NOMINATION OF STEPHEN S. GARDNER

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

THE NOMINATION OF STEPHEN S. GARDNER TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JANUARY 26, 1976

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NOMINATION OF STEPHEN S. GARDNER

MONDAY, JANUARY 26, 1976

U.S. SENATE,
COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10:10 a.m. in room 5302, Dirksen Senate Office Building, Senator William Proxmire, chairman of the committee, presiding.

Present: Senators Proxmire, McIntyre, Morgan, and Garn.

The CHAIRMAN. The committee will come to order.

This morning, we meet to consider the nomination of Mr. Stephen Gardner for a term as Governor of the Federal Reserve Board. That is as long a term as I think anyone in the Government has—14 years. So this is, of course, a matter of great importance because the Federal Reserve Board has probably more influence on our economy than any other agency in the Government.

It is this agency that determines monetary policy as we all know, credit policy. So we will have some questions for you on those matters this morning, Mr. Gardner. Let us insert your biographical sketch in the record at this point.

[The information follows:]

BIOGRAPHICAL SKETCH OF STEPHEN S. GARDNER

Stephen S. Gardner, of Pennsylvania, was sworn in as Deputy Secretary of the Treasury on August 2, 1974—the position Bill Simon held prior to his appointment as Secretary on May 8.

Mr. Gardner had served as Chairman of the Board of the Girard Trust Bank in Philadelphia. He joined Girard as a credit analyst in 1949. In 1963, he became a Senior Vice President of the bank, Executive Vice President and Director in 1965, President in 1966, and Chairman of the Board in 1971. Mr. Gardner has served as a member of the Boards of Directors of INA Corporation, Narco Scientific Industries, the Budd Company, and Amstar Corporation.

In Philadelphia, Mr. Gardner also served as Chairman of the Greater Philadelphia Movement and the Mayor's Advisory Committee. He was the Metro-Chairman of the National Alliance of Businessmen and Director of the Philadelphia Orchestra Association and the Philadelphia College of Art. He is also a member of the World Affairs Council and the Philadelphia Club.

He was born on December 26, 1921, in Wakefield, Massachusetts, and was educated at Harvard University, receiving his MBA from Harvard Graduate School of Business Administration in 1949.

Mr. Gardner is married to the former Consuelo Andonegui. They have five children and seven grandchildren, and maintain a home in Wawa, Pennsylvania.

The CHAIRMAN. Mr. Gardner, I understand until January 1, 1977—that is, until about a year from now—you will be officially on leave from the Girard Trust Bank.

I understand further that this arrangement is for the purpose of qualifying you for the bank's pension plan at age 55.

Can you describe for the committee what steps you have taken and what steps you plan to take during this period to eliminate any conflict of interest or any appearance of conflict of interest?

Mr. GARDNER. Yes, sir, Mr. Chairman.

As you know, I worked 25 years for the Girard Bank which vested a pension and certain pension rights under their plan. One cannot draw even an actuarially reduced early retirement until they have reached age 55.

January 1, 1977, in fact on December 26, 1976, I will reach age 55. I have told the bank that if permissable under the plan, I would like to terminate the leave of absence and draw my actuarially reduced vested pension rights at that time and terminate the leave of absence.

Under that leave of absence, which is covered in U.S. statutes and is permissible, a person is allowed to remain in various fringe benefit plans. I intend, if confirmed and sworn in to the Board of Governors' position, to eliminate any of the provisions of those fringe benefit plans such as group life insurance, medical insurance, and what have you, immediately.

I will seek similar coverage under the Federal Reserve Bank's normal employee benefits plan. I cannot terminate the leave of absence prior to age 55 without putting my pension into suspension for 11 years. And that pension carries a widow's benefit. So I think it is very important for the protection of my family, having worked 25 years there, that I qualify and meet as soon as possible the age requirements, which would be January 1, 1977, and then draw the pension and terminate the leave of absence.

But insofar as there are any other fringe benefits accruing from this arrangement and they are small, I will seek other coverage and eliminate those as soon as I am confirmed and sworn in.

The CHAIRMAN. Well, I have great sympathy for your position, and I think it sounds like a wise and prudent action on your part to protect your pension. At the same time, our concern, of course, is the potential conflict of interest represented by you as continuing to be an employee of the Girard Trust Bank while at the same time you are a Governor of the Federal Reserve Board.

And as a Governor of the Federal Reserve Board, you have considerable influence with respect to all banks, and particularly with respect to State member banks. What is the status of Girard? Is that a——

Mr. GARDNER. That is a member of the Federal Reserve System, Mr. Chairman, and a State-chartered bank. And obviously and importantly, I would disassociate myself with any matter having to do specifically with the Girard Bank during my service on the Board until I have reached the normal early retirement and drawn a pension.

The CHAIRMAN. Do you know if there are any precedents for this, people serving on the Federal Reserve Board while continuing to have this kind of connection with the bank under the Federal Reserve Board's jurisdiction?

Mr. GARDNER. I have not searched the record, Mr. Chairman. There are no retired bankers or current bankers on the Federal Reserve

Board at the moment. But there is a possibility it could have happened in the past. I have not searched the record.

The CHAIRMAN. Has this been reviewed by the Federal Reserve Board's legal counsel?

Mr. GARDNER. Yes; it has, Mr. Chairman.

The CHAIRMAN. What is their view?

Mr. GARDNER. Their view is it is entirely proper.

The CHAIRMAN. You say if you did not take this action, if you should separate yourself from Girard forthwith, that you would then have your pension in suspension for 11 years?

Mr. GARDNER. Yes, sir, until I reached 65.

The CHAIRMAN. In view of that fact this is a 14-year appointment, why would that put you in any particular jeopardy?

Mr. GARDNER. It puts my wife and my family in great jeopardy. I would have to live 11 years to assure they would have any residues from that pension. There is no widow's benefit if one separates early prior to the actual receipt of pension at age 65.

The CHAIRMAN. Is there any insurance benefit or anything of the kind at the Federal Reserve Board?

