NOMINATIONS OF RAOUL LORD CARROLL AND LAWRENCE B. LINDSEY

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON THE

NOMINATIONS OF RAOUL LORD CARROLL, OF THE DISTRICT OF COLUMBIA, TO BE PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

AND

LAWRENCE LINDSEY, OF VIRGINIA, TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE UNEXPIRED TERM OF 14 YEARS FROM FEBRUARY 1, 1986, VICE MANUEL H. JOHNSON, RESIGNED

APRIL 22, AND MAY 7, 1991

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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* Deceased April 4, 1991.

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TUESDAY, MAY 7, 1991

NOMINATION OF RAOUL LORD CARROLL, OF THE DISTRICT OF COLUMBIA, TO BE PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

MONDAY, APRIL 22, 1991

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

The committee met at 10:10 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome all in attendance this morning. We are pleased to have a Presidential nominee present whom I will shortly comment on.

He is accompanied by the Secretary of Veterans Affairs, Edward Derwinski. We are also pleased to have him here today—and I will say just a bit more about that in a moment.

We are here this morning to consider the nomination of Raoul Carroll to be the President of the Government National Mortgage Association, more commonly known as GNMA.

Mr. Carroll, I want to welcome you before the committee and publicly congratulate you on your nomination.

GNMA is perhaps best known for its mortgage-backed securities, the MBS Program, which increases the availability of mortgage credit for federally insured mortgages by attracting new sources of capital to the mortgage market.

Through this process, GNMA's mortgage-backed securities serve to increase the availability of credit for housing in all areas of the country, and to assure that such credit is available at reasonable interest rates.

The net effect is greater home ownership opportunities for a broad range of American families.

Given the alarming declines we have seen in our Nation's home ownership rates during the last few years, the role of GNMA in fostering home ownership is more critical than ever. Yet, we must also be very mindful of GNMA's fiscal stability as it seeks to fulfill its mission in fostering the American dream of home ownership.

So clearly there are important tasks ahead and, Mr. Carroll, you bring a diversified array of legal expertise to this challenge and I look forward to hearing your personal statement this morning, and also discussing with you some of the issues that face GNMA.

At this point, let me acknowledge the presence of a member of President Bush's Cabinet, and a former House colleague and a good friend, Ed Derwinski, who is here with you today.

We are very pleased to have you, Mr. Secretary, to come and be present at this hearing. I think it shows importantly your feeling about this nominee.

Why don't you pull that microphone over and we would be delighted to hear your statement at this time.

STATEMENT OF ED DERWINSKI, SECRETARY, DEPARTMENT OF VETERANS AFFAIRS, WASHINGTON, DC

Secretary DERWINSKI. Thank you, Mr. Chairman, I will be brief.

I am here with mixed emotions, since GNMA's gain is the VA's loss. Mr. Carroll has been a very effective General Counsel for us and has served with special distinction in the time we were formulating policies in the newly created Department.

He has been a very, very strong supporter of reforms that we have embarked upon, and he has been a tower of strength and a strong right arm to me.

At the same time, I realize that this assignment for which you are considering him is a very challenging assignment. His legal background is especially suited for it, and therefore it is with this sort of mixed feeling of losing a very key ally, but yet at the same time with the satisfaction of knowing he is going on to greater heights that I am very pleased to commend him to you in his professional capacity as an outstanding gentleman, dedicated public servant, and a very, very effective public official.

Mr. Chairman, I am pleased in that spirit to recommend Mr. Carroll to you and the members of your committee.

The CHAIRMAN. I appreciate your statement, as the committee does. I have known you now for 25 years, and I know when you come and make a personal statement of that kind it signifies how strongly you feel about this nominee. That has important weight with me, and it does with this committee.

I appreciate those comments, and I appreciate the time that you have taken to come and present them.

Secretary DERWINSKI. Thank you.

The CHAIRMAN. I am going to go to Mr. Carroll.

I want to allow you to excuse yourself and get on to other tasks.

Mr. Carroll, let me now ask you to stand and let me administer the oath.

[Raoul Carroll duly sworn.]

The CHAIRMAN. Let me again welcome you. I have had the opportunity to meet your lovely wife and your sister who are here with you today, so maybe you would like to just introduce them to the room so we will have it as part of the record that they were present, and anybody else who may be accompanying you who you would like to introduce this morning.

TESTIMONY OF RAOUL LORD CARROLL OF THE DISTRICT OF COLUMBIA, TO BE PRESIDENT, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Mr. CARROLL. Thank you, Mr. Chairman.

I would like to introduce my wife, Elizabeth Carroll who is with me today, and my sister, V'nell Carroll, who is also with me today. Other people in the room include many of my staff from the Office of General Counsel of the Department of Veterans Affairs, and many of the officials with whom I will be working, hopefully, in the very near future at GNMA.

Thank you.

The CHAIRMAN. Thank you.

We are very pleased to have your family and the other guests who accompany you today. Let me now invite you, Mr. Carroll, to make whatever opening personal comments that you would like to make.

Then, when you conclude that, we will get into a discussion.

Mr. CARROLL. Again, good morning. Mr. Chairman, first of all I would like to thank Secretary Derwinski, a truly distinguished American, for introducing me.

During the past year, I have learned many things from the Secretary, but most important I believe—and you well know this about him—is that he can manage in a truly dynamic environment with both toughness and a sense of humor. These are two skills I hope to bring, if confirmed, to the Office of the Presidency of GNMA.

I will also greatly miss the people at the Department of Veterans Affairs. I have had a very enjoyable and rewarding experience with them.

Mr. Chairman, it is a privilege for me to appear before you today as President Bush's nominee to be the President of the Government National Mortgage Association, also known as "GNMA."

I am honored by the confidence President Bush and Secretary Kemp have shown in me by selecting me for this position.

I will strive to fulfill that responsibility in a manner that upholds the very highest standards of public service.

To be confirmed to this position would result in the realization of one of my highest professional goals. For almost a decade, as you know, Mr. Chairman, my professional life has been substantially devoted to helping low- and moderate-income Americans realize their dream of having a comfortable and safe home in which to raise a family.

As President of GNMA, I believe I would be serving in one of the most important agencies responsible for facilitating that dream.

The FHA insurance and VA guarantee programs are crucial vehicles which provide needed assistance to enable families to buy homes. GNMA, in turn, through its network of private issuers assures that the mortgage money will be available for deserving families when they are ready to buy.

GNMA's facilitation of the flow of private capital to mortgage lenders is the crucial link in the chain toward the realization of the American dream of home ownership.

I am excited about the opportunity to join Secretary Kemp and his very distinguished staff at HUD in working to achieve the administration's goal of expanding affordable housing and home ownership opportunities for all Americans.

I am particularly pleased about assuming the leadership of GNMA because of its fine reputation as one of the true Government success stories. The professional staff at GNMA is extremely well regarded by virtually everyone who has worked with them.

Already, several past Presidents of GNMA have contacted me to offer their congratulations, and each has commented on the quality of the staff.

I look forward to working with such dedicated men and women in the very near future.

Under former President Arthur Hill's direction, GNMA was made stronger through the implementation of numerous reforms that helped lead to increased profitability from $54 million in fiscal year 1989 to over $385 million in fiscal year 1990.

I intend to build on these successes by exploring new ways to improve GNMA's internal controls and enhancing its profitability; and, by continuing to make the agency more efficient, effective, and responsive in meeting the concerns of the industry and the needs of America's mortgage borrowers.

In particular, I am interested in continuing the development of GNMA's risk analysis systems, and in the establishment of efficient asset disposition policies.

I also look forward to building on and improving the working relationships between GNMA and its sister Federal agencies, including the FHA, the VA, and the RTC, as well as Government-sponsored enterprises Fannie Mae and Freddie Mac.

Over the past two decades, GNMA has served a vital role in making home ownership an affordable reality for nearly 13 million American families. In successfully carrying out this role, GNMA has helped eliminate regional differences in the availability of credit and reduced mortgage interest rates for millions of low- and moderate-income families who might not otherwise have been able to afford a home.

I look forward again to working with Secretary Kemp and with the members of this committee in exploring new ways to enhance GNMA's ability to carry out its vital mission.

Mr. Chairman, at this time, I will be happy to answer any questions you may have.

Thank you very much.

The CHAIRMAN. Thank you very much.

I appreciate that statement, and your nomination as well. Before we begin, I have a statement from Senator Dixon to be inserted in the record.

STATEMENT BY SENATOR ALAN J. DIXON

Senator DIXON. Mr. Chairman, before us today is the nomination of Raoul Lord Carroll to be President of the Government National Mortgage [GNMA] Association at HUD.

The purpose of GNMA mortgage-backed securities is to attract nontraditional investors into the residential mortgage market. This is an extraordinary important program given the current need for the production of low- and moderate-income housing today.

As my colleagues know, I am also particularly concerned about mortgage discrimination. I suggested to Mr. Carroll that I will be calling on his good office to assist the Subcommittee on Consumer and Regulatory Affairs, which I chair, in its efforts to fight and eradicate this housing discrimination problem.

I look forward to Mr. Carroll's confirmation and working with him as President of GNMA in the near future.

Thank you, Mr. Chairman.

The CHAIRMAN. It crosses my mind that if I wanted to really get a thorough understanding of your background and history, I ought to probably call your sister up to the witness table, because I am sure she could tell me all the things I really need to know that otherwise I may not learn—although, I sense that if your sister is like mine, she would only tell all the good things.

Mr. CARROLL. She is very good about that, Mr. Chairman. [Laughter.]

The CHAIRMAN. I thought she might be. So we will not call her today, for that very reason.

But in looking at your personal background, I am struck in doing so by thinking that, with a lot of hard work, you have come a long way since driving that taxicab back in New York City in the early 1970's.

Mr. CARROLL. That is true. I have not had to work as hard since.

The CHAIRMAN. But it is interesting to see the different things you have done over a period of time to prepare yourself, and to develop yourself professionally to come forward today to be able to stand on the threshold of assuming these very important national responsibilities.

Of course you have been doing that as General Counsel at the Department of Veterans Affairs, but this I think is a new assignment of great importance to the country, and I think one that will test you in new ways.

So I want to say, as we start down through some of the points I want to discuss with you, that assuming your confirmation, which I do, I look forward to you doing a fine piece of work here and us having a good working relationship back and forth personally, and with respect to this committee.

Let me now cover some items that I want to develop with you. I want you to describe for me, if you would, your familiarity with GNMA's portfolio, and elaborate on any relevant portfolio management experience that you have had during your career.

Mr. CARROLL. Thank you, Mr. Chairman.

I am familiar that GNMA presently has within its portfolio approximately $16 billion worth of servicing rights. Most of that is related to single family housing. Some of it is also multifamily, as well as manufactured housing.

In my past background, I have not been involved in the management of mortgage servicing rights, but I have been involved for many years in the development of low- and moderate-income single family and multifamily housing, usually in my role as bond counsel, or underwriter's counsel representing housing authorities or underwriters in the production of low- and moderate-income housing.

The CHAIRMAN. So on the issue though of portfolio management, as such, that is going to be more or less a new area for you?

Mr. CARROLL. That would be a new area for me, Mr. Chairman. That is correct.

The CHAIRMAN. In your qualifications statement, you indicate that you regularly review the activities of GNMA, Fannie Mae, and Freddie, and GNMA programmatic guides for issuers and default experiences.

Again, I want to have it on the record. In what professional capacity did you have the occasion to focus on these issues?

Mr. CARROLL. On two occasions, Mr. Chairman, again beginning with my private sector experience as a bond counsel and underwriters' counsel; and more recently as the General Counsel of the Department of Veterans Affairs.

As you know, Mr. Chairman, within the Department of Veterans Affairs, we do have a relatively small, in comparison to GNMA, mortgage securitization program. It relates to what we call our vendee loans.

The Department of Veterans Affairs issues approximately $800 million worth of mortgage securities a year. That program has been very successful over the last year and a half since I and my staff have been working there.

We came into the Department with the intent, hopefully, of joining with the professional staff there to develop that program, which at the time was in its infancy, and not as efficient as we believed it could be.

In that context, it has been necessary to follow both what Fannie Mae has been doing, and what GNMA and Freddie Mac have been doing, and we have done that on a routine and regular basis.

The CHAIRMAN. You have also indicated in your qualifications statement that you have kept abreast of recent developments in credit reform as it relates to Government-sponsored enterprises.

Do you feel that GNMA, and Freddie Mac, and Fannie Mae should have the same regulator?

If so, why?

Mr. CARROLL. Mr. Chairman, I understand that certainly it is the view of OMB that they should all be treated alike. Prior to becoming a Government official, I would have felt that there would be some different treatment for GNMA which does not have the same standing, statutory or otherwise, as the Government-sponsored enterprises.

I certainly would like to confer with this committee and confer further with OMB to see if their views have not changed on that.

Quite candidly, however, my view is that GNMA should probably be treated differently and not regulated the same way as Fannie Mae and Freddie Mac.

GNMA is a Government agency. The other two are Government-sponsored enterprises.

The CHAIRMAN. I think it is important to note that, if confirmed, you do not work for OMB! You work independent of OMB. That is not to say that you do not talk, and that you do not reason and think about problems together, but your responsibilities are different and more broad than that, as I am sure you know.

So I think it is very important that whatever your professional view, whatever professional view you develop as time goes on, that you exhibit and hold the independence that your position requires.

Mr. CARROLL. I guarantee it, Mr. Chairman.

The CHAIRMAN. Otherwise, these jobs are not much worth having, if they do not have that, as I am sure you know. So I think in the spirit of working with others throughout the Government, you have an obligation to speak your own mind and set forward positions that you think are right. And sometimes people some place or another may not agree with it, but I view that as the essential obligation of your work.

I want you to know that we will stand behind your ability and latitude to speak your mind. I want to be sure that you feel comfortable—in fact, that you will do so.

Mr. CARROLL. Again, only by example, Mr. Chairman, I can point out that while I was at the Department of Veterans Affairs we had many discussions with OMB regarding the Department of Veterans Affairs' Mortgage Securitization Program.

I think it is fair to say that we moved them substantially in the direction of what we wanted to do within the Department, and I would expect to have the same success in my subsequent position.

The CHAIRMAN. Some individuals within the housing finance industry have asserted that there is no significant secondary market for low- and moderate-income multifamily mortgages.

Such individuals point to Freddie Mac's difficulty in its multifamily program, and the Department's own problems in subsequent termination of the coinsurance program as indications of this fact.

I am wondering, what is your view of this assertion? And what do you think the role of GNMA should be in the multifamily arena?

Mr. CARROLL. Mr. Chairman, I believe that, to the extent that GNMA's overall mission is to support and facilitate development of low- and moderate-income housing, including multifamily housing, GNMA ought to have a role. I am certainly not an expert in their present programs, but it would be my intention to explore that from the time of my arrival to see if there is not a way to increase our role in that area.

The CHAIRMAN. We have a real problem, as you know, in the country where housing is becoming more and more difficult for a large number of people. I view it as an urgent national issue.

When we see on television scenes of the Kurdish people, dispossessed and scrambling just to stay alive, it is just a heartbreaking scene. But we do not have to go there to find problems that are similar to that right here in our own communities, as you well know.

All across this country we have got families today that are struggling economically, some with two parents and some with one, but in many cases with small children trying to just put a roof over their head at night. And all of our homeless shelters are overflowing throughout the country.

It seems to me that within the bounds of what is feasible and most practical, we have got to find a way to broaden out the housing opportunities here. It is not a one-dimensional problem, obviously, it is a multidimensional problem.

A substantial part of it I think does relate to the question of whether or not we can find a way to facilitate an expansion of low- and moderate-income multifamily opportunities, and obviously the financing that goes with that.

So I would ask you, just personally, to really zero in on that because I think that, but for the grace of God, we could be in anybody else's shoes. We happen to be in our own shoes, and we are in stronger situations today than a lot of other people in our society who have not been as fortunate as we have.

So I would hope that in that area we could really see an impact. It is not easy, but if the view of the man or woman who is in the position at the top of the organization is that we are going to find a way to make a little progress in that area, usually it happens.

Let me ask you. How will HUD's new delegated processing program affect GNMA's business?

Mr. CARROLL. Mr. Chairman, that is not a subject area with which I am very familiar. So what I would like to do is respond to you in writing to that question, if I may.

The CHAIRMAN. Very good.

Let me ask you if you have any plans now as to how you would allocate resources to monitor and rvew GNMA's portfolio. I guess that is another way of saying, and asking whether the present systems and personnel are sufficient to accomplish that task.

Mr. CARROLL. Mr. Chairman, I believe that the present systems are very good indeed. I know that my predecessor has continued to look at ways to improve them. I will do likewise.

