to speak frankly in FOMC meetings.

He said, and I quote, "Men competent to serve in these positions should be willing and anxious to stand on their records and be held responsible for the way in which they play their respective roles."

The men and women who serve on the FOMC today and those who will serve in the future should not be reluctant to go on record. Each will be backed up by some of the most competent economists in the world. Each one will already have won distinction as a responsible professional in some capacity before joining the committee.

I would suggest that any committee member who is afraid his or her statements might not stand up to the tests of time or outside view should either put more thought into the statements or seek a less demanding line of work.

Now we come to what I think is a crucial recommendation, which I would call a mandate for the Federal Reserve.

When considering the use of the minutes and other information from the Federal Reserve for establishing accountability one must ask, accountability for what? Most treatises on responsibility and accountability in business, government, and the military stress the need for a clear statement of the responsibility or mission for which an individual or an organization can be held accountable.

Such a statement or mandate is lacking here. After 200 years of constitutional history, we still have not clearly decided what the mandate for control of the money power is or where it resides.

The Federal Reserve System and most other central banks pursue multiple objectives at the same time, economic growth, employment, price stability, interest rates, and exchange rates and others. Experience of many years and many countries demonstrates that it is impossible to achieve all of the objectives set by central banks and the governments simultaneously.

In operating and in reporting to the governments and the public, it is agonizingly difficult for the central banks to decide which objective or objectives to stress.

Consequently, there is an inflationary bias in monetary policies of many countries that is extremely difficult to counteract.

Most important, there is no simple tradeoff that would permit central banks and governments to achieve higher real economic growth by tolerating more inflation. Instead, a stable price level would provide the best possible foundation for maximizing opportunities for increasing employment and real incomes.

Now, this Congress could cut the knot by instructing the Federal Reserve to maintain a stable price level—zero inflation—to regulate the value of the money. That is, the Congress could tell the Federal Reserve to do something it can do and that would have a tangible, measurable result.

The Federal Reserve could then concentrate on learning how to do that and doing it. The Congress could hold the Federal Reserve accountable for carrying out that responsibility.

The Congress could and should examine all information coming from the FOMC, including the memoranda of discussion, and the policy record, to assure itself and the public that the value of money is well regulated. The voters ultimately would hold both of these bodies accountable for the results.

Thank you.

Chairman GONZALEZ. Thank you very much.

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

Mr. Craven.

STATEMENT OF ROBERT CRAVEN, FIXED INCOME MANAGEMENT GROUP

Mr. CRAVEN. Chairman Gonzalez, members of the committee, thank you for the opportunity to address you this morning.

Congressman Neal, as you stated, the Fed clearly has done a good job and I would agree with you and I also would say it is easy to be critical and I would like my comments today to be taken in a constructive light.

It is a very, very tough job that the policymakers are harnessed to, I realize that, but it's a shame that they have chosen to cloak their communication in what I feel is unnecessary secrecy. Sometimes it seems almost designed to confuse and mislead the marketplace.

It is as if I were a heart surgeon and I was here before you, I could explain in two ways heart disease; one in medical terms, which none of us would understand; and the other is that the muscle is weak and the veins are clogged, and you would get the point.

When I look at the committee and I see few in attendance and I am told—believe me I am very naive in the ways of Washington—but I am told there are members who are intimidated by Fed language, by the members of the Fed, and I understand that completely. I think that the Fed is guilty of using language to intimidate and that is something that I think needs serious attention.

I would like to testify on the impact of leaks on the financial market as you asked me to do. I would like to expand also my comments to include what I feel to be a general lack of central bank control over the members use of the media, a lack of discipline, and how that is detrimental to the marketplace and ultimately costly to the taxpayer.

I am not here to solicit sympathy for the trading community because I don't think they need it, but if we can draw the line to the taxpayer maybe it makes more sense.

I would also like to suggest that procedure be improved as Dr. Schwartz and Jim Meigs have done, regarding dissemination of Fed policy.

My presentation is in three parts. The first concerns leaks of the outcome of the deliberations, that is the vote, and the turmoil caused by those leaks, the extreme volatility. I use the term violence in fact in the marketplace. As a result of these leaks, a premium of uncertainty is built into the interest rates (meaning higher) and the burden is carried by the taxpayer because of higher Treasury borrowing costs when auctions take place near or around the leak.

Two recent leaks will serve as examples and if I have time to plow through them, I would like to.

Second, I would urge change in procedure surrounding the release of the minutes.

My view is that the directive should be released immediately after deliberations; and second I would suggest that policy not be changed until the next meeting and I would just brush on this because it represents a major change in Fed operating procedure, but it dovetails with the discussion.

Last, other than leaks, under the Greenspan Fed, some policymakers use the media to air their own viewpoints even if at odds with current Fed policy. This is my personal view. Some policymakers seem to be intent, at this particular time, on selling themselves through the media.

Second, general commentary is often ill informed and reckless. Such commentary destabilizes the financial markets every bit as much as the "leak."

This loose cannon approach must be stopped. Although Greenspan pledged to stop the leaks after some urging by this committee, he needs to enforce a measure of discipline on policymakers general use of the media.

Let's first address the leaks and I will skip some of this given our time constraints. The leak of May 21, 1992, carried on pages A2 and C20 of the *Wall Street Journal*—by the way, on several occasions I have confronted the *Journal* and talked to the reporter involved and, of course, the response is the same, that we are doing our job. One wonders why Reuters and Dow Jones and Knight-Ridder are not doing their job?

This leak was carried first in the Asia edition of the *Wall Street Journal*. This means that while U.S. traders were asleep, prices dropped overnight on Euro and U.S. Treasury debt and fixed income products in general, which are traded on a 24-hour basis.

Short-term rates jumped, and this will give you a very practical view of the effects of a leak. Short-term rates jumped 15 to 25 basis points, which means a quarter of 1 percent, early in the U.S. trading day, the first half hour or so. I will always remember because it is branded on my soul, unfortunately. Bond yields, which had closed at 7.77 percent the day before closed May 21 at 7.86.

Now let's take this one more step.

One-year Treasury bill rates, that averaged 4.07 on May 20, a day before, were 4.24 on May 21. In the scheme of things in fixed income markets, a 4.07 to 4.24 in 1 day on Treasury bills is a very extreme jump. Had Eurobills been auctioned that day this would have cost the U.S. taxpayer an additional $24 million, which is 17 kicks or basis points on the average size of $14 billion, due to this leak-induced spike in rates.

It was pure luck that the $10 million, 30-year issue which was auctioned on May 7, was not auctioned on May 21. We would have had then 30 years of additional cost.

I mention David Jones in the next statement. He is a well-regarded Fed watcher, if you like, and he works for a Wall Street firm. His book, "Politics of Money, The Fed Under Alan Greenspan," is a good one.

When referring to the turmoil from the Thanksgiving Day fiasco in November 1989, he said that "The uncertainty almost certainly was reflected in higher average Treasury borrowing costs in the period immediately following the Thanksgiving fiasco, than otherwise would have been the case."

This so-called fiasco was not a leak, but it was a cause of extreme volatility, because of a Fed miscue in open market operations.

In addition the *Wall Street Journal* reporter or reporters didn't bother to talk to the Fed before reporting the story that the Fed had eased. The Fed had not eased and through subsequent open market operations indicated that, and the market settled back.

But the difference in these two is that the first was an honest mistake. Leaks are not honest mistakes.

The end result is the same, however; extreme market volatility and ultimately higher costs to the taxpayer.

Let's examine one more leak. The infamous leak of May 24, 1993. That was a very effective leak because through this leak, the Fed told all of us that they are on the ball, they will snug at the first indication of inflation.

It was in fact very effective. It put a cap on long-term rates by saying the second we see any indication of an inflation problem, we will snug.

The markets had taken a nosedive on May 21 just previous to this date when minutes of the March meeting were released. So there is an example of what might happen the day of release.

At any rate, on that day, rates on short-term debt jumped 10 to 15 basis points and bonds, after fluctuating wildly, closed a half point lower in price. That was on the day of the leak. This story was first carried again in the Asia edition of the *Wall Street Journal*. So when U.S. markets came to work, they saw significant losses.

Approximately 12 billion 6-month bills were auctioned at an average rate of 3.19 percent versus 3.10 on May 17, at the previous auction, for an additional cost of $11 million to the taxpayer.

It could be argued that all of that cost was not necessarily due to that leak, but a good part of it was.

The leak was followed by a May 27 CNBC story, placed by a Fed source, which gave an actual trigger for tightening; that is, if the CPI goes up 0.04, we will snug. There was more violence in the marketplace, higher rates.

Rates recovered from the May 24 leak, and then fluctuated wildly. All this due to uncertainty. The 39 recognized dealers on Wall Street, were extremely nervous. They are reluctant to inventory debt, and that drives up rates.

Again pure luck that other scheduled U.S. Treasury debt did not come on these days. We intend to study the amount of private debt that is associated around the leak dates, and what additional costs were incurred.

Had the 30-year bond issued on May 13 been auctioned May 31, it could have cost the taxpayer $4 million to $12 million annually for the next 30 years.

My view is not an extreme one.

Let's look at another view. On July 6, speaking of this leak to *Market News Service*, a reputable news organization, David Resler, chief economist to Nomura Securities in New York stated, "To select particular news organizations to divulge the contents of the meeting is criminal and absolutely immoral. The offending members should be subject to incredibly severe penalties, including being expelled from the Federal Reserve System, at a minimum."

In light of the Fed's leak to the *Wall Street Journal*, "They might as well own Dow Jones stock."

Now, President Jordan said that the Fed—I don't want to misquote him here—"central banks don't leak."

Yet, Chairman Greenspan told us that he hopes the leaks are behind us.

So there is some problem there.

Let's go next to the minutes. As Anna Schwartz and Jim have pointed out, the so-called minutes of deliberations are not real minutes. They are summaries of deliberations.

My view is different from Anna's on release. I don't really have a problem with the full minutes being released at a later date but I have a problem with the directive. The directive is the two- or three-page summary to the New York Fed which says "Tell us if the economy is hot, cold or in-between," do this, this or this until the next meeting. That is what I think should be released immediately, as does Milton Friedman.

For example, the minutes for the meeting of August 17 go on for 14 pages. They can be longer. They say at the conclusion of the meeting, "The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise to execute transactions in the system account in accordance with the following directive," and the directive is about two pages. That is what we want released immediately.

It is brief, gives the reason for the consensus and the action and the vote. The release should be by way of a press statement. It is true that BBK can release information immediately after meeting, but it is at their own volition. They only do so at their own volition. But what I feel is that the Fed must be compelled to release after every meeting.

Milton Friedman has been a proponent of immediate release, saying, "The whole thing is absurd and unnecessary." In discussion with my firm on October 13, he said he supports our view.

There is one change I might make to Anna Schwartz' view and that is release on a Sunday night or Friday. These minutes I feel must be released on a weekday and if released on a Sunday, again the Asians and the European Community have a shot at our U.S. rates. These are traded 24 hours. They are traded in FIMEX and Japan. This information must be released early in the U.S. trading day.

At that time, the Asian community is still trading and the European Community is still trading, so this is fair.

Chairman Greenspan's response to this argument as we have heard here and as originally given to Congressman Neal in 1989 and repeated many times since is that the immediate release will increase market volatility. The comment was spread through the entire discussion, every single policymaker, that the problem is the immediate release will increase volatility. But if anything, nothing could be further from the truth.

Under the present system we have to live with leaks almost on a weekly or monthly basis. We would much rather take our medicine in the middle of the week after the FOMC and be done with it.

The argument that immediate release would compromise the market, it is, if anything, 180 degrees from the truth.

There is another problem surrounding the deliberations I would like to address just for the record; that is, the intermeeting policy changes. I think the intermeeting policy changes should be eliminated. I think that they should say, "Look, here it is. This is the nature of the economy. This is our feeling. Here is the directive to the Board and that is it."

The current system is that the Chairman within certain parameters is allowed to change policy intermeeting. This causes volatility. Every time we have an economic number, we wonder whether this numbers will trigger a change. Over 30 percent of the last 2½ years of policy changes have been triggered right after a nonpayroll number. They [Fed] often hinge on one number even though they say they may not.

The marketplace tries to second-guess the Fed around every housing number, ever retail sales number, ever payroll number. I suggest the changes be limited only to the meeting date.

Last, many of these reports around which policies in fact hinge are revised several times. That makes it even more confusing.

The Greenspan Fed is clearly a more democratic institution than that under Paul Volcker. On its face, this is admirable, but as Martha Seeger said in referring to the Fed in the *Wall Street Journal*, "democracy is messier than dictatorship."

As a result, during the FOMC deliberations, we hear more than ever—it seems to me more than ever before—from individual policymakers. This is very unfortunate. Policymaker statements in the media are sometimes reckless, ill-advised, sometimes cheerleading, and sometimes are politically motivated. All this adds unnecessary volatility and confusion to the marketplace.

This can be traced back, ultimately, to the U.S. taxpayer.

In May 1992, as an example, at a Civil Rights Commission Conference in Washington, the Commission suggested to Governor Lindsey that U.S. manufacturing was in decline and Governor Lindsey responded the manufacturing is "going like gangbusters."

When the marketplace here that, that is important, rates move on that type of comment. Governor Lindsey was quoted on May 13 as saying "The economy is moving along quite well."

Again the market hinges on every single word these gentlemen say.

Just to add to the confusion, on that same day, Richard Syron, a voting member of the FOMC and president of the Boston Fed, was on the news saying that "the recovery could fall apart."

This is on the same day from two policymakers.

The market sold off on May 13 as a result of what we feel was either cheerleading, which I think is an inappropriate use of the office; or a total lack of knowledge of the real sector.

I list for the record the actual economic numbers which I won't go through, but they were showing an economy with decreasing vigor, an economy clearly slowing down and particularly manufacturing employment was indicated to be off. This was just preceding the Governor's commentary.

Then economic numbers showed an even slower economy in June. Direct Fed surveys, housing starts, manufacturing employment, again, all lower.

Finally the payroll number of July 2 was so weak the Fed cut the discount rate and the Fed funds on the same date.

So again, this is misleading commentary.

This is not "going like gangbusters," not an economy doing "quite well," and yet we are not just speaking of one opinion of one policymaker, but a policymaker whose commentary is taken to reflect the view of the FOMC. That is my point, that such reckless commentary leads to violence in the market, it leads to volatility in the market, it leads to higher rates.

Shall I go on?

Chairman GONZALEZ. Sir, we have notice of a recorded vote and, therefore, if you could summarize—we would be grateful to you.

Mr. CRAVEN. I will do so.

Let me say that I feel like the policymakers, most of the policymakers have not been guilty of these offenses, and other situations mentioned in the presentation, and they have the wisdom to keep it zipped for lack of a better term, between the meetings.

Others have not.

Let me quote again from the Jones book, that some ambitious, new breed Fed policymakers have, in competition with the Fed Chairman, begun to effectively use the media and public relations to sell themselves or their own ideas perhaps in seeking recognition for future administration appointments to the Fed the Chairman's job itself or other key government positions, through background press, and the infamous Washington leak they can advance their own policy positions.

I would say in conclusion, there must be a return to discipline at the Greenspan Fed.

Thank you, Mr. Chairman.

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

Chairman GONZALEZ. Thank you very much.

I thank each and every one of you. Members who have come in and walked out and those who have not been able to be here, will have questions that they will be submitting to you. Each has a copy of your testimony. I will have only one question since I believe I saw you all here during most of the testimony by the previous panel.

In your opinion, and it is just your opinion, could all of the leaks revealed today be possible without the knowledge of anyone on that first panel?

Ms. SCHWARTZ. I think from the way the stories were reported it was obvious that they came from some official source. I don't know who the official was.

Mr. MEIGS. I don't know how they did it but I agree with Anna, that somebody very high in the system who knew what was going on talked to a reporter, maybe the same one more than once, you know. That is a favorite—I don't want to make any invidious comments about Washington, but there are those living in the rest of the country who kind of think this is the way things are done a lot in Washington. The leak is the source.

Now, I think it is valuable that we get the information however we get it. I am not so—so I am sorry for the dealers who were caught short, the people in Asia got the word before they did, but it is just important to get the information out on what is the policy. Without a mandate, a clear mandate on what the policy should be, that expands the dimensions of all the possibilities that they react to.

If they were pursuing a stable price level, policy would be set for periods of years at a time, there wouldn't be all this fancy maneuvering and changing and speculating and leaks; there wouldn't be needed.

Mr. CRAVEN. I concur. The leaks clearly came from an official source. In the last four or five—the wording of the last four or five leaks clearly came from an official source.

Chairman GONZALEZ. Thank you Mr. Craven.

Mr. Neal.

Mr. NEAL. Yes, sir. I know we don't have much time. I just wanted to thank Dr. Schwartz for her endorsement of our bill.

Mr. Meigs, actually you didn't mention my bill but you said the same thing. So I thank you for the sentiments also.

Mr. MEIGS. Yes.

Mr. NEAL. I remember, Dr. Schwartz, you were executive director of the Gold Commission and I was one of our Banking Committee's representative to that. I just want to thank all three of you for your help this morning.

We don't have time to get into any substance here, but I thank you all very much.

Chairman GONZALEZ. Thank you, Mr. Neal.

You have been most patient. We have gone right through the lunch period and it's a quarter of 2 o'clock, but I do want you to know we are very grateful. Your help is a lot more valuable than you may think and the presence or absence here of members should not in any way detract from your impression that this committee is not interested.

Let me say that even in the present form, we have better than a dozen cosponsors on this committee, on this bill. We have 21, Dr. Auerbach tells me. Incidentally, I wish to thank him for putting these meetings together. He is the main instrument and the committee is very fortunate to have him on leave from the university and he at one time worked for the committee before so I think you have met him. I just wanted to give him the credit that ought to be his.

Thank you again very much.

The committee will stand adjourned until further call of the Chair which will be our fourth meeting next week.

[Whereupon, at 1:50 p.m., the hearing was adjourned, to reconvene subject to the call of the Chair.]

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A P P E N D I X

October 19, 1993

Opening Statement
by
Henry B. Gonzalez
Chairman
Committee on Banking, Finance and Urban Affairs

October 19, 1993

Third Day of Hearings
on the Issues Involved in
the "Federal Reserve System Accountability Act of 1993" HR 28
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Today, the Banking Committee begins the third day of hearings on issues involved in the "Federal Reserve System Accountability Act of 1993," HR 28. I welcome Federal Reserve Chairman of the Board of Governors, Alan Greenspan; Federal Reserve governors; and presidents of the Federal Reserve Banks. Chairman Greenspan testified at our last hearing that everything proposed in our legislation, HR 28, was a "major mistake." Today we are going to hear additional testimony to see if our proposals are needed reforms or major mistakes. HR 28 requires that the FOMC:

1) announce changes in its policy one week after its meetings and that it
2) make public a complete record of those meetings 60 days after each meeting.

The central issue of today's hearing is simple: Why is the Federal Reserve, among all Federal agencies, exempt from keeping complete and accurate records? If the White House, the Supreme Court, the Defense Department and every other government agency keep accurate records of what they are doing, why not the Federal Reserve? Are decisions by these parts of our government less sensitive than those made at the Federal Reserve?

You distinguished gentlemen who serve as Federal Reserve presidents, did not have to present your credentials and your views to the American public to secure your seats on the FOMC. President Jordan has previously gone through the confirmation process for his seat on the Reagan Council of Economic Advisors. I hope today's hearing will allow the citizens of our country to learn a little bit about you and how independent your views really are.

I would like each of you to tell me if you think the following information is of sufficient national importance to require recording and publication of minutes of your FOMC meetings.

Last week at these hearings I cited FOMC minutes of two meetings prior to the reelection of President Richard Nixon. Those minutes were released five years after the FOMC meetings. Although he was warned that projections were for fast money growth, Federal Reserve Chairman Arthur Burns had called for even faster money growth at these meetings. Why shouldn't the historical record reflect the truth that Burns was pursuing an inflationary policy?

The importance of accurate minutes is reflected in the records of a Philadelphia Federal Reserve Bank's board of directors meeting. The minutes reveal a possible cover-up by the Federal Reserve related to the Watergate burglary in 1972. Recall the Watergate scandal that began with the break-in of the Democratic National Committee offices in the Watergate office building on June 17, 1972. A dangerous political crisis rocked our country while Congress sought to uncover the facts, including who financed the break-in. I read now from page 77 of the June 22, 1972 minutes of the Philadelphia Federal Reserve Bank's Board of Directors meeting:

> "Mr [X] reported that $6,300 in one hundred dollar bills had been found on the persons arrested for breaking into the Democratic National Committee headquarters in Washington. The FBI came to this Bank and said that ten new 3-C notes [$100 bills] numbered in sequence were among those found. This Bank informed the FBI that they were part of a shipment sent to the Girard Bank on April 3. Mr. [X] also said that the Washington Post had called to verify a rumor that these bills were stolen from this Bank. The Post was informed of the CV&D thefts but told they involved old bills that were ready for destruction.
>
> Mr. [X] said that Chairman Burns doesn't want the System to get involved and issued a directive to all Reserve banks on June 21, which said, in effect, that the System was cooperating with law enforcement agencies but should not disclose any information to others."

Three days earlier, Chairman Burns had written the following to the Joint Economic Committee about rumors regarding the sources of funds used to finance the Watergate burglars:

> "We at the Board have no knowledge of the Federal Reserve bank which issued those particular notes or of the commercial bank to which they were transferred. Without this information, there is nothing that we can do to comply with your request."

The apparent lie to The Washington Post reporter, as a result of the directive issued by the Chairman of the Federal Reserve, may have been part of a cover-up of important information by the Federal Reserve. Did the Federal Reserve ever inform the U.S. Congress about these bills it had traced that were found on the Watergate burglars? If the answer is "No" it appears that the Federal Reserve blocked the public and the Congress from a significant part of the investigation of the financing of the Watergate burglars. The acting director of the FBI, who may have been given the information, testified that he burned some Watergate files. The Nixon administration asked him to limit the FBI's investigation of the burglars' financing on the grounds that further inquiry would "uncover CIA assets and sources." That sounds familiar. What was the Federal Reserve's role in this cover-up? Did the Federal Reserve deliberately obstruct the Congress and the public?

If we only had a formal directive giving the extremely truncated version of these meetings, as the FOMC publishes today, there would not be a historical record of these events. The American public and the Congress are not the barbarians at your gates. These are the people whom you must serve.

Our expert witnesses testifying today will tell you that, contrary to what Chairman Greenspan testified about at our last hearing, accurate information does not undermine markets. Partial information and leaked information undermines market efficiency. I want to highlight the astounding claim in Dr. Anna Schwartz's testimony: "The Wall Street Journal has reported the contents of the directive within a week of each of 11 out of 34 FOMC meetings that were held between March 1989 and May 1993." Since substantial information is already coming out in leaked form, why should we pretend that it a closely guarded secret? We need a straight-forward record with complete and accurate information.

Some claim we have all the information necessary in the formal directive that is issued five or six weeks after each FOMC meeting. That directive is sometimes called "minutes." However, the FOMC directive is far from a complete record and it is equivalent to the kind of information we would get if the Supreme Court only announced its decisions and not its opinions. Although the directive does contain the FOMC vote, those who understand the Federal Reserve know the objective in any FOMC meeting is to get a unanimous final vote regardless of any underlying disagreement.

Publishing only the final vote at FOMC meetings is little more information than could be obtained from the Congress if we issued only the vote on adjournment and none of the discussion. In order to obtain a record that establishes individual accountability, there must be a more detailed record. Most of the so-called "minutes" the Federal Reserve now issues are boiler-plate reports on the economy that anyone could copy out of government and newspaper reports.

In 1976, the FOMC members arbitrarily announced that they had stopped taking minutes of their meetings. In response to his inquiries, Congressman Steve Neal investigated and reported that among the 55 individuals who opposed the FOMC's decision to stop taking minutes were four former Federal Reserve Governors and two former presidents of Federal Reserve Banks. One of the strongest letters was from Jerry L. Jordan, formerly an official at the Federal Reserve Bank of St. Louis and here today as president of the Federal Reserve Bank of Cleveland. His letter of October 21, 1976 said:

> "As an economist in the Federal Reserve for over eight years, I found the "memoranda of discussion" [the name for the minutes] to be extremely useful. Even when I attended the FOMC meetings I always reviewed the memoranda of previous meetings as part of the preparation for the next meeting.

> The President of the St. Louis Federal Reserve Bank was definitely influenced in a very positive way by the existence of a permanent record that would eventually be made public. It helped him and his staff to maintain intellectual honesty, sometimes in the face of great pressure to bend. He knew that even when his views fell on deaf ears in a meeting, consistent analysis of the problem and the recommendation of solutions would be in the record to be viewed with historical perspective."

I want to know why minutes which were clearly helpful up until 1976, suddenly became harmful after 1976.

I understand the peculiar position of the distinguished presidents of the Federal Reserve Banks who are testifying today. I had thought that last week Chairman Greenspan would have emphasized that you serve as independent coequals on the FOMC. However, he contends that the "ultimate defense against a bank president ... is the power [by the Board of Governors] to remove that person from office." I think this says a great deal about your independence. Nevertheless, I hope that our distinguished witnesses will give their honest views today and that they will be perfectly frank while their comments are being recorded. I look forward to your testimony.

STATEMENT BY
REPRESENTATIVE JAMES A. LEACH
Before the Committee on Banking, Finance and Urban Affairs
Hearing on Reforming the Federal Reserve System
October 19, 1993

Today we hear from ten presidents of the Federal Reserve District Banks and six Governors of the Federal Reserve Board. Given that these individuals influence the allocation and expansion of credit, not only through their membership on the Federal Open Market Committee (FOMC) but through their regulation of the banking industry, it is important to note in the context of a hearing on reforming the Federal Reserve System that the American public is served by individuals represented here of distinctive quality and integrity. We welcome them in a spirit of appreciation and trust.

Here, I appreciate the sense of history the Chairman brought in his opening comments, but it should be noted that no member of this panel has in any sense been tarred by Watergate. All have agreed to appear voluntarily with no implication of wrongdoing. Given the braintrust assembled, I am only sorry the subject matter isn't the state of the economy and at the risk of presumption, I might suggest the panel -- or a representative grouping -- be invited back, perhaps in a Humphrey-Hawkins context to discuss the economy.

At the first two hearings, this Committee gave deserved attention to the political science predicament of Reserve Bank presidents, who are assigned a particular public responsibility but are selected by boards comprised in the majority by individuals not only from the private sector but one element of it. In defense of this selection methodology the Federal Reserve System can properly point to a tradition of independence, quality, and political insulation. Nevertheless, there is an element of unseemliness inherent in a system in which sectors of the public may view their interest as distinct from that of the banking sector, in particular when individuals are asked to regulate an industry while being accountable to boards of directors controlled by members of that industry.

While I have a high regard for current leadership of the Fed and the direction it is currently moving on the regulatory front, it may be useful to point out three areas where the Federal Reserve System in the past has instituted discriminatory regulatory policies. First, in the late seventies and early eighties, the Fed went along with the large money center banks in believing that sovereign guarantees were ironclad because governments never go broke and, accordingly, imposed lesser regulation on LDC debt. Second, the Fed has continued to assume that large banks, because of their large deposit and lending bases, need less capital than smaller banks. And, third, it has not required bad loans at large banks to be written off as rapidly as regulators require comparably bad loans at smaller banks.

My view is that discriminatory regulation skews the financial landscape and amounts to credit allocation. The irony in regulation being too accommodating, if not cozy, with individual banks is that management becomes misserved. For instance, New York money center banks for decades have been on the cutting edge of wanting to see liberalization of the Douglas Amendment and McFadden Act so that they could branch interstate. When interstate barriers started to fall, without Congressional modification of these laws, many of the money center banks were in no position to take advantage of the liberalization because their capital had been so dramatically depleted. This was due, in part, to lending mistakes which were in effect sanctioned by regulators. If regulators on a timely basis had insisted on stronger capital ratios for international lending or moved promptly to force recapitalization when problem loans, domestic as well as foreign, developed, these institutions would be larger and stronger today.

It is instructive to note that federal regulators, albeit a little late, forced Bank of America to restructure and recapitalize approximately five years before they served comparable notice on the East coast. Bank of America later credited regulator sternness with its turnaround and with its ability by the end of the decade of the 1980's to launch an expansionary drive.

One of the lessons of the S&L debacle is that capital moves toward institutions or industries which have the weakest regulation.

The problem of regulator driven deposit skewing was most evident in the 1980's in the thrift industry when institutions were allowed to leverage minimal and in some cases non-existent capital bases. It is, however, a not inconsequential problem today within the banking industry. For example, one ramification of over-reliance on the Basle Accord standards is that the more attention given to risk weighting assets, the less reliance national bank regulators are putting on the leverage ratio. Over-reliance on risk-based capital standards without use of an adequate leverage ratio leads to competitive inequities in deposit seeking and de facto credit allocation of those deposits. The fact that state bank regulators rely more on leverage ratios than federal regulators means that deposits will flow to national banks rather than state banks, to money center institutions rather than community banks, to bond buying instead of entrepreneurial lending.

Here, the anomaly exits as in virtually all regulated circumstances that regulatory agencies have a vested interest in the competitive vitality of the institutions they regulate. Hence, if the Fed wants to keep, which I support, a major regulatory function, it must be careful to insure that conflicts, perceived or otherwise, do not exist, that regional inequities are not allowed to develop, and that advantages are not provided one kind of institution over another.

As mentioned earlier, one of the lessons of the S&L crisis was that disparity in regulation skews capital flows. Another was the conclusion by Congress that it had been a mistake to allow the 12 district banks of the Federal Home Loan Bank System with boards comprised in the majority of representatives from member institutions a principal role in the regulatory process. Accordingly, as part of the S&L cleanup in FIRREA, Congress abolished the regulatory functions of the FHLB system and transferred them to an office which has its director publicly appointed.