Mr. GARDNER. They have insurance plans, sir, yes. They have group life insurance.

The CHAIRMAN. How would that protect you?

Mr. GARDNER. That would protect me modestly. And in judgment, it would not protect me in any comparable sense. I worked 25 years, Mr. Chairman. I earned a vested pension right. And I would lose——

The CHAIRMAN. As I say, I am very sympathetic; we want to do whatever we can to accommodate you. As you understand, we have a responsibility to avoid any kind of conflict if we can.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. I think you seem to have been very careful and prudent about this. I just want to explore this as much as possible.

Would you give us or see if we could have some kind of a memorandum that would indicate what kind of protection you would have if you separated yourself from Girard Bank forthwith, accepted whatever insurance protection you could get from the Federal Reserve Board?

Mr. GARDNER. Yes, sir.

The CHAIRMAN. And then in the event of your death in a year or two, what effect that would have on your estate compared with continuing your position with Girard. If we have those facts in front of us, we would know what we are doing.

Mr. GARDNER. I would be happy to, Mr. Chairman.

The CHAIRMAN. If you are confirmed, would you appear before any committee of Congress that is appropriate to give testimony when requested to do so?

Mr. GARDNER. Yes, indeed.

The CHAIRMAN. The Chairman of the Federal Reserve Board, Dr. Burns, takes the position that all requests from Congress for Board testimony should be made directly to the Chairman so that he can decide which members of the Board will present the Board's testimony.

Ordinarily, I have no objection to this arrangement, but there are times when this committee or other committees may want the individual testimony of a particular Board member such as yourself. I believe as long as the Senate confirms your nomination, the Senate and House committees are entitled to hear your individual views even when you may disagree with the Chairman or the majority of the Board.

Would you give us your thoughts on this?

Mr. GARDNER. My thoughts are very direct and very simple. When I appeared before the Senate Finance Committee to be confirmed as Deputy Secretary of the Treasury, I agreed I would appear before Congress when requested at any time. And I will make that same commitment to this committee.

The CHAIRMAN. All right, sir.

As you know, there has recently been a good deal of turnover on the Board. It seems that we have confirmation of Board members two or three times a year instead of once every 2 years as it would be if everyone served out their term. I am not sure whether this is good or bad, but I do feel our committee and the Congress should be fully informed.

You have been appointed to a 14-year term. Have you entered into any agreement or tacit understanding that you will not carry out your full 14-year term?

Mr. GARDNER. No, sir, not at all.

The CHAIRMAN. Do you intend at this time to do so?

Mr. GARDNER. I intend at this time to do so. Fourteen years is a long time. All of us have to realize, I guess, that things can intervene, but it is my intention to serve it.

I would like to point out also to the committee, Mr. Chairman, that under the Fed's rules, if a person resigns their term without completing their term, they are—if they were a banker, for example, or even if they were not a banker—prohibited from taking part in any banking activities for 2 years after such resignation.

I have been a banker all my life. And at this point, I think up until I became Deputy Secretary, the stream of my career has changed. Obviously, I am not going to be a banker again if I am confirmed and take this term.

The CHAIRMAN. Can you describe your educational background and training that will help you to carry out your responsibilities as a member of the Board if you are confirmed?

Mr. GARDNER. Yes, sir. Briefly, I always wanted to be a banker. I went to work at age 16 in a bank. I got involved in World War II so I didn't complete college until after World War II. I studied at Harvard as an undergraduate. I studied at Harvard Graduate School of Business Administration. Then I went immediately to a banking company in Philadelphia. And I have spent my entire career prior to coming to Washington with that banking company, the Girard Bank.

The CHAIRMAN. What was your field of concentration at Harvard Business School?

Mr. GARDNER. Finance and banking.

The CHAIRMAN. Have you had any opportunity to study monetary economics?

Mr. GARDNER. I am not a trained economist, although I studied it, of course, in college. I have not pursued the discipline of economics.

On the other hand, I have an opinion that a banker, particularly in the commercial lending field, becomes a sort of a grassroots economist. He deals with hundreds of different businesses; he sees the effect in regions and areas. So I would say I have had practical experience, Mr. Chairman.

The CHAIRMAN. What was the specific nature of your responsibility at Girard? Were you concerned as a loan officer? Were you concerned with economic policy in any particular way?

Mr. GARDNER. Well, I was in the later stages of my career. I began as a credit analyst, moved into lending as the assistant of the senior lending officer for a time, then switched into operations, then into branch management, then back to head the banking department which is the department that handles all the commercial lending and the bank's investment policy, then became executive vice president, then president, and chairman.

So my training was in the lending field and branching.

The CHAIRMAN. How about in the Treasury Department, what was your function there? What has been your function, I should say, is your function?

Mr. GARDNER. It has been very broad, Mr. Chairman, trying to cover those areas that the Secretary did not have the opportunity to cover. Under the Treasury's organization chart, the Comptroller of the Currency and the Commissioner of Internal Revenue and the Assistant Secretary for Tax Policy report directly to the Deputy Secretary and through him to the Secretary.

And all the other agencies and bureaus also report nominally through the Deputy Secretary.

So I would say I was in a chief-of-staff kind of position there, working in many areas, concentrating on tax matters, tax policy, from the Secretary's point of view, not from the expert point of view of the Revenue Service or the tax policy people. It is a very broad responsibility.

The CHAIRMAN. How long have you served in the Treasury Department?

Mr. GARDNER. I was sworn in on August 4, 1974, so it has been about 1½ years.

The CHAIRMAN. You have appeared before this committee on several matters.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. What was your responsibility?

Mr. GARDNER. I was testifying a number of times on regulatory reform matters. I am slated to testify on——

The CHAIRMAN. Yes; that's right, you testified on how or if we should reform the regulatory agencies.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. In their bank examination function.

Mr. GARDNER. Yes, sir, and also on the Financial Institutions Act.

The CHAIRMAN. Did you work on the Financial Institutions Act?