As far as staffing is concerned, I believe we have an excellent staff and they have the capability to do the job. Again, it is something that I will look at when I assume the position. But right now, I believe in both of those two areas GNMA is doing a pretty good job to a very good job.

The CHAIRMAN. I am wondering if you have any thoughts as to what criteria we should use from both a programmatic perspective and from a safety and soundness perspective to accurately measure the performance of GNMA over time?

Mr. CARROLL. Mr. Chairman, I think one of the things that we might look at, and certainly something that I will want to look at, is the level of default among our issuers.

GNMA does approve the issuers of its MBS's, and if we have a program which minimizes the default rate over a period of time, I think it is a very good way of measuring the effectiveness of GNMA.

Whether or not we can issue more MBS's in any given year certainly involves circumstances beyond just what goes on inside of GNMA. But if we can minimize the program's exposure to issuer default and maximize the flow of capital back to mortgage lenders so they can lend to low- and moderate-income Americans, then I think that is a very good way of measuring performance.

The CHAIRMAN. I have asked every other HUD nominee before this committee for their personal commitment that if at any time they see or sense any evidence of fraud, or abuse, or political favoritism of any kind, that they would take appropriate steps to deal with it and stop it.

I mean by that, not only just coming down as tough as nails on any situation like that that you catch wind of, but if there is a persistent problem I would expect to have it reported to this committee directly.

You will never be more than 2 minutes away from a phone, and I am very easy to reach if any problem like that arises. So I would like your personal assurance that if you see or sense anything like that, you will move on it immediately. And if it is a situation of sufficient gravity, that you will inform the committee of it.

Mr. CARROLL. You certainly have my assurances, Mr. Chairman.

The CHAIRMAN. I think that is very important. As I said, I put that question to everybody. So that question is not designed for you personally, but we have had enough problems going back over time, and some still up in the air as you know in some of the housing areas that are still unresolved.

So we want to leave that chapter behind us. So if anybody ever tries anything that raises a flag in your mind, I want you to be just about as blunt as I am sure you can be when you need to be.

Mr. CARROLL. I will, Mr. Chairman.

The CHAIRMAN. Very good.

We may have other questions to submit to you for the record from other colleagues.

Senator Garn wanted to be here this morning and was not able to do so.

He wanted me to express his regret for that. But other members of the committee, to the extent that they have questions, will forward those to you.

But I look forward to working with you and support your nomination, and I look forward to working with you.

Mr. CARROLL. Thank you very much, Mr. Chairman.

The CHAIRMAN. With that, the committee stands in recess.

[Whereupon, at 10:30 a.m., the committee was adjourned, subject to the call of the Chair.]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR RIEGLE FROM

Raoul Lord Carroll

U.S. Department of Housing and Urban Development
Washington, D.C. 20410-1000

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MAY 7 1991

OFFICE OF THE ASSISTANT SECRETARY FOR
LEGISLATION AND CONGRESSIONAL RELATIONS

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510-6075

Dear Mr. Chairman:

This responds to your April 23, 1991 letter in which you requested responses to questions posed by Committee Members as a follow-up to the April 22 hearing on Raoul L. Carroll's nomination to be the President of the Government National Mortgage Association.

Mr. Carroll's responses to the questions are enclosed along with his corrected copy of the hearing transcript.

If further information is needed, please contact Paul Ruppert of my staff at (202) 708-0005.

Very sincerely yours,

Ivan A. Ransopher
Assistant Secretary
(Acting)

Enclosures

Chairman Riegle
Questions for the Record

Q.1. How will the Department's delegated processing program impact GNMA's operations

A.1. GNMA does not anticipate any material or adverse impact on its operations as a result of the implementation of FHA's delegated processing program. GNMA currently provides, and has provided in the past, a means to securitize FHA-insured multifamily loans thereby returning capital to multifamily lenders and assisting in providing adequate housing for low- and moderate-income families. GNMA will be able to provide for the securitization of this fully-insured program as the loans are originated and available for securitization.

GNMA, unlike many other federal loan programs, does not, and estimates show that GNMA will not, require any subsidy in order to meet its loan guaranty obligations. Moreover, GNMA is at the forefront of federal programs in estimating and managing credit risk. GNMA has developed extensive computer systems which will allow it to better understand the credit risk inherent in its program. In addition, as part of the annual audit of its financial statements by an independent accounting firm, GNMA reviews the estimates of future loss. Through these steps, GNMA already quantifies its credit risk on an annual basis, accomplishing one of the main goals of credit reform. GNMA's implementation of the rigid reporting requirements of credit reform would, therefore, generate little additional information to assist in the assessment of the credit cost of Federal programs.

Implementation of credit reform as currently contemplated, would, however, have a significant impact on the operations of GNMA. A completely duplicative and complicated general ledger system would have to be established, major computer systems would be revised and up to ten additional staff persons (over the 69 currently employed) would be needed to meet credit reform reporting obligations. In addition, credit reform may result in the application of additional burdensome requirements on private sector issuers of GNMA securities and additionally encumber the efficiency of operations of federal loan programs.

GNMA has begun planning to implement credit reform. Nonetheless, as a program which traditionally has required no federal subsidy and which has traditionally earned revenue in excess of its expenses on an accounting basis, would seem to fall outside the scope of programs and costs intended to be addressed by credit reform.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SASSER FROM

Raoul Lord Carroll

Q.1. With the decline in interest rates, there may be an opportunity to refinance the mortgages on many of the defaulted properties serviced by GNMA and/or assigned to FHA as a result of the defaults of several coinsuring lenders. Some have advocated that HUD could save significant sums of money if GNMA would participate in a process to reinstate the defaulted mortgages. Are budgetary savings achievable? Would GNMA facilitate in such a program?

A.1. The Government National Mortgage Association ("GNMA") currently holds a number of mortgages for which refinancing is a viable alternative. GNMA is actively participating with the Federal Housing Administration ("FHA") in an effort to reinstate defaulted, formerly coinsured multifamily loans. To date, these efforts have involved a form of refinancing which allows for the reduction of a project's debt service payments by substituting low floating-rate, tax-exempt bonds for fixed-rate tax exempt bonds. To date, GNMA has been able to utilize these procedures to refinance successfully approximately $110,000,000 of defaulted loans. These refinancings have reduced the expense of carrying the loans.

However, there are many mortgages in the GNMA portfolio of assets acquired as a result of issuer defaults which are incapable of being successfully refinanced. Many of these loans are delinquent or were over-mortgaged by the initial coinsuring lenders to the point where there is virtually no chance of the loan ever becoming current, even if refinanced at a lower interest rate utilizing the most creative refinancing techniques available.

Once a mortgage has been converted to full insurance (under the coinsurance program regulations) and assigned to the FHA, the mortgage is no longer under GNMA's control. We understand that the FHA intends to deal appropriately with refinancing requests for those loans.

GNMA is committed to working with the FHA to reduce the overall Departmental loss caused by the coinsurance program through refinancing when appropriate.

Q.2. The Omnibus Budget and Reconciliation Act of 1990 created a new system of budget accounting for Federal Credit programs. How will "credit reform" change the operations of Ginnie Mae? What problems are anticipated in the implementation of credit reform?

A.2. GNMA has begun planning to implement credit reform. Early analysis indicates that, at a minimum, implementation of credit reform will require:

-- Creation and maintenance of a separate general ledger and treasury system to track pre- and post-credit reform activity, allocating revenue and expenses first between pre- and post-credit reform activities. The system will then require allocation of post-credit reform revenues and expenses between each of up to 30 separate annual components (matching the life of a GNMA security);

-- Revision of all pool submission documents, related processing procedures and computer systems to allow for tracking of loan pools by year of issuance;

-- Creation and revision of multiple internal computer systems to allow for tracking of information on a year-by-year basis; and

-- Revision of all master subservicer and contractor accounting systems to provide for reporting by contractors and master subservicers in the appropriate pre- and post-credit reform components.

GNMA estimates that the above changes could result in the expenditure of up to $10 million in systems revision costs and the dedication of additional staff resources to develop and implement the accounting systems described above. GNMA estimates that credit reform implementation would result in the addition of up to ten additional staff persons (over the 69 currently employed) to handle the increased administrative burdens of credit reform.

Q.3. Coopers and Lybrand is performing a comprehensive review of GNMA's programs. What are the parameters of this study and what are some of the initial findings? When will this study be available to the Congress?

A.3. The question refers most likely to a Coopers and Lybrand study the scope of which is limited to analyzing the adequacy of GNMA's current single-family program guaranty fee. The guaranty fee, which is determined by statute, is paid to GNMA by the issuer on a monthly basis and is calculated upon the amount of the remaining principal balance of the mortgages underlying the GNMA-guaranteed security. GNMA feels this study is extremely important to GNMA's efforts to ensure that adequate funds are reserved to properly account for any potential losses that might occur as GNMA performs its vital function of providing liquidity in the secondary mortgage market for government guaranteed or insured mortgages.

The current schedule calls for the delivery of the final version of the guaranty fee study by July 1, 1991.

Q.4. What have been the total unrecovered losses and increased administrative costs to GNMA from: A) VA No-bid loans; B) Coinsured Lenders; and C) mobile home defaults?

A.4. GNMA has incurred direct losses as set forth below:

A) VA No-bid loans:

1) Losses from VA No-bid loans erode the capital of GNMA issuers and thereby increase the risk of default of GNMA issuers. VA No-bids have been a primary factor contributing to issuer defaults that otherwise would not have occurred and are directly related to GNMA's recording (since the beginning of Fiscal Year 1987) of $354 million in liabilities for estimated future losses in creating a reserve for losses in the single-family program. GNMA has already realized $110 million of these estimated losses to date.

2) GNMA's subservicers estimate that GNMA has incurred direct, out-of-pocket VA No-bid losses of approximately $6,000,000 between October 1990 (when GNMA began tracking No-bid losses separately) and February 1991 on loans currently held by GNMA. These losses are based upon an average VA No-bid loss of approximately $20,000 per No-bid loan, which is consistent with the industry average.

B) Coinsured lenders:

GNMA began experiencing significant defaults by coinsuring lenders in February 1989. Direct expenses from the default of coinsuring lenders between February 1989 to February 1991 were approximately $10.5 million.

C) Mobile home defaults:

Direct expenses from the default of mobile home issuers between February 1986 to February 1991 were approximately $423 million.

The only administrative expense directly linked to issuer defaults is the expense of subservicing the acquired portfolios. Because this expense is paid on a per-loan basis, subservicing expense increases as the size of the portfolio serviced by GNMA increases as a result of issuer defaults. The increase between FY 1989 and FY 1990 was approximately $600,000 and would have been higher if significant cost savings had not been achieved through the implementation of master subservicing contracts.

Other administrative expenses, such as additional staff and computer resources are more difficult to quantify but also increase directly with the size of the acquired portfolio.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Carroll (LAST) • Raoul (FIRST) Lord (OTHER)

Position to which nominated: President, Government National Mortgage Association, Dept. of H.U.D.

Date of nomination: March 13, 1991

Date of birth: 16 (DAY) March (MONTH) 1950 (YEAR)

Place of birth: Washington, D.C.

Marital status: Married

Full name of spouse: Elizabeth J. Carroll

Name and ages of children: Alexandria (9)

Christina (3)

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Morgan State College	1968-72	B.S.	May, 1972
St. John's University School of Law	1972-75	J.D.	June, 1975
George Washington Univ.	9/78-1/79	N/A	N/A
Georgetown University Law Center	9/80-6/81	N/A	N/A

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Joint Service Commendation Medal, Who's Who Among Black Americans

Army Commendation Medal, Who's Who in Politics

ROTC Scholarship, Outstanding Service Award, ACIL

Trustee Scholarship (College), Outstanding Young Man in America

St. John's Law School Scholarship, President, Martin D. Jenkins Emeritus Award

Who's Who in American Law, Distinguished Military Graduate ROTC

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
American Center for Int'l Leadership, Baltimore, MD	Chairman (1988-89)	1985-Present
Nat'l Association of Securities Professionals	N/A	1986-88
Nat'l Association of Bond Lawyers	N/A	1985-89
D.C. Bar Association	N/A	1979-Present
New York State Bar	N/A	1976-Present
D.C. Black Assistant U.S. Attorney Association	President	1981-83
Omega Psi Phi Fraternity	Chapter Basileus 1970-71	1970-Present (Inactive)

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

General Counsel; U.S. Dept. of Veterans Affairs, Wash. D.C.
October 1989-Present

Partner, Bishop, Cook, Purcell & Reynolds, Wash. D.C.
October 1986-Sept. 1989

Partner, Hart, Carroll & Chavers, Wash. D.C.
October 1981-Sept. 1986

Associate Member, Board of Veterans Appeals, Wash. D.C.
October 1980-Sept. 1981

Assistant U.S. Attorney, Dept. of Justice, Wash. D.C.
Sept. 1979-Oct. 1980

Officer, U.S. Army, Dept. of the Army,
May, 1972-Sept. 1979

Taxi Driver, Chad Operating Corp., New York, N.Y.
April 1973-April 1974

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

General Counsel, U.S. Dept. of Veterans Affairs, Wash. D.C. 10/89-Present

Private Counsel, D.C. Housing Finance Agency
Wash., D.C. 1983-89

Private Counsel, Harrisburg, PA School District, 1985

Associate Member, Board of Veterans Appeals
Wash. D.C., 10/80-9/81

Assistant U.S. Attorney, Dept. of Justice, Wash. D.C.
9/79-10/80

Director, D.C. Local Development Corp., Wash. D.C.
1987-89

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

"Effectively Using Offers of Proof," The Advocate, Vol. 10, No. 2

"After the Dust Settles" (Collateral Remedies Outside The Military Justice System), The Advocate, Vol. 10, No. 5

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Volunteer Surrogate Speaker, Bush/Quayle '88

Republican Eagle 1988

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

$5,000; April 1989; Republican National Committee, Wash., D.C.

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

(See Attachment "A").

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

   Yes - By Resignation Effective on Confirmation Date

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

   No

3. Has anybody made you a commitment to a job after you leave government?

   No

4. Do you expect to serve the full term for which you have been appointed?

   Yes

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

N/A

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

There is a pending civil suit, Vermont Investment Limited Partnership vs. Christopher A. Hart, et al., Civil Action No. 90-2126, Superior Ct. of the District of Columbia. The claim is for breach of lease terms. All claims have been denied. Plaintiff's claims, if valid, arose after I withdrew from the firm. I am a named defendant because I was an officer in the professional corporation at the time the lease was signed.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

Attachment A

Qualifications

For approximately 10 years, I have been involved in the financing and development of housing for low and moderate income citizens. Many years were spent in private law practice serving as Bond Counsel or Underwriter's Counsel for tax-exempt bond offerings to support the construction or renovation of multi-family housing projects insured or co-insured by FHA. Most of these projects were developed in Washington, D.C. In addition, I also served as Bond Counsel on single family tax-exempt offerings issued to provide mortgage money to low and moderate income purchasers of private residences. Over the years, I have been involved in a dozen or more bond issues all related to the development of low and moderate income housing.

With the development of my tax-exempt housing finance practice, I also became generally familiar with capital market activities related to mortgage finance. During this period, I have regularly reviewed the activities of GINNIE MAE, FANNIE MAE and FREDDIE MAC. More particularly, I routinely review the programmatic guides for GINNIE MAE issuers and monitor the institutions qualified by HUD as issuers and those which default on their obligations to GINNIE MAE. Importantly, I have kept abreast of the recent developments on credit reform, particularly as related to government sponsored enterprises, even though such discussions may not be directly relevant to GINNIE MAE.

Over the years, I have been regularly briefed on the pricing of U.S. GINNIE MAE securities and their relation to the pricing of Treasury debt. In addition, I worked extensively with one client on structuring a private label collateralized mortgage obligation bond issue backed by GINNIE MAES. Though the issue was never sold, I learned a great deal about the development of the CMO/REMIC market and how the transactions were structured. As the committee is well aware, many of these issues were collateralized with GINNIE MAE securities.

Finally, while serving as General Counsel of the Department of Veterans Affairs, I have played a substantial role in the development of the Department's securitized mortgage sale program (referred to as "vendee loan sales" within the Department). Upon my arrival the Department was raising a little more than fifty cents ($.50) in up-front cash per one dollar ($1.00) of assets sold, using a senior/subordinate structure with VA retaining the subordinates. Eighteen months later, we have a program which routinely raises over ninety-five cents ($.95) per one dollar ($1.00) of assets sold. Expenses have been trimmed substantially during the same period. The VA now sells approximately Eight Hundred Million Dollars ($800,000,000) of mortgage backed REMIC securities a year to a very receptive market with a full VA guaranty on the underlying loans. We are still working on further refining the product. It should be noted that these changes have taken place without increasing the government's risk and, therefore, the program has retained the support of Congress and relevant executive department officials.