As we consider regulatory consolidation, there is a case for and against providing continuation of regulatory responsibility for the Federal Reserve System. But if it is to be preserved, an institutional arrangement must be established which gives no hint of self -regulation, of the fox guarding the foxes. In a country in which process is our most important product it simply is unacceptable for regulators, in any sense, to be accountable to boards which in turn are controlled by the regulated.

I look forward to the testimony of today's witnesses.

OPENING STATEMENT OF THE HONORABLE ERIC D. FINGERHUT
before the
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
of the
U.S HOUSE OF REPRESENTATIVES
on
OCTOBER 19, 1993

Thank you Mr. Chairman. Throughout my career, I have been a strong and outspoken advocate of government reform. A regular, in-depth examinationn of the operations of all branches of government, including this institution, is in the best traditions of representative democracy. For example, I believe instituting congressional reform will restore our credibility with the public and enable us to address the serious problems facing our country. Until the country believes in the process once again, our attempts to make difficult decisions will continue to be stalled by a wall of public cynicism. However, a re-examination of all levels of government does not mean we always need to take action. I do not believe in reform for reform's sake.

It is from this perspective that I have approached these hearings. After listening to the witnesses and studying the testimony, particularly that of Chairman Greenspan, I have reached some conclusions. While there is always room for improvement in the procedures of the Federal Reserve, I am sure of one thing: the Federal Reserve is working. During the last 12 years, while the executive and legislative branches quadrupled our national debt, the Fed whipped inflation and brought down interest rates. In fact, the Fed has done their job so well, that when inflation crept over just 4% earlier this year, most of us were startled.

I am also convinced that this outcome is a result of the independent status of the Fed. The ability to focus on long-term stability is compromised when political pressures interfere. The short-term economic benefits of decisions based on political expediency are far outweighed by the inflationary costs which inevitably occur after a lag. International comparisons confirm this relationship between Central Bank independence and low inflation rates. Before we change the decision process of the Fed, I want to be sure we are not risking the soundness of our monetary policy.

This should not be interpreted as a blanket approval of all of the Fed's actions. It is not. Most of the reforms Chairman Gonzalez has proposed are modest and would not do irreparable harm to our monetary policy. For example, I believe publishing the minutes of the FOMC's meetings on a more timely basis would reduce information uncertainty and increase market efficiency.

However, I am concerned that Congress has once again taken up a more glamorous and high profile issue at the expense of others which are more mundane, but more substantial. I believe easing the credit crunch, reducing burdensome bank regulations, instituting community banking, and creating a secondary market for business, commercial and community development loans would go a long way to stimulating our economy and building a base for long and sustainable growth. Reforming the Federal Reserve processes adds nothing to that fundamental responsibility of government and may indeed detract from it.

I thank Chairman Gonzalez for raising these issues. I know this issue is very important to the Chairman. I would only urge this Committee not to get sidetracked when the American economy deserves our full attention.

OPENING REMARKS FOR REP. SAM JOHNSON
BANKING COMMITTEE HEARING ON
FEDERAL RESERVE OVERSIGHT - OCTOBER 19, 1993

THANK YOU MR. CHAIRMAN:

I LOOK FORWARD TO THIS HEARING TODAY TO HOPEFULLY GET A NEW PERSPECTIVE ON POSSIBLE CHANGES TO THE FEDERAL RESERVE SYSTEM. I WOULD LIKE TO THANK ALL OF THE WITNESSES FOR BEING HERE TODAY AND ESPECIALLY RECOGNIZE MR. BOB MCTEER, THE PRESIDENT OF THE DALLAS FEDERAL RESERVE BANK.

AS WE CONSIDER LEGISLATION TO OPEN THIS SYSTEM, I FEEL THAT IT IS ESSENTIAL TO HAVE INPUT FROM ALL THOSE EFFECTED. FURTHERMORE, I FEEL THAT WE SHOULD NOT CHANGE THIS SYSTEM UNLESS IT IS ABSOLUTELY NECESSARY.

HOWEVER, I DO HAVE SOME CONCERNS WITH REGARD TO THE REGIONAL RESERVE BANKS. I AM CONCERNED THAT SOME BANKS, SPECIFICALLY NEW YORK, HAVE MORE SAY IN DOMESTIC MONETARY POLICY AND INTERNATIONAL CURRENCY POLICY THAN OTHER FED. BANKS.

I AM ALSO CONCERNED THAT THE CURRENT GAO AUDITS ARE NOT REVEALING TO THE TAXPAYERS REAL AND UNNECESSARY SPENDING BY THE REGIONAL BANKS. FOR EXAMPLE, IS ANY GAO AUDIT GOING TO REVEAL THE $200,000 THE DALLAS FEDERAL RESERVE IS SPENDING TO RENOVATE THEIR GUN RANGE IN THE BASEMENT? I HOPE THE REGIONAL PRESIDENTS CAN GIVE ME SOME INSIGHT ON THESE CONCERNS. THANK YOU MR. CHAIRMAN.

Opening statement of
Congresswoman Lucille Roybal-Allard
Banking Committee Hearing on the Federal Reserve, #3
October 19, 1993

Mr. Chairman, I want to commend you for holding these hearings on H.R. 28, legislation which would establish accountability on behalf of the Federal Reserve. This is a bill which merits serious attention and I look forward to hearing our expert testimony. Specifically, I am anxious to hear how the Federal Reserve intends to improve its record of minority and women hiring.

Last week, Chairman Greenspan highlighted the sluggish pace at which women and minorities have moved into the top echelons of the federal reserve. I concur with the Chairman that this problem, which exists throughout our society, is very damaging. In order to rectify pervasive discrimination, we must make the necessary changes now-- and wherever possible, change must be applied equally to all areas of the federal government, including the Federal Reserve.

Mr. Chairman, for twenty-nine years the Federal Reserve has been exempted from compliance of Title VII of the Civil Rights Act of 1964. This exemption has effectively allowed the Fed to view the matter of minority and women hiring as merely a goal, not a directive. There is no good reason for this exemption to remain-- it must be repealed and the time for change is now.

Mr. Chairman, I look forward to working with the committee as we consider H.R. 28 and as we examine the Federal Reserve's dismal performance with regard to the hiring and promoting of women and minorities.

For Release on Delivery
10:00 A.M. EDT
October 19, 1993

Testimony by

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

I appreciate this opportunity to provide my views on the appropriate degree of disclosure by the Federal Open Market Committee (FOMC).

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

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

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

These minutes, a copy of which for the meeting of February, 1993, I have attached to this statement, can run from 15 to more than 30 pages, presenting a comprehensive record of the economic factors and analysis and alternative policy approaches considered in reaching our decisions.

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

Suppose, for example, a central bank that operated by targeting the foreign exchange rate decided that it might be appropriate to change the target rate at a given point in the future. Or, to bring the discussion closer to home, say that the central bank phrased its policies in terms of contingency plans--that is, if certain economic or financial conditions prevailed, a particular action would be taken. If those decisions were made public, markets would tend to incorporate the changes immediately, preventing the policies from being effectively carried out as planned.

More broadly, immediate disclosure of these types of contingencies would tend to produce increased volatility in financial markets, as market participants reacted not only to actual Federal Reserve actions but also to possible Federal Reserve actions. It is often the case that the FOMC expresses a predisposition toward a policy change in its directive to the Open Market Desk. Such a predisposition, for example toward easing, implies that the FOMC is more concerned about developments that would dictate an easing of policy rather than a tightening, and therefore wants to respond relatively promptly to information suggesting the need for such action. We often express this predisposition without any change in instrument settings in fact resulting. In such circumstances, the release of those directives during the period they are in force would only add to fluctuations in financial markets, moving rates when no immediate change was intended.

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

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

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

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

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

Let me take a moment to describe more fully the process followed at FOMC meetings to reach decisions on monetary policy. After staff presentations of recent developments and emerging economic trends, a roundtable discussion of all nineteen participants begins. The Reserve Bank presidents describe conditions and developments within their districts, and both they and the members of the Board of Governors go on to evaluate the outlook for the U.S. economy. All members bring in, where relevant, international economic and financial considerations. In light of this discussion, we then consider whether the stance of monetary policy needs to be adjusted, either immediately, or possibly in the future under particular circumstances.

A considerable amount of free discussion and probing questioning by the participants of each other and of key FOMC staff members takes place. In the wide-ranging debate, new ideas are often tested, many of which are rejected. Ideas initiated by one participant are frequently built upon by others. This type of discourse is an invaluable ingredient of our policymaking process.

As I indicated before this Committee last week, the prevailing views of many participants change as evidence and insights emerge. This process has proven to be a very effective procedure for gaining a consensus around which a directive to the Open Market Desk can be crafted. It could not function effectively if participants had to be concerned that their half-thought-through, but nonetheless potentially valuable, notions would soon be made public.

I fear in such a situation the public record would be a sterile set of bland pronouncements scarcely capturing the necessary debates which are required of monetary policymaking. A tendency would arise for one-on-one pre-meeting discussions, with public meetings merely announcing already agreed-upon positions, or for each participant to enter the meeting with a final position not subject to the views of others. Such a record would be far less informative than the minutes we currently publish.

It has been averred that, because the minutes we release do not indicate which individuals voiced which views at the meetings, the FOMC members themselves escape accountability for their actions. This is contrary to fact. The vote of each FOMC member is recorded, by name, and the reasons for that vote are also recorded. In the case of a dissent from the majority, the reasoning behind the vote is generally explained separately. In the case of a vote cast with the majority, the members review drafts of the minutes to assure themselves that the record will accurately reflect their views and the reasons for voting as they did.

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

Mr. Chairman, in your letter of invitation to this hearing, you also posed several specific questions related to the maintenance of notes or records of FOMC meetings and to the premature release of FOMC information. I would like to turn now to the answers to those three questions.

At FOMC meetings, I take very brief, rough notes on the views expressed by participants. These notes assist me in keeping track of Committee sentiment as the meeting progresses and thus in judging where a consensus may be reached with respect to monetary policy. After the meeting, the notes are kept in a locked file cabinet along with other FOMC materials.

Others attending the FOMC meetings may also be taking notes, and I am sure they will tell you about them in their own responses. I have suggested to the Reserve Bank presidents that they respond to your questions regarding whatever records may be kept at their own Banks; I will cover records made by the Board staff, and, in particular, by the FOMC secretariat.

Some individual members of the Board staff take handwritten notes and retain them to help them in discharging their responsibilities. The meetings are recorded electronically by the FOMC secretariat. These audio tapes are used to assist in the preparation of the minutes that are released to the public following the subsequent meeting; thereafter, the tapes are recorded over. In the process of putting together the minutes, an unedited transcript is prepared from the tapes, as are detailed notes on selected topics discussed in the course of the meeting. These materials generally are seen only by the staff involved in preparing the minutes, and the documents are kept under lock and key by the FOMC secretariat.

With regard to your final query, on the release of information about FOMC meetings, I would again state my strong view that any unauthorized release of FOMC decisions is a very serious matter. Leaks of FOMC proceedings are clearly unfair to the public, potentially disruptive of the policymaking process, and undoubtedly destructive of public confidence in the Federal Reserve.

Any leaks that may have occurred were most assuredly not orchestrated or directed by the FOMC. A deliberate premature leak of information is repugnant. Our current policies that call for delayed release of information are in place for good reasons, as I indicated previously. They are grounded on an assumption of confidentiality; leaks undermine these policies.

I suspect that, to an extent, what appear to be deliberate leaks may instead represent something quite different. In some cases, FOMC participants who speak to the press may believe they have revealed nothing about recent monetary policy decisions, but they may in fact have inadvertently provided enough of a sense of the policy considerations to allow conclusions to be drawn, especially for experienced reporters speaking to several sources. This puts us in a difficult situation. We should not reveal confidential information about our decisions. At the same time, we cannot and should not wall ourselves off entirely from the media; it is our obligation to explain the broad considerations that motivate monetary policy, to correct certain misimpressions, and to convey as much information as possible, without roiling markets, creating inequities, or violating the trust of our colleagues.

The FOMC has discussed this issue extensively, and we have taken several steps that we believe will curb any further unauthorized release of information. We have re-emphasized the necessity of avoiding contact with the press during the periods surrounding FOMC meetings and of caution at other times. Moreover, it has been made clear that any future leak from an FOMC meeting will be followed up very aggressively--by a full investigation that will include gathering sworn statements from all attendees.

As to whether I personally played a part in past leaks of FOMC information, I can assure you that I have never knowingly released to the press or to other members of the public any information about the results of an FOMC meeting prior to the formal, scheduled release. I would include one footnote to this statement, however: From time to time, I have briefed members of various Administrations about the outcomes of FOMC meetings, because that knowledge could assist them in the formulation of government policies for which they have responsibility. This qualification has not, however, been a relevant one over the past year or so, as the Federal Reserve has not altered its instrument settings.

I trust the problem of leaks is behind us. If I am wrong about this, the FOMC's policy on delayed disclosure of decisions will have to be reevaluated. Should we have to change our policy as a result, it would be unfortunate, for I firmly believe that a shift to prompter disclosure of the substance of our deliberations will adversely affect our discussions and decisions and therefore monetary policy itself.

FEDERAL RESERVE press release

For Use at 4:30 p.m. March 26, 1993

The Federal Reserve Board and the Federal Open Market Committee today released the attached minutes of the Committee meeting held on February 2-3, 1993.

The minutes for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and subsequently are published in the Federal Reserve Bulletin. The summary description of economic and financial conditions contained in these minutes is based solely on the information that was available to the Committee at the time of the meeting.

Attachment

Minutes of the Federal Open Market Committee Meeting of February 2-3, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 2, 1993, at 2:30 p.m. and was continued on Wednesday, February 3, 1993, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly,[1] General Counsel
Mr. Patrikis,[1] Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene,[2] Deputy Manager for Foreign Operations
Ms. Lovett,[2] Deputy Manager for Domestic Operations

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors

1. Attended Wednesday session only.
2. Attended Tuesday session only.

Mr. Brady,[3] Section Chief, Division of Monetary Affairs, Board of Governors
Mr. Rosine,[3] Senior Economist, Division of Research and Statistics, Board of Governors
Mr. Wiles,[4] Secretary of the Board, Office of the Secretary, Board of Governors
Mr. Winn,[4] Assistant to the Board, Office of Board Members, Board of Governors
Ms. Werneke,[4] Special Assistant to the Board, Office of Board Members, Board of Governors
Mr. Siciliano,[4] Special Assistant to the General Counsel, Legal Division, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Richmond, and Atlanta, respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston
Mr. Gavin, Assistant Vice President, Federal Reserve Bank of Cleveland
Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis
Ms. Meulendyke, Manager, Open Market Operations, Federal Reserve Bank of New York

The Secretary reported that advices of the election of the Reserve Bank members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1993, and ending December 31, 1993, had been received and that these individuals had executed their oaths of office. The elected members and alternate members were as follows:

E. Gerald Corrigan, President of the Federal Reserve Bank of New York, with James H. Oltman, First Vice President of the Federal Reserve Bank of New York, as alternate;

Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, with J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, as alternate;

Silas Keehn, President of the Federal Reserve Bank of Chicago, with Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as alternate;

3. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.
4. Attended portion of the meeting relating to the release of FOMC information to the public.

Robert D. McTeer, Jr., President of the Federal Reserve Bank of Dallas, with Robert P. Forrestal, President of the Federal Reserve Bank of Atlanta, as alternate;

Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Robert T. Parry, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the Committee elected the following officers of the Federal Open Market Committee to serve until the election of their successors at the first meeting of the Committee after December 31, 1993, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
E. Gerald Corrigan	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R. V. Bernard	Deputy Secretary
Joseph R. Coyne	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Ernest T. Patrikis	Deputy General Counsel
Michael J. Prell	Economist
Edwin M. Truman	Economist
Richard G. Davis, Richard W. Lang, David E. Lindsey, Larry J. Promisel, Arthur J. Rolnick, Harvey Rosenblum, Karl A. Scheld, Charles J. Siegman, Thomas D. Simpson, and Lawrence Slifman	Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1993.

By unanimous vote, William J. McDonough, Margaret L. Greene, and Joan E. Lovett were selected to serve at the pleasure of the Committee in the capacities of Manager of the System Open Market Account, Deputy Manager for Foreign Operations, System Open Market

Account, and Deputy Manager for Domestic Operations, System Open Market Account respectively, on the understanding that their selection was subject to their being satisfactory to the Federal Reserve Bank of New York.

> Secretary's note: Advice subsequently was received that the selections indicated above were satisfactory to the board of directors of the Federal Reserve Bank of New York.

On January 15, 1993, the continuing rules, regulations, authorizations, and other instruments of the Committee listed below were distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the February 2-3 organization meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting. No requests for substantive consideration were received.

At the meeting, the Committee voted unanimously to update the references to the Management of the System Open Market Account that were contained in the following: (1) Procedures for allocation of securities in the System Open Market Account and (2) Program for Security of FOMC Information. Apart from the indicated updating of titles, all of the instruments listed below remained in effect in their existing forms.

1. Procedures for allocation of securities in the System Open Market Account.
2. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank is unable to function.
3. Resolution of FOMC to provide for the continued operation of the Committee during an emergency; Resolution of FOMC authorizing certain actions by Federal Reserve Banks during an emergency.
4. Resolution relating to examinations of the System Open Market Account.

5. Guidelines for the conduct of System operations in Federal agency issues.

6. Regulation relating to Open Market Operations of Federal Reserve Banks.

7. Program for Security of FOMC Information.

8. Federal Open Market Committee Rules.

By unanimous vote, the Authorization for Domestic Open Market Operations, as shown below, was reaffirmed:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U. S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U. S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U. S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $8.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods;

provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(c) To buy U. S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and prime bankers acceptances of the types authorized for purchase under 1(b) above, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U. S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U. S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 15 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U. S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

By unanimous vote, the Authorization for Foreign Currency Operations was amended to update the title of the Manager of the System Open Market Account. The Authorization, as amended, is shown below:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U. S. Treasury, with the U. S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	700
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph I(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign

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currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U. S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager of the System Open Market Account, for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

By unanimous vote, the Foreign Currency Directive, as shown below, was reaffirmed:

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U. S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks and with the Bank for International Settlements.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

By unanimous vote, the Procedural Instructions with respect to Foreign Currency Operations were amended to update the title of the Manager of the System Open Market Account. The Procedural Instructions, as amended, are shown below:

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager of the System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes

that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payments Systems as of the close of business on July 31, 1992, was accepted.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on December 22, 1992, were approved.

The Deputy Manager for Foreign Operations reported on developments in foreign exchange markets during the period December 22, 1992, through February 2, 1993. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager of the System Open Market Account reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 22, 1992, through February 2, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook, the ranges for the growth of money and debt in 1993, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting indicated that economic activity rose appreciably further in the fourth quarter. Final demands were buoyed by strength in consumption, business spending for durable equipment, and residential construction. Manufacturing activity also increased considerably, and employment appeared to be on a modest upward trajectory, despite a continuing flow of announcements of layoffs by large corporations. Although recent data on wages and prices had been mixed, on balance they suggested that inflation was trending gradually lower.

Total nonfarm payroll employment registered a small increase in December for the fourth consecutive month. Service industries, notably business and health services, and retail trade accounted for nearly all of the rise in jobs. Manufacturing and construction payrolls changed little, and government employment fell as temporary election workers were dropped from payrolls. The civilian unemployment rate remained at 7.3 percent, almost 1/2 percentage point below its mid-year peak but slightly above its level at the beginning of the year.

Industrial production advanced further in December and was up considerably over the fourth quarter as a whole. Motor vehicle assemblies rose sharply during the quarter; strong gains also were registered in business equipment, partly reflecting a further jump in output of computers, and in nondurable consumer goods. By contrast, the production of durable consumer goods other than motor vehicles was lower on balance after changing little over the third quarter, and the output of defense and space equipment remained on a downward trend. Total utilization of industrial capacity increased significantly in the fourth quarter and for the year as a whole.

Consumer spending was up substantially in the fourth quarter. Retail sales, after rising sharply in October and changing little in November, posted a further sizable increase in December. The largest sales gains in the fourth quarter were reported at automotive dealers and at building material and supply outlets, but most other types of retail stores also recorded higher sales. By contrast, consumer spending for services, as indicated by data on personal consumption expenditures, rose more slowly. Housing starts surged in December, with single family starts reaching their highest level in nearly three years and multifamily starts picking up slightly from the very low levels of October and November. Sales of new and existing homes remained on a strong upward trend in December.

Real outlays for business fixed investment apparently registered a notable gain in the fourth quarter, particularly for producers' durable equipment. Shipments of nondefense capital goods rose in November and December after changing little in October; for the quarter as a whole, shipments advanced substantially, with increases widespread by category. Business purchases of cars and trucks were up sharply in the fourth quarter, while nonresidential construction activity retraced a small part of a third-quarter decline.

Business inventories expanded moderately in November as a sizable drop in manufacturing inventories was more than offset by increases in wholesale and retail inventories. At the manufacturing level, the drawdown of stocks was associated with strong shipments of durable goods, and inventory-to-shipments ratios in most industries were at or near the bottom of their recent ranges. In the wholesale sector, sizable inventory increases were reported in November for a second straight month; most of the buildup was limited to machinery, motor vehicles, and miscellaneous nondurable goods. With stocks rising in line with sales since September, the stock-to-sales ratio in wholesaling remained at the low end of its range over the past year. Retail inventories increased moderately further in November; the inventory-to-sales ratio for the sector was slightly below its average for previous months of the year.

The nominal U.S. merchandise trade deficit widened slightly in November. For October and November together, however, the deficit narrowed a little from its average rate in the third quarter, as the value of exports rose more than the value of imports. Most of the increase in exports was in capital goods, both machinery and aircraft, and in consumer goods. Passenger cars accounted for a considerable part of the rise in imports, while the inflow of consumer goods eased from the very strong pace of the third quarter. Recent indicators suggested that economic activity had remained weak in the major foreign industrial countries and that unemployment rates had increased further in most of those countries. The recovery in Canada appeared to be continuing, but the downturn in western Germany and Japan evidently had persisted into the fourth quarter.

A small November decline in producer prices of finished goods was reversed in December, with a rebound in prices of finished foods outweighing a further drop in energy prices. For finished items other than food and energy, producer prices rose in December, but the advance followed six months of no change on balance; for 1992 as a whole, this measure of prices increased by a considerably smaller amount than in 1991. At the consumer level, the index for prices of nonfood, non-energy items edged higher in December after somewhat larger increases in the two preceding months. The rise in this index in 1992 was the smallest for any year since the early 1970s, when wage and price controls were in effect. Hourly compensation of private industry workers advanced a little more rapidly in the fourth quarter than in the two previous quarters, but the rise in total compensation over the year as a whole was considerably smaller than in 1991. The slowing of labor cost increases last year occurred in both the wages and benefits components.

At its meeting on December 22, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, the directive indicated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with expansion of M2 at an annual rate of about 1-1/2 percent and with M3 remaining about unchanged on balance over the four-month period from November through March.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing was well above expected levels in the first two full reserve maintenance periods in the intermeeting interval; borrowing was sizable over the long New Year's weekend and also later when unusually heavy Treasury tax receipts drained reserves from the banking system. The federal funds rate averaged close to expected levels over the intermeeting period. However, the rate was somewhat volatile in late December as a result of sizable swings in market factors affecting reserves and of shifting market anticipations regarding year-end pressures.

Most other short-term interest rates declined somewhat over the intermeeting period, in part reflecting the passing of year-end pressures. Intermediate- and long-term rates, including those on fixed-rate mortgages, also moved somewhat lower; the declines occurred in response to growing indications that any proposed near-term fiscal stimulus would be quite moderate and that the new Administration intended to recommend steps, possibly including new taxes, to lower the trajectory of the fiscal deficit appreciably over time. Broad indexes of stock prices exhibited mixed results over the intermeeting period: Indexes giving heavy weight to large companies changed little, while those primarily reflecting smaller companies rose significantly.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose on balance over the intermeeting period. Through early January, the dollar appreciated against both the yen and the mark, especially the latter, in response to actual and expected further declines in interest rates in Japan and Germany. Subsequently, the dollar's gains were partially erased as the prospects for near-term easing in Germany diminished somewhat and perceptions grew that fiscal initiatives in the United States would lower the deficit and reduce the chances that monetary policy might be tightened in the months ahead.

After expanding at a moderate pace over the course of earlier months, M2 contracted in December and January. Some of the weakness reflected a slowdown in M1 growth associated with lower mortgage refinancing activity. Within M2's nontransaction component, the expansion of savings and money market deposit accounts slowed abruptly, perhaps owing in part to the wider spread that had developed during the fall between market rates and those paid on these accounts, as well as to the use of monies in these accounts to fund a step-up in consumer purchases and nonwithheld tax payments. In addition, the continued attractiveness to investors of bond and stock mutual funds might have contributed to a quickening of the runoff of holdings of money market mutual funds and to the persisting weakness in other M2 accounts. Appreciable declines in M3 in December and January reflected both the contraction in M2 and reduced needs by banks for managed liabilities at a time of weak overall credit demand. From the fourth quarter of 1991 to the fourth quarter of 1992, both M2 and M3 grew at rates somewhat below the lower ends of the Committee's annual ranges. Total domestic nonfinancial debt appeared to have expanded at the lower end of the Committee's monitoring range for 1992.

The staff projection prepared for this meeting suggested that economic activity would expand over the year ahead at a pace that would be sufficient to reduce gradually margins of unemployed labor and capital. Recent declines in long-term interest rates and more optimistic attitudes on the part of businesses and households were expected to support further solid gains in business fixed investment and in homebuying. Continuing progress in reducing debt service burdens and a gradual lessening of concerns regarding job security were projected to foster an expansion of consumer spending a shade faster than the growth in incomes. Export demand would be damped for some period of time by the appreciation of the dollar since mid-1992, but an anticipated pickup in growth abroad later this year would begin to counteract the effects of the higher dollar. Against the background of considerable uncertainties associated with still unannounced fiscal policy initiatives, the staff retained for this forecast the assumption contained in several previous forecasts that fiscal policy would remain mildly restrictive, largely because of declining defense outlays. The persisting slack in resource utilization over the forecast horizon was expected to be associated with some additional progress in reducing inflation.

In the Committee's discussion of current and prospective economic developments, the members were encouraged by the mounting evidence of appreciable momentum in the economic expansion. On the whole, recent developments tended to reinforce their forecasts of continuing growth at a moderate pace over the year ahead, especially in light of the improvement in business and consumer confidence. The impact of some retarding influences on the expansion, notably various balance sheet adjustment activities, appeared to be waning. In addition, while some major sectors of the economy such as defense spending and commercial construction remained weak, the economy was benefitting from considerable growth in consumer spending, from rising business expenditures for producer equipment, and from increasing outlays for housing. In one view, the recent behavior of commodity prices also tended to indicate some strengthening in the economy's expansion. Despite various indications of a more firmly established expansion, however, the members felt that the outlook remained subject to a good deal of uncertainty, and some commented that substantial deviations--in either direction--from their current forecasts could not be ruled out. It was noted in this connection that the specifics of the President's fiscal policy proposals were still unknown, and their reception by the public and the Congress would have a major influence on confidence, interest rates, and the performance of the economy. Other sources of uncertainty related to the outlook for further restructuring activities that involved cutbacks in operations and employment by many firms, and the prospective lending policies of banking institutions. With regard to the outlook for inflation, most of the members believed that some further progress toward stable prices was likely over the year ahead, given an economic outcome about in line with their forecasts of continued, albeit reduced, margins of unutilized or underutilized productive resources. Some members also referred to the extended period of relatively sluggish growth in the broad measures of money as a favorable indicator in the outlook for inflation.

In keeping with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the Committee members and the Federal Reserve Bank presidents not currently serving as members had prepared projections of economic activity, the rate of unemployment, and inflation for 1993. The central tendencies of the forecasts pointed to slightly faster economic growth this year than currently seemed to have occurred in 1992. The anticipated rate of economic expansion would be at a pace that was rapid enough to reduce the rate of unemployment a little further. Nonetheless, with some slack in productive resources persisting, price and cost pressures would remain subdued and modest additional moderation in inflation was expected by most members. Measured from the fourth quarter of 1992 to the fourth quarter of 1993, the forecasts for growth of real GDP had a central tendency of 3 to 3-1/4 percent within a full range of 2-1/2 to 4 percent. Projections of the civilian rate of unemployment in the fourth quarter of 1993 were concentrated in the upper half of a 6-1/2 to 7 percent range. For the CPI, the central tendency of the forecasts for the period from the fourth quarter of 1992 to the fourth quarter of 1993 was centered on increases in a range of 2-1/2 to 2-3/4 percent, and for nominal GDP the forecasts were clustered in a range of 5-1/2 to 6 percent for the year.

In the course of the Committee's discussion of various factors underlying the outlook for economic activity, the members observed that on the whole the effects of a number of structural impediments to the expansion seemed to be diminishing as the financial condition of households, business firms, and financial institutions continued to improve. Household and business debt-service burdens had eased substantially, but it remained difficult to predict to what extent and for how long the ongoing balance sheet adjustments would continue to divert an unusual proportion of cash flows from spending to balance sheet repair. Improved profitability and new capital-market issuance had strengthened the capital positions of banking institutions, and in general they were now in a much better position to augment their lending activities. However, there were few indications thus far of any easing in terms or standards on business loans, and the depressed and uncertain values of commercial mortgages and real estate held in bank portfolios might continue to exert an inhibiting effect on the willingness of banks to lend. Another negative factor was the persistence of downsizing and other restructuring activities by numerous firms, notably large businesses. Such restructuring activities had not fully run their course as many firms continued to pare excess production capacity and to modernize production facilities to meet strong competition in domestic and foreign markets. The resulting layoffs had damped overall job growth.