Mr. GARDNER. Yes, indeed. I was really the coordinator for the administration on the Financial Institutions Act. It was a Treasury issue.

The CHAIRMAN. My time is up.

Senator Garn?

Senator GARN. In the past year there has been a great deal—particularly on this committee—of talk about monetary policy and expansion rate of our money supply. There should have been 5 to 7 percent or somewhat larger.

I am not asking the question of what you think it should be or should not be, but how you feel about the role of the Federal Reserve in making those decisions versus Congress getting involved to attempt to dictate the money supply.

Mr. GARDNER. Senator Garn, I think we have developed a wise system. We have an agency with considerable independence that is charged with maintaining an appropriate monetary growth in the economy. I think we have an outstanding example of the disaster in the recent inflationary period.

I am very worried and concerned that we not continue in the boom or bust type of economy that we have had. I think it is a highly sensitive measure.

I also think it is becoming more difficult to manage monetary policy because our infrastructure is changing to some extent. The velocity of money, which we can't seem to control very well, tends to often negate or supplement the activities of the Fed in determining what the appropriate monetary goals and target will be.

I am firmly committed to allowing a modest growth of the money supply that is not so stimulative that it brings us back to the brink of inflationary problems that we have had before.

Senator GARN. I would certainly agree with you on that point.

The major thing that I was trying to establish, to see how you felt, is about the independence of the Federal Reserve. My own feeling is, that whatever errors may or may not have been made in the past, that an independent body removed from political pressures is better able to make those decisions than a political body such as the Congress which has no trained economists as members and many of the members with no training in practical economics.

I certainly don't consider that my background lends itself to making a decision as to what the monetary supply, the supply of money, should be. Yet, there are some, particularly in the House, as you know, who feel very strongly, even have bills in the House, to dictate a certain increase in the supply of money.

And I would assume from your previous answer that you would agree that this is a proper role for an independent body and not a political body.

Mr. GARDNER. I do, indeed, sir, completely agree with that.

Senator GARN. I have no other questions at this time.

The CHAIRMAN. Senator McIntyre?

Senator MCINTYRE. Thank you, Mr. Chairman.

Mr. Secretary, it is a pleasure to welcome you here this morning. My congratulations on your appointment to become vice chairman of the Federal Reserve Board. As Deputy Secretary of the Treasury, sir, I think you have demonstrated the kind of competent leadership and dedication which will guarantee your success in your new endeavor.

I would like particularly at this time to express my personal appreciation for the fine efforts you made in support of the Financial Institutions Act. I have heard from many quarters of Steve Gardner's fairness, openmindedness, and forthrightness in terms of diffusing much of the parochial opposition to FIA and encouraging the various forces into adopting responsible positions.

First and foremost, Mr. Secretary, is your own involvement in recognizing from the standpoint of the administration, the need for compromise and willingness to go forward on the basis of that compromise. Frankly, I attribute a great deal of the bill's success in the Senate to your background efforts on behalf of the administration.

I am concerned, however, that your departure from the Treasury will leave a void in this area just when we are approaching the most critical period. At the Federal Reserve Board, will you be in a position to continue your support of this bill and who in the administration will be picking up where you leave off?

Can you answer that?

Mr. GARDNER. Senator McIntyre, thank you.

The Federal Reserve has a clear interest in the Financial Institutions Act. My counterpart at the Federal Reserve, George Mitchell, has been active in these matters and in coordinating committee matters. I would hope that my new duties would encompass such responsibilities at the Fed.

I don't know what the chairman and other Governors will do about ordering various areas of interest, but certainly my disposition would be to attempt to pursue this.

At the Treasury, we will have, hopefully, appropriate candidates for the Deputy Secretary's position. And I would expect, having many associates at the Treasury who have worked with me on the Financial Institutions Act, that the Treasury will continue to carry the administration's initiative on the Financial Institution's Act. I don't consider this a problem.

Senator MCINTYRE. Dealing with these trade associations can be trouble.

Mr. GARDNER. Yes, sir.

Senator MCINTYRE. Mr. Gardner, I am going to refer to the chairman on some of the more specific questions regarding regulatory restructuring and adequacy of bank examination. But as a general matter, this committee is involved on a number of fronts with the issue of disclosure.

Traditionally, banks have not been subject to much in the way of disclosure. And in general bankers, I think, as you know, are not very comfortable with having their laundry washed in public. But have we not progressed now to the point where the public is entitled to much more openness with regard to banks and banking operations and examination than has been the case in the past?

What are your views on that matter?

Mr. GARDNER. Senator McIntyre, banks have been in recent years coming much more heavily under the purview of the SEC. At least the larger banks have. For a time, banks were kept from many of the SEC disclosure provisions, but in recent years, the Bank Holding Company Act and the like, the banks have been forced to—not forced,

67-457—76——2

but have been brought into—the scope of many SEC disclosure requirements.

I think there is definitely a trend in at least my own experience in banking to fuller disclosure through the formation of holding companies, through the extension of SEC-type procedures to the bank holding companies, and the like.

If we turn to the question of examinations, I am sure we must strike a balance somewhere.

Senator, I find having experienced examinations both from the Federal and State authorities for many years in the private banking world that this is really not an adversary procedure when literally 100 or 200 auditors descend on a Friday afternoon and begin examining a bank. Banks and the regulatory agencies usually work reasonably close in reviewing the quality of assets and the fact that the assets are there.

If we develop a procedure where those close audits and studies, many of which are based on the opinion and the analysis of individual examiners, become instantly public, I think we may have defeated our objective.

We have a very heavy regulatory hand laid on the banking business. No other business has such a detailed, regularly-scheduled, Federal oversight and in fact audit as banks.

Now, surely, we can improve the techniques. We have been through a terrible economic period, and I am not surprised at some of the revelations that are coming up. I want to suggest, however, that we must be very careful not to compromise this window we have to the internal activities of banks by disclosure that goes beyond the disclosure that is required both under the security laws and for most other corporations.