As a result of my substantial experience with housing production, mortgage finance, mortgage securitization and the capital markets, I believe I am exceptionally well suited to assume the presidency of GINNIE MAE. In closing, I should further note that my experiences with the agency have caused me to have a very high regard for the staff, and I know that it is well regarded by all the constituent groups that work with the people there on a regular basis. I, too, look forward to working with the many fine professionals at GINNIE MAE.

NOMINATION OF LAWRENCE LINDSEY, OF VIRGINIA, TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE

TUESDAY, MAY 7, 1991

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

The committee met at 2:40 p.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order. Let me welcome all those in attendance this afternoon. We're a little late in starting due to the fact that we were anticipating a vote on the Senate floor at exactly 2:30 and, as is often the case, that time got moved. And, as well, downstairs in the Finance Committee, where I serve as a member, we are having a hearing this afternoon on the proposed United States-Mexican Free Trade Agreement. Carla Hills and the Labor Secretary and the Director of the Environmental Protection Agency are all downstairs testifying, and that has also required my attendance.

I'm told that Senator Warner is coming for the purpose of introduction. And, we'll call on Senator Warner when he arrives.

This afternoon's hearing is on the nomination of Lawrence Lindsey to the Federal Reserve Board for the remainder of a term ending in the year 2000. Mr. Lindsey is an economist on leave from Harvard University who has served as Senior Staff Economist at the Council of Economic Advisers, and most recently as Special Assistant to the President for Policy Development.

The fact that this is an extremely important position in our Government is very much apparent at the present time because of the economic recession that we're dealing with and the hardship that we're seeing throughout the economy. We just saw a reduction in the discount rate recently as an effort to try to bring interest rates down generally and put some additional strength into the economy, and we'll see the effect that has as the weeks go by.

A new appointee to the Fed will immediately have an opportunity and a responsibility to try to reverse the difficulties that we see today in the economy. The task is in large measure that of attempting to try to bring about an economic expansion, while at the same time restraining inflation. We'll be interested in learning today more about Mr. Lindsey's views on monetary policy generally and also in some more detailed respect to his views on the state of the economy: where we are and where we might be going.

In addition, the Federal Reserve has substantial bank and financial market regulatory responsibilities. There are several recent proposals, including the administration's, that would make major changes in the Fed's regulatory role. In his current position, Mr. Lindsey was the White House chief's participant in the development of the administration's banking reform proposal. The Fed and others have proposed some of the key provisions in that proposal, including those dealing with the mechanism for providing funding to the FDIC with the bank regulatory design, and with the merging of banking in commerce. So, we will want to hear Mr. Lindsey's views today on those issues and other issues that are raised by the administration's proposal.

Also, Mr. Lindsey's professional work is focused on analysis of the effects of tax changes. He's written a provocative book in which he claims, for example, and I'm quoting:

> The Reagan tax cuts contributed only trivially to the booming deficits of the 1980's.

And in another quote:

> The Reagan boom was distinguished by an especially rapid growth in business investment.

And, another quote:

> The United States is once again the leader of the world economy.

I take some strong exception to these last comments, and they're a matter of concern to me, quite frankly, if those continue to be your views.

Let me ask for the sake of setting the stage for our discussion today if someone would go over and put the two charts up. The first chart shows net business investment as a percent of net national product. This chart shows as a percentage of net national product the amount of business investment in various time periods, the first one being 1952–61. And then it goes in 10-year time periods: 1962–71, 1972–81 and 1982–90. What one can clearly see in looking at this chart is that we were in the range of 3 percent to 4 percent in each of those first three decades. But, in the 1982–90 period, we see a very measurable drop in terms of that historical performance, dropping down to something just slightly over 2 percent.

That would strike me as a measure of the fact that net business investment, rather than booming, was, in fact, retreating relative to what we had seen in earlier periods.

Let me ask that the other chart be put up now. This one also reflects a very serious erosion in the U.S. financial position, in my view. And this is a chart that shows America's slide out of the creditor nation status in the mid-1980's, which is measured by that blue zone above a zero line, to the red area, which is the debtor nation indication, with the United States plunging down into an international debtor position in $100 billion increments, down through the end of 1990, where we were up in the range of nearly $700 billion, in terms of our net debtor position, and certainly headed for $1 trillion. Our trade deficit continues at a very high level, even now, which will continue to take us down over time.

At the same time, measures of comparison with how we're doing, say, vis-a-vis the Japanese, in terms of investments are also alarming. The latest data that I have indicates that they have been putting about 5 times the amount of investment in equity capital in their businesses as we were in the United States. Their capital investment rates are way above ours and other economies as well.

I don't want us to kid ourselves about the nature of where America is today and whether or not it is really performing in an exceptionally positive fashion compared with the rest of the world, or whether we've got some very serious problems.

If I thought that you were convinced that things were just terrific and that we're just riding a gigantic boom, I think I'd be convinced that you were the wrong person for the job. Now, I'm 1 vote and there are 99 others. But, I have the deepest and the most serious interest in what kind of economic trend lines we're riding into the future. And your views on that are very important to me.

So, when we get into that today, it's more than an academic exercise. I think it's the most important question to be asked in terms of the kinds of policy decisions and orientation that you would bring to this task.

With that, let me call on Senator Garn. And then, in a moment, I'll call on you to introduce members of your family and others that are here today.

Senator GARN. Thank you, Mr. Chairman.

Due to the lateness of the hour, I will not take the time of Dr. Lindsey to make an opening statement at this time.

The CHAIRMAN. Very good.

I also have a statement from Senator Moynihan on behalf of the nominee that he would like made a part of the record. And so I would ask that, without objection, it be made a part of the record.

[The complete prepared statement of Senator Moynihan follows:]

FROM THE OFFICE OF

Senator Daniel Patrick Moynihan

New York

STATEMENT OF SENATOR DANIEL PATRICK MOYNIHAN
ON THE NOMINATION OF LAWRENCE B. LINDSEY
FOR GOVERNOR OF THE FEDERAL RESERVE SYSTEM

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

May 7, 1991

I am pleased to commend Larry Lindsey to the attention of the Banking Committee on his nomination for Governor of the Federal Reserve System. I have known him for some six years and have both worked with him and sought his views on matters of public policy on numerous occasions. The breadth and depth of Dr. Lindsey's knowledge, his skills and abilities make him, in my estimation, an ideal candidate for the Board of Governors.

Dr. Lindsey and I share much in common. Larry is a former academic and Harvard professor. He too has chosen to leave the ivory towers behind for public service. We share the view that educating the nation's future policy makers is important, but we agree that serving the American people directly is the greatest contribution one can make.

Although we belong to different political parties, we abide by a common faith that sound public policy decisions must take precedence over partisan advantage. This fundamental principle of serving the public good is important for all of us who work in government, but it is essential for a Governor of the Federal Reserve System, an arm of government which was created to be independent of partisan politics in order to safeguard the stability of our monetary system.

Dr. Lindsey is a man of fine intellect, as I am sure many of you have already discovered. He is an economist, policy analyst and public administrator with considerable and proven skill. He has served in two Administrations with distinction. In each case, he has moved up quickly into positions of greater importance, influence and responsibility.

President Bush has made a fine choice in nominating Dr. Lindsey. I am sure that the committee will enjoy questioning him and learning more on his views as they consider his confirmation.

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I will also attempt to interrupt the proceeding at such time that Senator Warner comes because we want to have his comments.

Let me now ask you to stand and take the oath.

Do you swear that the testimony you are about to give is the truth, the whole truth and nothing but the truth, so help you, God?

Mr. LINDSEY. I do, Senator.

The CHAIRMAN. Do you agree to appear and testify before any duly constituted committee of the Senate?

Mr. LINDSEY. Yes, sir.

The CHAIRMAN. Very good.

Senator Warner has now come into the room. Let me invite you, Senator, to come on up to the table, and I know you have some introductory comments you wish to make.

Senator WARNER. I would just apologize. We had a vote scheduled for 2:30. I was there on the floor.

But, I think what I'll do is just submit this for the record and not delay the hearing. This is such an outstanding man, he doesn't need senatorial introduction.

You're on your own. [Laughter.]

[The complete prepared statement of Senator Warner follows:]

JOHN WARNER
VIRGINIA

COMMITTEES
ARMED SERVICES
SELECT COMMITTEE ON INTELLIGENCE
ENVIRONMENT AND PUBLIC WORKS
SPECIAL COMMITTEE ON AGING

John Warner

United States Senate

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235 FEDERAL BUILDING
180 WEST MAIN STREET
ABINGDON, VA 24210-0887
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DOMINION BANK BUILDING
213 S. JEFFERSON ST. SUITE 1003
ROANOKE, VA 24011-1714
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STATEMENT OF SENATOR JOHN WARNER

BEFORE THE SENATE BANKING COMMITTEE

ON THE NOMINATION OF

LAWRENCE B. LINDSEY

TO THE FEDERAL RESERVE BOARD

MAY 7, 1991

Mr. Chairman and members of the Committee, I am pleased to introduce Mr. Lawrence B. Lindsey, who has been nominated to be a governor of the Federal Reserve Board. It is my privilege to recommend Mr. Lindsey to the President.

Mr. Lindsey, a longtime resident of Virginia, has enjoyed a varied and extensive career. He is currently an Associate Director for Domestic Economic Policy in the Office of Policy Development at the White House. He has been there since 1989.

Mr. Lindsey's past experience is equally impressive. He served as an Executive Director for the President's Council on Competitiveness. He served as a senior staff economist for tax policy for the Council of Economic Advisors, and he taught economics as an Associate Professor at Harvard University.

Mr. Lindsey's educational background, as well as his honors and awards, speak well for his dedication to his profession. He received his undergraduate degree from Bowdoin College where he was Phi Beta Kappa and graduated Magna Cum Laude. He received his graduate degree and Ph.d in economics from Harvard

University. He was awarded the Outstanding Doctoral Dissertation Award, was a Citicorp/Wriston Fellow for Economic Research, and was elected to the National Tax Association's Federal Taxation and Finance Committee.

Mr. Lindsey has also enjoyed extensive international consulting experience. He has served in the Republic of Ireland, West Germany, Sweden and the United Kingdom. While abroad, he was involved in consortiums on tax reform, tax rate reduction and the role of personal tax rates and tax revenues.

Lastly, the nominee boasts an extremely impressive list of publications which is too extensive to present in its entirety. The list includes books, magazine, newspaper and journal articles as well as testimony presented before the House Ways and Means Committee.

Lawrence Lindsey will make a great contribution as a governor to the Federal Reserve Board, and I endorse his nomination.

Thank you Mr. Chairman and members of the Committee for your attention to this matter.

Mr. LINDSEY. Thank you, Senator.

The CHAIRMAN. You know, when Senator Warner was Secretary of the Navy, that's what he used to do, you know. He'd bring these young officers up to the deck and he'd say, "All right, now you steer this ship." And then——

[Laughter.]

The CHAIRMAN. Now, we do have a vote that's starting. We'll go for a short period of time here before we'll have to recess long enough to go and vote.

I know your wife is present. We'd like you to introduce her and any other members of your family that might be here, or anyone else that's accompanying you.

Mr. LINDSEY. Yes, Senator. My wife, Susan. I'm lucky enough to have her join me today.

Thank you very much.

The CHAIRMAN. Why don't you go ahead and begin any opening comments you wish to make. And then we'll see how far we get before we have to recess briefly for the vote.

Mr. LINDSEY. Thank you.

TESTIMONY OF LAWRENCE LINDSEY, OF VIRGINIA, TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE

Mr. LINDSEY. Chairman Riegle, members of the committee, it is a privilege to appear before you this afternoon as a nominee to serve on the Board of Governors of the Federal Reserve System.

President Bush has greatly honored me by asking me to serve in this capacity. If confirmed by the Senate, I'll devote all of my energy and ability to fulfill the trust that you and the President will have placed in me.

I'm most deeply grateful for the kind words of Senator Warner, who is from my home State of Virginia, for his confidence, and also for the generous support of Senator Moynihan, whom I've known and worked with for many years.

For a number of reasons, this is a particularly exciting and challenging time to be considered for the position of Federal Reserve Governor.

First, the economy is at a crucial point in the business cycle. Policy makers, particularly those with responsibility for monetary policy, face a challenging task. Concern about the health of the economy and especially for those individuals who are unemployed prompts one to favor policies that will accelerate economic growth.

At the same time, history has taught that excessive monetary ease leads to higher inflation as the economy recovers. Great care must be taken to strike the proper balance.

Careful thought and balanced action will also be needed as the Nation reforms and strengthens its financial services industry. The Federal Reserve will play a crucial role in that process in the years ahead as one of the principal regulatory organs of Government.

America needs financial market rules appropriate to our economic leadership position in the emerging global market of the 21st century. We also need consistent and equitable application of our regulations.

If confirmed as Governor, I shall seek to promote an appropriate regulatory environment which is both equitable and consistent.

The Federal Reserve is also an institution which is particularly well suited to the pursuit of long-term economic objectives. As a result, it has as one of its responsibilities the long-term mission of promoting price stability.

In the long run, there is no tradeoff between higher economic growth and lower inflation. Indeed, there is good reason to expect that price stability might produce a lower real after tax cost of equity capital to American business, thus, accelerating the process of economic growth.

The third challenge confronting the Federal Reserve in the coming decade is to gradually reduce the rate of inflation so the Nation may come to enjoy the long-term benefits of price stability.

Given these challenges, let me briefly comment on the contribution and insights that, if confirmed, I believe I can bring to the Board of Governors.

Although my professional career has been somewhat shorter than that of most nominees to the Fed, it has been wide ranging. I've been fortunate to have been exposed to and participate in the formation of economic policy in both the Bush and Reagan administrations, as well as conduct academic research and develop a university curriculum based on contemporary economic thought and policy.

My 3 years on the staff of the Council of Economic Advisers under Chairman Murray Weidmanbaum and Martin Feldstein and 2 years at the White House Office of Policy Development under Roger Porter have taught me valuable practical lessons in the possibilities and the limits of economic policy.

The key lesson is that policy involves the need to strike a balance between conflicting national objectives. This is especially true in matters dealing with financial markets.

As Special Assistant to the President for Policy Development, one of my responsibilities was to work with the Department of the Treasury in developing a comprehensive banking and financial services reform package.

In between periods of public service, I spent 4½ years on the Harvard University faculty involved in both research and key public policy issues and the development of comprehensive academic curriculum.

The latter included responsibility for managing the introductory economics program and the creation of a course on American economic policy.

Both courses place particular emphasis on the effects of monetary and fiscal policy.

My academic research has been published in leading economic journals, including the Journal of Finance, the Journal of Public Economics, as well as in research volumes sponsored by the American Enterprise Institute and the National Bureau of Economic Research.

I believe that having interspersed academic and practical economic policy experience has prepared me intellectually and temperamentally for the tasks which, if I am confirmed, lie ahead.

In my case, the idealistic tendencies of the academic ivory tower have been tempered by practical political experience.

Conversely, the harsher demands of political life have been softened by time for academic reflection.

I believe that this background will be helpful in the collegial, yet, policy and decision oriented environment of the Federal Reserve.

The Federal Reserve faces an ambitious and challenging agenda in the years ahead. Should the Senate confirm me, I believe that I can make a useful contribution to meeting those challenges.

I cannot promise this committee that my confirmation will solve our Nation's banking problems, and the recession, or usher in a new age of price stability.

But, I can and do pledge that, if I'm confirmed, the Nation and the Federal Reserve will have my unflinching commitment, time and energy devoted to addressing those tasks.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Very good.

We'll shortly be going, I think, to the second bells on this vote, so we'll just get started here. I've been going through your résumé here, which I looked at previously, and I see the experiences that you've cited, the time at Harvard, the time as a faculty research fellow, your time on the Council of Economic Advisers.

It appears to me that, essentially, the bulk of your background training would be in academic areas, as well as advisory positions in Government.

Would that be a fair statement? Or, what else?

Mr. LINDSEY. Yes, Senator, I believe that's accurate.

The CHAIRMAN. Now, I take it that you don't think the lack of any direct business experience is a handicap in terms of your ability to be able to bring that kind of perspective to bear here?

Mr. LINDSEY. Senator, I don't think so. I think I have, in my university time, had managerial experience. I'm used to working with staffs. I had 40 teachers and 1,000 kids I was responsible for. So, I understand the challenges of a manager, but you're right, I have not been in the private sector.

The CHAIRMAN. When you want to try to get a private sector assessment, and I'm sure you talk to any number of people and I'm sure you would have been talking with people from these different policy positions you've been in, who do you talk to on the manufacturing side? Who are some of the people that you rely on for advice and insight who would be some of the kinds of people that on some kind of a regular or periodic basis you would talk to just to take a reading on what's happening in the economy?