Despite tepid job growth, retail sales had strengthened markedly during the closing months of 1992, and several members commented that such sales had continued to display surprising vigor in some parts of the country during the early weeks of 1993. Apart from the improvement in consumer sentiment, other favorable factors cited with regard to the outlook for consumer spending included lower debt-service burdens and the capital gains or enhanced cash flows now being realized as sales of homes picked up and mortgage refinancings again strengthened. Some members nonetheless expressed a degree of concern about the sustainability of the gains in consumer spending unless there were faster growth in employment and income to support such spending. Announcements by prominent firms of cutbacks in their workforces had continued into the new year, and while job gains at other firms, especially smaller ones, were contributing to modest net growth in overall employment, the publicity surrounding the persisting job cutbacks and a tendency for many new jobs to be lower-paying added an element of caution to the outlook for consumer expenditures. On balance, with the measured saving rate already at a low level, though an argument could be made that the actual rate was somewhat higher than indicated by the currently published data, consumer spending seemed likely to expand about in line with the growth in consumer incomes over the coming year.

The growth in consumer incomes in turn was likely to depend importantly on the expansion in business investment spending, and members cited a number of factors that were expected to provide a favorable setting for sustained momentum in such spending over the year ahead. These included the strengthening of final demands, the recent declines in intermediate- and long-term interest rates, the greater leeway for financial intermediaries to increase their lending to businesses, and a continuing desire by business firms to improve their operating efficiencies. Commercial construction activity, however, was likely to remain quite sluggish. There were indications that commercial real estate values had stabilized in a number of areas, but at low levels, and given the persistence of marked imbalances in numerous real estate markets that were the result of several years of overbuilding, a significant rebound in commercial building activity for the nation as a whole might well be several years away. The outlook for housing construction was much more promising. Against the background of a general upswing in consumer confidence and the improved balance sheets of many households, the declines that had occurred in mortgage interest rates had fostered a marked strengthening in the demand for single-family housing as evidenced by reports from many parts of the country as well as the overall statistics on housing. On the basis of these developments, the members anticipated a continuing impetus to the economic expansion from housing construction and from related industries over the year ahead. In addition, the current indications of generally lean business inventories, associated in part with strong final demands over the past several months, suggested that the prospects for further gains in overall spending were likely to stimulate efforts by business firms to build up inventories over the quarters ahead.

The increasing signs of slow growth or recession in a number of foreign nations represented a greater downside risk to the demand for U.S. exports than had been apparent earlier. It was noted, for example, that firms engaged in business activities abroad were reporting substantial deterioration in markets for U.S. goods in many foreign countries. Growth in U.S. exports might remain positive over the year ahead, but against the background of a relatively expansive U.S. economy and the dollar's recent appreciation, the value of exports might well fall increasingly short of that of imports with adverse effects on the growth of U.S. economic activity.

Turning to the outlook for fiscal policy, members were encouraged by the prospect that the President would soon propose a program that would produce substantial reductions in the federal deficit over the years ahead. Such a deficit-reduction program, if deemed credible, could result in lower intermediate- and long-term interest rates than would otherwise prevail--even before the program was enacted--with very positive implications for interest-sensitive expenditures. For the nearer term, the President was expected to announce some modest fiscal stimulus relative to what was currently in train. However, the specifics of the President's proposals were not yet known and there was little current basis on which to judge prospective public and Congressional reactions. Members emphasized the critical need for long-term deficit reduction, and some expressed concern about the adverse effects on financial markets if fiscal stimulus measures were to be enacted for the short run without the assurance of further legislation to cut federal deficits over time.

With regard to the outlook for inflation, most of the members anticipated that the trend toward lower price and wage inflation would be sustained over the year ahead, and one member observed that the disinflationary momentum in the economy might well be underestimated. Favorable developments relating to the outlook for inflation included evidence of slowing increases in labor costs and continued aggressive efforts by many business firms to improve productivity and reduce costs in the face of intense competition from domestic and foreign producers. Indeed, anecdotal reports from around the country continued to suggest little or no upward pressure on prices in many regions. In addition, the behavior of interest rates in longer-term debt markets was consistent with spreading expectations of gradually diminishing inflation. Some members believed, however, that little or no further progress in reducing inflation was a more likely outcome in the year ahead, though none anticipated higher inflation. Some commodity price indexes had edged higher recently, apparently in response to growing demands related to strengthening activity in several sectors of the economy. Lumber prices in particular had risen considerably in conjunction with the uptrend in single-family housing construction and various constraints on lumber supplies. Some business contacts reported for the first time in a long while that they were experiencing or anticipated some upward pressure on their raw materials prices. Further, while most business contacts saw or anticipated little or no upward pressure on prices in their own industries, many continued to expect rising inflation more generally. The still relatively steep slope of the yield curve and its implications with regard to expectations of future increases in interest rates also suggested that investors remained concerned about the possibility of higher inflation over the longer run, even though such concerns might have abated somewhat recently and did not appear to extend to the next year or two. In general, however, the members viewed the inflation outlook with considerable optimism on the presumption of favorable fiscal and monetary policy developments.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee at this meeting reviewed the ranges for growth of the monetary and debt aggregates in 1993 that it had established on a tentative basis at its meeting on June 30-July 1, 1992. The tentative ranges included expansion of 2-1/2 to 6-1/2 percent for M2 and 1 to 5 percent for M3, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 4-1/2 to 8-1/2 percent for 1993. All of these ranges were unchanged from those that the Committee had set for 1992 at its meeting in February of last year and had reaffirmed at mid-year. When the provisional ranges for money growth were established, the Committee had noted that they were especially tentative and subject to revision in the latter part of 1992 or early 1993 owing to the considerable uncertainty about the evolving relationship of money to income.

In the event, the velocities of M2 and M3 had increased appreciably in the second half of 1992 and analysis of the factors behind this development suggested further increases in the year ahead. Consequently, in the Committee's discussion, which tended to focus on M2, all the members indicated that they could support a proposal to lower the tentative ranges for growth of the broad monetary aggregates by one-half percentage point for 1993. At the same time, a number of members indicated that they preferred somewhat different ranges including the retention of the tentative ranges, lowering the ranges by more than the proposal, and widening or narrowing them. All the members were in firm agreement that the purpose of the proposed reductions was not to signal or implement any change in monetary policy or to convey any intention to move away from the Committee's commitment to maximum sustainable economic expansion. Rather, the reductions were motivated by the persistence of marked shortfalls in the growth of M2 and M3 from their historical relationships with various measures of aggregate economic performance; those shortfalls appeared to be the technical result of forces that are altering the relationship between money and income. Members of the Committee urged that the Board's report to Congress and the Chairman's accompanying testimony make clear the reasons for the unusual behavior of money and its consequences for the Committee's choice of ranges.

The deviations in monetary growth from historical norms reflected a number of developments whose relative importance and intensity had shifted to some extent over the course of recent years, but in general they had served to rechannel funds away from depository institutions, and the associated weakness in deposit growth had raised velocity--the ratio of nominal GDP to money. The result was the need for lower money growth than in the past to support a given rate of income growth. Among the developments that had tended to retard the relative growth of M2 and M3 was the unprecedented steepness of the yield curve that had prompted large shifts of funds by savers from M2 accounts to higher-yielding intermediate- and long-term assets. At the same time, credit growth at bank and thrift depository institutions had been weak, partly as a result of efforts by these institutions to improve capital and liquidity positions, and partly owing to weak demand. As a consequence, they also had maintained relatively low offering rates on deposits that had provided consumers with an incentive to reduce or hold down their deposit holdings in order to pay down relatively high cost mortgages and other debts. In 1992, sluggish growth of M2 and M3 had been associated with a considerable acceleration in nominal spending. Indeed, despite growth of both M2 and M3 at rates below the Committee's ranges, the expansion of the economy had exceeded most forecasts.

The members generally anticipated that the intensity of these forces might diminish in 1993 as borrowers and lending institutions achieved more comfortable balance sheet positions. Nonetheless, the relative weakness in money growth was seen as likely to persist to a marked extent. The yield curve, while it had flattened a bit recently, was still expected to provide a considerable incentive for many savers to shift funds out of M2 assets, especially as relatively high-yielding time deposits continued to mature. In addition, banks were likely to remain generally unaggressive in bidding for deposits, in part because their substantial earlier acquisitions of securities would permit them to accommodate some of the anticipated growth in loan demand by selling securities or limiting purchases. In these circumstances, restrained money growth seemed likely to remain consistent with relative strength in the economic expansion.

The members recognized that the strength of the factors that were expected to continue to depress broad money growth in relation to income in 1993 was still subject to considerable uncertainty, and this implied the need for flexibility in assessing the implications of money growth relative to the Committee's ranges. Should the factors influencing the behavior of the broad aggregates persist in holding down money growth to the extent seen in 1992, expansion of M2 and M3 in the lower portion of their reduced ranges would be consistent with considerable further growth in nominal spending. Indeed, a shortfall from the reduced ranges could not be ruled out, and one member felt that the potential for such a development warranted consideration of a somewhat larger reduction in the M2 range; such a reduction also would signal more clearly the Committee's commitment to price stability. On the other hand, the upper portions of the reduced ranges would still accommodate an ample provision of liquidity to support further economic expansion even if the growth of money and of income were to move toward an historically more normal alignment and velocity were to slow from its high rate of increase. In one view, widening the tentative M2 range by reducing its lower limit while retaining its upper limit would help the Committee to convey its views regarding the potential for a continuing but acceptable sluggishness in M2 growth while leaving room for the possibility of faster M2 expansion should changing circumstances foster diminishing strength in velocity. Another member expressed a preference for narrowing the tentative range by lowering only its upper limit as a means of signaling the Committee's intent to resist both inflationary and recessionary developments. In light of the uncertainties that were involved, the informational content of the aggregates probably had diminished and in any event the Committee would need to continue to evaluate monetary growth developments in the context of a careful assessment of a wide variety of other financial, economic, and price developments. In this connection, one member observed that the uncertainties were of such a magnitude that, while plausible arguments could be made for a number of different ranges, retention of the tentative ranges would be appropriate in light of the Committee's willingness to review the ranges in the event that unanticipated developments were to unfold.

All of the members agreed that it would be desirable to retain the monitoring range of 4-1/2 to 8-1/2 percent that the Committee had established on a provisional basis for the growth of total domestic nonfinancial debt in 1993. The expansion in such debt had not been damped by special forces to the same extent as the broad monetary aggregates in 1992. Over the year ahead, growth in the federal debt was likely to remain substantial, and the expansion of debt in the nonfederal sectors was projected to accelerate somewhat given the continued improvement in borrower balance sheets and an anticipated increase in the willingness of financial institutions to lend as the economy continued to expand. Nonetheless, in the context of still cautious attitudes on the part of both borrowers and lenders, the growth of nonfederal debt probably would remain below that of nominal GDP in the year ahead.

At the conclusion ot the Committee's discussion, all of the members indicated that they favored or could accept a technical downward adjustment of one-half percentage point in the tentative ranges for the broader monetary aggregates for 1993 to rates of 2 to 6 percent for M2 and 1/2 to 4-1/2 percent for M3. It was agreed that there should be no change from the tentative range for total domestic nonfinancial debt. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, the ranges would be reviewed at midyear, or sooner if deemed necessary, in light of the growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, by unanimous vote, the following longer-run policy for 1993 was approved by the Committee for inclusion in the domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2 to 6 percent and 1/2 to 4-1/2 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Turning to policy for the intermeeting period ahead, all of the members endorsed a proposal to maintain unchanged conditions in reserve markets, and all indicated that they could accept a directive that did not incorporate any presumption with regard to the likely direction of possible intermeeting adjustments to policy. While there was concern about the weakness in the monetary aggregates, the members generally agreed that recent economic developments tended to reinforce the view that monetary policy was on an appropriate course. The economy seemed to be on a stronger growth track than earlier in the expansion, and inflation remained quite subdued--only a bit above some estimates of price stability--and likely to moderate further in coming quarters in the view of most members. Some commented that a further easing move at this juncture might well have adverse effects on inflation sentiment and on interest rates in intermediate- and long-term debt markets. A few referred to the recent firming in some commodity prices and the consensus among private forecasters that inflation could drift higher over the next few years. In the view of one member, these developments might argue for a tilt in the directive toward possible restraint, but they did not call for an immediate tightening in reserve conditions.

A staff analysis prepared for this meeting suggested a resumption of some growth in the broad measures of money later in the first quarter but a decline in both M2 and M3 for the quarter as a whole. While part of the declines appeared to reflect reflect difficulties with seasonal adjustments and the ebbing of special factors that previously had boosted growth, the uncertainties surrounding the behavior of these aggregates tended to reduce their role in current monetary policy. Neverthe-less, there was concern about the persisting weakness in the broad aggregates, including the likelihood that they would fall well short of the Committee's new ranges over the first part of the year. Some members also noted that the growth of M1, while still fairly robust in December and January, was markedly below its pace over most of 1992. On the other hand, bank loans had increased in recent months, and the weakness in the monetary aggregates did not appear to reflect underlying softness in the economy. In these circumstances, a number of members believed that any effort to stimulate monetary growth under immediately prevailing economic conditions and market expectations might well prove to be counterproductive. An easing at this time could accelerate outflows from interest-sensitive M2 assets if the easing were seen as signaling a weakening of the System's anti-inflationary resolve and were to result in higher rates on intermediate- and long-term debt securities.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. They also noted their preference for, or acceptance of, a directive that did not include a presumption about the likely direction of any adjustment to policy over the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with little change in the levels of M2 and M3 over the two-month period from January through March.

By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The information reviewed at this meeting indicates that economic activity rose appreciably further in the

fourth quarter. Total nonfarm payroll employment registered another small increase in December, and the civilian unemployment rate remained at 7.3 percent. Industrial production posted solid gains over the closing months of the year. Retail sales were up substantially in the fourth quarter; and residential construction activity increased sharply. Indicators of business fixed investment suggest a notable gain in recent months, particularly for producers' durable equipment. The nominal U.S. merchandise trade deficit narrowed slightly in October-November from its average rate in the third quarter. Recent data on wages and prices have been mixed but they continue to suggest on balance a trend toward lower inflation.

Interest rates have declined somewhat since the Committee meeting on December 22. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose on balance over the intermeeting period.

M2 appears to have contracted in December and January, after expanding at a moderate pace over the course of previous months; M3 is estimated to have declined appreciably in both months. From the fourth quarter of 1991 to the fourth quarter of 1992, both M2 and M3 grew at rates somewhat below the lower ends of the Committee's annual ranges for 1992. Total domestic nonfinancial debt appears to have expanded at the lower end of the Committee's monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2 to 6 percent and 1/2 to 4-1/2 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with little change in M2 and M3 over the period from January to March.

At this meeting the Committee discussed a preliminary report of a subcommittee that had been established to examine various issues relating to the release of information about Committee meetings and decisions. All of the members agreed that the Committee should keep the public as fully informed as possible about its monetary policy decisions and their rationale. Such information could reduce uncertainty about the stance of policy and about the factors the Committee takes into account in reaching its decisions. However, release of information should not be allowed to compromise the overriding objective of making and implementing the best possible decisions. In that regard, the Committee noted that its deliberative process requires a free flow of ideas, including the ability to advance or question hypotheses, to speculate on alternative outcomes, and to change opinions in response to the views expressed by other members. The members also needed to feel at liberty during meetings to use a wide array of information that is obtained on a confidential basis; at least some of that information would no longer be provided to the Committee if there were a risk of public disclosure. Moreover, the Committee wanted to give further consideration to the risk that the adoption of a different schedule for releasing information about policy decisions might have the effect, in difficult circumstances, of reducing its willingness to make needed policy adjustments promptly. No decisions were made at this meeting concerning various options for apprising the public more fully or promptly of the Committee's actions, and it was understood that the subcommittee would continue to study the matter.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 23, 1993.

The meeting adjourned.

Secretary

For use at 10 a.m., EDT
Tuesday, October 19, 1993

Statement of

David W. Mullins, Jr.
Vice Chairman
Board of Governors of the Federal Reserve System
Washington, D.C.

Hearing on Issues Raised by HR 28
"Federal Reserve System Accountability Act of 1993"

Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives

October 19, 1993

Chairman Gonzalez, Congressman Leach, and members of the Committee. I appreciate your invitation to report my views on that portion of H.R. 28, "The Federal Reserve System Accountability Act," dealing with disclosure. I would like to offer this Committee a perspective that was gained from my career both inside and outside the Beltway.

Before I arrived in Washington, I taught and conducted research in financial economics for over a decade. Many of my professional writings explored the estimable ability of financial market participants to absorb and interpret information and then reflect that knowledge in market prices. As a policymaker in Washington, serving in a variety of jobs at the Treasury and the Federal Reserve, I have been exposed to the flow of confidential intelligence on the condition of financial institutions, the settings of policy instruments, contingency plans for a wide array of conceivable emergencies, the views of other agencies, and the operations of foreign official institutions. I have routinely participated in meetings with other officials and staff of the Federal Reserve, the Congress, the Treasury, and banking and securities regulators, as well as representatives of foreign governments and international institutions. From this experience I would respectfully offer three points.

First, what often makes news is not always informative. As the members of this panel are well aware, part of the deliberative process is actually thinking out loud. In my current role, whether in meetings of the Board or the FOMC or in less formal settings, I routinely engage in dialogues with others who are concerned about the nation's interest, exchanging views on possible policy options, planning for contingencies that none of us hope will happen but that must not catch us unprepared, and contemplating the market's reaction to what we might do. Much of the job of a central banker involves worrying about events that have a small probability of occurrence, but would impose large costs on the financial system and the economy were they to occur. Unfortunately, the public release of such discussions would only serve to focus attention on the sensational--the differences in opinion, the fears about individual institutions, and the concerns about worst-case scenarios--that normally have little consequence on net to the setting of policy and that would distract people from more fundamental issues, almost certainly heightening market volatility.

Secondly, and this is generalizing from a frustration that I likely share with anyone who has sat in many public meetings, the prospect of detailed and complete exposure tends to cast a chill on some proceedings. A speaker has to weigh the effects of every word, guarding against the possibility that subtle distinctions in opinion or conditional speculations will be splashed about the newspapers. One possible outcome of this fear of unfortunate headlines is that the critical conduct of policy gets pushed onto the sidelines, where fewer people can participate. The result could be less public disclosure of the policy process. My chief concern is that the quality of policymaking would suffer, with adverse consequences for the nation. If too many participants in a deliberative group speak to the record rather than to each other, innovative ideas do not get their due and the search for a consensus settles too quickly on the status quo or the easiest, though not the best, solutions.

Third, from my experience, the monetary policy process is open where it counts. Our actions matter, not our deliberations. It is our actions that affect interest rates and the economy, and those actions are made public immediately. Changes in reserve conditions are transparent to the market by 11:30 am on the day of the change in the open forum of the financial market. The reasons for the action are laid out in the minutes of the meeting that are released just six weeks later, and all votes are tallied and dissents explained. Discount rate changes are also publicly announced. To provide a broader overview to Congress, the Chairman of the Federal Reserve offers a semiannual review to members of the Banking Committee and their counterparts in the Senate encompassing recent policy decisions, a summary of the economic forecasts of members of the Board and Reserve Bank presidents, and plans for policy for the coming year. On a more irregular schedule, members of the Board, Reserve Bank presidents, and officials of the Federal Reserve System often sit before committees of Congress to discuss aspects of monetary policy. Meanwhile, System staff produce a steady stream of analyses of the economy and critiques of policy that are published in the Federal Reserve Bulletin, Reserve Bank Reviews, and the academic press.

To sum up my views on the issue of disclosure, the central concern is the quality of monetary policy decision-making, which depends upon the effectiveness of the FOMC deliberative process. I believe a substantial degree of confidentiality is necessary to ensure the effectiveness of this deliberative process. It is my view that, on the whole, the current process works well and proposed substantial changes in disclosure of FOMC deliberations would threaten the quality of monetary policy decisions, and therefore such proposed changes would not, in my view, serve the public interest.

With respect to the other information requested in your letter of invitation, during FOMC meetings I do occasionally note very rough summary observations which are subsequently kept in my locked confidential files and are destroyed after approximately one year's time. I also keep edited notes of some of my personal oral interventions in the FOMC meetings in my locked files. I have observed others present at FOMC meetings occasionally engaged in note-taking as well. As I believe Chairman Greenspan plans to discuss, I am aware that FOMC staff do retain some detailed, though edited, notes and rough transcripts for use in preparation of FOMC minutes.

As for your third question, I do not know of any case of willful or intentional leaking of confidential FOMC information to the press or the public, although I am aware that there has

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been confidential communication with appropriate senior administration officials. While all involved are very careful to avoid release of confidential information, it is possible that leaked stories may have resulted from inadvertence or skillful inferences. In my view, it is imperative that we ensure the confidentiality of FOMC information, and I can assure the Committee that we are making every effort to do so.

STATEMENT PREPARED FOR THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

HEARINGS OF OCTOBER 19, 1993

WILLIAM J. MCDONOUGH

PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

Mr. Chairman, you invited me to appear before the Committee to present my independent views regarding the accounting of FOMC meetings. As you know, it is not possible for me to appear at the hearings, but I submit herewith my views, as well as the answers to three questions to me in your letter of September 20.

I believe that the primary responsibility of the Federal Open Market Committee is to develop and carry out a monetary policy which contributes to sustained economic growth with price stability. Therefore, I address myself to the question before us guided essentially by whether the present accounting of the FOMC meetings is more or less supportive of that responsibility than would be the case under the provisions proposed in the legislation being considered, H.R. 28.

In addition to serving as President of the Federal Reserve Bank of New York and Vice Chairman of the FOMC, I also bring to this consideration a period as Manager of the Federal Reserve System Open Market Account with responsibility for the day-to-day execution of FOMC decisions. In the hope of adding some specialized value to the Committee's consideration, I will direct my consideration to the market effect of one aspect of H.R. 28, release of the policy decision of the FOMC within seven days as compared with the release of the directive the Friday after the subsequent meeting, i.e., with a delay of about seven weeks.

We all may have differing views either in general or from time to time regarding the right direction of monetary policy. But whatever these views, the actual carrying out of monetary policy in the best interest of the American people must involve flexibility. Why?

It is frequently the case that the right monetary policy conclusion is not an immediate change in policy. On occasion, the FOMC decides that there should be a "tilt" between meetings towards a shift in monetary policy; that "tilt" may or may not result in an actual policy change, depending on how circumstances in the economy and in financial markets play out. The present policy of releasing the minutes and the directive after the following meeting permits this flexibility, since by the time of release under the present policy it is a clear fact whether policy has been changed or not.

A person who has not spent much of his or her life in these markets may say that nothing would be lost by immediate disclosure. That is simply not so. I can assure the Committee, based on over two decades of private sector experience in financial markets, that the disclosure of an FOMC policy tilt would be translated by the financial markets in moments after the release to an execution of the policy shift. A policy change which the FOMC thought might make sense only if certain economic circumstances evolve would become an executed policy as market participants acted instantly to either profit or avoid loss. In other words, market participants would immediately assume that the policy tilt would become reality and protect themselves by immediately moving market rates accordingly. With that being the case, the FOMC would be deprived of the inter-meeting flexibility which I believe is essential for carrying out the optimum monetary policy. The Committee would be convinced that it could not choose a tilt, even if it thought a tilt was the right decision. The FOMC would be left with only the binary choice of maintaining present policy or changing it immediately. Monetary policy is simply too important to the good of the American people to force it into that kind of arbitrary and inappropriate straightjacket. The greater good of the best monetary policy which the FOMC can devise and carry out must be given priority over a great, but lesser, good of immediately informing the public.

Mr. Chairman, you asked that I also respond to three specific questions included in your letter to me of September 20. I provide these answers as follows:

First, I have made no notes or records of the FOMC meetings I have attended.

Second, an officer of the Open Market Function at the New York Fed attends the FOMC meetings to provide backup for the Manager for Domestic Operations. That officer prepares informal written notes during the meeting which are not intended to be a record of events, but rather a guide to the Open Market officers in the day-to-day management of the account between meetings. These notes are given very limited distribution within the New York Fed: to the President, the First Vice President, the General Counsel and the other system account officers, a total of about seven people. Recipients return the notes to the officer who has prepared them and they are immediately destroyed. No file is maintained.

The Research Director of the New York Fed is my principal advisor on monetary policy matters. He attends the FOMC meetings and keeps handwritten notes; these notes are not transcribed and are kept in the Research Director's own files, not those of the Research Group.

I have no personal knowledge of any other notes or records that others may have made at FOMC meetings or the release of FOMC meeting information prior to the official release of that information.

As President of the Federal Reserve Bank of New York, I appreciate this opportunity to address myself to the Committee. The Federal Reserve was created by the Congress and we are accountable to the American people through the Congress as the people's elected representatives. I hope that these comments are helpful to you in your deliberations.

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For Use at 10:00 a.m. EDT
Tuesday,
October 19, 1993

Testimony by

Robert T. Parry

President and Chief Executive Officer

Federal Reserve Bank of San Francisco

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

As President of the Federal Reserve Bank of San Francisco, one of my jobs is to contribute to Federal Reserve policy deliberations with information and ideas from my District. The Twelfth Federal Reserve District is highly diverse: it is made up of the nine western states, which at present include three of the more robust state economies in the country (Utah, Idaho and Nevada), and one of the weakest--California. In fact, California has seen employment fall by 592 thousand jobs (4.7 percent) since mid-1990.

With that introduction, I would like to express my appreciation for this opportunity to discuss my views on the disclosure of information about Federal Open Market Committee (FOMC) meetings. I believe that there should be a presumption that Federal Reserve deliberations should be fully disclosed, unless there is a compelling reason not to do so. (I expressed this view in my letter to you dated January 13, 1993.) However, in the case of FOMC deliberations, such a compelling reason exists. Given the importance of the decisions being made, it is essential to ensure the effectiveness of the decision-making process. In order to reach the best possible policy decisions, it is important that there be a free flow of information and ideas at each meeting.

Some of the information discussed at FOMC meetings is inherently confidential -- for example, because it pertains to individual firms and was obtained under a promise of confidentiality, or in some instances, because it pertains to confidential matters in other countries. Video tapes or verbatim records of our meetings would severely limit the information that would be brought into the decision-making process.

It also is important that members of the FOMC feel free to advance their ideas in the context of a freely flowing discussion. By the very nature of any productive discussion, some ideas are discarded or modified in the process of reaching a consensus. Yet such comments could be seriously misinterpreted if taken out of the full context, which may include discussions at previous meetings or collective institutional memories. I am concerned that verbatim records or video tapes would inhibit the free flow of comments at our meetings, and in the process, limit the effectiveness of our policy discussions.

I have considered the merits of returning to detailed non-verbatim minutes with attribution revealed after a long delay, as was done until the mid-1970s. If it were possible to ensure that such minutes would not be made public for an extended period of time--say, five years--after a meeting were held, many of my objections would be assuaged. Such records might have value to researchers studying U.S. monetary policy. However, I am skeptical that such a delay in the release of information could be guaranteed. Even the possibility of an early release of a transcript could hamper the deliberative process at FOMC meetings. I might also add that the preparation of such detailed minutes would be very burdensome, and I am not convinced that the social benefits would justify the costs.

Also, I believe that the Minutes of FOMC meetings that currently are made available provide an accurate and thorough distillation of all the comments made by me and my FOMC colleagues, while avoiding the problems associated with direct attribution or a verbatim record. The current document accurately reflects the issues and discussions leading to policy decisions by clearly describing the views of the majority, as well as contrary points raised in the discussion. Moreover, members who dissent from the final decision of the Committee explain their reasoning, and are identified by name in the Minutes. The document covers expectations of policy over the period until the subsequent meeting, and normally is released a few days after that subsequent meeting.

In your letter requesting me to attend this session, you asked for information concerning notes or records that I have made in connection with FOMC meetings I have attended, and any knowledge I have of notes that others have made.

I do not take notes of what is said at FOMC meetings. However, I do take into the meetings notes concerning the comments I plan to make about the national and Twelfth Federal Reserve District economies, about monetary policy, and occasionally about special topics that are on the agenda for a particular meeting. These "talking points" are stored in locked files at the Federal Reserve Bank of San Francisco in accordance with FOMC security procedures. My actual statements often diverge somewhat from my notes, and I also make impromptu comments at each meeting, for which I have no notes. I also take into FOMC meetings a briefing book prepared by the Research Department at the Bank. This book contains analysis and forecasts of developments in the U.S. economy, analysis of developments in the Twelfth Federal Reserve District, occasionally discussions of special topics related to FOMC issues, and analysis of monetary policy issues and recommendations by my staff.

The Director of Research at the San Francisco Reserve Bank, and occasionally his alternate, take hand-written notes of comments made at FOMC meetings when they attend as my advisor. These notes are for their own use in directing FOMC policy analysis within the Research Department. They are stored in their locked files at the Federal Reserve Bank of San Francisco in accordance with FOMC security procedures.

Finally, with respect to your question about "leaks" of confidential FOMC information, I have never divulged any FOMC information to unauthorized persons prior to the official release date, and I have no information concerning anyone else doing so.

FOR RELEASE ON DELIVERY
10:00 A.M. EDT
OCTOBER 19, 1993

Statement by

Wayne D. Angell

Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

Mr. Chairman and members of the Committee, I appreciate this opportunity to give you my views on the accountability of monetary policy. As I have indicated previously in correspondence with you, my perspective is of one who throughout his career as an elected and appointed official has been in favor of opening government proceedings to the public and the press. Our democracy demands that the actions of its government be conducted "in the sunshine" to the greatest extent possible to ensure that the process of public policy formulation is appropriate and equitable; it also demands that government agencies adopt the very best policies. In some cases, there is a trade-off between these two objectives. As my statement will explain, I believe the current legislative requirements for monetary policy accountability and the Federal Reserve's current policies regarding the provision of monetary policy information strike a reasonable balance between these objectives.

Monetary policy is best formulated within a framework that provides an appropriate degree of insulation from day-to-day political pressures while requiring full accountability. The Congress gave the Federal Reserve some insulation, for example, by establishing long terms for members of the Board of Governors and by exempting the budget of the Federal Reserve System from Congressional appropriations of funds.