I think the jury is very much still out on the extended disclosure here, but what I am suggesting is that a confidential detailed overview which is the mission of bank regulatory authorities may be hampered to some extent if it becomes simply or totally a public hearing on the condition of each bank.

I think the revelations of the last few weeks are not surprising in terms of the difficulties banks have faced, considering that extremely long period we had of a booming economy, inflation and the like.

I am trying to separate these issues because it seems to me that the revelations themselves prove that detailed and careful bank examinations were made. I think what we are arguing about or apparently arguing about today is the fact that these detailed revelations of what are interdepartmental confidential memoranda have now become fully public.

I think perhaps there is a place where reasonable men could agree that a confidential examination can be summarized or a confidential examination should not be totally disclosed to the public. I don't know where that place is. I am impressed with the depth of the examination structure. I am also certain that we want a strong banking system, and we don't want to unnecessarily alarm our constituencies in this country about the banking system.

I think the basic fact that we have had so many disclosure of difficulties and yet so few failures in some sense validates the work that has been done in the regulatory agencies.

Senator McINTYRE. You indicate the trend is toward disclosure, but your overall advice is to exercise caution as we proceed in that direction?

Mr. GARDNER. I think that would be it.

Senator McINTYRE. Let me ask you another question. Another matter that concerns me involves the operation of U.S. banks overseas. More and more of the income of many large U.S. banks is being derived from overseas operations. Yet, I am not at all convinced either the Congress or the bank regulatory agencies have an adequate understanding of the way in which the growth of foreign operations affect the overall health and competitiveness of the U.S. banking community.

As George Mitchell's successor, do I assume correctly one of your principal responsibilities will lie in this area? And if so, what general observations can you make at this point in time about the growth of U.S. banking operations overseas and the adequacy of our regulatory system to monitor them?

Mr. GARDNER. Senator McIntyre, I would hope that that would be one of my responsibilities. I have been interested in this bill that the Fed has proposed, and I think this committee is hearing on Wednesday or perhaps sooner.

I have tried to develop the Treasury point of view on the bill to regulate foreign banks in the United States. Abroad, our regulatory policies should indeed perhaps be thoroughly reviewed. We do have a regulatory process today. And the activities of foreign branches of U.S. banks are within the scope of the examination procedures that are conducted today.

But you are very correct in one respect. Banking has changed internationally enormously. American banks have become perhaps more central to the trading economy of the Western nations than the banks of any nation in the world. There is a very simple reason for this.

Despite its difficulty in the world, the dollar is really the trading currency of the world. And U.S. banks are the purveyors of that dollar. And so their activities in many respects are different from the activities of other large banks in the European and in the Far Eastern community of Western powers.

I think we have had many studies over the years about the concerns expressed about the Euro-dollar market and offshore use of dollars. And of course, the basic fact is very simple. Euro-dollars grew up because people preferred to hold Euro-dollars rather than their own currency. And when they were permitted to hold dollars by their own governments, we developed a monetary exchange system that is basically the U.S. dollar.

So these have raised some very broad issues. I think there is much that can be done in terms of understanding the full complexity of these issues. I think our regulatory processes may indeed require some additional initiative, but I also want to suggest that the system has worked to date.

The biggest problem that I foresee today is not the problem of 5 or 10 years ago when everyone was concerned about what will happen to the Euro-dollar market and will it disappear and leave all banks in dreadful shape and so forth. It has not done that.

I think the biggest problem today is a full recognition on the impact of America's major trading banks. And those are the top tier of 24

or 30 banks in the United States who are really keyed to this whole process of using U.S. dollars as a world currency for trading purposes.

So I agree with you.

Senator McINTYRE. Thank you, Mr. Secretary.

Thank you, Senator.

The CHAIRMAN. Mr. Secretary, you will be responsible for credit policy, our monetary policy.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. You will be one of seven men who have a profound effect on interest rates and availability of credit. Could you describe to the committee how you feel monetary policy affects employment, unemployment, how it affects inflation? What is your understanding of how our credit system works?

Mr. GARDNER. Well, monetary policy has to be linked also to fiscal policy because they are not indivisible, as you know, sir. And I think in having an independent agency of the Federal Government such as the Federal Reserve doing its best to respond to the economy—and I say that very distinctly because I think the role of the Fed is not totally active in this area. The role of the Fed is in a sense one of response to see that under the fiscal policies currently in effect by the Government and under the economic conditions as we perceive them, there is an appropriate monetary policy somewhere.

I am not sure that monetary policy itself should ever lead this whole parade because you do have the condition of Government spending, Government revenues, the whole fiscal activity of the Government. And you do have the real world of economic activity in the private sector.

So I think an independent agency, one headed by seven Governors of the Federal Reserve System, plus all of their aides and their associates in both staff and regional banks and advisory committees and the like, are really searching always for an appropriate monetary policy that takes into account where we stand presently on our fiscal policies, where we stand presently in our economy.

And I can see times when monetary policy must be supportive of stimulus because the country and all of our goals are to bring greater stimulus to economy under a certain set of conditions.

But I want to suggest in my view monetary policy is not the point from which we start. We start from the condition of the economy and the fiscal conditions that are imposed on us by our revenues and our spending procedures. And then appropriate monetary policy must be designed.

I am more conservative perhaps. I am conservative on this issue if you want to categorize me, Mr. Chairman.

The CHAIRMAN. We now have a situation in which we have a very, very large deficit. In the current fiscal year, we have a deficit of $75 billion; next year a deficit of more than $43 billion, may be $50 billion, maybe more than that. We have inflation on a historical basis very high, much better than it was, but very high still.

We also have the serious unemployment problem. Industry is operating well below capacity, great need for growth in our economy.

What monetary policy under present circumstances seems to you to be most appropriate and logical?

Mr. GARDNER. My shortest answer would be a moderately stimulative policy, Mr. Chairman, because we do have, as you know, and we have had, a great decline or significant decline in the private interest rate structure. We have the capacity to lend money. We have the beginnings of a recovery which I think are well documented.