Mr. LINDSEY. Well, Senator, in my current position, I meet regularly with any number of representatives of business and industry who come through.

The CHAIRMAN. But, who do you seek out? Who do you pick up the phone and call when you want to get a reading as to what's going on out there with people who run business and, you know, are trying to make a go of it in the private sector?

Mr. LINDSEY. Well, I think that I would call academic economist friends of mine who have worked for business organizations. The conference board, for example.

I also have friends who are responsible, have been entrepreneurs, particularly in high-tech areas, in biotechnology.

And I find that I have no shortage of individuals who want to give me their advice. And I've learned that having a good ear is a very important part of my responsibilities.

So I do feel that I'm open to anyone who would express their views.

The CHAIRMAN. Let me put us into a recess here briefly. The second bells have rung and Senator Garn and I have to go over and vote. We'll be back just as soon as we can get here.

The committee stands in recess. [Recess.]

The committee will resume. I don't know exactly what our outlook is for additional votes, but we're going to stay here this afternoon until we've gone through these issues.

We are pleased to have been joined by Senator Sarbanes, and also Senator Dixon came by and left his statement, which we'll make a part of the record, without objection.

[The complete prepared statements of Senators Dixon and Sanford follow:]

MAY 7, 1991

STATEMENT OF SENATOR ALAN J. DIXON

SENATE BANKING COMMITTEE

NOMINATION HEARING ON LAWRENCE LINDSEY

MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS AFTERNOON AS THE SENATE BANKING COMMITTEE CONSIDERS THE NOMINATION OF LAWRENCE LINDSEY TO BE A GOVERNOR ON THE FEDERAL RESERVE BOARD.

I UNDERSTAND THAT MR. LINDSEY HAS WRITTEN A BOOK CALLED <u>THE GROWTH EXPERIMENT</u>. AND, I UNDERSTAND THAT THE BOOK ARGUES, IN EFFECT, THAT THE REAGAN SUPPLY-SIDE POLICIES WERE A BIG SUCCESS, A POSITION WITH WHICH MOST MAINSTREAM ECONOMISTS WOULD DISAGREE, I BELIEVE. THIS AFTERNOON, I HOPE WE WILL EXPLORE WHETHER OR NOT "GOVERNOR LINDSEY" WOULD TAKE A RIGIDLY IDEOLOGICAL AND EXCLUSIVELY SUPPLY-SIDE APPROACH TO ISSUES PUT BEFORE HIM AT THE FEDERAL RESERVE.

WOULD "GOVERNOR LINDSEY" ARGUE, FOR EXAMPLE, THAT THE MARKET-PLACE CREATES SUFFICIENT DISINCENTIVES AGAINST DISCRIMINATION AND OTHER CONSUMER CONCERNS THAT THE FED

NEED NOT WORRY ABOUT MORTGAGE DISCRIMINATION OR OTHER "CONSUMER ISSUES"? WOULD "GOVERNOR LINDSEY" BE CONCERNED ABOUT THE UNITED STATES MOVING IN 1981 FROM BEING THE WORLD'S LARGEST CREDITOR TO THE WORLD'S LARGEST DEBTOR IN 1989 -- A SHIFT OF $0.8 TRILLION IN NET FOREIGN INVESTMENT? WOULD "GOVERNOR LINDSEY" SHOW SUFFICIENT CONCERN FOR AVERAGE WORKING AMERICANS IN FORMING MONETARY POLICY?

THESE ARE CONCERNS OF MINE AND PROPER CONCERNS, I BELIEVE, OF THE FEDERAL RESERVE BOARD AND ITS GOVERNORS. I HOPE THAT THIS AFTERNOON'S HEARING WILL EXPLORE THESE AND RELATED BANKING POLICY MATTERS.

Terry Sanford

OPENING STATEMENT OF SENATOR TERRY SANFORD
HEARING ON THE NOMINATION OF LAWRENCE LINDSEY
TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE
FREDERAL RESERVE
MAY 7, 1991

Thank you, Mr. Chairman. I appreciate your calling for this hearing and look forward to hearing the views of Mr. Lindsey.

I must say at the outset, however, than I am quite troubled by a number of the things Mr. Lindsey has written, particularly in his recently published book, The Growth Experiment: How the New Tax Policy Is Transforming the U.S. Economy. From what I have read, this book clearly takes the view that the 1981 tax cuts were only a minimal cause of our tremendous budget deficit and that more of the same is what we need to build a better, stronger nation. I don't know of anything that could be further from the truth.

I am extremely concerned about placing someone on the Federal Reserve Board who takes the Reagan Administration's "don't worry, be happy" mentality to heart, while we have watched the rich get much richer, the poor get much poorer; our cities and states fall into fiscal crisis from being asked to shoulder an ever increasing array of problems that the federal government has dumped on them; and our federal bduget deficit grow to the point where it threatens the very solvency of the nation and the well being of every citizen in the country.

I am equally concerned about a mentality that simply says that Congress should cut out the so-called "waste, fraud and abuse" and that would solve all our problems. While I certainly agree that we need to cut out waste, fraud and abuse whenever and wherever we find them, I think it is naive at best to look to spending cuts to solve all our ills.

First of all, the budget, as Mr. Lindsey knows, starts with the President. If there is all of this clear waste in the budget that he suggests, then why has the President failed to send to the Congress a single budget in the last ten years that was balanced or even close to balanced? If it is so easy to find clear areas for cuts, then why has the President failed to make those cuts in his budget?

Moreover, even if we agree to massive cuts in spending, that won't solve our fundamental problem. We would cut all domestic discrectionary spending and get rid of the entire Federal government--from the federal prison workers, to air traffic controllers, to the Congress and the Administration, to all agency employees and we would not save enought money to pay the interest on the national debt, let alone start reducing its principal.

The real problem, I would suggest, is not that we've had a "tax and spend" philosphy. Rather, our real problem is that for the last ten years, the Administration has adopted a "borrow and spend" program that is much worse than any alleged tax spending program could be, because it carries with it tremendous interest costs. This year, interest on the national debt becomes the single largest item in our budget. It is destroying our country, eating away at the fabric of society, driving up the costs of capital for everyone in the nation and leading us down the road to ruin.

I am afraid we need someone at the Federal Reserve who is concerned abou the fiscal soundness of the nation, not someone who wants even more of what we have now--a borrow and borrow and borrow program.

I look forward to hearing Mr. Lindsey's remarks, but must say that at the beginning that I am very troubled by this nomination.

The CHAIRMAN. In the interest of time now, I want to just raise one item. And then I'm going to go to Senator Garn and go to Senator Sarbanes.

You should infer from my comments about some of the quotes that I took from your book and my own sense as to what happened in the 1980's and where we are now, that I think that economic assessment just doesn't make much sense.

Now, I know you probably have just as strongly a held view on the other side. But, I guess I would like to hear an explanation from you as to why, with the statistics that I've cited, huge structural deficits now in the Federal budget, a very substantial trade deficit—some improvement, but still very large, huge overhang of debt throughout the economy, serious recession on our hands, capital investment looking pretty anemic when you really compare it with other countries, how do I make a silk purse out of all of that rather perverse economic data and those trend lines, which I think are really quite adverse to our future?

Mr. LINDSEY. Senator, let me say that I share your concern about the level of savings and level of investment in America.

We can all agree that America would be better off if we had more. And I think that the tasks ahead at the Fed in the monetary sphere touch to some degree on that.

In looking at the 1980's, I think it's important to put them into the context of the challenge that we entered the 1980's with.

I suppose it's true with generations as well. Each generation makes forward steps, but the next generation inherits new problems that, although the previous generation had solved some problems, new problems emerge.

I think that, when one looks at the underlying inflation, unemployment tradeoff that we began the 1980's with, I think there was substantial improvement. I think we had a substantially improved functioning of our market economy as the decade went on.

In the long run, I think that is the great strength of the American economy and the one that will be most helpful in the decades ahead, as we enter a global marketplace.

But, I share your concern about getting the savings rate up. Absolutely.

The CHAIRMAN. Well, I remember when Ronald Reagan took over the Presidency and, if my memory is right and I think it is, he said that we'd have a balanced budget by 1984.

Well, 1984 came and went. And 1988 went by. And 1990 went by. And we're in 1991. And no one really yet sees out on the horizon a balanced budget.

Do you see one? I mean, are you willing to hang your professional hat on a date by which you think is we're going to have a balanced Federal budget?

Mr. LINDSEY. Well, it very much depends on our policy decisions. In the book that you cited, what I laid out was a scenario where, if we had average economic growth and 4-percent inflation, I charted the path of revenues, compared it to the chart of spending with an assumption about spending. And that was what we would be able to have with zero real spending growth. In other words, has spending keep pace with inflation. And then rise at 2 percent a year.

And, under that scenario, we were able to obtain budget surpluses by later in the decade, actually, by mid-decade.

Now, when the book was written, again, that's based on the assumptions. We have not restrained the growth of spending, as was suggested in the book. Nor have we attained the rate of economic growth, the average rate of economic growth, in recent years.

But, I do think that, over the long haul, given that revenues will rise faster than the economy, if we can simply restrain the rate of spending growth to the rate of inflation or, at most, to the rate of economic growth, the tax line will overtake the spending line.

The CHAIRMAN. As I understand it, what you had projected and thought might happen was less spending and greater growth, we didn't get the less spending. We got more than you anticipated.

And I would think that that ought to have driven the growth line up even higher on the theory that, if you add additional stimulus, you get more growth.

Now, maybe you would argue to the contrary, but what happened to the growth? Why did it fall short? [Pause.]

Mr. LINDSEY. The reason I pause is you're asking a very good question, one with many answers.

In part, I think we've seen a slowdown because we are at the end of a period of extended economic growth, what has turned out to be the longest peacetime expansion we've had in American history.

There were some signs late last year, during the year, that the economy was slowing down. I think that the Iraq-Kuwait crisis sent what was a slow growing economy into a negative growth situation. I think that the loss in consumer confidence had a tremendous amount to do with that.

So, again, there are many, many reasons explaining why the economy has slowed down. They include the normal business cycle type of reasons—the Iran-Iraq war, monetary policy.

It is important when you examine the deficits as well to consider the nature of the deficit and how much fiscal stimulus one would get from each particular kind of spending.

A number of commentators have noted, for example, that, in our effort to make sure that depositors in financial institutions get their money, it costs the Government money. But, it's not necessarily clear that you'll get a substantial fiscal stimulus from that. The individuals who are getting their money guaranteed think they have the money already, and so they don't feel any wealthier from that spending.

So, again, it's a very, very complicated picture with regard to the fiscal stimulus part of your question, as well.

The CHAIRMAN. Let me go to Senator Garn.

Senator GARN. If I may follow up on that specifically. Would you amplify your answer on how much impact you think that monetary policy had on the recession and the way the Fed has conducted monetary policy?

Mr. LINDSEY. Well, it's always difficult, Senator, to put a precise quantification on things until we get a lot more data. And, even then, it's somewhat doubtful.

I don't mean to use that as an evasion, however.

I think that in the latter part of last year, in retrospect, monetary policy was below what would be desirable.

I was not at the Fed at the time. I don't know what data the Governors and the other members of the FOMC had when they made those decisions, so I don't mean that as a criticism.

But, having the benefit of 20/20 hindsight, I think that monetary growth in the latter part of last year was far too slow. I think that, to a significant degree, that has been rectified.

Senator GARN. Well, I would agree with you. I would make the statement then, of the various Fed Chairmen that I've served with since I have been here and members of the Federal Reserve Board, that that is normally the practice.

I'm a little bit puzzled as to why the Fed doesn't seem to be bold enough to act—either way you're going, either tightening or loosening. It always seems they are waiting for a little more data and usually I think it's too much too soon or too little too late.

And I happen to think in this case that you don't have to. There are some times you don't have to examine all that data. You don't have to have a Ph.D. from Harvard or any place else just to have that gut feeling, the general thing, that, hey, we're getting into this. And while inflation is a worry, it's certainly not what it was in the past. We ought to be pumping more money into the system and interest rates ought to be lower.

So, I'm a general supporter, not a big critic of the Fed. Other than in that general sense, I would agree with you completely. It was way too slow. And I don't think it has to be in hindsight.

There were a lot of us in this town who were not only feeling that way, but also saying interest rates ought to come down.

Maybe it wouldn't have avoided what we've been through. I don't know. But, I still have that general feeling. And when you're on the Fed, I hope you would remember that general feeling to be a little bold. Don't wait for that last set of statistics, which may be absolutely meaningless anyway.

And try to propel the Board to be, whichever direction we're going, a little more bold than they tend to be. And that seems to be an institutional problem down there, regardless of who is there. It's, "Well, let's wait another month for more data." Sometimes, those gut feelings might be better than waiting for that extra day.

In the past, you've argued to cut capital gains. Would you restate your arguments for the committee on why you feel a capital gains tax would be helpful? And particularly helpful to small business?

Mr. LINDSEY. Certainly, Senator. I do feel it would be particularly helpful to small business. I think, if you look at the sources of capital of startup firms—now it's important to differentiate between start-ups and venture capital; venture capital usually comes in when a firm is much larger; the sources of funds tend to be the individual's own resources, money that comes from family or money that they're able to get people who have a lot of excess money to invest.

I spoke to one biotech entrepreneur, for example, from Massachusetts, who said the way he raised funds was to literally go to the country club and sell himself and his company's ideas.

The reason that the capital gains is so important is that following the 1986 bill, the tax system was stacked against risk-taking capital. If individuals lost money, there was no tax offset—or limited tax offset. If they made money, they were taxed fully.

That made it very, very difficult for these individuals to attract investors because it's so high risk.

And so I think that one of the key reasons for small business is that we need to sort of right the balance.

Rather than have a playing field that's uphill against small business raising capital, we need to have one that's more balanced.

Senator GARN. Do you believe that the Federal Reserves need to be involved in bank supervision and regulation in order to have input for monetary policy?

Mr. LINDSEY. Well, you're asking a good question. I'll tell you, it would be one I could answer better and with more detailed knowledge in a year or so, I hope.

Senator GARN. How about a simple yes or no?

Mr. LINDSEY. A simple yes. I'll start with that. And the reason I do, Senator, is that I think that, if you're concerned about liquidity crises, about the state of business loan demand and what-have-you, having your finger on the microdata, having feedback come up through the channels is very, very important.

Senator GARN. Well, let me say respectfully that——

Mr. LINDSEY. That would be my answer.

Senator GARN. My answer would be no. Mr. Greenspan doesn't agree with me. Paul Volcker didn't agree with me. I very rarely find anybody on the Fed who does.

But, we simply have, in my opinion, a proliferation of regulation and examinations. I have never understood that answer from any of you on the Fed, or proposed members of the Fed, that you have to do it yourself in order to play with the M's.

We've got FDIC. We've got all kinds of agencies out there. I can't believe that we have to have that overlap and duplication of rules and regulations. And that, in working for the same Government, that the information that I agree with you that you do need—there's no doubt about that—but you have to have your own examining force and regulatory force in order to gain that information. You can't trust one of the other regulatory bodies; because I do think we need some streamlining, some reduction of the overlap and duplication.

I believe the first place to start is the Fed, and give you more time to play with your M's, unfettered with that regulatory burden.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Sarbanes.

Senator SARBANES. Mr. Lindsey, are you on leave from your position at Harvard?

Mr. LINDSEY. Yes, I am, Senator.

Senator SARBANES. Well, how long have you been on leave?

Mr. LINDSEY. I've been on leave now since January 31, 1989.

Senator SARBANES. So, your presence down here at least was temporary in nature? Is that correct? I mean, you were assuming a return to Harvard?

Mr. LINDSEY. I didn't know what I was going to do, Senator. And I thought it best to have an option.

Senator SARBANES. So, you've maintained this Harvard connection during the time you've been down here.

Is that correct?

Mr. LINDSEY. I have maintained leave from Harvard University since I've been down here. Yes, Senator.

Senator SARBANES. All right. Now, for what geographic region are you being appointed to the Board to represent?

Mr. LINDSEY. I'm representing the Richmond Federal Reserve District?

Senator SARBANES. What's your connection with the Richmond Federal Reserve District?

Mr. LINDSEY. I own a house in Virginia. It's the only house that my wife and I own. I pay income taxes there, personal property taxes there, vote there. We've actually spent half our married life there, in two stints.

Senator SARBANES. How much of your life have you spent there?

Mr. LINDSEY. Five years.

Senator SARBANES. Out of how many?

Mr. LINDSEY. Thirty-six.

Senator SARBANES. Well, half of your married life is not highly relevant to the nexus with the Richmond Reserve District, is it?