But at the same time, the Congress has provided for full accountability of monetary policy. As you know, the Board of Governors is required to report to the Congress on its monetary policy plans and objectives twice each year. In hearings before this Committee and the corresponding body in the Senate, the Chairman of the Board presents testimony on the monetary policy report and responds fully to your questions on monetary policy. Federal Reserve policymakers also testify as requested before this and other Congressional Committees about monetary policy and other matters of interest, including a detailed accounting of our expenditures.

Beyond the statutory requirements, the Federal Reserve provides significant additional information to the public about the conduct of monetary policy. In particular, the Federal Open Market Committee publishes minutes of each of its meetings. These minutes summarize fully the discussion and indicate the attendance at the meetings. They show the results of all recorded votes, including statements that explain dissenting votes. Significant decisions taken by the FOMC should always be made on the basis of recorded votes--in accord with an important principle of accountability. Each member of the Committee is afforded an opportunity to participate in the preparation of the minutes so that no individual or shared views are omitted. In my view, the minutes present an accurate account of each FOMC meeting.

With regard to the timeliness of the release of such minutes, as you know they are published shortly after the following Committee meeting. It seems to me that such a lag is appropriate. The immediate release of information on the Committee's plans for contingencies could increase market volatility, particularly in circumstances when the contingencies do not eventuate. Such volatility is unnecessary, and could be especially counterproductive if concerns about possible volatility deterred some members of the Federal Open Market Committee from discussing such contingencies or drove them to relying on implicit or behind-the-scenes understandings. On balance, the market and the public are better served by more detail and more openness with delayed publication as compared with the realistic alternative of less specificity that would likely accompany earlier publication.

Similarly, I believe that provisions in the Federal Reserve System Accountability Act (H.R. 28) that would require release of videotapes or transcripts of Committee meetings would have deleterious consequences. In any setting, the recognition that one's remarks will be reported verbatim will dampen participation of most members in the discussion. In the context of monetary policy, such provisions likely would cause many policymakers to be much less willing to conjecture about future economic and financial developments, to explore alternative policies, or to challenge others' views. Under those conditions, discussions during FOMC meetings are less likely to lead to appropriate policy decisions. The willingness of individual members to explore verbally what may seem to be low probability events may be the beginning of a new perspective that elicits more careful watching and continued debate. The process of developing a consensus view through an open contrarian forum is essential if monetary policy is to lead toward monetary stability.

For these reasons, I believe that the relevant provisions of H.R. 28 would do little to make the monetary policy process more transparent and, unfortunately, would do much to make the conduct of monetary policy less effective. In my view, our current procedures regarding disclosure are on the right track: They permit a careful review of alternative policies while allowing the Congress and the public to analyze both the process by which our decisions are reached and their results.

In addition to soliciting my comments on the accountability of monetary policy, you also asked about notes or records regarding FOMC meetings and about premature release of information pertaining to the discussion at such meetings. It has been my practice to take sketchy notes during the course of FOMC meetings; the notes are kept, solely for my own use, in a locked file cabinet in my office at the Federal Reserve. Others may also take notes, but I have no information regarding the location and disposition, and I assume the others will answer your question themselves. Some years ago I became aware of the existence of rough transcripts of the meetings when I was writing a dissenting statement. The secretary of the FOMC made available to me a transcript of my statements, and only my statements, from the previous meeting. With regard to premature disclosure of confidential FOMC information, over the years I have been troubled by the appearance in the press of information that serves to give credence to conjecture and thereby damages Federal Reserve credibility. I have no knowledge as to the source of such information.

Thank you again for the opportunity to testify on this important subject.

For Release On Delivery
10:00 A.M., EDT
October 19, 1993

Statement

by

Edward W. Kelley, Jr.

Member

Board of Governors of the Federal Reserve System

Before

The Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

Washington, D.C.

October 19, 1993

Thank you for an opportunity to present my views on HR 28, the "Federal Reserve System Accountability Act of 1993". Pursuant to the request in the Chairman's letter of invitation, I shall first answer, in order, the three specific questions posed therein and then offer my perspectives on the bill in the area of maintaining a record of the Federal Open Market Committee (FOMC) meetings.

Question 1: I have generated rough pencil notes of my own thoughts, and summaries of the views of other members as I understood them, at most meetings. These notes reside in a locked file in my office.

Question 2: I would assume that various persons present at the meetings prepare and keep notes and records of their own, including the FOMC secretariat, but I am unaware of specifically who does what in this regard. Doubtless others will report on their own activities.

Question 3: I have no information whatsoever about unauthorized or premature release of FOMC information.

Let me move on to comment on HR 28 which would require, among other things, complete release of FOMC meeting proceedings within sixty days. I must oppose this proposal.

It seems to me that the issue here is the reconciliation of two basic principles for conducting public business in a democracy. The first is the obvious requirement that public policy be generated to further the public interest in the soundest possible way. The second is that the public has the right to know what its leaders are doing in the conduct of its business, including how and why they are doing it. While these two principles can often be fully accommodated, there are clearly cases wherein the second, fully implemented, can potentially degrade the first. In such cases, the overriding requirement is that public policy must be of the highest possible quality.

The meetings of the FOMC are such a case. In these meetings twelve voting members augmented by the seven additional Reserve Bank Presidents debate and decide important public matters of monetary policy. To work well such an arrangement must proceed in private, where the participants may freely and easily exchange perspectives and confidential information, dispute, alter viewpoints, and work toward discovery of common ground. In this manner, responsible public policy is created. To expose this process to public scrutiny would, in my view, very clearly introduce an atmosphere that would be detrimental to the final result. The quality of the final result, sound monetary policy to undergird and support our economy, is the most important of the interests in question. I believe HR 28 would be counterproductive in this respect.

The requirement remains that the public be as informed as possible in these matters and that those involved in the process be accountable. I believe that the existing procedures for release of FOMC decisions are responsive to the public's right to be informed. Concerning accountability, FOMC decisions are the result of the votes of the participating members and each participant's vote is recorded and made public. Affirmative votes are explained in the minutes as released, and dissenting votes are accompanied by individual explanations. Thus, there is complete accountability for results.

In summary, I feel that the public's interest in this matter is best served by maintaining a system wherein the process is confidential and the policy results are made public in appropriate ways, with personal and group accountability for such results.

FOR RELEASE ON DELIVERY
10:00 A.M. EDT
OCTOBER 19, 1993

Statement by

John P. LaWare

Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

Mr. Chairman and Members of the Committee --

I am here with my Federal Open Market Committee colleagues to comment on the initiatives in H.R. 28 which are purportedly designed to improve the accountability of the Open Market Committee for monetary policy. Specifically, you have asked for comment on the proposed requirement for a full and, timely accounting of each FOMC meeting.

I would strongly urge the Committee to continue, as in the past, to concentrate its appropriate oversight efforts on the substance of monetary policy rather than on the procedures by which it is determined. The mandated Humphrey-Hawkins testimony, presented twice a year and intensely scrutinized and analyzed by Congress and the media, provides a rather full description of policy moves, historic economic performance and future objectives for policy, expressed in terms prescribed by the statute. It is perhaps the fullest public accounting of monetary policy provided by any central bank in the world.

I can honestly see no purpose to be gained by publication of a verbatim transcript of the Federal Open Market Committee's deliberations and even less purpose in a videotape record of the proceedings, which might provide prime-time competition for Congressional Committee hearings and speeches on the floor of the House, which I don't believe have particularly high ratings.

A verbatim transcript or a videotape recording of the meetings of the Open Market Committee might significantly inhibit the members from the free exchange of ideas which presently characterizes our meetings. We are, after all, human, and we all have a certain amount of self-consciousness about being "on stage," as we would certainly be under the suggested protocol. This problem would be heightened by the knowledge that the matters under discussion are highly sensitive for financial markets here and around the world. Consultation "in camera" gives the members of the Open Market Committee the same privileges of open communication and free exchange, enjoyed by juries. Importantly, it also gives the Committee members the same right to change their minds as jurors enjoy. I can't imagine how juries might deliberate in the presence of a scribe or a tape recorder or a video camera. I am sure the quality of jury decisions would be significantly changed. I am equally sure the process of developing monetary policy would suffer under such a regime of public performance.

I am much less concerned that the quality of policy decisions would be adversely affected by a memorandum of discussion carefully edited to delete market-sensitive information provided on a confidential basis and released on some delayed schedule, perhaps one year after the meeting it described. Even there, some behavioral change on the part of Open Market Committee members could be expected, but I would not think it would be sufficient to significantly inhibit the deliberations of the Committee or alter the course of policy.

Finally, the issue of the timely release of the Directive for open market operations is a tricky one. On the one hand, the market knows at 11:30 or so the morning after the FOMC meetings whether there has been a policy shift. This is almost immediately discernible from the way the Desk at the New York

Federal Reserve Bank enters the market. So, from this perspective, there is little to be gained or lost from the publication of FOMC decisions within a week, as proposed under H.R. 28. On the other hand, immediate release of the directive would probably discourage the use of asymmetric language in the directive, because asymmetry reflects the tilt of the Committee either toward ease or tightening. Markets might react impulsively on such news, to no one's best interest except speculators. And, internally, such a stricture against asymmetric language would inhibit quick inter-meeting response to changing market conditions.

As to the three specific questions in your letter of invitation:

1. I make no notes at FOMC meetings other than brief bullet points to outline my own comments to assure coherence. These, together with all analytical materials supplied by the staff prior to the meeting, are given by me to my executive assistant for destruction as soon as the FOMC meeting adjourns.
2. I have no knowledge of notes or records made or retained by other members of the Committee.
3. I have no knowledge of the source of the notorious "leaks" of FOMC information. Such "leaks" are irresponsible and reprehensible. If unintentional, they reflect a naiveté which should not be allowed to lurk anywhere near the FOMC. If intentional, they should be punished to the full extent of whatever

remedies are available, no matter who the culprit may be.

I appreciate the opportunity to participate in this hearing and look forward to answering any further questions the Committee may have.

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For release on delivery
10:00 am, EDT
October 19, 1993

Statement by

Lawrence B. Lindsey

Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

Mr. Chairman and members of the Committee, I appreciate this opportunity to comment on provisions of the Federal Reserve System Accountability Act (H.R. 28) that pertain to the release of information on monetary policy.

The Federal Reserve currently provides a great deal of information to the public about the monetary policymaking process both formally and informally. We report to the Congress semiannually on our objectives and plans for monetary policy, and we provide additional testimony on request. We publish a considerable volume of timely data on our monetary policy actions. In addition, we publish minutes of each FOMC meeting shortly after the following meeting. These minutes fully summarize the discussion at Committee meetings and are reasonably timely. Federal Reserve officials frequently discuss the economic situation and monetary policy in informal contacts with members of the Congress, members of the Administration and their staffs. We publish numerous articles relating to monetary policy in System publications.

Members of the Board and Presidents of Federal Reserve Banks have an obligation to the public to explain their policy positions, and we therefore often speak out through speeches and other forums, not just on monetary policy but on economic policy more generally. We go out into communities across the nation, partly to understand the economic circumstances and concerns of all Americans, but also to articulate the Federal Reserve's position on the economy. For example, Mr. Chairman, I have visited the fine city of San Antonio twice during my 23 months as a Governor and have met with citizens from all walks of life to listen to their needs and to explain our mission. In fact, in virtually every city to which I have travelled, over 30 in all since becoming a Governor, I have met with local businesspeople, bankers and citizens to discuss the economy and its direct impact on their businesses and daily lives. I consider the process of carrying on a public dialogue to be central to my responsibilities. There are no mysteries regarding my position or thinking. And I believe the same is true of my colleagues.

In my view, the provisions of the proposed legislation directed at increasing the availability of monetary policy information probably would suffer from the law of unintended consequences. Videotaping FOMC meetings would likely reduce the usefulness of these meetings considerably. Participants would hesitate to use hypothetical or speculative examples to explain points, because these examples could be misinterpreted and cause unnecessary volatility in the financial markets. Information learned from meetings and travels is often proprietary in nature, and thus could not be shared if the meetings were taped. More generally, the give and take in the discussion among policymakers would be sharply reduced. Policy discussions would tend to take place outside of Committee meetings, and members of the Board and Reserve Bank Presidents would come into meetings with preconceived views to a much greater degree than is the case currently. Videotapes of these meetings might, in fact, consist of nothing more than prepared speeches by the Board members and

Reserve Bank Presidents.

The ideas that arise in the current process of open, candid discussion would no longer be produced at Committee meetings, and thus would not be reported in FOMC minutes. Their loss would limit the flexibility and give and take of the policy process and in so doing produce the unintended consequence of actually reducing the net amount of publicly available informed debate on monetary policy.

I am also skeptical that, on balance, immediate release of the directive would be useful. While there may be some advantages, there are also costs. Under current procedures, market participants and others are able to recognize an actual shift in the Federal Reserve's policy stance on the morning that the change is implemented. Thus, an immediate verbal statement on policy changes would provide no additional information to the market. A requirement to publish information could be damaging in cases where policy contingencies are part of the FOMC directive. In fact, increased market volatility could potentially result due to market speculation. Moreover, such a requirement could diminish the Committee's ability to provide instructions to the Federal Reserve Bank of New York to respond to contingencies, potentially hobbling the Federal Reserve's ability to resolve financial crises.

Let me turn next to the three specific questions that you posed in your letter of invitation to this hearing. First, I do take very sketchy notes during FOMC meetings to help organize my own comments. These notes are discarded by me after each meeting. Second, I believe that others will be describing their own note taking practices and that the Chairman will describe the note taking process of the FOMC Secretariat. Finally, I have no information for the Committee on any premature release of FOMC confidential material.

In summary, Mr. Chairman, I believe that there will always be a tension between the benefits of an open and ongoing public debate on economic policy and benefits of confidentiality. Although the current system is imperfect, it is probably better than resolving the current tension in favor of either fuller openness or greater confidentiality.

For release on delivery
10:00 A.M. EDT
October 19, 1993

Testimony by

Susan M. Phillips

Member, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

73-208 0 - 94 - 6

I am pleased to have the opportunity to appear before this Committee to present my views on the reporting of Federal Open Market Committee actions, with specific reference to sections of HR 28, "Federal Reserve System Accountability Act of 1993" that focus on maintaining a record of the FOMC meetings. I am the newest member of the Board of Governors and am therefore also a voting member of the FOMC.

Since joining the Federal Reserve Board, I have been deeply impressed by the care and attention given throughout the System to the incorporation of a broad range of viewpoints in the development and conduct of monetary policy. This information gathering or economic monitoring is done through a variety of means -- advisory and consultative committees to the Board and individual Reserve Banks, studies requiring specialized surveys or data gathering, financial reports submitted to the Board as part of the regulatory oversight process, Reserve Bank reports and the various analyses and studies undertaken as background for the Beige Book and staff FOMC documents. The cooperation received by the Federal Reserve System in this enormous task of economic monitoring is no doubt attributable to the serious manner, and in some cases the confidentiality, in which business and economic information is treated by the Board and the Reserve Banks. This cooperation demonstrates considerable confidence in the FOMC's processes and is likely bolstered by the unique quasi-public organizational structure of the Federal Reserve System, carefully crafted by the Congress to contain an inherent number of checks and balances, with the private sector an integral part of the System.

The manner in which the Board and the FOMC communicate with the markets and the public is crucial not only to maintain trust and confidence in the national's central bank but also to assist members of the FOMC in gathering sufficient information to assess the various trends in both the real and financial sectors of the economy. The ability to receive and relay to the FOMC confidential financial information is vital to a full understanding of the complex U.S. economy. I believe that releasing a literal transcription or videotape of the meetings would seriously inhibit members' abilities to obtain and relate such information because of its potential market sensitivity.

A videotape or transcript also could have other harmful effects on the nature of discussions at FOMC meetings. The structure of those meetings allows all Board members and Bank presidents an opportunity to present their views. These voting and non-voting members come from very diverse backgrounds, representing different parts of the country, and varying perspectives on the macroeconomy and the operation of monetary policy. The process of explaining different viewpoints and reconciling them requires significant explanations and considerable give and take. Efforts are made by members to compare and contrast their particular regional or economic observations with those of other members, rendering the use of complete prepared statements extremely difficult. If a literal transcript or videotape of FOMC meetings were to be released, I believe many members would feel constrained to speak only from prepared statements, thereby losing the analytical approach now used in building upon each other's observations in a truly deliberative process. Moreover, there would be reduced capability to reach a consensus, since members' initial statements may limit their flexibility to adjust their positions. The current approach to constructing and releasing the minutes, which allows complete recordation of the subjects discussed and views presented without specific attribution, contributes to this analytical deliberative process. All members have an opportunity to edit the minutes before the next meeting.

I review the draft to assure that my own views are adequately reflected in the minutes, and make editorial suggestions as appropriate. To assist in this process, I take sporadic personal notes during some parts of the FOMC meetings to remind myself of, for example, economic conditions noted by other members and my own positions on various issues. Those handwritten notes are retained in my personal confidential files, shared with no one. I presume other members will comment on their own or their staff's notes.

The preparation, circulation and editing of the minutes takes some time, but in any case is complete before the next meeting. I know of no one who shares this information with members of the public or the press prior to its official release.

Earlier release of the minutes, or very rapid release of the Committee's decisions and directives, would curtail the flexibility of the Committee's decisions. Those directives frequently contain or reference longer-run strategies the Committee wishes to adopt, though the precise form those strategies would take depends on subsequent economic developments. No major market participant can announce its future strategy without having an impact on the market itself. Such announcements would be self defeating and limit the Federal Reserve's flexibilities and ability to affect the market when it wishes to do so.

I hope these comments are helpful to the Committee in its deliberations. I would be pleased to respond to additional questions.

For release on delivery
10:00 a.m., EDT
October 19, 1993

Statement by

Edward G. Boehne

President, Federal Reserve Bank of Philadelphia

before the

Committee on Banking, Finance, and Urban Affairs

U.S. House of Representatives

October 19, 1993

I am pleased to testify on the provisions of Section 4 of H.R. 28, the "Federal Reserve System Accountability Act of 1993," that involve public disclosure of FOMC meetings.

Let me begin by saying that I take very seriously my role in FOMC proceedings and have a natural bias toward public disclosure and personal accountability. I also take seriously the collective responsibility of the FOMC to formulate the best possible monetary policy. An essential ingredient in formulating the best possible monetary policy is an effective deliberative process -- one that fosters the free flow of information, the ability to speculate about the effects of alternative policies, the general give and take among members, and the ability to reach a consensus. The challenge is how to maintain an effective deliberative process and still achieve meaningful disclosure and accountability. I believe the FOMC's existing procedures provide a workable balance between the need for a process that allows for the formulation of an effective monetary policy and the need for public disclosure and accountability.

Let me comment briefly on the specific provisions of the bill. I believe the FOMC already complies with the provision of H.R. 28 that requires that a written copy of the minutes of each FOMC meeting be made available to the public within 60 days of the meeting. The FOMC currently releases minutes of its meetings six to eight weeks after each meeting, which is consistent with the bill's proposed 60-day period. For those who read them regularly, these minutes are quite comprehensive. They include information about current and prospective economic and financial conditions, the pros and cons of alternative policy actions, the reasons a majority favored a particular action, plus comments, by name, of those members dissenting.

The minutes the Committee now releases are not as detailed as the Memorandum of Discussion that was released prior to 1976. But in my view the old Memorandum had some disadvantages that hindered the FOMC's deliberative process. I attended FOMC meetings in the early 1970s when the Memorandum was still being prepared. At those meetings, as I recall, members of the Committee tended to stick to their prepared statements and there was less give and take about alternative views of the economy and policy options. This occurred even though the Memorandum was released only with a long lag of five years. I believe the current arrangement of releasing the minutes of the FOMC meeting in summary form -- but much more promptly than the Memorandum -- has served the deliberative process well, while at the same time providing relatively prompt public disclosure.

For the same reasons, I believe the bill's provisions to require a verbatim transcript or videotape of each meeting would impede the FOMC's deliberative process. They would tend to lock members into prepared statements and reduce the give and take of discussion. Innovative proposals could easily be stifled. Members would be less willing to play devil's advocate in proposing policy alternatives, and the quality of monetary policy decision-making would suffer accordingly.

With regard to the bill's proposal for public release of the directive or other FOMC decisions within one week, I believe such a provision would not be very helpful to the public. The directive is best read along with the minutes of the meeting. Indeed, the two are currently released together within 60 days of each meeting. To release the directive earlier is likely to confuse, rather than clarify, people's perceptions of the stance of monetary policy because they will not have the full context in which the directive was prepared. Consequently, I do not favor this provision of the bill.

Mr. Chairman, in your letter of invitation to appear today, you also requested my comments on three other areas. Let me now turn to those. First, during my tenure as President of the Philadelphia Reserve Bank, which began in 1981, I have not taken notes during FOMC meetings. My economic advisor usually takes handwritten notes during meetings, which are then kept in a locked file cabinet with other materials prepared for each FOMC meeting. He uses these notes to identify issues that should be investigated for future pre-FOMC economic briefings. And finally, I am aware, of course, of news stories that have discussed the premature release of information about FOMC meetings. I deplore such leaks. Security of FOMC information is taken very seriously at the Philadelphia Reserve Bank, and I do not have any direct knowledge about how such leaks occurred.

For use at 10:00 a.m. EST
Tuesday
October 19, 1993

Testimony by

J. Alfred Broaddus, Jr.

President

Federal Reserve Bank of Richmond

before the

Committee on Banking, Finance and Urban Affairs

U. S. House of Representatives

October 19, 1993

I am pleased to be here today to discuss the procedures the Federal Open Market Committee follows in recording policy information and releasing it to the public. My views in this area are based on two principles. First, these procedures should enable us to make the best possible monetary policy decisions. Second, in general we should release as much information to the public on our policy decisions as promptly as possible, provided such release does not compromise our ability to make sound decisions. My views also reflect substantial experience with the Committee. Although I have been in my present position only since the beginning of the year, I previously attended committee meetings as an advisor over a period of approximately 20 years.

At each FOMC meeting, the Committee reviews current and prospective economic conditions, discusses current policy issues, and then decides on an appropriate policy direction. This decision is communicated to the Trading Desk at the Federal Reserve Bank of New York in a "directive" that instructs the Desk to take actions in the money market that are consistent with the desired policy direction. The directive is the Committee's primary policy document. It contains the Committee's decision on whether to ease or tighten reserve conditions or leave them unchanged immediately following the meeting. It also signals, through the symmetry or asymmetry of some of its language, the most likely direction of any prospective changes in policy during the period up to the next meeting.

Currently, the directive for a particular FOMC meeting is released immediately following the next meeting along with a "record of policy actions." This record provides a lengthy and thorough summary of the discussion leading up to the Committee's policy decision. It indicates in considerable detail the views of those supporting the decision and contains a full explanation of any dissenting votes. It also lists by name the Committee members voting for or against the policy decision. As a long-time attendee at FOMC meetings, I can attest that the record of policy actions always conveys the content and flavor of the Committee's deliberations as well as its specific decisions fully and accurately. In my view, the record fully satisfies the need for the Committee to be accountable to the public.

HR 28 would change these procedures in two ways. First, it would require that videotapes of FOMC meetings be made and released along with verbatim transcripts within 60 days. Second, it would require that Committee decisions (i.e. the directive) be released within one week. Let me comment on each of these changes.

FOMC Policy Discussions. My views on releasing videotapes and verbatim transcripts of FOMC meetings have not changed since I responded to Chairman Gonzalez on this issue earlier this year. I believe that the prospect of a literal record, even if it were released after a long period of time, inevitably would introduce a self-consciousness into Committee proceedings that would seriously inhibit the flow of information and ideas. Members would almost certainly be reluctant to speak and argue as freely and frankly as they do now if they knew that their statements would be recorded and released publicly. In sum, I believe that releasing a literal record of Committee meetings in any form would restrain Committee members in debate, undermine the deliberative process, and therefore risk lowering the quality of policy decisions.

While I cannot support release of a videotape or any other verbatim transcript of the FOMC meetings, I do believe that there might be benefits from releasing a nonliteral but relatively complete record of FOMC proceedings similar to the "memorandum of discussion" that we prepared until 1976, <u>if there were a long and enforceable delay of the release</u>. As I said in my earlier letter, such a record would assist researchers interested in monetary policy by helping them focus more clearly on the issues that most concerned the Committee at a particular meeting and by strengthening their appreciation of some of the more practical aspects of formulating policy. Over a long period of time it might also provide a clearer picture of the evolution of the positions of various members of the FOMC than is currently available, which some researchers might find useful.

I believe strongly that such a nonliteral record should only be released after a delay of several years, such as the five-year period in the case of the memorandum of discussion. Early release of even a nonliteral record like the memorandum could inhibit FOMC discussion and reduce the quality of monetary policy decisions. Consequently, I think it is essential that any reinstitution of something like the memorandum of discussion be accompanied by a legislative guarantee that it would not be released prematurely.

<u>FOMC Policy Decisions.</u> The second change proposed in HR 28 is to release the directive one week after an FOMC meeting. Arguments can be made both for and against this proposal. Earlier release would be consistent with the general principle that we should inform the public of policy decisions as soon as possible. At the same time, I believe that early release of the directive could well have announcement effects that could create unnecessary volatility in interest rates. The FOMC's policy decision at a particular meeting is often <u>conditional</u> on economic data that become available in the period after the meeting, and the language of the directive frequently reflects this conditional element. If the directive were released soon after

the meeting, interest rates typically would react immediately to any policy action contemplated in the directive even though the actual policy action had not yet been taken. If the action subsequently did not take place, then the initial reaction of rates would be reversed.

One can distinguish, of course, between the part of the directive that announces the Committee's decision regarding any immediate policy actions and the part that may predispose the Committee to undertake a particular future action. It is the latter, conditional part of the current directive that causes my concern regarding financial volatility because it suggests a direction in future policy that may or may not be implemented subsequently. This problem could be dealt with by removing the conditional language from the directive. Doing so, however, could well reduce the usefulness of the directive, both as a policy instruction to the Trading Desk and as a focal point for the Committee's deliberations. The Committee would need to consider very carefully the potential loss from changing the form of the directive before making any such change.

Notes on FOMC Meetings. Let me respond now to the specific questions raised in Chairman Gonzalez's letter regarding my knowledge of notes made at FOMC meetings. As I indicated earlier, I have attended FOMC meetings for a number of years, mostly as the advisor to the president of the Richmond Reserve Bank. While in this advisory position I took notes in order to serve the president more effectively. Monetary policy is a continuous process in which particular issues, such as how to interpret the behavior of the monetary aggregates, frequently recur at subsequent meetings. Consequently, it is sometimes helpful, in preparing for a meeting, to be able to review the discussion of a particular issue at an earlier meeting. I used my notes for this purpose during my years as an advisor. The notes were handwritten, were never transcribed to typewritten or any other form, and were not distributed to anyone. I have always kept these notes in locked, confidential files. I should add that I have taken only very partial notes since assuming my current position at the beginning of the year. I now rely on the notes taken by my advisor, who follows exactly the same procedures I did.

I have only limited knowledge of notes or records made by other FOMC participants and have not read or used any such notes. Finally, I do not personally know of any information that has been released by anyone at the Federal Reserve Bank of Richmond or elsewhere in the Federal Reserve to persons outside the Federal Reserve prior to its official release.

ORAL TESTIMONY

presented to

House Committee on Banking, Finance and Urban Affairs

by

Thomas M. Hoenig

President

Federal Reserve Bank of Kansas City

Kansas City, Missouri

October 19, 1993

Washington, D.C.

Good morning, Mr. Chairman and members of the Committee. My name is Thomas M. Hoenig, and I am president of the Federal Reserve Bank of Kansas City. This bank serves the Tenth Federal Reserve District, which includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri. I am pleased to have the opportunity to express my views on the disclosure of information from Federal Open Market Committee (FOMC) meetings.

The Federal Reserve must be accountable for its actions and has an obligation to disclose as much information as possible about its deliberations and decisions subject to maintaining the highest possible level of policy effectiveness. It is my belief that the Federal Reserve's current disclosure policies achieve these ends.

The current policies provide a detailed accounting of FOMC deliberations and decisions. The minutes of FOMC meetings are comprehensive. They document the information considered during a meeting and the decision of each voting member. Moreover, the minutes provide the rationale for the majority's decision and include statements filed by members who dissent from the majority. In addition, the Federal Reserve reports regularly and frequently to Congress, ensuring further that we are accountable for our monetary policy actions.

Current procedures foster an environment of open and candid discussion among the members of the FOMC. Valuable information from a variety of sources is brought to the discussion, some of it provided with the understanding that it be kept confidential. The give and take among members provides an opportunity to clarify issues and allows the FOMC to synthesize a range of views. Any proposals that would impair this deliberative process, given current procedures that ensure accountability, would compromise the quality and effectiveness of Federal Reserve monetary policy.

Current procedures, in my opinion, also strike an effective balance between timely disclosure and the need for flexibility in the conduct of monetary policy. These procedures, which provide for the release of the minutes shortly after the subsequent meeting, allow the FOMC to respond flexibly to various contingencies over the intermeeting period. Earlier release of the minutes would restrict this flexibility and could have the unintended effect of contributing to market volatility.

With regard to the three specific questions posed to me in Chairman Gonzalez's letter of September 24, 1993, my answers are as follows. One, I make brief notes for my personal use during FOMC meetings. Our bank's Research Director also occasionally takes notes. These notes are kept in locked files, as is other confidential FOMC material. Two, I have observed other participants taking notes during FOMC meetings, but I have no knowledge of their content or disposition. Three, I have no information about the release of information by anyone employed at the Federal Reserve about FOMC meetings prior to the official release of that information by the Federal Reserve.

In closing, let me reiterate that I believe the FOMC must be accountable for its actions, and I believe that its current disclosure policies are appropriate and effective in achieving this end. They provide the public with comprehensive information about the FOMC's decisions and deliberative process and they enhance the Federal Reserve's ability to pursue the nation's objectives of economic growth and price stability.