Credit is not unavailable or scarce today. Our monetary aggregates are not showing much growth at the moment. I think the Federal Reserve or my vote on the Federal Reserve, if I were there, would be to continue a moderate target for the growth in the money supply system.

I would be against raising those targets to a very high or much higher number than has been announced by the Board because I am dreadfully afraid of the ravages of inflation. And I don't want to see us get back into double-digit inflation or even something on a higher scale than we have today.

I think it is terribly important that we preserve the stability in this economy. I am disappointed as I know everyone is that unemployment isn't falling faster. On the other hand, I think we could reach a wrong conclusion here and provide far too much stimulus and regenerate those problems that we had just a year or 2 years ago.

The CHAIRMAN. How would you personally measure a monetary policy to see if it is tight or loose? What in your view are the most important variables or the most important elements?

Mr. GARDNER. Well, my own experience is such that I would be closely monitoring the availability of money as evidenced by the rate structures throughout the credit markets and the investment markets in terms of the adequacy of the money supply at any particular time.

I need instruction and guidance as to how good our quantifying of aggregates is because we have another thing in there called velocity. And we are never quite sure how velocity will affect a given set of aggregates and the like.

So I would be looking at all of the market rates that I am familiar with. I know the Fed has aimed or looked very carefully at the Federal funds' rate, but we also have a prime rate, and we also have a long-term bond rate; we also have bill rates and what have you.

The CHAIRMAN. You say you would look at the rate, the interest rate?

Mr. GARDNER. Yes, sir.

The CHAIRMAN. Interest rates, I should say.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. Rather than at the various measures of the money supply M 1, 2, 3, 4, and so forth. You think that the rates are the most appropriate basis to determine the availability of funds?

Mr. GARDNER. I said that, sir, on the basis of my experience as a banker that is what I looked at when I was in the banking business.

The CHAIRMAN. Of course, it can be argued that the monetary supply may be expanded too slowly in view of the failure of the economy to grow as rapidly as it should to keep our resources employed and that because of a weakness of demand, rates are falling, but are not falling fast enough.

Historically, they are still very high, based on historical experience. They are not high as compared to what they were a few months ago, but historically.

Let me ask you this: In 1975, the narrowly defined money supply, M_1 grew at an annual rate of 4.4 percent. During the first 6 months, it grew at a 6.9-percent annual rate. And during the last 6 months, it grew at a 2-percent annual rate.

The corresponding figures for M_2 were 8.8 percent for the year, 11.4 percent for the first half, and 6.3 percent for the second half.

Short-term interest rates were around 5.5 percent for most of the year except for 3½ months in the summer when they were between 6 and 6½ percent. In the last 3 months, short-term interest rates have declined sharply.

Putting all these facts together, how would you characterize monetary policy during the first half of 1975 and during the second half—tight or loose?

Mr. GARDNER. I would not characterize it as tight. I don't think it was excessively loose either because the aggregates didn't grow in concert with the targets announced by the Board. The aggregates grew less rapidly.

On the other hand, we have had a useful rate experience. And let me comment for a minute if I may, sir, on interest rates.

The Federal Government borrowed a great deal of money last year, a lot of new money. It took maybe 80 percent of the funds that went into the securities markets. It will take perhaps a good deal less than that this year, even though we have a new budget and a deficit again and what have you.

If the economy had started back faster, we could have seen a tightening obviously of interest rates, but because of the general slack in the economy and the lack of demand for money for many reasons, we didn't have a tightening except as you point out in the midsummer period.

But our problems, as I see them before us in the months ahead, are that we still have to manage a very heavy Federal dip into the capital markets. Hopefully, the signs we have seen of recovery will continue. And as this occurs, I think monetary policy will have to be sufficient to accommodate this so that we don't have a significant, perhaps an unconscionable rise in interest rates.

You say, and I agree with you, that rates are historically still very high. Yet, as I look at this interdependent world, if you will forgive me, we have an enormous need for capital throughout the whole world. And those demands and needs are increasing very significantly.

And I just don't think that the world of 1975 or 1976 is ever going to see a return to the kind of an interest rate structure that we had in the fifties. I think there is too much demand for capital throughout the entire developed world. And I suspect——

The CHAIRMAN. Doesn't that really depend on the rate of inflation? You moderate inflation; wouldn't there be a much better prospect interest rates would tend to moderate, too, as long as the inflationary strains are high?

I agree there is very little incentive for saving if interest rates are going to be so low that in the long term you get back less than you invested. You have to have high interest rates as long as inflation is as high as it is. These two things are related.

Mr. GARDNER. They are, indeed. I accept and agree with what you said. It used to be loans abroad were made at several points on the scale above domestic commercial loans. I can remember lending Mexico at 9 percent or 10 percent during the late fifties and the sixties when domestic rates were much lower.

I am only pointing out that even our own market here which is the largest capital market in the world is impacted by the tremendous need for capital throughout the world. And we are going to see, I think, hopefully, if we keep inflation under control in the United States—they won't have as much success overseas, I am sure—a price of money in my judgment that does not return to the very low levels that we once knew following World War II.

The CHAIRMAN. My time is up again.

Senator Garn?

Senator GARN. Mr. Chairman, I have no more questions at this time unless in the course of your questioning, you stimulate me to some more.

The CHAIRMAN. I am sure I will.

Senator McIntyre?

Senator MCINTYRE. Thank you, Mr. Chairman.

One other matter, Mr. Secretary, I would like to inquire about. As you know, I am extremely interested in EFTS, although I must say my confidence in the EFTS Commission at this point in time is not very strong.

One of the more important issues to be addressed by the Commission in my opinion is the appropriate role of the Federal Government in developing EFTS systems.

The Federal Reserve, of course, has been active in trying to delineate its proper role in this area, particularly through regulation J. The Board has just announced new proposals, for example, with regard to access to automated clearinghouses.

Mr. Gardner, in your opinion, what role should the Federal Reserve and, indeed, the Federal Government, play in the development of EFTS at this time as compared to the role that should be left appropriately to the free enterprise system?