Mr. LINDSEY. Well, Senator, my——

Senator SARBANES. Why do you think that requirement is in the law, in the Federal Reserve law? Why was it put there? Why do we have a geographical requirement?

Mr. LINDSEY. I would—I'd have to go back and check the 1913 act to be sure. My suspicion is to get people with a variety of backgrounds and geographic distribution.

Senator SARBANES. Wasn't one intent at least to get people from different regions of the country who participated in the economic life of their region to sit on the Federal Reserve Board making nationwide monetary policy?

Mr. LINDSEY. Very well could have been, Senator.

Senator SARBANES. I don't understand how you under any stretch of the imagination would meet that criteria for the Richmond Reserve District.

Have you ever engaged in economic activity in that District other than simply living there for 5 years while you've been working in Washington?

Mr. LINDSEY. Aside from being a taxpayer, no.

And, I voted.

Senator SARBANES. Do you think there's a credit crunch underway right now?

Mr. LINDSEY. Yes, Senator. And I do in this context. I think of the term "credit crunch," the best definition that I've seen is: a significant increase in the standards for credit availability.

And I think that in particular industries, particular regions of the country, that is especially true. I think, if one looks to experiences in the late 1980's—and a point Senator Riegle made earlier—perhaps some increase in credit standards was appropriate in those industries.

However, I share what I think is your concern that, in many cases, that increase in standards has gone too far.

Senator SARBANES. What do you think the Fed can do about it?

Mr. LINDSEY. Well, there are a number of things that the Federal Reserve has already done. I think one positive step was the Federal

Reserve and the other regulators getting together to clarify a set of regulations for purposes of valuing assets and valuing assets on bank balance sheets.

I think that that will have more impact as time goes on, as regulators and bankers become familiar with it.

I think that the reduction in interest rates, while not a direct way of solving the credit crunch, is an indirect way when you lower the cost of funds, make more funds available. I think that you're making access to those funds to more and more borrowers.

So I think those are two important steps that have already been taken. And I think that more will follow.

Senator SARBANES. Do you think that an increase in the deficit would impact negatively on the level of interest rates?

Mr. LINDSEY. I think that it would depend on what the funds were expended for.

Senator SARBANES. Let's assume it's to cut taxes.

Mr. LINDSEY. I think that—again, it would depend on what taxes were cut.

If, for example, taxes on the supply of loanable funds were reduced, I think you may not see an increase in interest rates. We're experiencing that, for example, in the case of what types of levels of insurance to charge banks.

There's a limit to the amount. I don't know what that limit is. But, certainly increasing the BIF premium, which is a form of tax, would—there's an example of where it would reduce the availability of loanable funds and drive up interest rates.

So, again, it would depend very much on the nature of the expenditure or the nature of the tax involved.

Senator SARBANES. How did this nomination come about?

Mr. LINDSEY. Well, all I know and can answer is from my experience. And, late last summer, Roger Porter, who's the person I report to, and Michael Boskin spoke to me and asked me if I would consider having my name included, among other names. And I thought about it. I talked to some friends. And, said yes.

Senator SARBANES. Had you indicated an interest in the position, yourself?

Mr. LINDSEY. Not before they spoke to me, Senator.

Senator SARBANES. You were sort of sitting there doing your job, so to speak, down at the White House on the staff, and they came to you and said, "Are you interested in serving on the Federal Reserve?"

Mr. LINDSEY. Yes, Senator.

The CHAIRMAN. Thank you, Senator Sarbanes.

Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Lindsey, let me ask you, have you been following the Federal Reserve's policy as it relates to interest rates, and the debate that has pursued within the councils of the Federal Reserve?

Mr. LINDSEY. Senator, I have not been privy to the debate within the councils.

Senator D'AMATO. You mean you haven't heard anything about it?

Mr. LINDSEY. All I can tell you is what I read in the paper. In that sense, I have no private knowledge of the debates. That is one of the restrictions on a designee, a Governor designee.

Senator D'AMATO. Before you became a designee. This has been going on for a period of time, hasn't it? The question as it relates to what the policy should be with respect to interest rates? What are the policies as it relates to the regulators, and the Reserves and the requirements for Reserves?

Has that not been an ongoing matter of concern for a period of time now, prior to your becoming a designee?

Mr. LINDSEY. Senator, let me say that I am very much aware of discussion of those issues. I may have mistook your question. I do not have any knowledge of the private deliberations within the Federal Reserve, but I am aware of the general debate about those issues.

Senator D'AMATO. Would you care to share with this committee what your thoughts have been with respect to that? Do you think that the Federal Reserve has moved expeditiously enough as it relates to, let's say, the discount rate, and lowering the discount rate?

Or, has it moved precipitously?

Or, has it moved just about on target?

And what relevance do you think that all plays in the economic situation that we now face?

Mr. LINDSEY. Senator, in my view, the rate of money creation, the growth of the money aggregates, particularly during the latter half of last year, was probably too slow.

I think, to some extent, that has been rectified in recent months.

Senator D'AMATO. Do you think it's been possibly too slow and rectified in recent months?

Mr. LINDSEY. I think that it was certainly too slow in the last year and has largely been rectified in recent months.

Senator D'AMATO. Let me ask you, if you were to look in the last 10-year period of time, do you know what the low point for the discount rate has been?

Mr. LINDSEY. In the last 10 years, we are probably at the low point in the discount rate right now.

Senator D'AMATO. Do you know if the discount rate was ever this low prior?

Mr. LINDSEY. Oh, yes, it would be in the——

Senator D'AMATO. Well, in the last decade.

Mr. LINDSEY. In the last decade.

Senator D'AMATO. The last 5 years. Let's put it that way.

Would it surprise—let me be fair to you. I'm not trying to—would it surprise you to know that the discount rate was 5.5 percent—that's the same rate that it is now—in the period of August 1986 through August 1987?

Would that surprise you?

Mr. LINDSEY. No, it would not surprise me.

Senator D'AMATO. It wouldn't?

Well, as an economist, would it seem to you that the discount rate of 5.5 percent back in 1986—and you remember. You were working in the White House in 1986, weren't you?

Mr. LINDSEY. No.

Senator D'AMATO. No? Where were you then?

Mr. LINDSEY. I was at Harvard.

Senator D'AMATO. That's why you lost track of it, huh?

Mr. LINDSEY. Ivory tower, I guess. That's right. [Laughter.]

Senator D'AMATO. Well, let me ask you. Let's look at the economic period in terms of growth, et cetera, and all of those indicators that we know about the health of the economy. If you can look back to August 1986 and reflect—don't ask me to name a specific thing back then. I couldn't. Yes, I could. On July 4, we had the dedication for the Statute of Liberty, and it was the hundredth dedication. That's about—my mother and father had their fiftieth anniversary. Anything else, I probably couldn't recall, but—between the period of August 1986, and 1987, would you say that the economy was rather prosperous, strong?

Mr. LINDSEY. Yes, Senator, it was.

Senator D'AMATO. Very strong? [Pause.]

Do you think that the discount rate then today, was the economy—how would you rate the economy today?

Mr. LINDSEY. The economy is, or has been, certainly, in a recession.

Senator D'AMATO. Are we in a recession, in your opinion?

Mr. LINDSEY. Well, I think we certainly were through the first quarter this year.

Senator D'AMATO. You were doing very well. Now you're beginning to get like a politician.

Are we in a recession today?

Mr. LINDSEY. Um—probably.

Senator D'AMATO. Did that hurt you to say that?

Mr. LINDSEY. Well, I of course wish we were not.

Senator D'AMATO. Well, I had Greenspan here—listen, don't hesitate. It only took him a year and a half of me asking the same question every time he came as to when he was going to lower the discount rate.

I mean, you know that. They prepped you for me, didn't they?

Mr. LINDSEY. I'm sorry, Senator? What——

Senator D'AMATO. Let's get to the point. Do you think the discount rate is where it should be at the present time? Are you satisfied that it's low enough?

Do you think the economy needs any additional stimulation?

Mr. LINDSEY. If the question is: If I were confirmed, would I raise or lower the discount rate, I would have to say it would depend on the data that was available to me then and I do commend, I think the Fed made the right move last week in cutting the rate to 5½ percent.

I would want to—I know Senator Garn doesn't think we should wait for more data either.

Senator D'AMATO. We should what?

Mr. LINDSEY. Wait for more data. But, I think I would be——

Senator D'AMATO. Well, you have to be blind, deaf, and dumb not to know that we're in a recession. I don't know what the heck took Greenspan so long and the Board over there to find out. It's given a man who is dead artificial respiration so, fine, you'll save the rest of them, but you didn't help——

Senator GARN. I already gave him the same speech. Not quite as colorfully, but——

[Laughter.]

Senator D'AMATO. Well, I just want to know what we're going to be in for, Jake.

Are we going to have somebody who says all these nice things and then when we come up——

Senator GARN. I agree. I said they waited too long, they were too slow and they ought to trust their gut and quit waiting for more reports.

Senator D'AMATO. And the reports don't say a darned thing anyway. Do you really think employment's up? I wonder where they got those figures, and what they discounted.

But, that little light went on, so I'll pass to another round of questions to somebody else.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

I have a statement, Mr. Chairman, which I would ask appear in the record.

The CHAIRMAN. Without objection, so ordered.

Senator SASSER. In toto, as if read.

[The complete prepared statement of Senator Sasser follows:]

STATEMENT OF SENATOR JIM SASSER ON THE NOMINATION OF LAWRENCE LINDSEY, MAY 7, 1991

THANK YOU MR. CHAIRMAN, FOR CALLING THIS HEARING ON THIS IMPORTANT NOMINATION. THE ECONOMY IS AS WE ALL KNOW MIRED IN A DEEP RECESSION. THE BANKING SYSTEM IS EXPERIENCING ITS GREATEST CRISIS SINCE THE DEPRESSION.

INDEED, THERE HAS BEEN CONSIDERABLE COMMENT OVER THE PAST YEAR AND A HALF OR SO ABOUT THE ROLE OF THE FEDERAL RESERVE IN RESPONDING TO THE ECONOMIC DISASTER THAT WE SEE ALL ACROSS THE COUNTRY.

THE FEDERAL RESERVE IS IN A CRITICAL POSITION. GIVEN THE CURRENT SIZE OF THE FEDERAL BUDGET DEFICIT THERE AREN'T MANY OPTIONS FOR A FISCAL STIMULUS TO GET THE ECONOMY MOVING AGAIN. MONETARY POLICY COULD DICTATE THE LENGTH AND DEPTH OF THIS RECESSION.

AND THERE ARE VERY SERIOUS CONCERNS ABOUT OUR NATION'S BANKING SYSTEM. THERE IS SOME QUESTION THAT THE TAXPAYERS MAY BE CALLED UPON TO BAILOUT THE FDIC. I THINK THE FED NEEDS TO BE FOCUSSED ON BOTH THESE ISSUES.

SO THEREFORE, I LOOK FORWARD TO HEARING DR. LINDSEY'S VIEWS ON THESE MATTERS -- MONETARY POLICY AND BANKING REGULATION -- THAT ARE THE CRUX OF THE FED'S MISSION. WE ARE FAMILIAR TO SOME DEGREE WITH DR. LINDSEY'S SUPPLY SIDE TAX IDEAS, BUT KNOW VERY LITTLE ABOUT HIS EXPERTISE IN THE MATTERS THAT HE WOULD PRESIDE OVER AT THE FED.

THANK YOU MR. CHAIRMAN.

Senator SASSER. Dr. Lindsey, looking back over the course of last year, even late 1989, it appears to me that the economy has shown rather significant signs of weakness. The last quarter of 1989, for example, in the last quarter, the economy grew at less than a 1-percent real rate of growth.

Through the first 6 months of 1990, the indicators were uniformly bad, according to the economists that I talked to. And probably the most alarming thing was that the banking system was showing serious signs of weakness. Unemployment was going up. And housing in the first 6 months of 1990 was in the most dramatic decline since 1982.

Now, the Fed did not move until the middle of 1990 to reduce interest rates. And that was a very minor adjustment. And Dr. Greenspan made it clear at that time that they weren't doing this in an effort to spur the economy, but rather this was being done to counteract the work of overzealous bank examiners who had caused a credit crunch because of the pressure they were putting on the banks and the banks didn't want to lend.

And it wasn't until very late last fall, actually, December, if memory serves me correctly, that the Fed actually began to lower rates.

Now, this happened, of course, after nearly every forecaster told us we were in a recession. We now learn that, officially, the recession started in July. It took the Fed from July to December to begin lowering rates.

And this raises a lot of questions in my mind about what the Fed should have been doing.

Let me just put you back to January 1990 and let's say that Dr. Lawrence Lindsey was sitting on the Board of the Fed at that time.

Would you have been urging further and more aggressive rate reductions during calendar 1990?

Mr. LINDSEY. Senator, I do not know what data would have been available to me as a Governor of the Federal Reserve Board back then. Today, we have the advantage of hindsight.

From hindsight, I believe that monetary growth was too slow, particularly during the last three-quarters of 1990.

I think that, to some extent, that slow money growth has been rectified since January of this year. The rate has been rectified.

But, I can't—I don't know what I would have known if I were there. I really can't answer what I would have been arguing. But, I do know from hindsight that I believe money growth was too slow last year.

Senator SASSER. Well, what would you be advising now with regard to interest rates?

Mr. LINDSEY. I think that, knowing what I know now, that the vote last week was an appropriate one. I think it was one I would have cast.

And I would want to study the data that was before me, data from the banking system, which I'm not privy to now, and take that into consideration before making a definitive judgment on that matter.

Senator SASSER. Well, now, Dr. Lindsey, I'm not an economist, but it became obvious to me at least by the middle of last year that we had serious problems. And I, along with others, began admonishing Dr. Greenspan when he appeared before the Budget Committee and also before the Banking Committee that, in my view, the Fed was overly concerned about inflation, that inflation was not the danger to this economy, that the danger really was in imminent and impending economic slowdown.

We were unable to get the Fed's ear at that time. But, just to the layman, and I'd characterize myself as a layman in economic matters—perhaps knowledge a little superior to the average layman. I'd give myself that credit without hoping to appear immodest—but it was apparent to us at that time that the economy was slowing down and it needed the stimulus of lower rates.

Now, this comes around to your philosophy with regard to the Fed and how you would view your job there, view your role.

Do you think that the Fed should be just solely reactive as it has been over the past few years? Or, is it your view that the Fed ought to be proactive? That the Fed, through its monetary policy, ought to be attempting to lead this economy, to lead it on to greater growth in a noninflationary way?

Mr. LINDSEY. Senator, I think it important that when we—when any policymaker makes a decision, that they have their eyes on the future and try to take actions today to achieve the future result that they view desirable.

And, in that sense, if it's proactive, I think that they should be proactive.

Senator SASSER. But, in other words, if you had your choice between just sitting back and reacting to what has occurred, perhaps even reacting 6 months too late, you would choose to have the Fed take a more active role and try to lead this economy through monetary policy?

Mr. LINDSEY. If I might, as an example, Senator, we have a relationship between the level of money—I'm going to pick M-2 as an example—and the level of future economic activities 6 or 9 months hence.

When you have a target level of activity 6 or 9 months hence, if you make an assumption about the—the technical term is velocity. It means how fast the money turns over. You have an idea of what your target level of money stock should be today.

So, in that sense, yes, the Fed should be looking down the road 6 or 9 months to the desired level of economic activity at that time and setting its monetary aggregates, its policy to attain monetary aggregates today to effect that desired result down the road.

Senator SASSER. And that desired result would be enhancing economic growth?

Mr. LINDSEY. That desired result would be maximum economic growth without accelerating inflation, yes.

Senator SASSER. Well, Dr. Lindsey, we have an area of agreement there. Now, let me move on to another area where I think we may have a disagreement.

You're a prolific writer and you wrote in one of your books, and I quote it, that:

> Despite claims to the contrary——

Mr. Chairman, I think I may be overrunning my time there. That red light's gone on.

The CHAIRMAN. Well, that may be. Did you have more than one additional question right now? Or did you want to raise one more and then we'll go?

We've been kind of flexible during the discussion.

Senator SASSER. There's somebody been waiting here. I'm really hesitant to go forward. It's Senator——

The CHAIRMAN. Fine. Let's go to Senator Mack.

Senator MACK. I'd be happy to yield on my time.

I was not here when you first came, so let me welcome you before the committee. And I am also very interested in your responses.

Let's just go back to the last point that Senator Sasser raised. And I would make the comment in the beginning that I don't think that the Fed can serve two masters. I mean, we're all very comfortable using that phrase, "maximum growth with price stability," you know. But, the bottom line is that the Fed has to make choices from time to time between those two very laudable goals.