That concludes my statement, Mr. Chairman. Thank you.

FOR RELEASE ON DELIVERY
10:00 A.M. EDT
OCTOBER 19, 1993

Testimony by

Jerry L. Jordan

President

Federal Reserve of Cleveland

before the

Committee on Banking, Housing, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

Mr. Chairman and Members of the Committee, I welcome the opportunity to appear before you this morning to discuss the release of information about the meetings of the Federal Open Market Committee.

Before I respond to the three specific questions raised in your letter of September 24, 1993, I would like to address a general issue that I believe is highly relevant.

The questions of what information to release and when to release it must be answered in the context of accountability for achieving clear, unambiguous objectives for monetary policy. If the FOMC is charged with conflicting or unattainable objectives, discussions about the appropriate timing and content of disclosure could easily reflect misplaced priorities. Congress could best contribute to a clarification of the FOMC's policy direction by enacting the Neal Resolution, which specifies an ultimate goal of achieving the highest sustainable rate of real economic growth through the maintenance of purchasing power stability. The timing and content of disclosure become less contentious issues in the presence of a credible framework for monetary policy.

Markets operate more efficiently with knowledge of the collective thought process that generates Committee decisions. Such information allows people to deal with uncertainties about how policy actions might respond to unknowable future developments.

It takes some time to ensure members' agreement on an accurate portrayal of a meeting, and to remove sensitive material. Thus, the minutes of a meeting, describing the climate and substance of Federal Open Market Committee decisionmaking, are released only after their formal acceptance, at the next regularly scheduled meeting.

Meeting minutes are released through an orderly process that guarantees equal access for everyone who wants to receive them, simultaneously, at numerous sites nationwide. In the interim, prior to release, actions in the open market are taken in accordance with a publicly understood procedure. Within seconds of any market action, electronic information services communicate the facts nationwide.

As a member of the Committee, I find it objectionable to see news stories that are not written on the basis of the Committee's well-defined, orderly procedures for information security and release. I do not condone the actions of individuals who unilaterally release such information, even through inadvertence. Chairman Greenspan indicated last week that measures have been taken to ensure that the procedures adopted by the Committee are followed.

You have asked me to respond to three specific questions. First, I do not take notes at an FOMC meeting. At the first few meetings I attended in 1992, I took a few notes during Committee meetings to remind me later of issues raised in the course of discussion, but soon decided that I did not need notes to remind me of the important issues. If I want staff analyses of theoretical or empirical issues in preparation for subsequent meetings, I discuss the issues with senior policy advisers. All this is done in accordance with the Committee's standard rules for maintaining confidential FOMC information. We adhere to a "need to know" policy when relating information to research economists conducting studies on policy issues. Second, I have not questioned any other participants in FOMC meetings about the procedures they follow, and consequently am not aware of whether they keep notes or records of the meetings. Finally, I have no information about the premature disclosure of FOMC meeting materials by anyone employed at the Federal Reserve.

For release on delivery
10:00 a.m. EDT
October 19, 1993

Remarks of

Silas Keehn, President
Federal Reserve Bank of Chicago

before the

United States House of Representatives
Committee on Banking, Finance and Urban Affairs

Washington, D.C.

October 19, 1993

Mr. Chairman and Members of the Committee:

As requested, let me briefly summarize my views on the question of the appropriate record keeping and public release of the deliberations of the Federal Open Market Committee.

As I stated in my letter of January 13 of this year to the Chairman of this Committee, I fully support Chairman Greenspan's previously stated position on the various proposals for maintaining and releasing a more detailed record of the FOMC's deliberations. In my view, the minutes of the FOMC, as they are currently written, provide the right level of reporting and detail necessary to communicate the current policy concerns and actions of the Committee. The minutes explicitly document the full range of policy arguments made during the discussion and when a member of the Committee disagrees with the resulting consensus, that member's dissent becomes an integral part of the public policy record.

Based on my participation in FOMC deliberations, I believe that releasing more detailed minutes, most especially a verbatim transcript of the meeting, without a significant delay would be counterproductive and would impede the development of sound monetary policy --- first, by limiting the free flow of necessary information into the policy process and second, by hindering the consensus process so essential if policy is to adequately reflect economic conditions in all regions of the country.

As President of the Federal Reserve Bank of Chicago, I have an important responsibility to convey to the FOMC the economic conditions of the Seventh Federal Reserve District. To meet this responsibility, I and other senior members of our staff maintain extensive contacts with District businesses (large and small), community groups, and state and local government officials. From these individuals we are able to gather a wide array of highly significant information about the District that cannot be derived from the public data sources --- information not only about current economic conditions, but about changes in business practices, future production, labor negotiations, investment and hiring plans and a host of other issues that have important value to the policy process.

This type of information is particularly important at the present time. The economy is going through a very different phase than any that we have experienced in the past. Many of the economic indicators that have been useful guideposts in developing policy in the past are now proving unreliable. In such an environment, I find the regional information derived from local contacts, both about the Seventh District and elsewhere in the country, essential to the policy process. In the context of these hearings, it is important to understand that much of the information that these contacts provide is highly proprietary and very confidential in nature. I have absolutely assured these contacts that the source and nature of the data will not be divulged in a way that they would find compromising. I have never had anyone decline to speak with me about their activities. If I could not provide such assurances, then much of this significant information would not be forthcoming and the development of monetary policy would be impeded.

It is precisely this type of information about local businesses, communities and financial institutions that demonstrates the value of the regional structure of the Federal Reserve System and District representation on the Federal Open Market Committee. The impact of releasing such information as part of the written record of the FOMC without a significant delay would only result in the exclusion of this vital information from the FOMC policy discussion. In my view, this would not be in the public interest, especially when the current system of disclosure is able to convey an accurate description of the key issues and arguments underlying the FOMC decisions, as well as record individual votes and dissenting positions. If it became necessary to prepare more detailed minutes, then they should only be released after a period of five years and with all confidential information about individual corporations excised, as well as confidential information about foreign countries, foreign central banks and international institutions.

As to the specific questions you asked us to address:

I prepare an outline of economic conditions in the District which forms the basis for my remarks at each meeting of the FOMC. After the meeting, these notes are kept secured in my office until the next meeting at which time I destroy them. I do not maintain notes on the discussion that takes place at the meeting itself and Chairman Greenspan is in a better position to describe the records that are kept by the FOMC Secretariat.

As to the premature release of information from the FOMC meetings, I have not talked to the press or other outside contacts, nor to other Federal Reserve officials who do not have authorized access to FOMC information and my only direct knowledge of such premature releases arises from articles that I have seen in various newspapers. I completely concur with Chairman Greenspan that premature releases of this type are highly inappropriate and totally unacceptable.

Thank you.

For release on delivery
10 a.m. E.D.T.
Tuesday, October 19, 1993

Statement by

Robert D. McTeer, Jr.

President

Federal Reserve Bank of Dallas

Before the

Committee on Banking, Finance, and Urban Affairs

U.S. House of Representatives

Washington, D.C.

October 19, 1993

Thank you, Mr. Chairman, for your invitation to testify on HR 28. As requested, I will limit my testimony to the issue of FOMC records, although I do have opinions on other parts of HR 28, especially the part that puts me out of work.

I became President of the Dallas Fed in February 1991, so I'm a relative newcomer both to the FOMC and to your great state of Texas, Mr. Chairman. As the bumper sticker says, " I wasn't born in Texas, but I got there as soon as I could. "

Prior to moving to Texas two and a half years ago, I was with the Federal Reserve Bank of Richmond for 23 years, the last 11 of which I served as manager of its Baltimore Branch. I have participated in FOMC meetings since 1991, but did not vote until this year.

You asked us to respond to three specific questions regarding note-taking in FOMC meetings. Regarding my own practice, I don't take notes of the type I assume you mean. I do a lot of reading and homework prior to the meeting, and I go into the meeting with some tentative ideas in mind. I doodle during our discussion and occasionally write down a word or phrase for reference when I speak. I don't write down decisions because they are simple and easy to remember and come at the end of the meeting. My doodles and notes would be of no use to traders or journalists. I destroy them after the meeting and rely only on official documents for future reference.

Regarding your second question, notes kept by others, my impression is that most other members and staff probably follow a pattern similar to my own since all who are present presumably have access to the official records and documents. At least, I have no knowledge to the contrary.

In answer to your third question, I have no information about the premature release of FOMC information by anyone at the Federal Reserve. Let me add that, in my opinion, if someone wanted to leak valuable information about the Committee's decisions, such notes would not be necessary nor even very helpful. While the decision process may be difficult, the decisions themselves are simple and easy to remember. Let me comment briefly on other aspects of meeting records. As a former economist, I have some sympathy for the idea of immediate release of the directive. Immediate release of the decision would eliminate any question of leaks or the appearance of leaks.

The practical problem with immediate release of the directive is that not all decisions are clear-cut decisions to ease, tighten, or remain unchanged. On occasion, the Committee votes to hold steady, pending further information or developments, and wishes to give the Chairman extra leeway to act on his own prior to the next scheduled meeting. More often that not, I believe, these "asymmetric directives" are not acted on, but occasionally they are. To announce a decision of "no change" without the proviso would be misleading, and to announce it with the proviso would likely cause the markets to react in a way not necessarily warranted by subsequent information.

Given this dilemma, I believe the current arrangement is best. Markets are able to discern the immediate decision by watching the federal funds rate the following morning, and we retain maximum flexibility to react to incoming data and changing circumstances without misleading anyone. Then as soon as another meeting is behind us, we release the directive that includes the prevailing circumstances, the rationale for the decision, and the identity of any dissenters and their reasons for dissenting.

I, personally, have a greater problem with videotaping and verbatim transcripts of discussions than with prompt release of decisions. I believe that videotaping or verbatim transcripts, no matter when they are released to the public, would diminish the quality of our deliberations. My colleagues and I are willing to listen to each other and adjust our initial leanings in the interest of consensus-building. We currently don't posture for the record or for the camera. There is no winning or losing the debate. There is no playing to the gallery or to the folks back home. This, I'm afraid, would all change with videotaping or its equivalent.

I would much prefer present arrangements even with more detail added, so long as the detail involves the substance of the discussions and decisions rather than the language used. I would also have no objection to detailed minutes (not a verbatim transcript) being released after a lengthy period, so long as the legal obstacles to a decent delay could be overcome.

For release on delivery
10 a.m. EDT
October 19, 1993

Statement by

Thomas C. Melzer

President, Federal Reserve Bank of St. Louis

before the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

October 19, 1993

I am pleased to appear before the Committee today to testify on Section 4 of the Federal Reserve System Accountability Act of 1993, entitled "Prompt Public Disclosure of Open Market Committee Meetings." As a creation of Congress, the Federal Reserve System is fully accountable to the public for its monetary policy actions. One way the Federal Reserve ensures this accountability is by releasing information about its policy decisions. The Federal Open Market Committee (FOMC) provides a full accounting of its actions in its "Minutes of the Federal Open Market Committee" (Minutes).

The Minutes contain all important information about FOMC decisions, including the policy directive agreed upon by the majority and the reasons underlying policy decisions. Any significant differences among those voting with the majority, as well as the views of any dissenting members, are included in the document. The Minutes are released upon their approval by Committee members at the next FOMC meeting. The public record thus contains the outcome of FOMC deliberations and the policy views of each member of the committee.

I am not in favor of producing a further detailed account of FOMC deliberations, either in the form of an edited transcript, such as the "memorandum of discussion," verbatim minutes, or an audio or videotape. Such a release would impede the deliberative process and thereby impair policymaking. Arriving at appropriate policy often involves considerable give and take, consensus-building and debate of alternative actions. Because of the possibility that a particular statement might be misunderstood or taken out of context, FOMC members would be reticent to engage in the kind of open discussion that leads to good policymaking if they knew that all of their statements would be in the public record. Furthermore, the release of verbatim minutes or any other detailed record of deliberations would discourage other parties from supplying the FOMC with confidential information that is useful in determining appropriate policy.

Turning to the timing of the release of the FOMC policy directive, I believe that immediate release of the outcome of FOMC deliberations would interfere with the deliberative process and would lessen the flexibility with which the Federal Reserve can respond to changing economic conditions. If directives were released immediately, the FOMC might be reluctant, even if economic conditions warranted, to take a timely subsequent action because of concern that such action would add to the uncertainty in financial markets. In addition, the FOMC would be less inclined to bias its directives toward ease or restraint, in effect limiting its policy options. Consequently, reaching a consensus among FOMC members would be difficult, which might delay policy actions and add uncertainty to financial markets.

Finally, let me turn to the specific questions that I was asked to address in my statement.

- In response to your inquiry about my own notes or records, I usually take some notes at FOMC meetings for my personal use. They are not typed, copied or shared with anyone else and are maintained in a locked file cabinet in my office.

- Your second question concerns my knowledge of notes or records that others have made at FOMC meetings. Though others who attend FOMC meetings sometimes appear to take notes, I am unaware of their content, disposition or location.

- In response to your third query, I have no knowledge about the release of information on FOMC meetings prior to its official release by the Federal Reserve.

To sum up, the Federal Open Market Committee is committed to informing the public of its policies, which ultimately must be judged by their results. The "Minutes of the Federal Open Market Committee" convey fully the relevant information about FOMC decisions and do so in a timely way. Thus, in my view, there is little to be gained by providing detailed minutes or mechanical reproduction of FOMC deliberations, while the adverse consequences of doing so are potentially very great. In addition, the benefits of immediate release of the policy directive would not seem to outweigh the potential costs of doing so. By inhibiting the frank exchange of views and possibly reducing the willingness of the FOMC to take timely actions, public release of the details of committee deliberations or immediate release of the policy directive could harm the policymaking process. Though intending to increase the accountability of FOMC members, the proposed changes specified in HR 28 may thus impede monetary policy performance.

Thank you.

For Release at 10:00 a.m. E.S.T.
October 19, 1993

TESTIMONY

by

Gary H. Stern
President

Federal Reserve Bank of Minneapolis

before the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

October 19, 1993

SUMMARY

Mr. Chairman and members of the Committee, I appreciate this opportunity to discuss issues related to maintaining a record of Federal Open Market Committee (FOMC) meetings and procedures followed at the Federal Reserve Bank of Minneapolis to handle confidential monetary policy material. These are, indeed, significant matters. I will try to keep my comments direct and succinct this morning and ask that my complete statement be included in the record.

As indicated in my January correspondence, I am convinced there is considerable value in our current report of FOMC proceedings. As you know, we release extensive minutes of each FOMC meeting shortly after the subsequent meeting. The minutes describe the discussion and the votes of individual members. More specifically, they include an assessment of business conditions here and abroad, price developments, and the performance of financial markets and monetary aggregates. They report the Committee's views of prospects for the economy, frequently including information gleaned from personal contacts in individual Federal Reserve Districts. The minutes also report discussion of monetary policy options as well as the decision ultimately reached by the Committee, including dissents, if any, and the logic underpinning the dissents.

This amounts to a good deal of information in my view, and I do not find merit in suggestions to prepare and release, at any time, a literal record of FOMC deliberations -- through videotaping or other vehicles. Three issues in particular concern me. First, given the gravity of our responsibilities, I believe it imperative that the quality of our deliberations be maintained. Open discussion of ideas, of policy alternatives, and of significant potential risks to the economy are critical to sound policymaking. Secondly, some of the information we discuss is voluntarily provided on a confidential basis. We have an obligation to maintain that confidentiality. Thirdly, I believe our procedures carefully balance the need to provide information to the public with the necessities of effective monetary policy. Even small changes carry the considerable risk that they will disturb, perhaps unknowingly and unintentionally, this balance, with adverse consequences for financial markets and economic performance.

As indicated in my earlier correspondence, I believe there could be some merit to reintroduction of something like the "memorandum of discussion," a very detailed, although edited, accounting of FOMC discussions, provided that the confidentiality of such material is assured for several years. As I see it, such a document could be useful to historians and students of monetary policy when they investigate the broad context of policy decisions and the evolution of the policymaking process.

Finally, in response to your specific inquiries about confidentiality, I am unaware of any unauthorized release of monetary policy information ever emanating from the Federal Reserve Bank of Minneapolis. My economic advisor and I leave highly confidential material at the Board of Governors and do not return with it to Minneapolis. I take limited notes during the meeting, as does my advisor. All notes and other materials are handled according to strict guidelines, the essence of which is to limit their distribution and access and assure proper disposal. (A copy of our Bank's procedures is appended to my complete testimony.) Thank you.

TESTIMONY

Mr. Chairman and members of the Committee, I appreciate this opportunity to discuss issues related to maintaining a record of Federal Open Market Committee (FOMC) meetings and procedures followed at the Federal Reserve Bank of Minneapolis to handle confidential monetary policy material. These are, indeed, significant matters.

As indicated in my January correspondence, I am convinced there is considerable value in our current report of FOMC proceedings. As you know, we release extensive minutes of each FOMC meeting shortly after the subsequent meeting. The minutes describe the discussion and the votes of individual members. More specifically, they include an assessment of business conditions here and abroad, price developments, and the performance of financial markets and monetary aggregates. They report the Committee's views of prospects for the economy, frequently including information gleaned from personal contacts in individual Federal Reserve Districts. The minutes also report discussion of monetary policy options as well as the decision ultimately reached by the Committee, including dissents, if any, and the logic underpinning the dissents.

In light of these minutes, I believe that the views of the Committee members are known. In addition, FOMC members reveal their policy positions in other ways. Certainly, I take full responsibility for my positions at FOMC meetings, and I have presented my policy views in Federal Reserve Bank of Minneapolis publications, among other places. (Two examples, one from 1990 and one from 1993, are appended to this document). In addition, Congress can at any time ask us about our views, as the Senate Banking Committee did last March.

Thus, a good deal of information is available in my view, and I do not find merit in suggestions to prepare and release, at any time, a literal record of FOMC deliberations -- through videotaping or other vehicles. Three issues in particular concern me. First, given the gravity of our responsibilities, I believe it imperative that the quality of our deliberations be maintained. Open discussion of ideas, of policy alternatives, and of significant potential risks to the economy are critical to sound policymaking. Secondly, some of the information we discuss is voluntarily provided on a confidential basis. Much of this information would be lost if we were unable to insure the integrity of confidential treatment. Moreover, we have an obligation to respect anonymity and confidentiality. Thirdly, I believe our procedures carefully balance the need to provide information to the public with the necessities of effective monetary policy. Even small changes carry the considerable risk that they will disturb, perhaps unknowingly and unintentionally, this balance, with adverse consequences for financial markets and economic performance.

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TOP OF THE NINTH

Comments by Gary Stern, *President*

The Goal of Price Stability

Over the past year or two, there has been considerable discussion of price stability as the preeminent goal of Federal Reserve monetary policy. This discussion has generated support for the goal but has also touched off a variety of concerns, including the compatibility of this objective with other policy goals, the potentially high cost of achieving price stability, and the means of conducting policy to achieve this objective. These concerns are worthy of serious consideration but, on balance, price stability should remain the overarching goal of monetary policy.

In two pieces of legislation—the Employment Act of 1946 and the Full Employment and Balanced Growth Act of 1978—Congress has specified objectives for monetary policy. To paraphrase a bit, these objectives include achievement of high employment, economic stability and growth, price stability and balance in our international transactions. Clearly, these objectives represent a highly desirable state of economic conditions, but I sense concern that if prominence, or preeminence, is given to one, especially price stability, others may be compromised. That is, these objectives may conflict in a fundamental and lasting way, which implies that the policy challenge is to somehow strike a reasonable balance among these objectives.

I don't find the vision of fundamental conflict persuasive for several reasons. There is a plethora of evidence indicating that monetary policy significantly influences price performance, implying that, if properly designed and administered, policy can reasonably be expected to achieve price stability in the long run. On the other hand, the influence of monetary policy on the other objectives is limited and indirect at best. For example, economic growth depends in part on demographics such as labor force growth, and on the quality of the labor force, matters over which Federal Reserve policies have no influence or effect.

Equally important, in the long run no fundamental incompatibility exists among these multiple objectives. The principal contribution monetary policy can make to achieve sustainable growth and high employment is to establish an environment of overall price-level stability. Beyond demographic factors, growth depends on the capital stock with which the labor force works. Capital investment is likely to do well in a non-inflationary environment. In sum, price stability is compatible with the other objectives specified by Congress and is the principal contribution the Federal Reserve can make toward attainment of those objectives and continuing economic prosperity.

Perhaps a more serious concern about dedicating monetary policy so exclusively to achievement of price stability is that, while this objective is embraced in the abstract, many fear that it would impose substantial costs on the economy in practice.

Those who hold this view implicitly, if not explicitly, accept the Phillips Curve notion of a trade-off between inflation and unemployment or lost output. If this notion is accepted, there is little doubt that achieving price stability could prove very costly indeed.

However, conventional Phillips Curve analysis ignores the potentially crucial role of credibility in achieving policy objectives. If the Federal Reserve adopts and implements an anti-inflation policy that is widely believed and accepted by the public—that is credible—the costs associated with reducing the rate of inflation may be modest.

In a recent publication, the Federal Reserve Bank of San Francisco made this point very well. "Credibility means that the public quickly adjusts its expectations concerning future policy in response to the announcement of a change in policy, or to policy actions that suggest a new policy stance. Thus, a central bank with 'credibility' can announce a new disinflationary monetary policy and quickly achieve a lower inflation rate without a prolonged economic downturn because the public expects it to follow through with its new policy long enough to be successful. Consequently, wage and price increases moderate quickly."

How much credibility does the Federal Reserve have at present? I can't provide a quantitative answer, but probably not as much as I would wish. Thus, there are likely to be some costs, in terms of foregone output, in achieving price stability. But if an anti-inflation strategy is consistently pursued, credibility can be earned and costs held to reasonable levels.

Assuming that price stability is, in fact, the paramount goal of policy, what should the Federal Reserve do to achieve this objective? In my judgment, policy formulation and implementation would probably have to change little from current procedures. Growth in the monetary aggregates, especially M2, would be used to help assess and guide policy, and M2 growth would have to be reduced over a series of years to a pace consistent with stable prices. In terms of M2 growth ranges, the upper end would have to be lowered steadily to assure that there is no backsliding in this process.

We in the Federal Reserve would continue to recognize, as we do today, that price measures themselves may bounce around in the short run, due in part to swings in energy or agricultural prices that don't relate well in every period to macroeconomic conditions. Similarly, we would continue to recognize that current price performance results from past policies, so we would not necessarily react to every new statistic on inflation. And there would be nothing in our strategy to preclude a response to "shocks," such as a sharp break in stock prices, if that were appropriate. Stated more positively, we would continue to bear in mind our responsibility for the safety and soundness of the financial system, as well as the linkages between financial problems and business activity. Setting course for price stability need not constrain our ability to deal with these situations. Indeed, to the extent that speculative excesses contributed in the past to such problems, achievement of price stability may make such episodes less likely.

The Region

TOP OF THE NINTH

Comments by Gary Stern, *President*

Views on the Economy, Monetary Policy

Following is a summary of Gary Stern's March 10, 1993, testimony before the Senate Committee on Banking, Housing and Urban Affairs. Stern, along with the other 11 Federal Reserve bank presidents, was called to testify on the state of the district economy and to share his views on monetary policy.

Mr. Chairman and members of the Committee, I appreciate this opportunity to discuss with you economic conditions in the Ninth Federal Reserve District and my views on monetary policy. My task is somewhat easier today than it would have been eight years ago, right after I first took office. Over this period economic conditions generally have improved in the Ninth District, and over this period I have had the opportunity to refine my views on the role and conduct of monetary policy. Let me briefly address these two topics in turn.

The Ninth District economy is doing well relative to the national economy today, in large part because it did not participate as fully as some of the regions of the nation in the expansion and excesses of the middle and late 1980s. While the rest of the nation was affected by unsustainable expansions and subsequent sharp contractions in some sectors the Ninth District was more steady-as-you-go. Moreover, inflation appears to have diminished in the district in recent years.

The Ninth District has a relatively small population, but it is large geographically and contains a diverse industrial base. The Ninth District includes the states of Montana, North Dakota, South Dakota, and Minnesota, as well as western Wisconsin and the Upper Peninsula of Michigan. Important in the district are the natural resource industries of agriculture, forest products and mining; diverse manufacturing industries including modern computer, electronic and medical technologies; and tourism.

In the middle and late 1980s the district economy was a bit weaker than the national economy. The district did not benefit as much as others from the defense build-up, the commercial construction spree, or the real estate price run-up. Consequently, though, when these areas turned down, the district economy was affected relatively less than the national economy.

In addition, the district has been fortunate to have some growth industries within its borders. The district economy has been supported by growth in exports, medical instrument manufacturing, residential construction, medical services and tourism. And, notably, agriculture has for the most part recovered appreciably from the serious problems of the mid-1980s.

However, I do not want to give the impression that all is well in the Ninth District. Not all industries and not all regions are prospering. In particular, some natural resource industries, commercial construction, computer manufacturing and small-town retail stores all have been slumping to some degree. Nevertheless, I think it is fair to say that as a whole the district economy has improved.

The fortunes of the district's banks largely have reflected the ups and downs of the district's economy. In 1986 the district's banking system was far from healthy. The lagging effects of the 1981-82 recession, difficulties in the agricultural

sector and problems with loans to less developed countries had combined to weaken banks' financial condition. But since then, banking conditions have improved. Asset quality, earnings and capital all have improved. In the first three quarters of 1992 only 2 percent of the district's banks reported losses, down from 20 percent in 1986.

Much of the information I get on the district economy comes first-hand from District Dialogues with community and business leaders and from meetings with the bank's directors and advisory council on small business, agriculture and labor. Our involvement in district economic affairs has served both the community and Federal Reserve policymaking well, I believe.

The state of, and prospects for, the regional economy are important elements in my preparation for an approaching Federal Open Market Committee meeting. But, of course, regional considerations must be balanced and integrated with information about the national and international economy, for ultimately the effects of monetary policy transcend regional boundaries. Thus, a wide range of factors, combining regional economic and financial information with additional perspectives, helps to shape my view of the appropriate course of policy.

In the broadest sense, and taking a long-run perspective, the object of monetary policy is, it seems to me, to attain the highest possible living standards for our citizens over time. In order to give this goal operational meaning, the Federal Reserve in my view should seek to achieve over time maximum sustainable growth of real output.

My reading of the accumulated evidence on economic performance both here and abroad is that in the long run the most significant contribution monetary policy can make to achieving maximum sustainable growth in real output is to foster price stability. That is, I am convinced that in the long run, price stability goes hand-in-hand with sustained economic prosperity. The two goals are not antithetical and, indeed, price stability is best thought of as a means to the end of sustained prosperity.

In the short run, we in the Federal Reserve may indeed find it appropriate to respond to incoming financial and economic information in order to keep the economy on, or to return it to, its potential growth path. But, it seems to me, our short-run response should in general be cautious because of uncertainty both about the state of the economy and about the effects of policy on the economy. Moreover, we need to avoid the problem of turning long-run policy into a sequence of short-run decisions. If followed, such an approach runs the risk of adopting a strategy that is persistently inflationary or contractionary, depending on conditions prevailing when it is adopted. The Region

Photograph by Marc Norberg

Federal Reserve Bank of Minneapolis
Research Department Memorandum

Date: PACS: 2000.2

To: (Relevant Individuals)

From: Gary Stern

Subject: Safeguarding FOMC Class I, Class II, and Class III Confidential Material

To assure the necessary confidentiality, it is important that all staff members exercise special care in handling FOMC materials. Please read the following guidelines, sign attached sheet, and return to Vicki Reupke by Friday, (Date):

1. In addition to ensuring that the documents themselves are made available only to staff members who have been authorized access to them, the information they contain should be discussed with such persons only.
2. FOMC documents should not be left unattended on desk or table tops.
3. All FOMC documents should be out of sight when outside visitors are in the office.
4. FOMC documents may be carried by hand from one office to another. If sent by messenger, they should be placed in envelopes with a gummed-label seal bearing the initials of the person sending them.
5. When no longer needed, FOMC documents should not be disposed of by dropping in wastebaskets but by shredding or incineration.
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7. Double-sealed envelopes should be used for mailing all Class I and Class II FOMC materials from the Board and the Reserve Banks. The inside envelope for Class I material should be marked "Personal and Confidential" and delivered unopened to addressees.
8. No Class I or II documents should be reproduced by recipients.
9. The distribution of all FOMC documents, apart from the Managers' reports, should be handled through the Secretary who will attach the appropriate security classification before sending the documents to the Committee.
10. To facilitate the identification of FOMC documents that require safekeeping, distinctive covers should be placed on all such documents that are to be circulated System-wide. The Bluebook and the Greenbook are already distinctive in appearance and are exempt from this requirement. Documents of especially great sensitivity, e.g., copies of recently issued directives that are intended for the "eyes only" of specified recipients, should be so identified with appropriate further markings such as a special stamp or special cover sheet.

I have read the attached FOMC guidelines memo dated (   ).

____

Signature and Date

For release on delivery
10:00 a.m. EDT
October 19, 1993

Testimony by

Richard F. Syron
Federal Reserve Bank of Boston

before the

Committee on Banking, Finance, and Urban Affairs
U.S. House of Representatives

October 19, 1993

Thank you, Mr. Chairman and members of the Committee for this opportunity to share my views on maintaining a more extensive record of Federal Open Market Committee (FOMC) meetings.

Being involved in the making of monetary policy is a great honor and something in which I take deep personal pride. Thus, from a purely personal perspective, I might welcome my views and positions being made more public. However, the key issue to me is what will provide the best policy for the people of the United States and of the First District. I believe there are difficult trade-offs between openness and the effectiveness of the deliberations that lead to monetary policy. I would like to mention two specific reasons that contribute to this trade-off.

First, I am concerned that a highly detailed accounting of FOMC deliberations, unless its release were delayed several years, would impair the ability of the FOMC to obtain and discuss confidential information on individual companies and foreign central banks -- information that is essential to conducting monetary policy.