Mr. GARDNER. Well, prior to the development of the Commission's studies, Senator McIntyre, my disposition is that the Federal role should follow the mandate of the Commission which I think was given it by Congress to assure that there is a competitive and free access to the advantages of electronic funds transfer system.

The Federal Reserve is highly involved in the clearing of checks, as you know, and the transferring of funds throughout our financial system. And I would be very concerned if proprietary interest were developed that favored one type of financial institution over another.

I think the Federal role is to insure a fair use of these systems. And going beyond that, the basic change in our laws effecting negotiable instruments and transfer of funds, I think, are significant when we embark on an electronic world or a world where electronic systems become much more used than the paper system that we have today.

It is not a very good answer, I am sorry, but I look forward to the Commission. As you know, I was interested in it in the Treasury. It was part of Vice Chairman Mitchell's responsibility at the Fed. And

I hope to take his place on the Commission from the Federal Reserve point of view or Federal Reserve side.

Senator McINTYRE. You do want to take Governor Mitchell's part?

Mr. GARDNER. I do.

Senator McINTYRE. We will be continually interested in this. I just don't know how much this should be allowed to run free without some legislative action. I don't know.

Thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Morgan, would you like to proceed now or wait a bit?

Senator MORGAN. Let me wait just a minute.

The CHAIRMAN. As Senator McIntyre referred to it, and as you know, the press has recently reported a number of large banks have been placed on so-called problem lists maintained by the regulatory agencies. Some have argued that we need more effective regulation of commercial banks to prevent unsafe or unsound practices.

Can you give us your views on this? Do you think we need to get tougher with the banks and especially the big banks? Should we insist they do more to increase their capital position or liquidity?

Mr. GARDNER. I think, Senator, that we can strengthen the powers of regulatory authorities to demand or require banking institutions that have difficult positions to improve, find more capital, find more support, what have you, or improve their system.

The CHAIRMAN. Let me interrupt to say that the Comptroller who, as I understand, is part of the Treasury Department, their office—Mr. Smith didn't say this, but one of his top people said it—when we tell the banks that they have to follow a certain course, they tell us to go fly a kite. All we can do is go fly a kite.

Now, it is my understanding that is not the case; that there are all kinds of action that the Comptroller and the other regulatory bodies can take. So would you address yourself first to what power they do have and then with what they need in order to have the kind of muscle you think is necessary?

Mr. GARDNER. I think they have a broad opportunity to influence banks to improve in areas where they disagree. Having been examined, having been asked by the Fed to do this, and that and other things as a banker, it never occurred to me to tell the Federal Reserve System to go fly a kite. I don't think it would have been appropriate or a serious way to address the problem.

The Fed could hold up applications; the Fed could seek to meet separately with my Board of Directors; the Fed could have done all kinds of things to force me to make changes in bank policies.

And I think the basic structure for requiring banks to meet definite Federal objectives are there. There could be a further definition of these. I think there is a great deal of power in the hands of the regulatory agencies. I am sure the Comptroller has the same opportunity to meet separately with the Boards of Directors of banks.

Perhaps the law could be changed to spell it out a little more clearly so that the Federal regulatory agency could seek the removal of bank officers who were participating in both unsound or indeed criminal practices. I think perhaps we can clarify the law.

But it never occurred to me that we did not have enough powers of persuasion and demand. You know, banks——

The CHAIRMAN. It would be extremely helpful if you would give us your thoughts on this in the next few days in a memorandum. I will tell you why.

You are one of the very few people who have been in a position on both sides of this. You have been a banker for 25 years, in a very important and highly respected bank. You have been in the Treasury Department for several years now or for more than a year now. You are about to go into the Federal Reserve System. And you are a man of obvious intelligence and concerned with the public interest.

So that whatever you could indicate in detail as to what bank regulatory agencies can do now and what perhaps we can do to improve and strengthen their positions in legislation, we would certainly like to have that recommendation from you.

Mr. GARDNER. Very well, sir.

The CHAIRMAN. Now, one of the difficulties we have had is that we have asked the Fed for information with respect to so-called problem banks. And I think that there has been some reluctance to provide the names of the banks. I respect that. I think that may well be correct.

It is easier for us as a committee to understand this if we can know the banks and follow up on it.

On the other hand, there is a very serious problem of disclosure control. Disclosure may compromise a bank's position and destroy their credibility unfairly. So I am very reluctant to deal in the specific banks that are involved.

On the other hand, I think, as you say, we ought to have some means of having communicated to us the strength or weakness of our banking system. After all, we have the responsibility to provide the legislation on which the regulatory agencies operate.

It is up to us also to provide oversight with respect to regulatory agencies. We cannot do that unless we are informed constantly of the strength or weakness of the banking system.

We also should know whether or not there is a current problem. I didn't have any idea and the staff of this committee didn't have any ideas there was a problem as to holding companies until we read it in The New York Times. It was disclosed there for the first time. It was just a bolt from the blue.

It seems to me this is what we ought to know, not necessarily who is on the list; we ought to know there is a problem list. We ought to know the structure of the problem list. There seems to be three categories of problem banks and problem holding companies. We ought to understand the basis on which they are put on the list. We ought to understand how reliable the estimates are, how long this has proceeded, and how successful or unsuccessful this method of monitoring the bank holding companies has been.

The Fed, I think, has not come clear and clean with us. And I hope they will in the future.

What is your view on this?

Mr. GARDNER. I have had no experience with the intelligence committees of the Congress. But it seems to me that it would be possible—

and I cite that only as an example—for the key committees of the Congress to be briefed in at least semiannual sessions, confidential sessions, with an overview of the health of the banking industry.

I think if the committees of the Congress are willing to do that without specifying this is bank A, B, or C, you could, as a constituted committee of the Senate, get a very good view of the health of the banking system from periodic review of the health of the banking system.

And perhaps that might spark your interest in seeking other means of information. But I appreciate your interest in the confidentiality because we can't have mindless runs on important banks in the system based on information that is over a year old and is subjective to begin with.