And the real question is, if you had to pick between those two, what do you think the Fed's role is? Is it price stability? Or, is it, in fact, trying to produce economic activity?

Mr. LINDSEY. Senator Mack, I think you're asking the key question. I think that one of the lessons that I have learned is the need to balance often conflicting objectives.

I think that, in the immediate term, there may be the question of the tradeoff between inflation and economic growth.

I think that the Fed is uniquely able to pursue long-term objectives, given its independence, the length of tenure of the members. And I think that, in the long term, there really is no conflict between price stability and economic growth.

In fact, were we able to reduce——

Senator MACK. Let me just hop in there. That's under the assumption that really the primary objective is price stability. I think that's what you're implying there.

If the Fed maintains the policy consistently over a long enough period of time to maintain the value of the dollar, that we will have our greatest growth opportunity under those circumstances.

Mr. LINDSEY. We will have our greatest growth opportunity, I believe, in a period of—yes. I think you said it better than I could say it, Senator.

Senator MACK. Then you agree with that?

Mr. LINDSEY. I think that the long-term objective of monetary policy must be price stability. I think that the path of getting there is a challenging one. We want to attain price stability at minimum cost to the economy, in the short run.

In the long run, we agree that it is the objective that is best for the economy. And I think that a prudent, sustained effort at gradually reducing the rate of inflation is the best way. It must be credible to convince markets that the Fed means business.

But, I believe it also must be steady and gradual to give markets a chance to adjust to the declining rate of inflation.

But, yes, that is certainly—that's the task ahead. That's the task ahead for the Fed for the decade.

Senator MACK. Let me refocus this in saying I think what I would be most interested in at this point, and I think it would be very helpful to the committee, too, is to, given the comment that you would support or that you think that the Fed made the right decision, for example, in lowering the discount rate to 5.5 percent, what kind of data will you be most inclined to take a look at?

Will you be looking at the activities within our economy in the sense of production and those kinds of—or will you be looking to the monetary aggregates, as they're sometimes referred to?

Which of those two areas are you most inclined to look for, for information?

Mr. LINDSEY. Senator, the big problem with data is some data's good for some things and some's good for other things. And let me pick——

Senator MACK. You sound just like one of the economics professors that I had at the University of Florida.

Mr. LINDSEY. I don't know if that's good or bad.

Senator MACK. Well, it's an indication that you all have a tendency to use the same kind of language.

Mr. LINDSEY. I guess we do.

The level of nominal GNP is probably the one single variable that the Federal Reserve can affect the most.

Senator MACK. Did you say "can affect the most?"

Mr. LINDSEY. Can affect the most.

The problem is we get it 12 times a year. And 8 of the times are revisions of the other 4 times. So it's not that great a continuing piece of data.

The monetary aggregates which you mentioned, M-2, we get on a weekly basis. They're a pretty good forecaster of where the economy is going down the road. They're not perfect though. That's the problem.

So I think that you have to look at nominal GNP as your ultimate target, the monetary aggregates as a confirming number that you get more frequently. And then I think you should also be sensitive to conditions in markets, commodity prices, the yield curve, the whole array of data that the markets are telling you whether you're doing a good job or not.

So I would say that all of what you mention, nominal GNP is your ultimate objective, money as an intermediate term objective, with these other market signals telling you thumbs up or thumbs down along the way.

Senator MACK. In the debate that took place in the Fed, I think, in November-December 1989, there was an attempt by the Fed to bring short-term interest rates down. And, again, there was some dissension. I think Wayne Angel was the one that voiced his concern about the direction the Fed was taking, by arguing that the markets would react to your action as being inflationary. Long-term interest rates will go up.

And that's exactly what happened.

What makes you look at the situation now, for example, with the most recent decline in the discount rate and saying from what you can see—not necessarily what the Fed is looking at, but what you can see that that's not inflationary?

Mr. LINDSEY. Long-term interest rates did not respond this time the way they did then. There was also—we were at a position in the commodity markets and in the foreign exchange markets that indicated a lot more confidence in an anti-inflationary stance. That was true now and was not true before.

And so I think the yield curve, commodity markets and foreign exchange market would be the three things I would point to in support of the Fed's recent action.

Senator MACK. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Mack.

I'm next in the queue here. But, Senator Sasser, did you want to pursue a question now? And I'd be happy to yield my time to you, and then go after you in the order on the Democratic side.

Senator SASSER. Just one question, if I may, Mr. Chairman.

I had noted that Dr. Lindsey is a prolific writer and he's just published a new book, a few months ago, if I'm not mistaken, or maybe even more recently than that, dealing with the economic matters and tax policy as I recall in the decade of the 1980's.

And, Dr. Lindsey, you wrote in that book, and I quote:

> Despite claims to the contrary, the Reagan tax cuts contributed only trivially to the booming deficits of the 1980's.

Now, I find that to be a very interesting statement because, according to the Office of Management and Budget, and this was then President Reagan's own Office of Management and Budget, the 1981 tax cut occasioned a revenue loss of approximately $1.4 billion.

Now, by the end of this year, this revenue hemorrhage is going to be approaching $2 trillion. I may have said $1.4 billion when I meant to say $1.4 trillion a moment ago.

But, when you look at the increasing budget deficits in the 1980's and the explosion, virtual explosion that occurred in the national debt, a $2 trillion increase in the Reagan-Bush years alone, when you contrast that with the fact that it took us almost 200 years to build up an indebtedness of $950 billion, roughly, I don't see how you can ignore this revenue loss, or say that it contributed only trivially to the budget deficits.

It appears to me the biggest tax cut in history, and we ended up with the biggest deficits in history.

And I see my friend, the distinguished Senator from New Mexico, has arrived here on the committee and I remember when he was chairman of the Senate Budget Committee and was striving manfully with then Majority Leader Dole to try to find some way to stop this revenue hemorrhage and to stop the explosion that was taking place in the deficit.

Now, how do you explain the fact that this tax cut did not contribute significantly to this explosion in the deficit?

Mr. LINDSEY. Senator, the methodology I used in my book was to take the 1980 fiscal policy, President Carter's last fiscal policy, as a base and compare what happened during the 1980's compared to Carter fiscal policy as a basis. The basis for comparison was as a share of GNP.

I took the——

Senator SASSER. The deficit as a share of GNP?

Mr. LINDSEY. That's right. The tax, I broke it down into tax share, domestic spending, defense spending and interest. I charted——

Senator SASSER. All as a percent of GNP?

Mr. LINDSEY. All as a percent of GNP.

Let me explain briefly why I thought it important to do that. The number which you correctly cited would be the revenue loss had we maintained 1980 tax rates in place.

Now, if that were the case, it's important to keep in mind that a married couple with a taxable income of $45,600 would be in the 49-percent marginal tax rate bracket. That single individuals earning below——

Senator SASSER. Well, let me stop you there, Dr. Lindsey. Will you agree that, if we had kept the tax policy in place, that was in place in 1990, would you agree with those who say that we would now be running a budget surplus?

Mr. LINDSEY. I think that that would be a difficult question to answer. I would have to look very carefully at the numbers. My suspicion would be that it would have been very difficult to have had the kind of economic expansion that we had during the 1980's when the American middle class had to share half their additional income at the margin with——

Senator SASSER. Well, if I could just interrupt you there and say this. It's become fashionable these days and has been repeated so much that it's becoming sort of conventional wisdom that we had the longest sustained economic recovery in the history of the country during the 1980's.

That's not accurate, as I expect you know from your study of economics. There have been longer sustained periods of economic growth than the one in the 1980's.

But, we went through the most serious recession, indeed, depression in this country, in 1981 and 1982 since the Great Depression of the 1930's. And that occurred after this tax cut went into place.

Mr. LINDSEY. I'm not sure what your question is, Senator. If I could—the question about the levels of taxes contributing to the——

Senator SASSER. Well, that's the thrust of the question, so go ahead and try to answer that.

Mr. LINDSEY. What I did was, again, took the 1980 fiscal policy of President Carter as the base.

Senator SASSER. Right.

Mr. LINDSEY. Compared what actually happened to the tax share of GNP, to the spending shares of GNP, and took those differences between the Carter level and what actually happened, and added them up. And the result was that about 20 percent of the increase in the deficit could be attributed to the taxes.

The vast bulk was attributable to the rise in the defense share of GNP during the 1980's.

Senator SASSER. Now, but you're talking in terms of the deficit as percentage of GNP. And you're talking in terms of taxes as percent of GNP.

Well, now, taxes, as percent of GNP, when you take Federal, State, and local taxes, really, have they changed appreciably over the past decade?

Mr. LINDSEY. We are——

Senator SASSER. In other words, as we cut Federal taxes, local and State taxes have gone up?

Mr. LINDSEY. I'm most familiar with the Federal numbers, which is what I use for my book. Today, Federal taxes are roughly the same percentage of GNP as they were in 1980. They may be a few tenths of a percent one way or the other. But, essentially, they are the same percent of GNP today as they were in 1980.

Senator SASSER. And this is after we have been adding back additional revenues to fill in the void that was left by the 1981 tax cut.

In other words, if we'd left the 1981 tax cut where it was, it would have been as a percent of GNP, the taxes in 1990 would have been lower——

Mr. LINDSEY. Yes, that's correct.

Senator SASSER [continuing]. Than they were in 1980.

Mr. LINDSEY. Yes.

Senator SASSER. Well, my time's up again, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Sasser.

Senator Domenici.

Senator DOMENICI. Thank you very much, Mr. Chairman.

And I wanted to say to you that I know, Mr. Chairman, I know you're genuinely interested in some issues beyond today. And I wanted to say to you that I think from my standpoint on your banking reform and BIF and those issues, that I haven't had a chance to tell you, but I think I will have a little more time and look forward to working with you and Senator Garn. I think we ought to really do something in that reform area. And I want to be part of it for the remainder of the year.

Thank you, Mr. Chairman.

Mr. Lindsey, let me ask you. You obviously are a very, as history of this office goes, you're very young to be appointed to the Federal Reserve Board, which, so you don't misunderstand, is very exciting to me. I'm glad we didn't appoint one of the Board of Governors from out there in one of the regional Fed offices.

And I'm glad we picked somebody like you.

But, let me ask you why do you want this job?

Mr. LINDSEY. Senator, I have always liked jobs that present a challenge. And, at the moment, I can't think of any more challenging position that I would be considered for.

The Board of Governors must make difficult decisions in the short term about the business cycle, try and get us on the road to recovery. As one of the leading financial regulatory institutions, it's got a number of very difficult challenges ahead of it.

And I think, in the long term, we have an opportunity to gradually reduce the rate of inflation in this country, to return the country to a period of price stability and substantially lower interest rates.

And those are three tough challenges. And I've always liked to rise to a challenge.

Senator DOMENICI. So, without making your job too big, do you conclude, based upon your knowledge of the Federal Reserve's power, that, as an independent agency, it has as much or more to say about the future of the American economy and growth and prosperity as any institution around?

Mr. LINDSEY. I think that it's tough to say that one institution has as much or more power. What I would say is that the Fed is in the position to provide liquidity of the economy. The Fed is able to influence through monetary policy the level of nominal GNP in the economy.

But, the Fed is also quite limited with regard to tax and regulatory matters, budget policy. It also has a very, very important effect, and a far greater effect on the level of real economic growth.

So I think that the Board plays a necessary role, an important role, but it can't do without any one of the players. They all have to be involved. So it's very hard to say one is more important than the other.

Senator DOMENICI. I don't think I said that. I just said you're a very important——

Mr. LINDSEY. Very challenging, yes.

Senator DOMENICI [continuing]. Institutional player in America's prosperity and future growth.

Let me ask you. I didn't read your book and I surely don't want my good friend, the chairman of the Budget Committee, to attribute to me concerns that I may or may not have. Let me just suggest I don't know that I was overly concerned about tax cuts as I was about whether or not we were going to spend too much.

I found at one point that it was more difficult to get spending cuts than it was to recommend some tax increases at one point. I can't believe that that's the way things ought to be, but I did find that twice in my 8- or 9-year tenure as one who was moving the Budget Committee in one way or another and, thus, the Senate.

But, let me ask you this. We had a big recession at the end of the Carter administration in the early years of Ronald Reagan.

Have you ever analyzed that recession?

And, if you have, have you concluded that whether or not the Federal Reserve Board's policies had a lot to do with the length and depth of that recession or not?

Mr. LINDSEY. I have no doubt that Fed policies played an important role. I think that a decision was made in both the legislative and executive branches and also the Federal Reserve that we could not continue to tolerate the very, very high rates of inflation the country was experiencing in the late seventies.

And so a decision was made to end that inflation.

I think that the reduction in the inflation rate came about very, very suddenly, very quickly, relative to what most people expected. We went from double digit inflation to 4-percent inflation in a period of about 18 months, which was a remarkably quick reduction in the inflation rate.

You were quite right in that that was a very painful transition. But, I don't know if I would necessarily criticize the dilemma facing decisionmakers back then. It was necessary to get the rate of inflation down, and I think they did so expeditiously and relatively efficiently.

Senator DOMENICI. Yes. I didn't necessarily ask you to criticize. I merely asked you to make an observation as to whether or not the institution you seek to join was a significant player in the length and depth of the recession.

Mr. LINDSEY. Absolutely.

Senator DOMENICI. And I might ask as a follow-on question:

What's the most important or significant problem that we face in the United States with regard to sustained economic growth?

Mr. LINDSEY. I think our No. 1 challenge probably is our Nation's educational system. Making sure that our workers can compete with those around the world.

I think reducing the burden of Federal Government on the credit markets is also quite important.

I would rank those certainly as one and two.

Senator DOMENICI. Well, then, if those are the kinds of things that are going to cause us to have less sustained economic prosperity and less sustained growth than we should otherwise have, let me put it another way:

What is the symptom that will reflect itself in this economy that will show we're not doing as well as we could and we could do better if we did better in these areas you're speaking of?

Is it inflation?

Is it lack of productivities?

What is it?

Mr. LINDSEY. Well, I think that we do face a productivity challenge, not in absolute sense relative to our past, but in the sense that other nations are moving quite aggressively. And I think that we must tackle that productivity problem, yes.

Senator DOMENICI. Mr. Lindsey, there are some in the Federal Reserve System—I don't know all of those that you would join if you get confirmed, but certainly I've read what some of them out in the hinterlands say in the various Federal Reserve Regional Boards.

It seems to me they are overwhelmingly on the side of being much like the West Germans. They almost have a total fear of inflation. They write about it. They talk about it. Anything you all do up here that doesn't act in the direction of getting inflation down to zero, you're harming the American economy. In fact, I think some of them would like negative inflation. And I haven't seen that or heard how it worked, but——

So, let me ask you, it seems to me the Federal Reserve Board is reacting cyclically to inflation and responds almost overwhelmingly to the rate of inflation as a precursor to activities on their part to loosen money supply and lessen the cost of money.

Do you agree that that is the principal basis for action in the past and what will you base yours on?

Mr. LINDSEY. On the second part of your question, I do not believe that the focus on inflation is where primary emphasis should be. I think that the primary emphasis should be on the rate of nominal GNP growth. I think that is what the Fed is able to affect most directly.

I think, in the intermediate term, it's important to focus on rates of growth of monetary aggregates. But, I also think it's important to look at the performance of market conditions, the fact that we have slack, we have unemployment, is of great concern.

There are a whole range of issues that are important to balance. Inflation I think will be just one of those concerns.

Senator DOMENICI. Frankly, I want you to know that I consider that answer to be one of the most important in my judging, my position with reference to your confirmation.

So, let me ask a follow-on question.

I have heard the Chairman of the Federal Reserve discuss America's future sustained growth and what he perceives to be the kind of sustained growth that we can have without inflation, which I am not suggesting that you should not be concerned about inflation as it applies to sustained growth.

But, tell us how you as an expert in economics view America's sustained growth and the impact for sustained growth on inflation and are there some limiting aspects to America today with reference to sustained GNP growth that is healthy that you might feel strongly about.

Mr. LINDSEY. With regard to what the Federal Reserve can influence, I do believe that, in the long run, if we are able to gradually reduce the rate of inflation, attain something resembling price stability—and let me define that as where inflation does not enter as a concern in business decisions—we will see a decline in the long-term cost of funds, particularly of equity capital to American business.

I think that would make a very positive contribution to our rate of real economic growth.

So, I would say that, in the context of what the chairman—what you say the chairman is saying—in the long run, there is no conflict between price stability and real economic growth. Because of interactions with our tax system, bringing down inflation will help lower the cost of capital to American business.

Senator DOMENICI. Mr. Chairman, whenever you think I should be through——

The CHAIRMAN. Yes. I want to go another round here in a minute. Why don't you do one more and then we'll——

Senator DOMENICI. And I'll stay around for a second round. I don't want to use up your time.