New England's experience in the recent recession is a relevant case in point. The recession began earlier in New England and proportionately many more jobs were lost in the region than in the rest of the country. As a consequence, some problems surfaced in New England before they emerged elsewhere.

For example, the difficulties experienced by New England banks contributed to a "credit crunch" for small and medium-sized businesses. These problems were discussed at FOMC meetings and helped shape policy. It would not have been possible to convey the seriousness of the banking problems in New England, the potential for reduced credit availability and its impact on the economy as a whole without reference to individual borrowers and lenders. Yet to make such information public would have violated confidences; indeed, much information would never have been volunteered and our understanding of the problems would have suffered greatly.

Again, trade-offs are involved: the more specific are the references in the record of FOMC deliberations, the longer would be the time lag required before disclosure, if access to valuable but confidential information on individual companies is to be maintained and used.

Second, much of the discussion and economic information disclosed in FOMC meetings pertains to the valuation of assets priced continuously in world financial markets. Fluctuations in asset values can have a significant impact on the jobs of workers and on the incomes of investors. Public disclosure of preliminary and exploratory FOMC discussions could generate unintended value changes that could lead to harmful reactions and unnecessary volatility in the economy.

In summary, the ultimate objective of monetary policy is to promote the highest standard of living possible for Americans. The policymaking process should be as open as it can be, without diminishing our ability to achieve that objective.

In regard to the three specific questions you posed, I generally take rough, handwritten notes at FOMC meetings; these are subsequently kept in a locked drawer. Any notes taken by the senior economist accompanying me are also kept securely or disposed of according to procedures governing confidential documents. Except for the Secretary's maintenance of Committee records, I have no direct information about how others may keep notes. I have no information about individuals imparting information about FOMC meetings before official release.

STATEMENT OF ANNA J. SCHWARTZ ON OCTOBER 19, 1993

AT HOUSE BANKING COMMITTEE HEARINGS ON

THE FEDERAL RESERVE SYSTEM ACCOUNTABILITY ACT OF 1993 HR28

I am here to comment on two provisions in section 4 of HR 28 relating to prompt public disclosure of Federal Open Market Committee (FOMC) meetings.

One provision would require the Federal Reserve to videotape and transcribe FOMC meetings and to make the videotape and transcription public within 60 days after a meeting. Another provision would require the Federal Reserve to make public within a week of an FOMC meeting the Domestic Policy Directive voted upon and issued to the Trading Desk after each FOMC meeting.

Provision on Minutes and Their Disclosure

Let me first discuss the provision regarding the maintenance of detailed records of Federal Open Market Committee deliberations and their public disclosure.

To gain some perspective on this provision it is helpful to trace historical developments on the availability to the public of information on the Federal Reserve's conduct of monetary policy through its purchases and sales of open market securities. Three subperiods may be distinguished on this matter in the Federal Reserve's history: (1) the period before 1936; (2) the period from 1936 through March 1975; (3) the period since March 1975.

(1) In the period before 1936, abbreviated minutes of open market committee meetings beginning 1922 were maintained but restricted to internal use. Information on the Federal Reserve's activities is, however, available in two sources: the Library of Congress for the diaries of Charles Hamlin, a member of the Federal Reserve Board from 1914 to 1936, and Columbia University for the papers of George Harrison, a governor and then president of the New YorK Fed from 1928 to 1940.

Hamlin recorded his observations on the views of important Federal Reserve personalities and the pressure of events on the decisions reached by the Board. The Harrison Papers contain a wealth of documentary evidence including the minutes of open market committee meetings, official correspondence, memoranda exchanged in connection with those meetings, minutes of meetings of the board of directors of the New York Fed at which System policy was analyzed, and a full record of Harrison's conversations with leading figures in the System.

(2) In the period from March 1936 through March 1976 detailed minutes or memoranda of discussion were prepared for each FOMC meeting. Before 1965 these records were held to be confidential documents. In 1964 the FOMC adopted a policy to release minutes of each meeting held through 1960 and for the release of minutes for subsequent meetings with a five-year lag after the calendar year in which minutes were taken.

This action by the FOMC was a response to Congressional requests in the early 1960s for FOMC minutes and the publication in 1963 of <u>A Monetary History of the United States, 1867-1960</u> of which Milton Friedman and I are co-authors. While the book was in draft, we sought but were denied access to the minutes of the FOMC by the Federal Reserve at that time. We had to substitute the Hamlin diaries and Harrison Papers for the period they covered. By 1964, despite its refusal two years earlier to let us see minutes of meetings, the FOMC apparently decided that disclosure of the minutes after a five-year lag posed no threat to the Fed.

(3) In May 1976 the FOMC announced that after the March 15-16 meeting, memoranda of discussion would be discontinued, and the views of individual participants expressed at FOMC meetings would no longer be documented. The announcement apparently was inspired by the adoption of the Freedom of

Information Act and the Sunshine Act that made it difficult for the Federal Reserve to maintain confidential and secret information. The March 1975 meeting of the FOMC is the last one to date of which minutes have been made public.

I favor reinstatement by the FOMC of its former practice of maintaining detailed minutes of its meetings and publication of the record after a fixed period of time to protect the Federal Reserve against premature disclosure of ongoing unsettled issues. The record should be verbatim. A videotape is neither essential or desirable. The record should be verbatim subject to correction within a brief period by the participants for inadvertently misspeaking. If the Federal Reserve regards 60 days as too short a delay for publication, I would not object to lengthening the delay to one year.

Absence of the minutes of meetings since March 1975 has deprived scholars of information on the formation of monetary policy and limits research. I am familiar with a recent proposal by a well-known scholar to study Federal Reserve performance in recent decades. That scholar intends to resort to interviews with former Federal Reserve officials as a substitute for the unavailable minutes since 1975. The better course would be for the Federal Reserve to publish whatever documentation it has maintained for each meeting in the period since 1976.

Provision on the Directive and Its Disclosure

Let me now discuss the question of the appropriate length of delay of the release of the FOMC Domestic Policy Directive. Current practice, which began in 1976, is for directives to be released after financial markets close on the Friday after the subsequent FOMC meeting. This is a lag of approximately 45 days after the meeting at which the directive was adopted and after another directive has been adopted. The directive that is released is always an outdated one.

The position of the Federal Reserve is that early release would harm its ability to conduct monetary policy and the government's commercial interests. It has asserted that prompt release of the directive would have an announcement effect on financial markets. Market participants would hasten to realize gains in anticipation of the FOMC's purchases or sales of securities that would lead to substantial additional costs for the government's debt financing. The Federal Reserve argument boils down to the claim that prompt release would cause increased interest rate volatility that would raise the average level of interest rates. Is there evidence to support these claims?

Although official release of the directive is delayed for approximately 45 days, the Wall Street Journal has reported the contents of the directive within a week of each of 11 FOMC meetings out of the 34 meetings that took place between March 1989 and May 1993. These are leaks that the newspaper attributes to "government officials" or "people familiar with the Fed's deliberations." The newspaper stories correspond closely with the FOMC directives that were later published.

Professor Michael T. Belongia of the University of Mississippi and his co-author Kevin Kliesen have analyzed the 11 leaks as if they represented immediate release of the directive. The authors examine changes in the Treasury bill rate on each of five days before and five days after the Wall Street Journal story appeared to see if the T-bill rate changes support the Federal Reserve's argument that the early release of the content of the directive would be associated with increased volatility in short-term interest rates. They find that any such effect was negligible even when the directive contradicted expectations based on current market rates. Moreover, even if there were large responses of interest rates to each of the 34 directives since 1989 on the assumption that they contained news different from existing market expectations, the increase in variance was numerically small. Belongia and Kliesen also raise doubts that increased volatility of the limited magnitude they find around the dates of leaks would raise the average level of interest rates on all other days.

I reach two conclusions. One is that the Fed would be better advised to release the directive promptly instead of selectively leaking its content. Market participants scrutinize every scrap of information on prospective Federal Reserve actions. The market will perform better if the scrutiny is based on the actual directive, however delphic its content, rather than on rumors and conjectures about the directive. It is hard to accept the view that markets perform better the less information they have.

My second conclusion is that the Fed is needlessly concerned about the supposed disturbing effects of prompt release of the directive on volatility and the level of interest rates.

If FOMC meetings were held on Thursday and Friday and participants had an opportunity over the weekend to review the verbatim record to correct instances in which they misspoke, the Fed could then release the domestic policy directive on Sunday night.

Finally, let me say that these hearings are devoted to peripheral aspects of Federal Reserve operations. The hearings do not touch on the substantive questions: What are the Fed's objectives? How effective are the operating procedures it follows to achieve its objectives?

Statement Prepared by A. James Meigs
for Hearings before the
Committee on Banking, Finance and Urban Affairs,
U. S. House of Representatives
October 19, 1993

Mr. Chairman and Members of the Committee: It is an honor for me to appear before you to express my views on producing, maintaining, and publishing records of the proceedings and policy decisions of the Federal Open Market Committee. I am familiar with these materials because I used them for many years as crucial sources of information for my work in three major capacities:

1. As an economist with the Federal Reserve Bank of St. Louis, 1953-1961, where I helped to provide analytical support for the President of the Bank in preparing for his meetings with the Federal Open Market Committee and in interpreting the discussions and policy decisions afterwards.

2. As a researcher, writing and lecturing on money and banking, monetary policy, and world financial markets.

3. As an economist or consultant for banks, securities firms, savings and loan associations, and other institutions. One of my main problems always was, and still is, how to figure out what the Federal Reserve did in the past, is doing right now, and might do in the future.

I have had no experience in the oversight role implied by the Congress's power "to coin Money, [and] regulate the Value thereof," in Article I, Section 8, Clause 5, of the U. S. Constitution. However, I plan to make some recommendations concerning the Federal Open Market Committee Policy Record, the Memoranda of Discussion, and the Federal Reserve's policy mandate that I believe would be useful to this Committee and the Congress in providing oversight.

Recommendations

1. The Federal Reserve should publish the Policy Record of the Federal Open Market Committee within one or two days after each meeting of the Committee. The Policy Record should clearly state any changes in policy and the reasons for the changes.

2. The FOMC should resume the practice discontinued in 1976 of having the Committee Secretary prepare a Memorandum of Discussion for each meeting (the minutes). The Memorandum should summarize the statements of each member of the Committee, each non-voting Reserve Bank President (or alternate) attending the meeting, and each member of the Committee Staff or Board Staff who presents information or recommendations during the Committee discussion. The Memorandum of Discussion should be released to the public after one year.

3. The Congress should provide a clear mandate for the Federal Reserve to pursue a stable price level for the U. S. economy; i.e. to regulate the value of money. This Banking Committee then could concentrate on holding the Federal Reserve accountable for how it carries out that delegated responsibility.

In the rest of this statement I plan to explain some of the reasons for the recommendations and to try to meet objections that you and the Federal Reserve might raise. I believe that adopting these recommendations would benefit all the classes of information users I mentioned above, including the Federal Reserve itself and the Congress.

The Policy Record

At the end of my statement for hearings of this Committee on September 11, 1973, I said:

> My one additional suggestion is to eliminate the secrecy that now cloaks the processes and decisions of the Board of Governors and the Open Market Committee. I see no reason why Policy Directives of the Open Market Committee should not be publicly announced immediately after each meeting of the Committee, preferably with a discussion of the reasons for policy decisions. Ending the secrecy would not only facilitate the monitoring of System actions by the President and the Congress, but it would greatly reduce uncertainty among the general public.[1]

At the time I wrote that, I was advising clients in securities firms and commercial banks. My inability to provide them with more nearly current information on Federal Reserve policies was extremely frustrating. Now, twenty years later, I am even more firmly convinced that the Policy Record should be released immediately after each meeting.

Participants in U. S. and world financial markets are as skittish as gazelles drinking from a river infested with crocodiles. Over the last twenty years they have invested vast resources in equipment and techniques designed to shorten the time they need to react to new information about economic policies and prospects. Securities firms and banks hire experts, some of whom are former Federal Reserve officers, to analyze every scrap of information they can pry out of Federal Reserve reports or the remarks of Federal Reserve officials. They especially would like to know what the FOMC decides about policy at each meeting and what circumstances might lead to a change at a future meeting or in the period between meetings. The slightest hint of a change in U. S. monetary policy can affect securities prices and exchange rates around the world within minutes.

These well known facts about financial markets' sensitivity to changes in Federal Reserve policy have been used in arguing for delay in releasing the Policy Record in order to avoid destabilizing financial markets. I believe to the contrary that the effects of reducing the delay in releasing the Policy Record would be in the other direction. Immediate or early release would exert a stabilizing influence on financial markets by reducing uncertainty. That does not necessarily mean the markets would not jump when a new issue of the Policy Record announces a policy change. People with their own or clients' money at risk adjust quickly to any announced or suspected policy change.

Market jumps in reaction to early Policy Record releases might embarrass policy makers, especially when interest rates or exchange rates shift in an unpopular direction. But the markets would be more likely to jump in a direction that would be consistent with Federal Reserve policy objectives than when the markets react to rumors, leaks, innuendo, or conjectures which later prove to be unfounded. It would be better to provide the markets with the truth -- whether potentially disturbing or not -- and let them sort it out.

Early release of the Policy Record would have the further virtue of leveling the playing field. Some market players now are believed to have better access to information on Federal Reserve policy than others do. This perceived inequality of access obviously can lead to hard feelings or worse when some institutions believe competitors receive valuable information from Federal Reserve sources sooner than they do. The Policy Record should be thrown on the table for everybody at once as soon as the facts are in, like a crop report.

The Memoranda of Discussion

The Policy Record is useful as a way to keep financial markets and the general public informed on current Federal Reserve policy and changes in policy. It would be even more useful if it were released immediately after each meeting. But it does not now provide enough detail on the discussions preceding policy decisions to enable analysts to determine how decisions are made and how the FOMC members react to various kinds of information. Contributions of non-voting members are not identified. Recording votes at the end of a meeting does not reveal how the committee members distill their technical advice and masses of information into decisions for action.

The Memoranda of Discussion that were discontinued in 1976 provided fascinating insights into FOMC policy making procedures, although with an intolerably long delay. A new series of minutes or Memoranda of Discussion, released with less delay, would be extremely useful to future policy makers, researchers, and market practitioners.

Chairman Arthur Burns told the Subcommittee on Domestic Monetary Policy in 1977 that he thought a bill to require the FOMC to maintain detailed minutes and to publish them after three years was "clearly motivated by a concern for the interests of scholars and others who may have occasion to do historical research in the area of monetary policy."[2] Numerous other researchers and I had written to the Subcommittee on Domestic Monetary Policy to express various degrees of anguish over losing the Memoranda of Discussion.[3]

Chairman Burns conceded that the newly revised and expanded Policy Record "does not preserve a historical record as detailed as that contained in the earlier Memoranda of Discussion." However, Chairman Burns said, "In the absence of express statutory protection against premature disclosure of the memorandum, we would feel compelled to object to a proposal for returning to the practice of keeping extensively detailed minutes of FOMC meetings." Monetary scholars evidently were not an effective interest group in those days; H. R. 9465, which would have required keeping and publishing FOMC minutes, never found its way to the President's desk for signature.

While expressing his regret over no longer producing FOMC minutes for scholars to mull over, Chairman Burns slighted a much more important group of readers. He hardly mentioned members and staff of the Open Market Committee and innumerable people throughout the System who have to interpret, explain, and carry out monetary policy. For example, at the Federal Reserve Bank of St. Louis, we were not limited by the five-year delay in releasing the minutes to the public. We used the draft minutes of each meeting to help our President prepare for the next meeting. The economist who accompanied the President to FOMC meetings seldom could take enough notes to tell the rest of us who said what and why in a meeting of 12 Reserve Bank Presidents, 7 Board Members, and several staff advisors. We searched back issues of the minutes for references to points of view that might not have seemed important at the time but became more significant later. Hearings of the Subcommittee on Domestic Monetary Policy in 1977 reported that several former FOMC members said they found the minutes useful.[4]

The point of this anecdote is that Federal Reserve views on how monetary policy should be formulated and carried out were evolving then at a rapid rate, as they must still be evolving now. There was no clear manual of procedure for dealing with a menu of policy problems. The FOMC was adapting to changing economic conditions, changing financial institutions, and changing doctrines in monetary economics. Because the membership of the Committee was continually changing, the FOMC needed an institutional memory to organize and to preserve this learning experience for future generations of policy makers.

The Memoranda of Discussion provided a fine vehicle and repository for the FOMC institutional memory. The Memorandum for each meeting recorded the discussion, was reviewed by the participants to guard against errors in transcription or wording, and was locked up in final form for posterity at the next meeting, usually one month later. Years of such a record of experience are now lacking, never to be retrieved.

The significance of keeping a consistent, comprehensive set of minutes of the meetings was brought home to me when I tried to write about an episode in FOMC history about 15 years after it had occurred.[5] I thought the infra-committee policy discussions of 1959 and 1960 were engraved on my brain, because they had provided an unusually clear contrast between opposing views of how the Committee should tell the Open Market Manager what to do. They seemed almost a laboratory demonstration of how imprecisely framed instructions could produce results the Committee had not intended. But when I checked the minutes I found I was off by months in my chronology. I had forgotten some significant contributions from people in addition to those I remembered as playing the leading roles. This experience convinced me that an inside observer's memory of such complex discussions can not be be trusted fully. Not even my own.

Keeping and publishing detailed minutes of FOMC meetings would help to answer three overriding questions:

1. How do members of the Federal Open Market Committee learn to exercise the awesome powers delegated to them?
2. How does a corporate body made up of ever-changing individual members remember and employ what it learns from its mistakes and successes?
3. How can the government that delegated those powers oversee the performance of their stewards?

Former Reserve Board Member and Vice Chairman J. L. Robertson summed up these issues in a letter to the Chairman of the Subcommittee on Domestic Monetary Policy in 1976:

> In my view, the formulation of monetary policy by the Open Market Committee is one of the most important factors influencing the economy. Hence it should be mandatory that there be kept a detailed record (to be made available to Congress and the public after a lapse of appropriate time) . . .
>
> If minutes of the meetings are not kept and eventually made available, there would be no possible way for the Congress or members of the public to appraise the contribution of any member of the Committee to the formulation of monetary policy. Such appraisals are essential to any study of how to improve the system . . . [6]

Governor Robertson also answered the question of whether knowing they were on public record would inhibit members' willingness to speak frankly in FOMC meetings. He said, "Men competent to serve in these positions should be willing and anxious to stand on their records and be held responsible for the way in which they play their respective roles."

The men and women who serve on the FOMC today and those who will serve in the future should not be reluctant to go on record. Each will be backed up by some of the most competent economists in the world. Each one will already have won distinction as a responsible professional in some capacity before joining the Committee. I would suggest that any committee member who is afraid his or her statements might not stand up to the tests of time or outside view should either put more thought into the statements or seek a less demanding line of work.

A Mandate for the Federal Reserve

When considering the use of the minutes and other information from the Federal Reserve for establishing accountability, one must ask: Accountability for what? Most treatises on responsibility and accountability in business, government, and the military stress the need for a clear statement of the responsibility or mission for which an individual or an organization can be held accountable. Such a statement or mandate is lacking here. After 200 years of constitutional history we still have not clearly decided what the mandate for control of the money power is or where it resides.

The Federal Reserve System and most other central banks pursue multiple objectives at the same time -- economic growth, employment, price stability, interest rates, and exchange rates. Experience of many years and many countries demonstrates that it is impossible to achieve all of the objectives set by central banks and governments simultaneously. In operating and in reporting to their governments and the public, it is agonizingly difficult for the central banks to decide which objective or objectives to stress. Consequently, there is an inflationary bias in monetary policies of many countries that is extremely difficult to counteract.

Most important, there is no simple tradeoff that would permit central banks and governments to achieve higher real economic growth by tolerating more inflation. Instead, a stable price level would provide the best possible foundation for maximizing opportunities for increasing employment and real incomes.

This Congress could cut the knot by instructing the Federal Reserve to maintain a stable price level -- zero inflation -- to regulate the value of money. That is, the Congress could tell the Federal Reserve to do something it can do and that would have a tangible, measurable result. The Federal Reserve could then concentrate on learning how to do that, and doing it. The Congress could hold the Federal Reserve accountable for carrying out that responsibility. The Congress could and should examine all information coming from the FOMC, including the Memoranda of Discussion and the Policy Record, to assure itself and the public that the value of money is well regulated. The voters ultimately would hold both of these bodies accountable for the results.

[1] A. James Meigs, Statement prepared for Hearings before the Committee on Banking and Currency, House of Representatives, Ninety-Third Congress, Part 1, September 10, 11, 12, 13, and 14, 1973, p 261.

[2] Statement of Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System, in Hearings before the Subcommittee on Domestic Monetary Policy of the Committee on Banking, Finance and Urban Affairs, Ninety-Fifth Congress, First Session, on H.R. 9465 and H.R. 9589, October 27, 28; November 17, 1977, p. 56.

[3] These letters were published in Appendix III. Compilation of Opinions Received From Prominent Business Leaders and Economic Professors on H.R. 9465 and H.R. 9589, in Hearings before the Subcommittee on Domestic Monetary Policy of the Committee on Banking, Finance and Urban Affairs, House of Representatives, Ninety-Fifth Congress, First Session on H.R. 9465 and H.R. 8589, October 27, 28; November 17, 1977, pp. 187-312.

[4] Among former members of the FOMC who cited the usefulness of the minutes were Jeffrey M. Bucher, J. Dewey Daane, Sherman J. Maisel, and J. L. Robertson. See Appendix III. Compilation of Opinions, Hearings before the Subcommittee on Domestic Monetary Policy, October 27, 28; November 17, 1977, pp. 187-312.

[5] A. James Meigs, "Campaigning for Monetary Reform: The Federal Reserve Bank of St. Louis in 1959 and 1960, Journal of Monetary Economics 2 (1976), 439-453.

[6] J. L. Robertson, letter to Stephen L. Neal, October 1, 1976. Published in Appendix III. Compilation of Opinions, Hearings before the Subcommittee on Domestic Monetary Policy, October 27, 28; November 17, 1977, p. 245.

Fixed Income Management Group Inc.

Tuesday, October 19, 1993.

Statement of Robert Craven to the Committee on Banking Finance and Urban Affairs, U.S. House of Representatives.

Hearings on HR28.

I have been invited by Chairman Gonzalez to testify on the impact of Federal Reserve leaks on the financial markets. I would like to expand my comments to include what I feel to be a general lack of Central Bank control over members' use of the media. I would also suggest that procedure be improved on dissemination of Fed policy.

1) Leaks of the outcome of FOMC deliberations cause turmoil and extreme volatility in the financial markets. As a result, a premium of uncertainty is built into interest rates. The immediate burden is carried by the United States taxpayer because of higher average Treasury borrowing costs. Higher costs are also associated with private debt offerings. Two recent leaks will serve as examples.

2) Change is needed in procedure surrounding the release of the FOMC vote. Release should immediately follow deliberations. I would suggest that policy not be changed until the next scheduled meeting.

3) Under the Greenspan Fed, some policy makers use the media to air their own viewpoints, even if at odds with current Fed policy (FOMC vote). Some policy makers seem to be intent on selling themselves through the media. Secondly, general commentary is often ill-informed and reckless. Such commentary de-stabilizes the financial markets just as much as "leaks". This loose canon approach must be stopped. Although Chairman Greenspan pledged to stop leaks relating to FOMC deliberations (after some urging by this Committee) he also must enforce a measure of discipline on policy makers' general use of the media.

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1) The leak of 5/21/92, carried on pages A2 and C20 of the WSJ, began, "Federal Reserve policy makers decided this week (5/19) against any immediate cut in short-term rates, people familiar with the Fed's deliberations said". The Asia edition of this paper carried the story while the U.S. was sleeping and prices dropped overnight (interest rates up) on Euro and U.S. Treasury debt, which is traded on a 24 hours basis. Short rates jumped another 15 to 25 basis points (1/4 of 1%) early in the U.S. trading day. Bond yields, which had closed on 5/20 at 7.77%, closed 5/21 at 7.86%. One year treasury bill rates, which averaged 4.07% on 5/20, averaged 4.24% on 5/21. Had year bills been auctioned on 5/21 the higher discount would have cost the U.S. taxpayer an additional $24,000,000 (17bp on an average size of 14Bln) due to this leak induced spike in rates. It was pure luck that the $10 bln 30 year issue auctioned 5/7 was not auctioned on 5/21. As David Jones stated in his book, Politics of Money, The Fed Under Alan Greenspan, when referring to the turmoil from what is known as the Thanksgiving Day fiasco, 11/22/89: "The uncertainty almost certainly was reflected in higher average Treasury borrowing costs in the period immediately following the Thanksgiving fiasco, than otherwise would have been the case". The Thanksgiving fiasco was not a leak but a case of a Fed miscue (a communication problem) in their open market operations, and irresponsible WSJ reporting, that led the market to believe the Fed had eased. The difference is that the Thanksgiving Day fiasco was an honest Fed mistake; leaks are not. The end result, whether leak, or Fed miscue, is the same: extreme and unnecessary market volatility and ultimately higher costs to the taxpayer.

The leak of 5/24/93, was first carried on page A2 on the WSJ. It began, "Federal Reserve officials voted to lean toward higher short-term rates at their closed-door meeting last week (5/18) people familiar with the Fed's deliberations said". The markets had already taken a nose dive on 5/21 when the minutes of the March meeting were released. On that day rates on short term debt jumped 10 to 15 basis points, and bonds, after fluctuating wildly, closed 1/2 point lower. The 5/24 story was carried first in the Asia edition of the WSJ so that U.S. markets faced losses on inventories of US debt first thing Monday morning. Approximately 12 bln six month bills were auctioned on 5/24 at an average rate of 3.19%, vs 3.10% on 5/17, for an added annual cost of some $11 million. This leak was followed by a 5/27 CNBC story, placed by a Fed source, which gave an actual trigger for tightening. More violence in the market place. Rates, which had recovered somewhat from the 5/24 leak, fluctuated wildly. Again, pure luck that other scheduled U.S. Treasury debt did not come on these days, yet private debt undoubtedly did. Had the 30 year U.S. bond issue which was auctioned on 5/13 been auctioned on 5/21 or 5/24, the leak could have cost the taxpayer anywhere from .05 to .15 of 1% on the issue size of $8.26 bln, or from $4 to $12 million annually for 30 years.

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The Fed likely never ever intended to tighten, but instead planted the 5/24 message in the media as a way of communicating their view. This is not acceptable behavior. On 7/6, speaking of this leak to Market News Service, David Resler, chief economist to Nomura Securities in NY, stated: "To select particular news organizations to divulge the contents of the meeting, is criminal and absolutely immoral". "The offending members should be subject to incredibly severe penalties, including being expelled from the Fed Res system, at a minimum." In light of the Fed's leak to the WSJ, "they might as well own Dow Jones stock".

2) The so-called "minutes" of the deliberations of the FOMC are not actually a complete record of the meeting. This practice was stopped by Arthur Burns. The "minutes" are a summary of the deliberations. The minutes should be issued in complete form, but it is not critical they be released immediately in their entirety. It is the directive to the NY Fed which should be released immediately, or the next weekday, during U.S. market hours. For example, the "minutes" for the meeting of 8/17 go on for some 14 pages and then leading into the directive: "At the conclusion of the meeting, the Federal Reserve Bank of NY was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:" The directive is brief, giving reasons for the consensus, action to be taken, and the vote. The release should be by the way of a press statement following every meeting. This would do nothing to impinge on Fed independence. Milton Friedman has been a frequent proponent of immediate release. "The whole thing (delay) is absurd and unnecessary", he said in a recent interview. In a discussion with Dr. Friedman 10/13 he supports our view and also the notion of a weekday release. In the words of a past Fed President, "Tell us if the economy is hot, cold, or in between and if the directive is to firm, ease or do nothing, and that's it until the next meeting".

Chairman Greenspan's response to this argument, as given to Representative Neal in 1989, and repeated many times since, is that such disclosure would increase market volatility when decisions didn't match market expectations. There would indeed be movement on release day, but this is preferable to the present system which, as we have seen by previous example, instills fear and volatility in the market on a week to week basis.

There is another problem surrounding the deliberations and the directive: inter-meeting policy changes. Such changes should be eliminated. The Fed often changes policy just after an economic release, often the non-farm payroll number. They deny that any one number can trigger a policy change and have said that they monitor a whole range of indicators. The last three years of evidence suggest otherwise. This again creates unnecessary market

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volatility surrounding individual reports as investors try to gauge the Fed's response. To add to the confusion, many of the reports released by Commerce or BLS are revised by a large margin, sometimes more than once. Further, inter-meeting changes lead to confusion over daily Fed operations (Thanksgiving day fiasco).

3) The Greenspan Fed is a more democratic institution than that under Paul Volker. On its face this is admirable. But as Martha Seeger said, in referring to the Fed, "Democracy is messier than dictatorship". As a result, during the period between FOMC deliberations, we hear more than ever before from individual policy makers. This is unfortunate. Policy makers' statements in the media are sometimes reckless, sometimes ill-advised, sometime pure cheerleading and sometimes likely politically motivated. All of this adds unnecessary volatility and confusion.

In early May of 1992, at a Civil Rights Commission conference in Washington, a commissioner suggested to Gov Lindsey that US manufacturing was in decline. Governor Lindsey responded that manufacturing was "going like gangbusters". On 5/13 Governor Lindsey was quoted by a news service as saying that "the economy is moving along quite well". (Just to add to the confusion, on the same day, Richard Syron, a voting member of the FOMC and President of the Boston Fed, was on the news saying that the "recovery could fall apart, but the chance of that was decreasing".) The markets sold off 5/13 as a result of what we feel was either cheerleading (an inappropriate use of the office), or a total lack of knowledge of the real sector (Fed staff?). Let's look at the economic facts preceding this statement.