But I see no reason why we couldn't, or the regulatory authorities couldn't, spend some time in something very simple called "communication and briefing of the committees of the Congress" that are charged with oversight.

The CHAIRMAN. Well, I hope we can find some way of getting far more comprehensive disclosure than we have at the present time without, as you say, compromising the banks. It is not only a matter of compromising the banks, but also as the staff has pointed out to me, compromising the examination.

If an examiner feels his classification is going to be disclosed publicly, he is going to pull his punches in some places, feeling he doesn't want to destroy a bank. We certainly don't want to inhibit that kind of frank, objective appraisal of a bank's weakness. So it is a tough problem from a number of standpoints.

But we would like to work out as full and complete a disclosure as we can because I think that is good discipline in the bank. If they know they are going to have information disclosed about them, about the weakness of their loans and so forth, I think they are going to be a little more careful.

I think that is all to the good. Some people have argued that the Fed is already overburdened with monetary policy and should transfer its bank regulatory policies to another agency. Would you give us your views on this?

Mr. GARDNER. Yes, sir. And I had earlier promised you my views in the review of another hearing. I have thought about this a good deal, and I would like to make a very general explanation of what I think my views are at this point, although they haven't been ordered or written down.

The monetary policy aspect of the Fed is terribly important. I think it is also very closely connected with credit.

The state of credit granting in the economy, I think credit policy, is very important for the reason that credit policy is very closely allied to monetary policy; and that the Fed needs to have some regulatory overview of key banks in the country.

The Fed does have over 1,000 members, and they do examine these banks. And I think that is useful because it helps in the development of both monetary and credit policy.

I also think as I have said before to you, Mr. Chairman, that we can improve the regulatory structure which is developed into almost—you look at it broadly—a five-part structure if you include the Federal

Home-Loan Bank Board and National Credit Union Administration. And I have been thinking about this very carefully.

And it seems to me that if we start on improving the regulatory structure by looking at the fact that we have a dual banking system and nobody is recommending at the moment that we remove from the States the right to regulate banks within their borders that wish State charters, then we begin from a position that says what makes the most sense if we have this enormous Federal overview divided into three agencies as far as commercial banks are concerned and the State overview?

And frankly, I would come down this way, I think: I would leave the Fed in the business of examining member banks who are members of the system. I would leave the Comptroller in the business of examining national banks because that is almost the full mission of the Comptroller of the Currency, examining and regulating national banks who seek national charters.

And then I would wonder why the insurance agency is the one that presently examines most of the other banks in the country. The FDIC is an insurance agency, and they are examining a far larger number of banks, all of them smaller than the other two agencies that are examining banks.

And I would try to relate the State supervision and examination to a Federal oversight.

I have to say I think if we do that, we ought to perhaps transfer to the regional Federal Reserve banks which are made up of—and they are in 12 parts of the country with many branches—Boards of Governors from regions, different disciplines, advisory boards and community leaders and experts from the regions, and say to the regional Federal Reserve banks, "All right, you oversee the quality of State regulations, and you decide under certain conditions if that State examination is sufficient to be passed on for Federal purposes.

"And if it is not, then oversee the examination of the banks that are so insured."

I would bring the insurance company, the FDIC, into a different role, a role of insuring, a role of looking over the various examinations performed by the other Federal or State agencies, a role of liquidating the banks.

I would vest in the regional banking system of the Federal Reserve the examination and regulation of those State-chartered banks which are not members of the System and which do not have adequate State examination.

As a banker, I was examined by a dual system: 150 examiners came in from the State of Pennsylvania and 150 from the Federal Reserve Bank. They usually came in together and worked side by side for 6 or 8 months before the examination was complete. That is the extent of those examinations.

It seems to me that there are a great number of things we can do here.

The CHAIRMAN. I think we can. I think the great weakness, though, as far as the failure to do an adequate job, it seems to me, has come from the Comptroller. Every big failure has been a national bank, and the banks that seem to be in difficulty now are largely national banks.

It has been a competition in laxity in the view of the Chairman of the Federal Reserve Board, not this Senator or some other outside critic, but the Chairman of the Federal Reserve Board is the one that coined that phrase—competition in laxity.

That is, regulatory bodies deliberately having a softer approach to regulation so they can persuade the banks to decide to come under their jurisdiction. That seems to me to be a situation that Congress ought to be very, very concerned about. We ought to try to correct it, and we can't correct it very well if we are going to reward the Comptroller of the Currency by letting him continue.

Mr. GARDNER. Mr. Chairman, yes. As the testimony will show in due course, if it has not already, he has had a very extensive consultant's overview of the whole agency. He started in a year or two ago. He has developed a plan which is in partial implementation already to improve the agency.

If I can be very candid, for a long time the Comptroller of the Currency did not participate actively in the changing role of banking. And then several years ago, a new Comptroller came in, not the present Comptroller, and he was very innovative. And the reason the banks came to him is because he was willing to innovate and try to change the regulations to permit things to occur that society was demanding.

That very innovative Comptroller——

The CHAIRMAN. Mr. Saxon?

Mr. GARDNER. Yes, sir; and he brought——

The CHAIRMAN. I agree with you on him. He was good. He brought a breath of fresh air, competition, vigor, that we needed. And it was a good shakeup.

Mr. GARDNER. And his development was in the area of innovation and change.

Now, when the present Comptroller came in, he looked at the organization and said to himself—he said to me: "This organization hasn't been changed structurally for 100 years. It is high time we took a look at reorganization and improvement in the Comptroller's Office."

And he started the Haskins & Sells study which is a bound volume this thick, which was announced last fall, which we have all been very interested in.

In other words, he has recognized the problem and done a great deal to start on the corrective measures.

The CHAIRMAN. Chairman Burns has said a number of times—I should say, since Chairman Burns has said a number of times—the Fed itself cannot carry on the fight against inflation. He has called for more active incomes policy to help restrain wage settlements and price increases in the past of big business and big labor.