The CHAIRMAN. Good.

Senator DOMENICI. Let me put this question, this point, another way. And I want to come back to the cost of capital shortly, on my second round.

But, is there a relationship demographically—population growth and the like—in the United States and our ability to sustain economic growth or not?

Mr. LINDSEY. There is no question that demographics play an important role. I think, during the 1990's, we have an opportunity for them to play a positive role, particularly in real wages, since the baby—my generation, the baby boomers, are coming into our most productive years, it's important that the country not squander that opportunity.

But, demographics are only one of the many factors that affect economic growth. The rate of capital formation, the rate of technological progress are also very important.

Senator DOMENICI. Mr. Chairman, I'd yield at this point. And, thank you for the time. And if you have a second round, I'll wait.

The CHAIRMAN. Oh, yes, we will because we're not going to hurry this. This is an important confirmation hearing and we've rescheduled it to accommodate members.

And so we're going to take as long as we need. And I'm very interested in the questions you're asking.

There are several things that I want to cover at this point.

Where did you vote in 1988?

Mr. LINDSEY. I voted in Massachusetts.

The CHAIRMAN. And was there an election in 1990 in Virginia?

Mr. LINDSEY. Yes, there was. Senator Warner, for example, was on the ballot.

The CHAIRMAN. And where did you vote in 1990? Did you vote in Virginia?

Mr. LINDSEY. I voted in Virginia.

The CHAIRMAN. So you changed your voting registration sometime then between 1988 and 1990?

Mr. LINDSEY. I changed it very shortly after moving to Virginia.

The CHAIRMAN. All right. Is it your intention—and I don't want you to hedge on me here. I want you to give me the full answer. Not that you wouldn't, but I want to emphasize the fact.

This is a 9-year term. Is it your intention to serve the full 9 years?

Mr. LINDSEY. Yes, Senator, as long as I feel I'm making a contribution, I will be a member of the Federal Reserve Board, to the year 2000.

The CHAIRMAN. Yes, I know, but I don't want any——

Mr. LINDSEY. Yes, it's my intention to serve the full 9 years.

The CHAIRMAN. OK. I mean, you don't really foresee exhausting your interest over the 9 years, I take it, in that assignment?

Mr. LINDSEY. That's correct.

The CHAIRMAN. Now, I want to go back to an example that you used with Senator Sasser. You were talking about the effect of the tax cuts that took place in 1981 and were in place down during the 1980's. And I think you referred to a taxable income level for a couple. If I heard you right, I think the figure was something like $46,900.

Is that right? Or, what was the number?

Mr. LINDSEY. That could be a guess. I thought I said $45,600. But——

The CHAIRMAN. Well, you probably did. Forty-five thousand six hundred dollars. And that was the taxable income figure for a family of two?

Mr. LINDSEY. A married couple.

The CHAIRMAN. American couple and——

Mr. LINDSEY. Married couple.

The CHAIRMAN. What year?

Mr. LINDSEY. That would be any time up to 1980. Well, the last year would be in 1980.

The CHAIRMAN. 1980. All right. Well, let's take 1980.

Now, let me tell you what troubles me. Give me your best professional estimate as to what percent of the American people in 1980 couples would have had taxable income of $45,600 or more?

Mr. LINDSEY. Married couples? I would say the number would be 20 percent.

The CHAIRMAN. I think that's high. You may be right and I may be wrong. My guess would be that, if you go back to 1980, I think the median income in the country for a family at that time—not just a couple of two—was probably around $20,000, or close to it.

My guess would be that for taxable incomes for a couple, $45,600 is probably in the top 15 percent, maybe higher than that. But, you say 20 percent.

Let's say it is 20 percent. If 20 percent at that level are higher, then 80 percent are beneath that level, are they not?

Mr. LINDSEY. Yes.

The CHAIRMAN. I guess I'm troubled by examples that are designed to make a point that I think have a load of ideology in them. I mean, a point of view that is more concerned with examples that talk about 20 percent of the population and not 80 percent of the population.

And I guess my concern would be that, when an example like that is used, I think it really tilts the analysis off its axis. I don't say it's an elitist illustration, but I think it's a distorted illustration in terms of what life is like for most people in the country.

And that's why I think there are an awful lot of frustrated people in the country who don't even in 1991 earn $45,600 and never will in their lifetimes, and they're probably sick to death of tax policies that are aimed at somebody else other than themselves.

The problem is taxes have gone up quite substantially in the last several years, partly because Social Security taxes have gone up, apart from the income tax changes. And, of course, we've been tapping the Social Security reserves to pay for the general cost of Government, as I'm sure you know.

I asked Senator Moynihan on the floor the other day:

How much money from the Social Security reserves had been transferred out and taken over and spent on the general operations of Government.

And the figure that he gave I think was $260 billion—$240 to $260 billion. It was in that range. An awful lot of money.

But I think it's a little bit of a shell game that's been going on with who pays taxes, at what marginal rates and what's it really done to the economy?

And we're still left with these yawning deficits that I think fly directly in the face of the analysis that's in your book, and which I think you essentially hold to today. You may make some adjustments in the way you present it, and I've listened and I appreciate the courtesy and in the fashion in which you put your answers. But, I haven't heard anything yet that really cuts against what you've presented in the book as a view of the 1980's. And I'm troubled about that view, quite frankly, because I think it's off-base.

I want to have you look at two charts. Would someone take these two charts down? I referred to one of these before. This is looking at decade long periods. This is Government data, they're from the Department of Commerce, so they're national income statistics.

And on the one, it shows net business investment as a percent of net national product. And it shows business investment falling sharply in the 1980's in relationship to what it had been in each of the three decades leading up to the 1980's. Now, when I say "falling sharply," what I mean is being cut by 40 percent. I mean, a very substantial percentage reduction.

Then, if you take the other chart, consumption expenditures as a percent of net national product over the same decades, what you find is that consumption jumped up quite substantially.

And so, you know, again, I studied some economics at the Harvard Business School and other places and from what I remember of what I studied, in applying it to this, it looks to me as if what happened is that the way we reconfigured our policies, we ended up with more consumption and less investment and we're paying for it today.

And I just don't want the notions that drove those kinds of imbalances and that tilted us off our axis and I think have given us bad results. I think that debtor nation status chart over there is not a badge of honor in terms of how we performed in the last several years with respect to being able to compete in this international economy.

I don't think the Federal budget deficits as they've accrued are a badge of honor either. And I'm terribly troubled about those.

I think the underinvestment in our economy is a real problem. And I think some of the inequities in income distribution, although I'm not going to get off on that to any great extent right now, I think are another problem here.

But, it seems to me that, you know, I guess I would feel that there has to be some effort made to reconcile these trend lines in this data in light of all of the supply side, if I may in all due respect say so, sophistry that we heard down during the 1980's.

You know, it's not just the recession and what's happening with the unemployment levels, it's these longer term underlying trend lines they are actually in some respects more disturbing because you assume that you'll get some improvement coming out of a recession here at some point, at least God hope that we will.

I want to make another point here, and then I'll let you respond to the two points that I'm making, I think we haven't always adhered strictly to these regional requirements, although we probably should because I think they're there for a reason. I think it's important to get the people from the different parts of the country reflecting those different regional views.

I think attributing you as someone from the Richmond District is really essentially a circumvention. One can say that having started to vote in Virginia in 1990 and owning a house there now puts you in that region. But I don't think that's what the law intended.

I think it was designed to get people who had some long and deep knowledge in the different regions of the country to come on the Federal Reserve Board and to reflect the different geographic understandings and realities, and so forth.

Now, whether it's a serious enough matter in and of itself to bear in your suitability to serve I think is a question that members have to weigh for themselves.

But, I guess what I'm more actually concerned about in that area is the question of your experience. You're obviously a very good scholar and a person with a very heavy academic and policy advisory background in Government. You obviously have enjoyed the confidence of the people who've asked you to do that. And I think that's a tribute to you. I think those are very important parts of your résumé. And I admire those things. I think those are very solid items to have on a résumé.

I'm not sure that, quite frankly, that is what should constitute the background of somebody today going on the Federal Reserve

Board. And we've never met before today and you're an engaging person and thoughtful and I'm very respectful of that.

I guess my concern is I think the country is in economic and financial difficulty, and I think we really need some very heavyweight experience and know-how and perspective in all of the key economic and financial policy areas. I think we need that on the Fed.

It's not easy to get good people to serve in Government, but I think it's very important what goes into monetary policy decisions, how practical is the insight, how seasoned is it, how deep is the experience base that somebody is drawing on, and quite frankly, to have someone with a strongly held philosophy, whatever it happens to be. Whether it agrees with mine or yours or somebody else's is something I put quite far down the list of really highly relevant qualifications.

You're way above the intelligence minimum that we would need because you're obviously an extremely thoughtful individual.

The question here is:

What's the experience base?

What's the know-how?

What's the perspective?

What's the vantage point that one brings?

And I would hope to get in the time we have left, in terms of what you might want to say in response to what I've just said and to further questions that Senator Domenici might ask or others, more of a sense of the depth of perspective and insight and know-how that you bring with respect to how this economy works.

That's why I asked, who you call in the manufacturing sector. I'm sure there will be a lot of people calling you, assuming you're confirmed for this seat. I'm less interested in that than who you call and where you get your information and how broad it is and how deep it is.

I mean, obviously, if you had had some business background, you know, then that automatically carries with it a certain kind of a preparation and qualification; that's not here in this case. So I'm interested in what really constitutes the base of experience upon which you draw. I wanted to be very frank in telling you what some of the things are that are in my mind, and I'd be happy to have you respond to that.

Mr. LINDSEY. Thank you, Senator.

I think, with regard to the 1980's, there's a question of viewing the glass as half full or half empty. And there's many very complicated questions involved with the data.

The statistics you present are of course quite right. The one concern one might have is looking at the trends. One of the reasons, or the reason, that we saw the results in this chart was the very high rate of depreciation during the 1980's. Gross domestic investment. The share, our GNP, we were devoting to actually setting aside as it came off the—as it was produced—set a record in 1986. Because of very high depreciation, we had a low net number.

A very, very complicated question: What's behind the depreciation data?

So, again, I think that reasonable individuals can look at the same data and say:

Is the glass half full or is it half empty?

Senator, with regard to—I'm 36 years old.

The CHAIRMAN. I understand.

Mr. LINDSEY. I have been very privileged in my current position as Special Assistant to the President for Policy Development to meet with many individuals, depending on the issue involved.

I have met with CEO's, with plenty of vice presidents for Government relations, with regard to the problems that they see in the economy. It's a regular part of my job.

I suppose one of my weaknesses is I have a lousy recall for names. And I guess I'll never run for elective office as a result. But, I have tremendous contacts with people all the time. I think that's an important part of my job.

One criticism of the Federal Reserve which I'm not sure if it's true, but I've certainly heard, is they sit in a marble palace on Constitution Avenue and don't have contact.

Let me assure you, Senator, that that is not how I would view my job as Governor. I have always felt that one is best when one seeks a variety of views, when one seeks out individuals throughout the country, listens to what they really have to say and, hopefully, as a Governor, one of my responsibilities will be to travel around the country to all the Federal Reserve Districts to see what's happening on the ground to business conditions there.

The CHAIRMAN. Well, let me just stop you right there.

How serious are our economic problems right now?

You're taking a lot of temperature readings, and so forth. So am I. I would like to compare what I'm hearing with what you're hearing.

How serious are our economic problems at the moment?

Mr. LINDSEY. There is a shortrun issue and a longrun issue. The shortrun issue is with regard to the current stage of the business cycle. It's very hard to tell whether we are now on the way out of the recession, or whether that will be a quarter or so hence.

We've got some very mixed signals recently. Certain industries, particularly the auto industry, is in very, very difficult shape. I think, in part, that has to do with credit market conditions.

Commercial real estate is in very, very difficult shape. Again, that's largely attributable to credit market conditions.

When I spoke of the need for consistent and equitable regulatory standards, I had those two markets in particular in mind.

On the other hand, our export sector seems to be doing quite well. We have had remarkable improvement in manufacturing productivity during the last 10 years. In fact, to the rate that's comparable to manufacturing productivity growth in Japan, and about 3 times that in Europe.

So, I think, in some sectors, the manufacturing outside of autos, we're doing reasonably well.

In the short run, therefore, the picture, I think is a mixed one.

In the longer run, I think we have longrun problems as a Nation. I share your concern about the saving rate. There's no question we need to get that up. We need to improve the education of our children as well.

Those are longrun factors. The Federal Reserve's ability to work in the long run is primarily one of moving the country gradually toward price stability. With price stability, the real after-tax cost of equity capital will fall.

That will be one of the best things that we could do for American business. So, as a Federal Reserve Governor dealing with the long-run problem, I think that we do have to pursue a consistent policy of reducing the rate of inflation——

The CHAIRMAN. Well, let me——

Mr. LINDSEY [continuing]. In achieving price stability.

The CHAIRMAN. Earlier you seemed to put a lesser weight on inflation fighting to the extent that a couple of reporters broke a chair to get that on the wire. That happens when you are on the Federal Reserve Board, you can create this sudden exodus of reporters that run for the phone.

But, while to my ear you seemed to be putting a lower premium on inflation per se earlier, I thought I just heard you put a higher premium on it now.

Mr. LINDSEY. If there was a question, I think it is important to differentiate between the short run and the long run.

I think there is no question that the single long run objective of the Fed throughout this decade, throughout the rest of my term will be to gradually reduce the rate of inflation. That is something we can do in the long run.

The discussion I was having at the moment, and I'm sorry, which Senator was it with?

The CHAIRMAN. It may have been Senator Domenici or Senator Mack.

Mr. LINDSEY. It had to do with whether there should be an exclusive focus on inflation and making short run policy decisions. And there I do not believe there should be. I believe in the short run it is important to strike a balance between the need for economic growth, the need for maintaining low unemployment, and concerns about inflation.

That's why I am a believer that the approach to reducing inflation must be a gradual one, which will take most of the rest of the decade to accomplish.

The CHAIRMAN. Senator Domenici.

Senator DOMENICI. Let me talk about that a little bit.

It seems to me that essentially the way you will get inflation under control in a society, an economic system like America's, is to increase productivity at a sustained rate and across the board if possible.

Now, frankly, one of the misunderstandings of the decade of the 1980's, after you got out of the recession, is that manufacturing productivity in the United States, which in the decade of the 1970's was deplorable, came to the forefront and became very, very positive.

Now it may be that it is such a challenging field that we may have to be at it all the time. Frankly, the Japanese don't beat us in technology applications and science breakthroughs as some people think. They literally beat us in the application of manufacturing the products and bringing the products to market. Not brandnew ones, but ones that are needed.

So it seems to me that in the United States, those who are interested in getting inflation under control have to be equally concerned about how do you increase productivity and what are its components.

So let me just ask you if I am correct, we are very good at measuring productivity in the manufacturing of the United States. But contrary to public opinion, and an average kind of talk about America's economy where we say let's go look at the Ford plant and if it is working well we are increasing our productivity, 70 percent of America's GNP is not manufacturing. If I am right, only 30 percent is. So 70 percent somewhere else. And a lot of that 70 percent is in real service-oriented activities and then a bunch of it is in a sort of hybrid, where we don't quite know where to put it yet, if I read what people like you write.

But let's take where are we today and try to measure productivity of that service sector. It seems to me we're in bad shape. We don't know how to do it.

Mr. LINDSEY. Senator, you're absolutely right. Chairman Boskin set priorities for improved data measurement and one of the leading ones was getting at just the issues that you are talking about.

A lot of the ways that we measure productivity now in the service sector are awful and we have to find a better way of doing it and improved data collection is one of the ways of doing that.

And I think the chairman is posing a series of very cost effective statistical improvements for the Federal data establishment.

Senator DOMENICI. Do you know whether the Federal Reserve Board has some way of trying to measure overall productivity that includes their own special way of measuring service sector productivity increases?

Mr. LINDSEY. I know they are constantly working at it. They have a very good staff there and I think that they are constantly looking at challenges.

As far as specifics, I don't know. But that would certainly be a fruitful area for research at the Fed.

Senator DOMENICI. Let me just take one service sector activity. There are really two giants that are public in nature that I know. One is education and one is health care. And I assume that they are both kind of in the monstrous category among the myriad of service activities.

Do you not believe that, or do you believe that the ever increasing cost of health care is a significant deterrent to long-term sustained growth in America, or is it not relevant?

Mr. LINDSEY. It is a major problem.

Senator DOMENICI. And that has to do with sustained growth and productivity increases as a major problem; is that correct?

Mr. LINDSEY. In the health care industry?

Senator DOMENICI. Yes. Tell me why it is a major problem economic wise. Maybe that's the way to do it.