4/1 - NAPM - Slightly higher (54.1 vs 52.4)
4/3 - Payroll - Up modestly but manufacturing payroll - down. A major surprise. A very weak number. Rates plummeted.
4/14 - Retail sales - down (-.4 vs +1.3)
4/15 - Industrial production - Up modestly (+.2 vs +.5)
4/17 - Building permits - down. Starts - higher.
4/23 - Durable orders - up modestly
4/29 - New homes sales - Down 14.8%.
4/30 - Factory orders - Up modestly
5/1 - NAPM - Down (51.3 vs 54.1)
5/5 - Auto sales - slow pace
5/7 - Payroll - modest increase, with average hours and earnings lower. Interest rates dropped again as this # indicated distress in the labor market.

Economic numbers showed an even slower economy in June. District Fed surveys, housing starts, NAPM, manufacturing employment, durable orders were all lower. Finally, the payroll number on 7/2 was shockingly weak, triggering another cut in both discount rate and FF's rate on that day. This is "going like gangbusters"? This is an economy "doing quite well"? We are not speaking about just one person's opinion (no matter how ill-informed) but a policy maker whose commentary is taken to reflect the view of the FOMC. If that's what he was doing, then we are all in deep trouble. If not, it was cheerleading and is an inappropriate use of the office.

Given such commentary, we might assume that Fed staffers are not up to par. According to Lyle Gramley, former research director at the Fed and former Fed Governor, the major problem at the Fed has been poor staff support in recent years. "The Federal Reserve staff forecasts have been abominable", he said in an interview the week of 5/18/92. "They sat all during the summer of '91 and didn't see the weakness that was coming". Indeed, they have been dead wrong on growth for the last three years. The WSJ leak of 5/92 indicated that staffers felt the labor situation was improving, that retail sales looked good, that housing starts would trend up and that lean inventories would soon lead to an increase in production. Wrong again and the Fed was forced to ease two more times that year. These folks need to turn off the main frame, step outside and sniff the air. (My wife's economic model consists of a car and a tank of gas. Her parking lot surveys proved superior to the Fed's model time and time again in noting consumer distress.)

Early in the day of 5/14/92, Governor Lindsey was carried on one or more news services as saying that "growth of M2 will rebound", and will "bounce back". As is Fed procedure, the aggregates are released every Thursday (5/14) at 4:30PM EST. Fed officials receive these figures before release but they are supposed to be under strict embargo. Here we have a Fed Governor spilling the beans pre-the scheduled announcement. This is absolutely unacceptable. It just so happened that the market was keyed to the 5/14 release because Chairman Greenspan led the market to believe that M2 weakness was the reason for the ease of 4/9/92. In fact, M2 was up $9.8bln, 5/14 as opposed to a drop of $9.7bln, 5/7. An almost precise "bounce back". This is another example of an inappropriate use of the office.

The London Financial Times ran a story 10/9/92 which quoted a "senior Fed official". This official indicated that the Fed was on hold, not being concerned with the pace of growth. This source cited "relatively strong" car, truck and general retail sales. On this occasion Chairman Greenspan actually called a special news conference to distance himself (and presumably Fed policy) from this article. Too late. The harm was already done. Another leak out of the cheap seats. Euros lost up to 30 ticks in the morning of 10/9 as rates jumped higher. On 10/8, year bills averaged 3.06%. On 10/9, 3.18%! Let us assume that 10/9 was auction day. Twelve basis points (.12 of 1%) on an average size of $15 Bln is $18MM extra to the taxpayer (ignore the private borrower who may have been unfortunate enough to have come to market on 10/9) thanks to a lack of discipline at the Fed.

As recently as 10/4 of this year Jerry Jordon, President of the Cleveland Fed and speaking before the Ohio Bankers Association, said that it is time to treat state chartered member institutions as clients rather than "captives". Local bankers were mystified. No one has a problem with an overbearing Fed, according to responses that day. Ohio bankers were "confused and irritated". A Fed staffer said, "I have no idea what he is talking about". "Jordon often says things that don't reflect the opinion of the board", said Ken Guenther, vp of the Independent Bankers assoc and a former assistant to Miller, Burns and Volker. "Jordan's public utterances have annoyed other central banker policy makers and could be construed as an inappropriate use of his office". (Jordan has been a suspect in past FOMC leaks.)

On 10/8, Dept Treasury Sect Roger Altman criticized the NY Fed for comments by a senior official that were seen as critical of a statement by Clinton administration officials on the Yen/$ exchange rate. Margaret Green, a senior vice president at the NY Fed suggested that these comments may have been made because of "inexperience". "It is not unusual for someone to move into an economic policy job, having been in public service for so much of their career, and answer a question without having fully thought through the consequences. When new people get into new positions, they may make such comments without realizing that the rest of the world is looking at their comments as indicative of policy". Exactly our point!

I feel that the majority of policy makers have not been guilty of these offenses and have the wisdom to keep it zipped between meetings. Others do not. To quote again for the Jones book, "...some ambitious, new-breed Fed policy makers have, in competition with the Fed Chairman, begun to effectively use the media and public relations to sell themselves or their own ideas (perhaps in seeking recognition for future Administration appointments to the Fed Chairman's job itself or other key government positions)". "Through background press interviews and the infamous Washington 'leak', they can advance their own policy positions." There must be a return to discipline at the Greenspan Fed.

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GARY H. STERN
PRESIDENT

November 8, 1993

The Honorable Stephen L. Neal
Committee on Banking, Finance
and Urban Affairs
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515-8050

Dear Congressman:

I was pleased to appear before the Committee on Banking, Finance and Urban Affairs on October 19, 1993, and I appreciate the opportunity to respond to the two questions you posed during those hearings:

1. "[Do] you agree that price stability is the best policy for the Fed?"
2. "[Do] you think the Fed should be held accountable for achieving and maintaining that policy—via legislation?"

My answer to both questions is yes—but with qualifications. I am on the record as favoring price stability as the objective of monetary policy. Nevertheless, I have two concerns about legislation that makes the Federal Reserve accountable for achieving this objective:

1. If the Federal Reserve's period of accountability were made too short, monetary policy could become a destabilizing force.

2. If Federal budget policy were not changed to be consistent with a noninflationary environment, uncertainty about the direction of future policy would be introduced into the markets.

My published remarks (The Conference Board's *Economic Times*, September 1992) convey my support for making price stability the objective of monetary policy, and in them I conclude

> that price stability should be *the* paramount objective of monetary policy. That conclusion rests on three main propositions: First, that the goal of economic policy is to achieve sustained prosperity. Second, that the principal contribution monetary policy can make to that goal is to establish price stability, since our economy does not work well in an inflationary environment. And third, that inflation is ultimately a monetary phenomenon.

I further indicate in those remarks that the debate about monetary policy centers on the second of the above propositions:

> Some maintain that the benefits of price stability are small and that most of them can be obtained by suitable indexing of taxes, compensation, and credit agreements. This position is seriously flawed, however, because comprehensive indexing is unlikely and at most would be a second-best substitute for price stability.
>
> A more serious intellectual challenge is posed by those who assert that the goal should be a stable inflation rate rather than price stability. The historical record argues against this position in two ways: First, for whatever reasons, countries that abandon price stability as a goal generally experience accelerating inflation, not a stable inflation. Second, comparisons across countries show that over the long term lower inflation rates are associated with stronger growth.
>
> Some worry that too rigid a commitment to price stability could prevent the Federal Reserve from responding appropriately to 'shocks,' such as a sharp break in stock prices or other threats to the financial system. Not so—even large injections of liquidity are compatible with price stability if they are temporary.
>
> A more substantial concern is the fear that the short-term pursuit of price stability will lead to losses of employment and output, as suggested by the Phillips curve. If, however, the credibility of the Federal Reserve's commitment to price stability and its ability to attain the goal are high, expectations about wages, prices, and interest rates are likely to moderate

> quickly. . . . If the Federal Reserve's policies are credible, price stability can be attained at acceptably low cost.

With all this support for price stability as the objective for monetary policy, why, you might ask, do I have reservations about putting the objective explicitly into law and holding the Federal Reserve accountable for achieving it? A careful reading of my remarks suggests my two reservations.

First, I am concerned about the length of the time period over which the Federal Reserve is held accountable for achieving the objective. I stated that "inflation is ultimately a monetary phenomenon." However, it is affected by many other factors in the short run: e.g., business cycle phase, oil price shock, and bad weather. Moreover, the best empirical research suggests changes in money affect prices after a considerable lag—upwards of two years. If the period of accountability were made too short, the Federal Reserve would be forced to move wildly within the period to offset shocks, and this could be destabilizing as the effects of the monetary policy moves amplify over time. If the period of accountability were made too long, in effect, there would be no accountability. So, I see this as a thorny issue.

Second, I am concerned about the coordination of monetary and budget policies. This relates to my statement that "if the Federal Reserve's policies are credible, price stability can be attained at an acceptably low cost." If the Federal Reserve were to pursue price stability, budget policy would have to be made consistent with that pursuit. A persistent deficit policy is not consistent with a nonaccommodating monetary policy: interest on the debt and the total amount of debt would continue to rise as proportions of total income. Were the two policies not consistent, the public would have to guess how they would be changed to make them consistent. Thus, if budget policy were not adapted to a noninflationary environment, more uncertainty would be introduced into the marketplace. It is unlikely that the Federal Reserve's credibility as an inflation-fighter could be maintained were budget policy not to follow suit.

My second reservation is not so much a criticism as a recommendation. I believe price stability should be a goal of macroeconomic policy, but I also believe both monetary and budget policies must pursue this goal. I have enclosed our 1990 annual report, which describes one way this could be done.

Sincerely,

Gary H. Stern

GHS:jf
Enclosure

Playing by The Rules

A Proposal for Federal Budget Reform

Playing by The Rules

A Proposal for Federal Budget Reform

By Preston J. Miller, *Vice President and Deputy Director of Research,*
and V.V. Chari, *Research Officer*

Contents

The views expressed in this annual report are solely those of the authors; they are not intended to represent a formal position of the Federal Reserve System.

President's Message

This year's essay proposes major changes in the federal budget process. But why should changes be considered now, when just last fall a major reform package was passed? V.V. Chari and Preston Miller argue that the fall reforms provide at best a transition to a more balanced budget; even if the reforms work, many problems will remain. The authors persuasively argue that addressing those problems requires a more fundamental reform of the budget process than the fall reforms provide.

Some may question why the Federal Reserve, which has responsibility for monetary policy, is addressing fiscal policy issues. My response is that the two policies are intertwined. Persistent budget deficits and a rapidly growing federal debt increase the pressures on the Federal Reserve to follow an inflationary policy.

I expect some will also argue that all this talk about the budget process is small potatoes when we know the real problem is policymakers' inadequate attempts to deal with the hard choice of higher taxes or major cuts in spending. No one disputes this is a major part of the problem. This essay's contribution is to show clearly that the process also matters. Under the rule changes proposed by Chari and Miller, problems would not be allowed to accumulate and be foisted on future generations; they would have to be resolved within a two-year balanced budget span.

Not only do they offer a treatment for the problem, but Chari and Miller also provide an analysis of its roots, showing that a sound framework for budget policy decisions is currently lacking. They go on to provide one, based on economic principles, for their proposed set of reforms.

I hope this essay stirs discussion on the nature of the budget policy problem and on economic principles that should be used to guide the process.

Gary H. Stern
President

Playing by The Rules

A Proposal for Federal Budget Reform

By Preston J. Miller, *Vice President and Deputy Director of Research,*
and V.V. Chari, *Research Officer*

The federal budget mess just won't go away. Despite the discipline of Gramm-Rudman-Hollings (GRH), the government is running ever larger budget deficits, making poor decisions and spending an inordinate amount of time on the process. In 1990 the budget deficit reached $220 billion. This year, after the torturous passage of a package of expenditure cuts and tax increases, it's projected to exceed $300 billion. Yet the original GRH deficit target for fiscal 1991 was zero. Voters are concerned; Congress is concerned; the administration is concerned. Although there is widespread agreement that something is seriously wrong with the budget process, there is less agreement about what should be done about it. In response to this concern, many proposals for reform have been suggested. Yet they miss the mark: they fail to address the problems inherent in the budget process and are not based on sound economic principles.

We propose that the federal government change accounting practices, institute rules on debt issue and impose enforcement mechanisms. Our proposal will produce budgets that are balanced over time in an appropriate rather than an arbitrary sense.

We provide a conceptual framework for budget policy. Based on this framework, we propose that the federal government change accounting practices, institute rules on debt issue and impose enforcement mechanisms. Our proposal will produce budgets that are balanced over time in an appropriate rather than an arbitrary sense. Our proposal also will help inform the decision makers and the public about their policy options and the financial consequences of those options. Of course, our proposal will not cure all the ills in the budget process. Hard choices will still have to be made.

But first a bit of history. Since the late 1960s, the federal government has consistently run large deficits (Figure 1). These large deficits have led to a dramatic increase in the federal debt as a percentage of GNP in the 1980s (Figure 2). Interest payments to service this debt have absorbed an increasing proportion of our national product (Figure 3).

The debilitating consequences of a growing federal debt are well-known. Large interest payments leave us with less to pay for education, highways, national defense and a variety of useful causes. A growing federal debt tends to raise interest rates and to increase pressure on the Federal Reserve System to follow inflationary policies. This litany of ills may be familiar; nonetheless, it is alarming.

To make things worse, even though total non-defense expenditures have been allowed to grow at double-digit rates, too little money has been allocated for capital

Components of the Federal Budget

Figure 1 **Net Deficit**

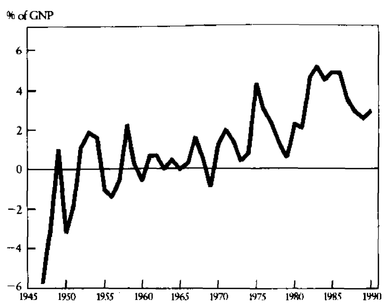


Figure 2 **Net Financial Liabilities**

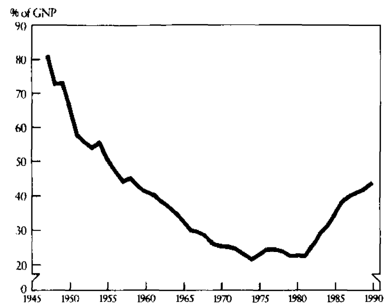


Figure 3 **Net Interest Payments**

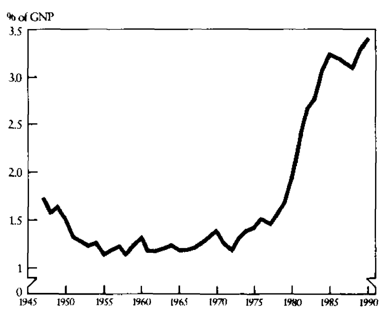
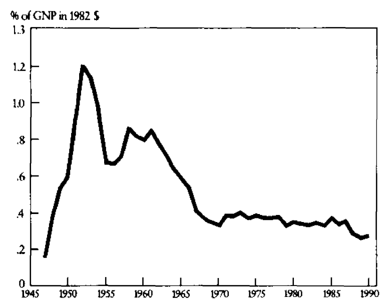


Figure 4 **Construction Expenditures**



Sources: U.S. Department of Commerce and
Department of the Treasury

projects, such as highways, airports and sewer systems. Federal capital spending in fiscal 1991 is projected to be roughly 2.2 percent of GNP, down from 4.4 percent of GNP in the early 1960s. Construction expenditures, which are an important component of capital spending, have declined over the postwar period (Figure 4). Surely we can do better than to leave our children decayed highways, crumbled bridges and antiquated sewer systems, with little or no ability to repair or replace any of them because of the enormous tax bills coming due for services consumed before they were even born.

We are not the first to offer solutions: The Gramm-Rudman-Hollings Act (GRH) and the reforms of last fall were attempts to respond to these problems. While these attempts to reach a balanced budget are laudable, we think our proposal is better. Specifically, we propose that the federal government adopt the following:

- Record transactions on an accrual basis and maintain separate operating and capital budgets,
- Require that the combined operating budget in the current and subsequent fiscal years be balanced, and establish overall limits on capital spending,
- Institute enforcement mechanisms based on performance to ensure that the rules are being followed,
- Set up rainy day funds to meet contingencies.

Why do we need these or any rules at all? Why not rely on policy-makers to make good decisions? The problem is that the policy-making process is fundamentally biased against the future. Without rules to constrain policy decisions, we will continue to have bad outcomes.

We would, of course, not be averse to an escape clause suspending the rules in the event of a war or national emergency. But we think that such suspension should require a supermajority of votes in Congress and the assent of the president.

Why do we need these or any rules at all? Why not rely on policy-makers to make good decisions? The problem is that the policy-making process is fundamentally biased against the future. Without rules to constrain policy decisions, we will continue to have bad outcomes. So the question is not whether to have rules, it is which rules to have. The current rules do not address the bias, nor are they based on sound economic principles. In the rest of the essay, we explain the bias in policy-making, show that the current set of rules is inadequate and argue that our rules will yield good outcomes.

The Need for Policy Rules

Our political system encourages elected officials to adopt policies that are biased against the future. They are biased, because they are not what voters ideally would like. Voters tend to have a long-term view on policy issues. They care about the outcomes of policy decisions not only over their own lifetimes but over the lifetimes of their descendants. Elected officials, however, tend to adopt a short-term view on policy issues.

But why should this be so? If voters could keep themselves fully informed, closely monitor decisions and understand the effects of alternative policies, surely they would force their elected officials to act in the public's interest. Voters would boot out officials who acted badly or develop institutional arrangements that set up proper incentives. But voters have neither the ability nor the incentive to get the information necessary to do these things.

It is especially difficult for voters to decide whether policy-makers are making wise choices on decisions that will yield benefits or costs several years into the future. So even though voters care about the future, they weight current results heavily. They rationally reward policy-makers who make decisions yielding large current benefits even if some of those decisions impose future costs. In order to get reelected, policy-makers have incentives to make decisions that are systematically biased against the future. Thus, it is not especially helpful to argue that if incumbent policy-makers were replaced, wiser policies would be chosen. The problem is that the system encourages policy-makers to adopt the short-term view.

Rather than curbing the government's bias to excessively discount the future, the Gramm-Rudman-Hollings process fed it.

This bias results in decisions weighted toward current rather than future consumption. In particular, these decisions mean too much deficit financing, too little capital investment and a proclivity to put off until tomorrow projects which should be undertaken today. The immediate benefit to elected officials is easily seen. Deficit financing shifts the tax burden for current consumption into the future. This allows more consumption now but less in the future as the taxes are paid. Less capital investment frees up resources and allows more consumption now, but since fewer resources have been invested, there is a smaller supply of goods available for future consumption. Elected officials can also make more resources available for current consumption by putting off projects such as maintenance of the infrastructure or closure of insolvent thrifts. But the problem is that such actions leave fewer resources available in the future as the real costs of the necessary, but delayed, expenditures escalate.

This policy-making bias against the future is not unique to the government, however. Corporate stockholders face many of the same problems as voters in deciding whether corporate managers are acting wisely. Corporate managers act on behalf of stockholders yet they have different interests. Stockholders have incomplete knowledge about the managers' decisions and the consequences of the managers' actions. These are features of the so-called *agency problem.*

Furthermore, no single stockholder has much incentive to monitor management's actions. Stockholdings are typically dispersed among many individuals. Each stockholder has an incentive to let other stockholders monitor the firm. As a result, typically there is less monitoring of firms' actions than would occur if the stockholders could act jointly. This is known as the *free rider problem.*

Voters also face the agency and free rider problems. It is difficult to know the consequences of policy-makers' actions and each voter has an incentive to free ride on other voters. The agency and free rider problems can be mitigated but not entirely solved. If stockholders cannot entirely solve these problems, certainly voters cannot be expected to solve them completely either, since compared to corporate decisions, government policy decisions are aimed at more diverse objectives and the responsibility for them is more diffuse.

How stockholders attempt to manage the agency and free rider problems suggests ways voters might deal with them, though. Publicly traded corporations, for example, are required to adopt standard accounting practices (known as Generally Accepted Accounting Principles) to inhibit inaccurate presentation of information. Corporate charters also limit management's discretion. We think these ideas can and should be used to design better policy procedures for the federal government. Corporations also adopt a variety of other practices to align managers' and stockholders' interests, including incentive contracts for managers, hostile takeovers and so on. It is not apparent how, or even whether, these other practices can be transferred to the government, so here we will stick to practices that seem readily transferable.

The agency and free rider problems point to a need for rules to limit policymakers' discretion. To understand why we are proposing new rules it is important to understand what's wrong with the old ones.

The Gramm-Rudman-Hollings process made deficit financing easier by encouraging the substitution of gimmicks for real actions. The gimmicks included the exchanging of assets, time-shifting of payments, movement of expenditures off the budget and use of unrealistic economic and technical assumptions.

The Problems With the Old Rules

The Gramm-Rudman-Hollings Process

Prior to the fall 1990 reforms, the budget process was designed to work roughly as follows: Early in January the president would submit to Congress a budget for the fiscal year beginning October 1. By the time Congress would adjourn in the summer it would pass bills and a budget resolution specifying amounts to be appropriated to discretionary spending programs and changes to be made to rules for entitlement programs and taxes. In mid-August the Office of Management and Budget (OMB) would determine whether the projected deficit for the upcoming fiscal year exceeded the GRH target by more than $10 billion. If it did, automatic spending cuts would be made according to a statutory formula to ensure that the projected deficit met the target. Then at some point Congress would raise the debt ceiling so that there was authority to issue additional debt to finance the projected deficit.

The GRH procedure was supposed to lead to balanced budgets and to eliminate the government's deficit financing bias by the use of rules. The procedure did not come close to achieving its goal and the original GRH targets had to be revised several times (Figure 5). In addition, the process led to other problems.

Rather than curbing the government's bias to excessively discount the future, the GRH process fed it. By focusing on the projected budget deficit in the approaching fiscal year, the process encouraged deficit financing, discouraged capital spending and made it more attractive to delay necessary expenditures.

Paradoxically, the GRH process made deficit financing easier by encouraging the substitution of gimmicks for real actions. The gimmicks included the exchanging of assets, time-shifting of payments, movement of expenditures off the budget and use of unrealistic economic and technical assumptions. Selling government assets, such as loans, for cash resulted in budget savings, even though all that occurred was the exchange of one asset for another one of comparable value. Time-shifting created one-time fictitious savings by taking payments scheduled for the approaching fiscal year

Figure 5 **Gramm-Rudman: Receding Targets**
(By fiscal year; in billions of dollars)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Actual Deficit	$221.2	$149.7	$155.1	$153.4	$220.4					
Gramm-Rudman I (1985)	171.9	144.0	108.0	72.0	36.0	0				
Gramm-Rudman II (1987)			144.0	136.0	100.0	64.0	28.0	0		
Gramm-Rudman III (1990)						327.0	349.8	285.2	157.5	117.3

Due to bookkeeping changes, the Gramm-Rudman III deficit targets are not directly comparable to those of the first two versions of the antideficit law. New accounting rules exclude the surplus in the Social Security trust funds from the deficit calculations; that has the effect of increasing the deficit by at least $60 billion a year. These latest targets are larger than those in the original 1990 budget deal because of pre-planned adjustments in the president's 1992 budget.

Source: *Congressional Quarterly Weekly Report,* February 9, 1991, Vol. 49, No. 6, page 337.

and moving them into the current fiscal year where they were simply spilt milk, or into the following fiscal year where they were not yet subject to a sequester. For example, the government achieved savings in an approaching fiscal year by taking payments such as employees' pay and farm subsidies due out in late September and delaying them until early October of the following fiscal year. Then without retribution, the government was able to switch the payments back once the new fiscal year was entered. Movement of expenditures off-budget, such as was done for the U.S. Postal Service and the Resolution Trust Corporation (RTC), produced budget savings by a stroke of the pen without doing anything real. Finally, projected deficits were reduced by use of optimistic economic and technical assumptions that overestimated tax revenue, underestimated interest expense and understated the costs of existing programs.

Just how extensively were these gimmicks used? Robert Reischauer, director of the Congressional Budget Office (CBO), notes that the amount of permanent deficit reduction enacted in the GRH period averaged a bit less than in the pre-GRH period of same duration: "What is different about the two periods is the reliance on one-time savings that became a feature of the GRH period. ...In the pre-GRH period, these gimmicks occurred so infrequently that CBO did not keep systematic track of them. In the GRH era, fully half of the apparent deficit reduction has been achieved by such devices" (Reischauer, 1990). Reischauer also notes that under GRH the amount of budget savings in the president's budget attributable to overly optimistic economic and technical assumptions more than tripled.

The GRH process, combined with existing accounting practices, also made capital spending highly susceptible to the knife. Existing accounting practices treat spending on capital projects, such as bridges, no differently than spending on current consumption, such as legal counseling. Yet the two are fundamentally different. A capital project provides services in the current year as well as in the future, while current consumption provides services only in the year in which they were purchased. As a result of this difference, spending on a capital project can be preferable to spending on current consumption yet can return less in benefits in the current year since it also provides benefits in future years. When GRH forced budget cuts in an approaching year, the existing accounting practice led government officials to believe that a dollar cut from capital spending would cause less immediate loss in benefits than would a dollar cut from current consumption. To understand better why this is so, consider the following example.

The Gramm-Rudman-Hollings process not only generated poor results, it also contributed to delays and confusion. Without a conceptual framework, policy-makers were forced to debate each minor budget variation as if it were a new theme.

Suppose the government has decided to build a bridge at a cost of $30 million which is expected to provide services over 30 years worth $6.4 million per year. Suppose the interest rate is 10 percent so that the present-value of these services is $60 million. With the present value of the benefits at double the cost, the bridge obviously should be built. But under the government's accounting system, dropping the project saves $30 million in costs and sacrifices only $6.4 million in benefits. In contrast, a $30 million cut in spending on a less attractive current consumption item, for which benefits only matched costs, would sacrifice $30 million in benefits. Given the short-term focus of GRH, accounting exercises such as these might well explain why capital spending was so susceptible to the knife.

In addition to capital spending, GRH made it unattractive to spend money on other projects having short-term costs and long-term benefits. For example, the government avoided proper maintenance of nuclear armaments plants to save money in the short term. Because of that neglect, the cost of keeping these plants operating has escalated and the additional cost is now estimated by the CBO to be roughly $160 billion spread over the next 40 years. Another painful example is the savings and loan crisis. If the government had dealt with the problem when it surfaced in 1986, it would have meant closing some insolvent thrifts at an estimated cost of $10 billion to $15 billion. But the government balked, at least in part because it didn't want to put more pressure on itself to abide by the GRH targets. So spending to remedy the problem was delayed, the problem mushroomed, and the cost to the government as estimated by the CBO and the General Accounting Office rose to over $150 billion in present-value terms.

The GRH process not only generated poor results, it also contributed to delays and confusion. Without a conceptual framework, policy-makers were forced to debate each minor budget variation as if it were a new theme.

The Fall 1990 Reforms

The government was well aware that the budget process was in need of repair and direction. The administration suggested numerous reforms, including instituting a line-item veto and changing the accounting procedures for loans and guarantees. The budget committees in both chambers of Congress held hearings on reform, several bills proposing reforms were introduced and the budget package that finally was passed last fall contains important reforms of the process.

It's too early to judge whether the fall reforms will lead to improvements in the process, but it's not too early to argue they don't go far enough. These reforms still fail to provide government officials with a conceptual framework for making decisions, and the definition of budget deficits and the targets for them remain arbitrary.

Main Features of the Fall 1990 Budget Process Reforms

- **Five-Year Budgeting.** Budget resolutions and necessary reconciliation bills must project spending, revenues and deficits for five years.
- **Discretionary Spending Caps.** Appropriations bills must stay within separate caps for defense, foreign aid and domestic discretionary spending for fiscal 1991-93; for fiscal 1994-95, the law sets overall discretionary spending caps.
- **Enforcement.** A complicated set of sequesters ensures that spending stays within the caps in the bill. Essentially, these sequesters apply if the Office of Management and Budget determines that spending will exceed the caps. The sequesters also "look back" to offset spending increases or revenue cuts in the prior fiscal year.
- **Pay-As-You-Go Entitlements and Revenues.** Bills containing increases in entitlement or other mandatory spending or reducing revenues must be offset by entitlement cuts or revenue increases.
- **Social Security and Deposit Insurance.** Social Security receipts and expenditures will no longer be included in budget calculations. Increased spending for deposit insurance activities—chiefly the savings and loan salvage operation—will not be allowed to trigger sequesters.
- **Emergencies.** If requested to do so by the president, Congress could enact emergency appropriations, entitlement increases or revenue cuts without triggering sequesters.
- **War and Recession.** A declaration of war would still cancel the sequester process. Congress could still vote to cancel the sequester process in the event of a projected recession or measured economic growth below 1 percent for two consecutive quarters.

The reforms make it more difficult to exceed the deficit targets, but they also make it easier to raise the targets (see box for details on the reforms). Under the new process, there are constraints placed not only on the size of the total budget deficit as before, but also separately on entitlements, revenues and three types of discretionary spending. In addition, a series of three sequesters can be prompted by spending overruns in the prior fiscal year. These reforms give Congress less maneuvering room to exceed budget deficit targets. But at the same time, the reforms allow the deficit targets to be raised for economic and technical reasons, emergencies and increased spending on deposit insurance activities. Since the targets are arbitrary, the government is highly likely to use these loopholes to continue its deficit spending ways.

The reforms also fail to resolve problems associated with the current accounting system. Under the fall reforms it is still possible to achieve budget "savings" by shifting payments forward into future fiscal years, although the reforms remove much of the incentive to shift them back to the current fiscal year. That's because past spending overruns could prompt a sequester and thus are no longer treated as spilt milk. However, the reforms do nothing to address the bias against capital spending. Capital expenditures are still treated no differently from current expenditures.

We have argued that rules are needed to address the policy bias problem, but we have seen that bad rules can create further problems. While the fall 1990 reforms improve the original GRH rules, a lot more should be done. That is why we offer our proposal.