At the same time, the administration has been strongly opposed to any kind of income policy. We have oversight over the income policy such as it is. The Committee on Wage-Price Stabilization is under the oversight of this committee.

As a member, a present member, of the administration and a potential member of the Board, can you tell us how you feel on this issue of income policy?

Mr. GARDNER. I have great concern of income policy if it means the kind of an experience or something similar to what we have been

through before. I guess you can perceive, Mr. Chairman, that I have been interested in supporting the free market, the free economy.

I think our problems with mandated wage-price controls were very visible. And I would be one for continuing emphasis on the private sector to develop an appropriate offset to raising wages and prices through competitive means wherever possible and through perhaps Government intervention as always to assure that we do have a free competitive market.

The CHAIRMAN. Well, I think that there is something to the position taken by Chairman Burns on this. As you know, he is a conservative economist and believes very strongly in our free enterprise system, but just yesterday, the New York Times reported the Dun & Bradstreet survey of 1,471 corporate executives. It was a fascinating result.

They showed that contrary to their views in the first three quarters of 1975, in the last quarter, 59 percent, more than half, almost 60 percent, predicted price increases.

Now, this is at a time when we still have very heavy unemployment, when these corporations are operating well below capacity. And obviously, the fiscal policy, monetary policy, restraint, isn't the answer.

At least, it is not the answer as far as their own price increases are concerned because they are not pressing against capacity. No shortages. Yet, they are predicting price increases.

This is why it seems to me that the Burns' argument for some kind of income policy, some kind of pressure to hold down those prices and wages, because this is a big year for wage negotiations, as you know, it seems to me to be logical and timely.

Mr. GARDNER. I have thought, Mr. Chairman, that we haven't yet solved our basic underlying economic problems insofar as they relate to energy, petroleum, as a major energy source, and environmental constraints which we are all for, and a much number are against for preserving our environment.

I think when you get 50 percent of the businessmen predicting higher prices, a good deal of this stems from the fact that we have had a quadrupling in energy costs; that the businessman and certainly the manufacturer faces extraordinary costs to cleanse his plant and his environment and his product to meet new and——

The CHAIRMAN. If I can just interrupt, that was in the last quarter of the most recent period. That is the last quarter of 1975; the first three quarters, that wasn't their view.

If there has been any indication, it is that prices are unlikely to go up at least for the next year or so—energy prices—on the basis of the bill we passed. Bad as that bill was in the view of many people, it would tend to hold down energy prices over the next year.

Mr. GARDNER. Well, you discovered my point of view is simply there are some underlying basic causes for price increases that are really technical in nature. And I am amazed that this innovative dynamic economy hasn't done more with all of the energy sources and cheaper means of environmental protection. I think it will.

The CHAIRMAN. Well, finally, I come to the point that Senator Garn raised, and I have a different view than he has as he well knows and you might expect.

He is right about your being an independent agency, independent of the executive. I keep stressing this over and over again. But that, I understand, is not an independence of the Congress. Maybe it should be. Maybe in some perfect system, we could find a responsible way of having unelected officials have public power.

The money power is given squarely and clearly to the Congress. And as Dr. Burns has admitted, the Federal Reserve Board is a creature of the Congress. And I mean the creature.

Mr. GARDNER. It does what the Congress says it can do.

The CHAIRMAN. If the Congress can ever make up its mind and have a clear directive.

Dr. Burns fought tooth and nail against having to come up with specific monetary goals, but he accepted that when we passed a resolution as something he had to do. He accepted it, I think, in very good grace and has cooperated very well.

I want to make sure I understand your position when you say the Federal Reserve Board is an independent agency. You are talking about independent of the executive, not independent of the Congress?

Mr. GARDNER. Yes, sir. I have been here only a year and a half, and I know it is very difficult to be independent of Congress. I am serious.

The CHAIRMAN. I agree with much of what Senator Garn said. Certainly, the Federal Reserve Board is more expert than we are. We don't have anything like your competence. And I think it would be a mistake for us to try to dictate the level of interest rates. But we may be close to doing that.

I don't know if you had a chance to follow some of the debate among the Presidential candidates, especially on the Democratic side, but there is almost a universal cry to put the Fed under the thumb of the President; have the Fed appointed for 4-year terms or relatively short terms; have the Chairman of the Fed's term coincide with that of the President; have the President in effect be a moving force in determining monetary policy.

It seems to me that would take a constitutional amendment to make that constitutional. But at any rate, there is a great deal of support for that position. I regret to say much of it in my party.

It is not my position. I think it is a mistake. But at the same time, I think we have to recognize the Congress has that responsibility. There is no way we can cop out under present law and the Constitution this is ours and it is up to us if we can decide to give you a directive that you must follow.

Is that your view?

Mr. GARDNER. Yes, sir. The Federal Reserve has been given many mandates by the Congress in the regulatory areas and the like. The act stems from the Congress, no question about that.

Senator GARN. Will the Senator yield?

The CHAIRMAN. Yes.

Senator GARN. I understand that, too. And I am sure you know that I do.

My point is that when you get to the point of directing and politically making specific monetary targets, to me, the evidence is clear there is no doubt where Congress' responsibility lies. But when they have such an unbelievably complete failure in handling fiscal policy,

my point is you don't give the burglar the monetary policy, too, and let him botch up both of them.

The CHAIRMAN. I think we have worked out a pretty good system now. The Federal Reserve Board comes before us once a year and tells us what their monetary goals will be. And then, that is subject to debate, discussion, and I presume modification if we want to take some kind of an action.

We didn't this year; I don't think we will normally in the future. I hope not. But at least, we then know what it is, and business is reassured they have some indication of what monetary policy will be. And it is possible to debate it and discuss it and have a better understanding of it.

Mr. GARDNER. Yes, sir.

The CHAIRMAN. Well, Mr. Gardner, thank you very much. You are obviously very well qualified for this position. And as far as I know, there is no opposition to your confirmation.

You have been a most responsive witness; we appreciate it.

The committee will stand in recess.

[Whereupon, at 11:20 a.m., the committee was adjourned.]

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