The fall reforms of the budget process provide a transition to a more balanced federal budget. But even if they take us to that destination, problems will remain. Without a logical basis for their targets, policy-makers will find ways to violate them. Without a sound accounting system, they will continue to bias their decisions. And without a conceptual framework, they will continue to debate every budget nuance as if it were a new problem.

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The Case for Our Rules

Basic Principles

Our budget proposal is a set of reforms intended to reduce both the policy-making bias and the confusion associated with current procedures, and it's guided by four basic economic principles.

First, the budget should be balanced in a present-value sense without use of the inflation tax. This principle is based on an accounting identity and on a stated goal of macroeconomic policy. The identity says that what goes out from the government must come in, and it implies that the present value of government expenditures cannot exceed the present value of government receipts. Since it would be inefficient for the government to take in more than was needed, it follows that the present value of government expenditures should equal the present value of government receipts. In this equality receipts can include proceeds from the inflation tax, that is, the depreciation caused by inflation in the value of government nominal liabilities. However, based on statements in Humphrey-Hawkins legislation and congressional testimony of high officials in the Federal Reserve, we take price stability to be a goal of policy. With zero inflation as a goal, the first principle follows.

Second, benefits should outweigh costs. This follows from the theory of economic policy-making which requires that government officials weigh alternative programs in terms of their economic benefits and costs to society. Since the services of programs occur over time, the government must measure benefits and costs in expected, present-value terms. Those benefits and costs are dated to occur when resources are transferred in and out of the private sector. Thus, when the government hires workers, the economic cost occurs when the workers enter the public sector and not when the government gets around to mailing their checks.

That beneficiaries of government programs should pay is partly a fairness argument. It also has the virtue of making it more likely that the benefits of public programs exceed their costs, since those costs cannot be pushed off on non-involved parties.

The third economic principle is that users pay. That beneficiaries of government programs should pay is partly a fairness argument. It also has the virtue of making it more likely that the benefits of public programs exceed their costs, since those costs cannot be pushed off on non-involved parties. This principle suggests that borrowing to finance current consumption is unacceptable because that method of financing pushes the costs off to future generations who do not benefit from the consumption. In contrast, it also suggests that borrowing to finance capital spending is acceptable since future generations will benefit from the services of that capital. Obviously this principle cannot be applied across the board. By definition, income redistribution programs, such as welfare, cannot be financed by recipients. But some other programs, such as the national parks and the highway system, would fall squarely under the user-pays principle. And most other programs would fall under this principle in a general way. Current services should be paid for by the current generation. And transfers to the poor of one generation, which are designed to even the income distribution, should be paid for by the wealthy of the same generation.

Our fourth economic principle, tax smoothing, is an implication of studies of the tax structure. The implication follows as long as the *deadweight loss,* the distortions caused by the tax and the resources burned up in collecting it, rises disproportionately with the tax rate. That is, the deadweight loss more than doubles when the tax rate doubles. Tax smoothing means that when the government has commitments to spend in the future, it should begin taxing for them today. This is true whether those commitments are contractual, such as underfunded pensions, or non-contractual but fairly certain to occur, such as wars or natural disasters. What this means in practice is that it's more efficient to raise taxes a little bit now and keep them there than it is to wait and raise them a lot when the spending takes place.

We believe that these four simple principles suggest reforms of the budget process which help deal with the policy bias problem. We also believe they can provide guidance on many current budgetary issues.

Our Reforms in More Detail

Our proposal for reform is hardly radical. It is composed of modest changes in accounting procedures, rules on debt issue and enforcement mechanisms. Most of the changes are either incorporated into budget practices of corporations and state and local governments or included in other proposals for federal budget reform.

The accounting changes we propose are that expenditures and receipts be recorded on an accrual basis and that separate accounts be maintained for operating and capital items. These accounting changes follow directly from our cost-benefit timing and user-pays principles. Our cost-benefit timing principle requires that expenditures and receipts be recorded when the activity giving rise to them occurs; that is, they should be recorded on an accrual basis. Our user-pays principle suggests that it is not appropriate to borrow for operating expenses but it may be appropriate to borrow for capital. Therefore, it follows that separate accounts should be maintained for operating and capital items.

Our proposal for reform is hardly radical. It is composed of modest changes in accounting procedures, rules on debt issue and enforcement mechanisms. Most of the changes are either incorporated into budget practices of corporations and state and local governments or included in other proposals for federal budget reform.

These accounting changes allow the financial effects of alternative policy actions to be more accurately represented. This facilitates official decision making and also makes it easier for voters to monitor officials' actions. Our proposals for accounting changes are not original. They have been proposed by the General Accounting Office (GAO) and they have been included in a bill introduced by Sen. Herbert Kohl of Wisconsin. Most firms and state governments, as well as the Federal Reserve, maintain separate operating and capital accounts. The federal budget is reported on an accrual basis in the National Income Accounts, and the budget, calculated as the GAO and we recommend, is produced by the OMB in a timely manner. Thus, all that is new here is that we are proposing using this existing budget information as the basis for policy deliberations and rules.

The rule changes we propose limit the amount of debt the government can issue on its operating and capital accounts. The rules follow from our principles and from our attempts to reduce the policy bias. Although they involve only minor changes to existing rules, they provide explicit policy targets.

We propose to limit the debt that can be issued on the operating budget by requiring that the combined estimated and projected budget balance be zero in the current and subsequent fiscal years. Since the accounts would be maintained on an accrual basis, the proposal allows operating debt to be issued temporarily when there is a mistiming of payments and receipts. It also could be issued temporarily when unforeseen spending increases or revenue losses occur. However, by including the current year's deficit in the calculation, the government would have to implement policies to eliminate debt caused by mistakes in budget projections. This proposal is similar to current GRH procedures and suggested balance-the-budget amendments. What is new in our proposal is that the budget being balanced is the operating budget and that adherence to the rule leads straightforwardly to present-value balance of the entire budget, without inflation, as our first principle requires.

But why a two-year rule rather than a five-year rule or a month-by-month rule? Given the nature of the policy bias against the future, a rule requiring a balanced budget over a fairly short time frame is desirable. Otherwise, policy-makers can continue to run deficits while claiming they will be offset by surpluses at some distant time. However, neither spending nor tax revenues can be forecasted very accurately, and unforeseen events do occur. Thus, if the time frame is too short, policy-makers will continually be forced to make changes to expenditure programs or tax rates. In our view, a two-year rule is a reasonable compromise.

We propose to limit the debt that can be issued on the capital budget by requiring Congress to pass a bill annually authorizing debt issue up to a specified ceiling. While this is much like current procedures, our ceiling applies only to debt issued to finance capital spending. This means that the ceiling would be an independent control on capital spending. It would not be redundant, required as it is now, to accommodate the operating deficits Congress has planned. Since all capital spending would be financed by debt issue, setting a ceiling on debt would be equivalent to setting a ceiling on federal capital spending. This would let policy-makers better decide on a desirable mix of private and public capital. More capital spending would be desirable as long as the benefits of a project were at least as large as its costs. We view a ceiling on total capital spending as desirable so that Congress as a whole can effectively force constituencies for capital spending to compete with each other. This reduces the incentives to spend excessively on capital equipment.

We propose to limit the debt that can be issued on the capital budget by requiring Congress to pass a bill annually authorizing debt issue up to a specified ceiling. While this is much like current procedures, our ceiling applies only to debt issued to finance capital spending. This means that the ceiling would be an independent control on capital spending.

We propose to enforce the rules using approaches similar to current practices. The rule on operating debt would be enforced with a sequester. The sequester could be applied in a disaggregated way, as it is under current procedures. The sequester would be triggered whenever the combined operating deficit in the current and succeeding year exceeded some small amount—say $10 billion to match the trigger amount under GRH. The sequester would require cuts in spending or increases in revenue to achieve combined budget balance. Thus, if there were an unforeseen deficit of $20 billion in the current fiscal year, the government would have to adopt policies leading to a $20 billion surplus in the succeeding year. We would limit the amount of deficit reduction in a sequester to 0.5 percent of GNP, which is roughly the amount of reduction that experts testified could be implemented without causing major economic disruptions.

The rule on capital debt would be self-enforcing. The Treasury simply would not be authorized to issue debt above the legislated ceilings.

Our proposals so far are derived from our economic principles of present-value balance, cost-benefit comparison and user-pays, but seem in conflict with our tax-smoothing principle. The reason is that government spending and revenues fluctuate due to causes that cannot be perfectly anticipated. Wars and recessions are as likely to occur in the future as they have in the past, but it's hard to know when. Therefore, meeting the two-year balanced budget rule would require sharp changes in tax rates when these contingencies occur. To avoid these kinds of changes in tax rates, we propose that rainy day funds be set up to meet contingencies. These rainy day funds would be set apart from the operating budget. Inflows of cash into these funds would be counted as outlays for the operating budget and outflows from these funds would be counted as receipts. By drawing down the funds in bad times and building them up in good times, tax rates would not have to be adjusted in conflict with our tax-smoothing principle. Since we recognize the temptation to raid these funds in good times, we suggest that a supermajority in Congress be required to use these funds.

What Our Reforms Will Accomplish

Our reforms are intended to lessen the government's bias to overly discount the future and to remove some of the confusion that surrounds current budgetary practices. We argue that they lessen the bias by making deficit financing more difficult, capital spending more attractive and procrastinating more costly. We argue that they reduce the confusion by providing a framework based on economic principles.

How do we make deficit spending more difficult? Reporting the accounts on an accrual basis takes away the budget "savings" options of selling off assets for cash and delaying payments to government employees or program beneficiaries. Accrual accounting records when activities take place and not when exchanges or payments are made. Including an explicit makeup for past errors in the enforcement mechanism reduces the incentive to use overly optimistic economic and technical assumptions. Mistakes require painful adjustments in the upcoming year. And, as we argue later, requiring present-value balance makes the movement of items to off-budget status less advantageous. However, the most important contribution the proposal makes to controlling deficits is that it provides a definition of budget deficit and specifications of targets which are guided by economic principles and, thus, have some logical basis.

One problem with the GRH targets is that they were designed to lead to budget balance for an arbitrary definition of the budget. There is no economic principle that suggests the deficit should be zero when capital transactions are included in the definition of balance. Moreover, under the GRH deficit definition there are different targets depending on whether Social Security or the RTC are included.

Our definition and targets are not as arbitrary as those of GRH, and that should make it harder to raise or disregard the deficit targets. They are guided by the present-value principle. The definition makes clear that capital transactions are excluded from the zero deficit target. Having a clearer idea of the reason for the targets should make it easier to stay the course.

Our proposal also makes capital spending more attractive by putting it on a more equal footing with current spending. A dollar cut from capital spending would have a comparable effect in the current fiscal year to a dollar cut from current spending. That is because in our proposal the operating cost of a capital asset is spread out over the life of the asset. While the purchase price of the asset is reported in the capital budget, only the annual depreciation and interest financing expense are reported on the operating budget. Thus, a dollar cut from capital spending cuts current spending by the amount of depreciation and interest. Our method spreads the cost of capital equipment over the years it provides services, while the current method charges it all to the current year. Our yearly charge is essentially what it would cost the government if it rented the capital from a private party.

The main difference between our method and current practices is how it treats dollars saved on capital spending in the current year. If the government decided not to purchase capital equipment, our method would show that the savings in current expenses would be only depreciation and interest. According to current practices the savings would be the cost of the capital purchase, which is much larger. As a result, current practices make cuts in capital spending look more attractive to policy-makers than they really are.

As is usual under standard accounting principles, we would require that the government's assets be carried on its books at the lesser of cost or market value. Some assets of the government have an ascertainable market value such as the assets acquired from failed savings and loans. Thus, for such assets the government would have an incentive to provide appropriate maintenance. If the government did not maintain such assets appropriately, their market value would fall, thereby resulting in a larger depreciation charge and adversely affecting the government's operating budget. Even for assets without a readily ascertainable market value, such as nuclear armaments plants, standard accounting practices provide better incentive for maintenance than current practices.

Our method also requires quick action to balance the budget when circumstances change. In this sense, under our proposal the federal government would be forced to act like state and local governments now do. Under our proposal, difficult choices could not be simply passed on to future Congresses and administrations.

To illustrate how our proposal and the economic principles on which it is based could work to reduce the confusion surrounding current budgetary issues, we examine the treatment of trust funds, the RTC, loans and guarantees and future commitments.

The controversy over trust funds, such as Social Security, is whether they should be on-budget or off-budget. If on-budget, their balances would be included in deficit calculations and targets. If off-budget, they would not.

Our present-value balance principle gives some guidance on this issue. To move a program off-budget means that the program should have an independent budget. It should neither rely on revenue from the general budget nor should its earmarked revenue be accessible to other programs in the budget. If it's not independent, then it's not truly a trust fund and it's not truly off-budget. The question of whether Social Security should be off-budget is then a question of whether its budget should be independent of the general budget. If the answer is yes, then by the present-value principle the Social Security budget and the general budget should be balanced independently in a present-value sense. If the answer is no, then just the sum of the two budgets should be balanced in present value. Within this framework, policy-makers must first decide whether they want Social Security to have an independent budget, and if they do, they will find their choices to be quite limited on the financing of committed Social Security benefits. For instance, experts believe that given current benefit schedules and tax rates the Social Security system is balanced in present-value terms. Thus, by the present-value and tax-smoothing principles, policy-makers would not be allowed to lower Social Security tax rates unless they also lowered the benefits.

We should also point out that our analysis of the policy bias problem suggests that trust fund accounting can be a useful disciplinary device. Because voters lack the information required to monitor the actions of policy-makers, it's hard to monitor whether policy-makers are following the cost-benefit principle. This monitoring difficulty is particularly acute when expenditures are financed out of general tax revenues. Beneficiaries have every reason to argue that the benefits accruing to them are large, whether they value the services a lot or a little. Dedicated programs with independent revenue sources that have strong safeguards against raiding the treasury can be useful in solving the monitoring problem. From this perspective, trust funds are not merely an accounting device; rather, they serve an important economic function.

We also recognize that trust funds can be abused. Given the bias in policy-making, policy-makers have an incentive to postpone costs and accelerate benefits. For example, policy-makers have an incentive to run a deficit or a smaller surplus than is desirable on the Social Security system. The result is that future benefits must be reduced or future taxes raised if the system is to be independently balanced. One crude way to limit abuses of this kind is to require that trust funds not run a deficit.

Our reforms are intended to lessen the government's bias to overly discount the future and to remove some of the confusion that surrounds current budgetary practices. We argue that they lessen the bias by making deficit financing more difficult, capital spending more attractive and procrastinating more costly.

The issue on RTC spending is how to split it up into on-budget and off-budget. The RTC handles the assets and liabilities of failed thrifts. Since RTC spending relies on general revenues, our reasoning on trust funds suggests all of it belongs on-budget. The drive to move some of it off-budget was mainly a result of the current procedure's failure to distinguish capital spending from operating expenses. What typically occurs is that the RTC takes over a failed thrift with assets valued at, say, $700 million and insured deposits of, say, $1 billion. The $1 billion must be paid off immediately, while the $700 million in assets is sold gradually over a number of years. By current methods the $1 billion is treated as a current expenditure. Then, when the assets are sold over time, the sale receipts are treated as revenue. The pay-off to depositors is funded by debt issue and the debt is in effect reduced when the assets are sold. The interest is also treated as an expenditure. The current procedure clearly overstates the deficit in the current year, since it assigns no value to the assets the government acquires. The drive to move RTC spending off-budget was a clumsy attempt to correct this problem.

Using our procedures, only the capital loss and interest expense would show up on the operating budget. That budget would not be affected by the timing of asset sales. When the RTC initially takes over the failed thrift, it would be considered a capital purchase of $1 billion financed by debt. However, since the assets were worth only $700 million, there would be an immediate write-off of $300 million charged to depreciation. As with other capital purchases, there also would be an associated interest expense. Future asset sales would affect the operating budget only to the extent that actual sale values differed from the capital budget's assumed market values. Thus, using our procedures, RTC spending would be treated no differently from other capital spending.

Capital budgeting also would clarify the treatment of government loans and guarantees. These items involve subsidies that are realized when private parties fail to maintain payments on loans. Past budget practices have treated the government loss of loan revenue or payment on a loan guarantee as a budget deficit increase at the time they occur. Thus, it appears to policy-makers as a good way to give out subsidies now and pay for them much later. Under our proposal, loans and guarantees would be included in the capital budget as assets and liabilities, respectively. The subsidies on loans and guarantees would show up on the operating budget at the time the loans and guarantees were granted. Under our proposal policy-makers would be confronted immediately with the costs of the subsidies. We should point out that the way loans and guarantees affect the operating budget under our proposal is similar to how they will affect the GRH budget following last year's reforms.

Finally, our tax-smoothing principle suggests that revenue should be collected today for future commitments. Currently the money is not collected until after the event occurs. Some of the commitments are contractual or explicit, such as pensions, and for these the government might make advance payments into something like an escrow account. Other commitments are not explicit but are fairly certain to occur in the future, such as wars and natural disasters. For these we have proposed that the government make advance payments into a rainy day account. The purpose of the escrow and rainy day accounts is to provide present-value budget balance without having to change tax rates. Assuming that the government's capital expenditures rise at the same rate as national income, the effect of the accounts is to lower the government's debt-to-income ratio over time until the commitments are realized and then to allow them to rise at that time. Over long periods of time, the debt-to-income ratio would remain constant.

The main difference between our method and current practices is how it treats dollars saved on capital spending in the current year. ... current practices make cuts in capital spending look more attractive to policy-makers than they really are.

The purpose of using our procedures to examine these issues is to show their practical value. We believe they can considerably reduce the confusion surrounding current budget practices.

Objections to Our Reforms

Since aspects of our proposal have been tossed around for some time, we can anticipate two important objections to it. One objection is that it does not accommodate countercyclical policy, and the other is that our proposal would encourage policy-makers to move everything over to the capital budget. Although these objections have some validity, we believe they are not decisive. We believe the constraint on countercyclical policy is not very costly, and we believe safeguards can be put in place to limit misclassification of expenditures.

Consider first the loss in flexibility to conduct fiscal policy. Our proposal allows some limited countercyclical policy, but it does not allow the government to suspend the rules in case of a recession. The availability of a rainy day fund would, in any case, allow for some countercyclical fiscal policy. But when an unforeseen shortfall does occur, it could be accommodated in the current year, provided it is made up for in the succeeding year. The government would also be able to increase capital spending in a recession when interest rates were low, because such spending then would generate less interest expense.

Nonetheless, our proposal is more rigid on countercyclical policy-making than current procedures. We do not think this rigidity is very costly because we are unaware of any evidence that discretionary countercyclical budget policy works. Most studies show that lags in responding to recessions cause any stimulative effects of fiscal policy to occur too late, well into the ensuing recovery. Furthermore, the rigidity could be beneficial. If the decline in the growth rate of real output goes on for a long period, perhaps there is a secular as well as a cyclical element. To the extent that an output decline signals a long-term reduction in output growth, the government should reduce spending.

Consider next the objection that policy-makers will want to move everything to the capital budget. To a great extent that's true, but we argue that now everything, in effect, is treated as a capital expense. The government can borrow to finance any expenditure. So by strictly defining what is a capital expenditure, as states have done and as the GAO proposes for the federal government, many expenditures can be kept off the capital budget.

Since aspects of our proposal have been tossed around for some time, we can anticipate two important objections to it. One objection is that it does not accommodate countercyclical policy, and the other is that our proposal would encourage policy-makers to move everything over to the capital budget. Although these objections have some validity, we believe they are not decisive.

Even with strict definitions, though, there will be problems with misclassifications or understating of depreciation on capital items. Some expenditures that provide benefits in future years would be classified as current. In fact, we would favor including most human resource programs, such as those for education, crime control and health, on the operating budget. We do not deny that a better educated, better protected and healthier population will make people better off in the future. We also do not deny that requiring these expenditures to be paid in full in the current year could lead to underfunding. It is just our judgment that the underfunding bias would be no greater than the policy-makers' bias to overspend on current consumption. Thus, we judge that by strictly limiting the capital budget to long-lived physical and nominal assets, a small cost in terms of underfunding of some expenditures would be more than offset: there would be a smaller bias toward overspending on current consumption, which now is facilitated by abuse of the debt-issue option.

The government would also try to understate depreciation, as states and corporaations have been known to do. It could classify some current consumption items as capital items and assign them value, even though, in a sense, they are fully depreciated in the current year and have no value. Or it could just overstate the value of some of its physical or nominal assets. This is where watchdogs such as the CBO and GAO would have to be on the alert. The logic of our proposal requires that depreciation be accurately recorded on the operating budget. If it were not, the budget situation could be seriously misrepresented. Understatement of asset depreciation led to the unrecognized deterioration in the financial condition of many state and local governments and various financial institutions.

Transition

How do we get from the current system to our proposed system? Some of our reforms—accrual accounting and separating the capital and operating budgets—could and should be adopted for fiscal 1992. All that is required is that policy-makers look at a different set of books. However, an immediate move to a balanced budget would require enormous and disruptive increases in taxes or reductions in spending. We believe the government should move to a balanced operating budget over a three-to-five-year period. Over this period, the goal of monetary policy should be to reduce the inflation rate gradually to zero.

Such transition periods have been abused in the past, but we think our enforcement mechanism provides a way to limit future abuses. Specifically, we propose imposing annual limits on the operating budget deficit during the transition period. These limits would be enforced with a sequester. If the limits are exceeded within a given year, then the sequester would require cuts in spending or increases in revenues in the following year. These proposals, combined with the fall 1990 reforms enacted by Congress, would go a long way to reducing the deficit to zero over roughly a five-year span.

We believe the government should move to a balanced operating budget over a three-to-five-year period. Over this period, the goal of monetary policy should be to reduce the inflation rate gradually to zero.

It's also possible to frontload the pain of spending reductions and tax increases to a greater extent than is now mandated under the fall 1990 reforms. One major problem with the GRH process was that large deficit reductions were supposed to occur toward the end of the targets, and this problem persists though to a lesser extent with the fall 1990 reforms. When the real pain of deficit reduction is postponed, however, the temptation to revise the targets often becomes irresistible. The only credible way around this problem is to ensure that substantial deficit reduction occurs in the early years of the transition period.

Our Rules Are No Panacea

We would like to conclude by claiming it would be all smooth sailing if only our proposal were accepted. But of course we know that's not true. No change in the process can make the difficult choices confronting policy-makers easy. They still would have to decide whose ox to gore by cutting spending or increasing taxes. But we think policy-makers would make better decisions if they understood what they were up against and what the consequences of their actions would be. No change in budget process is going to solve the policy bias problem or keep the government out of financial difficulty. Better budget processes than the federal government now employs have not stopped these problems with corporations or state governments. We nevertheless strongly believe our proposal can lessen the magnitude of the problems.

Will our proposal work, or is a more drastic measure such as a constitutional amendment necessary? We believe that the situation is not yet so dire as to warrant such an extreme action. Concern over the budget is widespread enough in the nation and among policy-makers that we feel the problems described here can be addressed legislatively.

The budget mess will not be completely cleaned up even if all our reforms are adopted. Hard choices will still have to be made. But we will no longer have the choice of inflicting costs upon future generations for programs that benefit us.

Suggested Readings

On Political Economy:

A classic in the field is...

Downs, Anthony. 1957. *Economic theory of democracy.* New York: Harper Press.

Other excellent readings are...

Buchanan, James and Tullock, Gordon. 1962. *The calculus of consent.* Ann Arbor: University of Michigan Press.

Olson, Mancur. 1971. *The logic of collective action.* Cambridge, Massachusetts: Harvard University Press.

On Agency Theories of the Firm:

Alchian, Armen A. and Demsetz, Harold. 1972. Production, information costs, and economic organization. *American Economic Review* 62, pp. 777-795.

Jensen, Michael C. and Meckling, William H. 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics* 3, pp. 305-360.

On Recent Budget Policy:

Miller, Preston. 1989. Gramm-Rudman-Hollings' hold on budget policy: Losing its grip? Federal Reserve Bank of Minneapolis *Quarterly Review* 13, pp. 11-21.

Reischauer, Robert. 1990. Taxes and spending under Gramm-Rudman-Hollings. *National Tax Journal* 43, pp. 223-232.

Schick, Allen. 1990. *The capacity to budget.* Washington, D.C.: The Urban Institute Press.

On Last Fall's Reforms:

Congressional Quarterly staff. 1990. Budget-reconciliation bill. *Congressional Quarterly,* December 1, pp. 4012-4036.

On Proposed Reforms:

Bowsher, Charles A. 1988. Budget reform for the federal government. Statement before the Committee on Governmental Affairs, U.S. Senate, June 7.

Budget reform proposals. 1989. Joint hearings before the Committee on Governmental Affairs and the Committee on the Budget, U.S. Senate, October 18, 26.

Acknowledgements

We wish to thank Rudolph Penner, Alice Rivlin, Mark Sniderman, Eugene Steuerle and John Sturrock for useful comments on an earlier draft.

Statement of Condition (in thousands)

	December 31, 1990	December 31, 1989
Assets		
Gold Certificate Account	$ 203,000	$ 198,000
Special Drawing Rights	172,000	153,000
Coin	13,228	12,281
Loans to Depository Institutions	5,495	8,450
Securities:		
Federal Agency Obligations	101,300	109,844
U.S. Government Securities	3,755,330	3,817,846
Cash Items in Process of Collection	364,686	434,312
Bank Premises and Equipment— Less Depreciation of $33,493 and $27,704	44,079	35,311
Foreign Currencies	978,960	1,002,624
Other Assets	96,005	77,371
Interdistrict Settlement Fund	(188,629)	(405,069)
Total Assets	$5,545,454	$5,443,970
Liabilities		
Federal Reserve Notes [1]	$3,928,662	$4,146,926
Deposits:		
Depository Institutions	1,027,895	685,999
Foreign, Official Accounts	4,500	4,800
Other Deposits	6,207	30,478
Total Deposits	1,038,602	721,277
Deferred Credit Items	395,132	389,555
Other Liabilities	46,036	51,448
Total Liabilities	5,408,432	5,309,206
Capital Accounts		
Capital Paid In	68,511	67,382
Surplus	68,511	67,382
Total Capital Accounts	137,022	134,764
Total Liabilities and Capital Accounts	$ 5,545,454	$5,443,970

[1]Amount is net of notes held by the Bank of $769 million in 1990 and $856 million in 1989.

Earnings and Expenses (in thousands)

For the Year Ended December 31,	1990	1989
Current Earnings		
Interest on U.S. Government Securities and Federal Agency Obligations	$322,275	$321,299
Interest on Foreign Currency Investments	78,441	33,152
Interest on Loans to Depository Institutions	5,596	6,173
Revenue from Priced Services	40,886	38,513
All Other Earnings	451	476
Total Current Earnings	447,649	399,613
Current Expenses		
Salaries and Other Personnel Expenses	32,901	31,024
Retirement and Other Benefits	7,567	6,648
Travel	1,643	1,382
Postage and Shipping	5,576	5,285
Communications	429	433
Software	2,041	1,510
Materials and Supplies	2,328	2,265
Building Expenses:		
Real Estate Taxes	(512)[1]	2,359
Depreciation—Bank Premises	1,071	1,072
Utilities	862	778
Rent and Other Building Expenses	1,029	965
Furniture and Operating Equipment:		
Rentals	567	600
Depreciation and Miscellaneous Purchases	4,573	4,462
Repairs and Maintenance	2,660	2,461
Cost of Earnings Credits	6,426	7,371
Net Costs Distributed/Received from Other FR Banks	2,103	1,784
Other Operating Expenses	1,689	2,585
Total	72,953	72,984
Reimbursed Expenses[2]	(811)	(2,496)
Net Expenses	72,142	70,488
Current Net Earnings	375,507	329,125
Net Additions[3]	65,190	41,303
Less:		
Assessment by Board of Governors:		
Board Expenditures	3,094	2,823
Federal Reserve Currency Costs	3,311	3,131
Dividends Paid	4,061	4,026
Payments to U.S. Treasury	429,102	359,912
Transferred to Surplus	1,129	536
Surplus Account		
Surplus, January 1	67,382	66,846
Transferred to Surplus—as above	1,129	536
Surplus, December 31	$ 68,511	$ 67,382

[1] Reflects a $1,424 refund of 1989 taxes and a reduction in 1990 taxes.

[2] Reimbursements due from the U.S. Treasury and other Federal agencies; $3,893 was unreimbursed in 1990 and $1,682 in 1989.

[3] This item consists mainly of unrealized net gains (losses) related to revaluation of assets denominated in foreign currencies to market rates.

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December 31, 1990

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Chairman and Federal Reserve Agent

Delbert W. Johnson
Deputy Chairman

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Chairman
Farmers & Merchants Bank & Trust Co.
Aberdeen, South Dakota

Joel S. Harris
President
Yellowstone Bank
Billings, Montana

James H. Hearon, III
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and Chief Executive Officer
National City Bank
Minneapolis, Minnesota

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Triple Adams Farms
Minot, North Dakota

Duane E. Dingmann
President
Trubilt Auto Body, Inc.
Eau Claire, Wisconsin

Earl R. St. John, Jr.
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Spalding, Michigan

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Minneapolis, Minnesota

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Minneapolis, Minnesota

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Minneapolis, Minnesota

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Butte, Montana

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Hogeland, Montana

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Federal Reserve Bank of Minneapolis

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Pacific Hide and Fur Corporation
Great Falls, Montana

Robert H. Waller
President and Chief Executive Officer
First Interstate Bank of Billings, N.A.
Billings, Montana

Officers December 31, 1990

Federal Reserve Bank of Minneapolis

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Senior Vice President

Ronald E. Kaatz
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Senior Vice President
and Director of Research

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Mildred F. Williams
Assistant Vice President

William G. Wurster
Assistant Vice President

Helena Branch

John D. Johnson
Vice President and Branch Manager

Samuel H. Gane
Assistant Vice President