Mr. LINDSEY. We have a situation where we have virtually unlimited demand and when we measure productivity it is very hard. How can you tell how much postponing someone's death 6 months, a year, 18 months' worth, you can't put a price on it. The way we measure output is by measuring input. And that is a lousy way of figuring out product activity.

Senator DOMENICI. Strike the productivity. Tell me quickly why does the spiraling cost of health care have a negative impact on America's economic future, if it does.

Mr. LINDSEY. We have virtually no checks on the commitment of resources, of new resources there. Those are resources that often could be used elsewhere. And in general there is no market type of check, consumer check, between buying health care or buying another good or investing in another good. That's really the problem.

Senator DOMENICI. My last question has to do with capital formation. Has the current situation with reference to the Communist regimes moving toward capitalism and the need for capital there, does it have a negative effect on capital availability here and capital formation? And if it does or doesn't, would you just answer—when you answer that question tell me what is the major problem you see with reference to capital formation in the United States.

Mr. LINDSEY. The answer to the question about overseas, there is no question that the worldwide demand for capital has increased as a result of changes in the Eastern bloc.

With regard to capital formation in the United States, I think that we have interaction between our tax system and regulatory policy and inflation which drives up the cost of equity capital.

And one thing the Federal Reserve can do, in gradually reducing the inflation rate, is to take out the extra inflation tax interaction.

Senator DOMENICI. Do you think the decade of the 1980's, once the recession abated, was a positive economic period for the United States overall?

Mr. LINDSEY. In my view, Senator, it was clearly positive.

Senator DOMENICI. I have been heard to say that for all those who bemoan it that if we could clone it for the next 3½ or 4 years at its peak, most people would opt for it tomorrow morning.

And let me close my remarks by saying that I really believe we are confusing what happened to American values with what happened to the American economy. And I think maybe we ought to be concerned about values.

But I am not at all sure that they are the same or that they run—that we can have economic prosperity and still have a different value system than we have currently in the United States.

The fact that you are worried about education, I am close to coming to conclusion and then I will quit, that our education system is not so bad but that the values that are attendant to young people is what is scaring us. But I can't prove that yet.

Let me tell you that I am pleased to be here and I hope that I can support you for this job.

Thank you.

Mr. LINDSEY. Thank you, Senator.

The CHAIRMAN. I might just say I have great regard for Senator Domenici, and we have served together for a long time, and I am just reflecting. We use as a national figure a high school dropout rate in America of about 26 percent. It may be off a point or two; it depends on where you are. The Japanese high school dropout rate is about 2 percent. We may have a values problem, and I think in some areas we do have a values problem. We also have a very tangible high school dropout rate problem. I don't know how much it is driven or not driven by values, but I am convinced that if a country runs those differentials year after year after year, they are going to end up way down the line, and that is what is happening to us, at least in that area, I think.

Senator DOMENICI. Mr. Chairman, I am having somebody see whether you're right or whether that researcher from Colorado who had a full page spread in the Washington Post over the weekend is right. He was pretty good. In fact, he says, ultimately, 91 percent of the class that was expected to graduate the year before last graduated from high school in the United States.

We don't make them all graduate when they're supposed to. We have an open-ended in and out. And he says, by the time we're finished, 91 percent of Americans that were supposed to graduate, get a high school diploma, did.

Now that doesn't mean I'm satisfied with the system. But I think that there are some very interesting facts about that that are coming out now.

The CHAIRMAN. Let me ask you this, Mr. Lindsey. Do you think the interest rate should be lower now? Can the Fed take the rates down from where they are now in your view?

Mr. LINDSEY. Senator, I cannot commit myself.

The CHAIRMAN. I'm not asking you to commit yourself. I'm asking you for an opinion. When you get there, you're going to have to look at the data and you may want to revise your opinion. But you are obviously a person that digests a lot of information. You are here as a nominee because you are thought to possess an expert opinion. And based on what you now know, do you think that the rates should be lower than what they are today?

Mr. LINDSEY. I believe that the most important rate to look at is long-term rate. That is what drives business investment. And I think that one of the focuses of the Federal Reserve should be to get that long-term interest rate down.

And I think that, with proper monetary policy, it doesn't necessarily mean cutting short rates right away. Proper monetary policy can get the long rate down.

The CHAIRMAN. So you rank the long rate higher than, say, the prime rate, which is obviously not a long rate, in terms of its impact on the economy?

Mr. LINDSEY. Yes, with business investment.

The CHAIRMAN. I think that's quite right on business investment if you're trying to bottom out of recession.

We had Alan Greenspan here 10 days ago. He told us the recession was still worsening, and we hadn't hit bottom yet. He wasn't sure where the bottom was.

When you're in that kind of a condition how important is the prime rate?

Mr. LINDSEY. There is no question that the prime rate is important, particularly with regard to business inventories, carrying business inventories with regard to large businesses. Because many cyclical changes often have a strong inventory component to them. There is no question that the prime rate also plays a role.

But with regard to long-term growth in business investment, it is the long-term rate.

The CHAIRMAN. It is interesting. I talk to the heads of the automobile companies quite often, as you might imagine, because they are centered in my State and it is a major part of the national and regional economy, and certainly a major factor in my State economy.

Auto sales, of course, have been very weak and that is part of what has caused this recession. We have had reported losses in the domestic industry approximating $5 billion. It is a major problem.

They are of the view that the prime rate, if it were to come down, would probably be more helpful with respect to consumer psychology and helping to bottom out this recession and getting economic activity to turn up again.

Would you agree or disagree with that?

Mr. LINDSEY. I think from their view, they are on target. But what we have is inventories. I think that is really one of the big costs now in the auto industry, the high cost of carrying the inventories. And I think that is correct. I do not argue with them at all.

The CHAIRMAN. What would happen if the Fed were to drop the discount rate another half a percentage point in your opinion.

Mr. LINDSEY. Well, on the short end, my suspicion would be that short-term rates would drop very close to one-half a point. With regard to the prime I couldn't tell for sure. I would say that it would decline. It may or may not go a full one-half point, but I would imagine it would be followed by a decline in prime.

The CHAIRMAN. Does the Fed have the room to do that?

What would that do to long rates, do you suppose?

Mr. LINDSEY. I think that is the $64 question.

The CHAIRMAN. What is your judgment?

Mr. LINDSEY. I would want to really look very long and hard at the conditions in the yield structure, in foreign exchange markets and commodity markets, particularly with regard to the last reduction because we just had a test.

On the question you are asking, I would want to see how markets respond over the next few weeks to that last reduction before deciding how they would respond to another reduction.

The CHAIRMAN. Some people feel that the Fed has the latitude to go lower and they ought to go lower and try to turn this recession around. I take it that you are not prepared to agree with that as such?

Mr. LINDSEY. I would like to see the reaction to the last cut before deciding whether or not it was time for another cut.

Again, I hope that over time the whole yield curve can come down, that we can bring down the rates. But whether or not that action should take place tomorrow, next week, 3 months from now, I would want to wait and see.

The CHAIRMAN. Now with the Federal deficit this year running up in the range of probably $380 billion—take it easy, let's not break the chairs.

With the Federal budget this year probably going to come in around $380 billion, give or take—it could be higher than that depending on how weak the economy remains, because that is very costly in deficit terms—how much does that reduce the latitude of the Federal Reserve Board with respect to what it can do with monetary policy?

Do the Federal deficits hem in the Fed, and if so, to what extent, in terms of its latitude to move monetary policy around to try to, say, get lower interest rates?

Mr. LINDSEY. There's no question that fiscal policy has an important impact on the economy, on inflationary expectations, on price movements, on interest rates, what have you. And they then impact on the decisions that the Fed will make.

I will stress that I think that that relationship is an indirect one and it is important to study the underlying data as opposed to what may be happening today or tomorrow with regard to the deficit.

The large part is cyclical, part of the stabilizing process——

The CHAIRMAN. They haven't been cyclical since the early 1980's. They have been cyclical to a limited extent, but they have been very large and they haven't gotten any smaller, have they?

Mr. LINDSEY. That is correct.

The CHAIRMAN. They seem to be cyclical on the side of getting bigger.

What is your estimate as to when you think we might see a balanced Federal budget?

Mr. LINDSEY. Senator——

The CHAIRMAN. By the time your term is up, the year 2000?

Mr. LINDSEY. I would hope we would get one before that.

The CHAIRMAN. We would all hope that but, as a practical matter, do you really think we're likely to?

Mr. LINDSEY. Senator, I really cannot predict what is going to happen. It depends on decisions I will not be involved in in large measure: spending decisions, tax decisions. So I am sorry.

The CHAIRMAN. If we use the last 11 years as a guide, if we just took those as a trend line guide and tried to decide where that might be taking us, is there much reason to think that when it has been going up like this over a period of time that, all of a sudden, it's going to go down by the same amount and get to zero?

Mr. LINDSEY. I think—I don't know if I would follow—I share your desire for lower deficit. I don't know if I would do the kind of linear extrapolation you just did.

The CHAIRMAN. Maybe not. Maybe you see something that will bring us down and get us off that trend line.

Mr. LINDSEY. I think working in favor of deficit reduction is—for every 1 point increase in real growth in the economy, the Federal Government collects substantially more than 1 percent more revenue. For inflation, it is slightly more than 1 percent more revenue.

As long as you can keep the Federal expenditures in line with GNP growth, or hopefully lower than GNP growth, the tax line will eventually catch the spending line. But again, there is no way that will happen unless spending is restrained to no more than the rate of GNP growth.

The CHAIRMAN. How serious are our banking problems at the moment?

Mr. LINDSEY. I think they are a matter of significant concern. I think to some extent things have improved slightly.

If you had asked me that question last December, I may have been more pessimistic than I am now. But I think we are beginning to see a response to regulatory actions.

I mentioned, in response to one of your earlier questions regarding the agreement between the various bank regulators on how one should evaluate asset values for banks. One part of that is still out for public comment. I think that when that process is finished that would also be helpful. I also think that the reduction in interest rates since then has been helpful with regard to the banking situation.

So although things have improved, I think it is still a matter of serious concern.

The CHAIRMAN. I know you worked on the administration's financial banking reform proposals. Do you support the proposal to allow nonfinancial firms to acquire banks?

Mr. LINDSEY. I do in the context that it was placed in the administration proposal, and it was as a way of increasing capital availability for the banking industry and it would come about only in circumstances where there was adequate capital in the bank in question.

Let me say, having that as a bottom line conclusion, that there are many pros and many cons to getting to that bottom line conclusion. And I fully appreciate some of the concerns that you and others have expressed with regard to that.

The CHAIRMAN. Let me ask you this. Do you feel sufficiently familiar with the regulatory restructuring proposals in that package to be able to say whether you support them or not?

Mr. LINDSEY. Yes, I support them.

The CHAIRMAN. Any reservations?

Mr. LINDSEY. I would phrase it this way: The one thing that struck me the most in working on that issue was that there is no single right issue to any problem. You've got a whole range of issues out there.

What I believe the Treasury package represents is a list of good answers that when put together in a balanced form probably represents the best package that could hang together as a whole package. To say that, are there reservations, could things be done another way, there is no question. But there is no single right answer.

The CHAIRMAN. If you look at it now with the Fed hat on, the Fed has argued that it needs some supervisory responsibility for international size banks?

Mr. LINDSEY. Yes.

The CHAIRMAN. Would you agree with that?

Mr. LINDSEY. Again, I think I would be able to answer that question best after I had some experience there. The Bush Task Force back in 1984 came up with that as one of the changes. Another is one of the differences between the Treasury's proposal and the Bush Task Force was just the point you mentioned.

I think it is a very arguable case. I think it can go either way. I am willing to say that that is not the kind of difference that I would fall on my sword on. I think it is one that could go either way.

The CHAIRMAN. The administration has advanced the position that when the FDIC needs to borrow more money, which they are now beginning to do, that they ought to come borrow it from the Federal Reserve. Is that a good precedent to be setting here?

Mr. LINDSEY. The precedent was set in the 1930's. That was how the FDIC——

The CHAIRMAN. Are we in the 1930's?

Mr. LINDSEY. No. But the precedent existed.

The choice really—there were four choices. One, you could not bail out the BIF, but I don't think that is a good one. You could have the Fed do it, you could have Treasury do it, or you could decide both in the cases of loans, or you could have it that the BIF put up the money or the Treasury or the Fed put up the money and the BIF did not have to repay it.

From a fiscal policy perspective, it really doesn't matter whether it be the Fed or the Treasury. And the reason that the Treasury study picked the Fed was that precedent that I just mentioned.

The CHAIRMAN. Well, I understand that they picked the Fed. We've got to make a decision up here. Do you think it ought to be the Fed?

Mr. LINDSEY. I don't think it matters, Senator.

The CHAIRMAN. That's interesting.

There are some other questions that I am going to submit to you for the record and ask you to respond to.

I want to pose one important question here that we pose to all prospective nominees to independent regulatory agencies, and I think it is particularly relevant in your case because you come out of an administration that obviously has been doing a lot of jawboning on the Fed. There are some people that have suggested that you are really designed to be the administration's man on the Fed because you are coming from the White House and you have been made to qualify for the Richmond seat, if you will, and I have already said that I have some question about that.

I need to know two things in this area. One is that you in fact would be an independent member of the Fed, and I mean absolutely independent and give John Sununu or anybody else that tried to impinge on your independence the cold shoulder. I need to know that and that is the easiest part.

And the second part is I need to know that you have enough independence of mind that you are not going in with a fixed notion, whether it is supply side economics out of the 1980's or whatever, that in effect gives you a locked mentality and would destroy your independence of thought, for reasons of the fact that you've already made up your mind from some rigid ideology or an ideological set of notions.

I would like you to comment on both of those.

Mr. LINDSEY. Senator, let me assure you I am absolutely committed to the complete independence of the Fed. I think that is its great strength. My career, I think, demonstrates that I make up my own mind and, when at the Federal Reserve, I will make up my own mind.

With regard to ideology, I would point out some comments of supply siders about my books. One of the things I found was that the demand side effect from the tax cuts was as large, perhaps larger, than the supply side effects. So I don't think that I have a rigid ideological position one way or the other. And I think—I will commit that I will make every effort to keep my mind open with regard to the information that comes before me.

The CHAIRMAN. I appreciate that.

It has been a long hearing this afternoon. We have had to move it on a couple of occasions. We had it scheduled earlier as an accommodation to you. But we had members on both sides who could not be present at a date that we had before, so we have had to change it to make it be a day at which you could be present and they could be present as well. So that has taken us a little longer.

I appreciate your comments today and we thank you for your testimony.

Mr. LINDSEY. Thank you very much, Senator.

The CHAIRMAN. Very good.

The committee stands in recess.

[Whereupon, at 5:11 p.m., the hearing was adjourned.]

[Biographical sketch of nominee, response to written questions, and additional material supplied for the record follow:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Lindsey (LAST) Lawrence (FIRST) Benjamin (OTHER)

Position to which nominated: Governor, Federal Reserve System Date of nomination:

Date of birth: 18 (DAY) 7 (MONTH) 54 (YEAR) Place of birth: Peekskill, New York

Marital status: Married Full name of spouse: Susan Ann (McGrath) Lindsey

Name and ages of children:

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Bowdoin College	1972-1976	A.B.	1976
Harvard University	1977-1981	M.A.	1981
Harvard University	1984-1985*	Ph.D.	1985

*During that academic year I was on the faculty as an instructor, pending completion of my dissertation. I was not an enrolled student.

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships, and any other special recognitions for outstanding service or achievement.

Citicorp/Wriston Fellow for Economic Research, 1988.

Outstanding Doctoral Dissertation Award, National Tax Association, 1985 for Simulating the Response of Taxpayers to Changes in Tax Rates.

Noyes Prize in Political Economy, Bowdoin College, 1976.

Elected to Phi Beta Kappa, Alpha of Maine, 1975.

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
Phi Beta Kappa		1975-present
National Tax Association	Federal Taxation & Finance Comm.	1986-1989
National Tax Association		1984-present
American Economics Assoc.		1983-present

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.

Special Assistant to the President for Policy Development
The White House, 1/90 - present

Associate Director for Domestic Economic Policy, Office of Policy Development, The White House, 1/89 - present

Associate Professor, Economics, Harvard University, 7/88- pres. (on leave)

Assistant Professor, Economics, Harvard University, 6/85-6/88

Instructor, Economics, Harvard University, 9/84-5/85

Faculty Research Fellow, National Bureau of Economic Research, 9/84-1/89

Senior Staff Economist for Tax Policy, Council of Economic Advisers, 7/83-8/84

Staff Economist, Taxation, Council of Economic Advisers, 9/82 -6/83

Junior Staff Economist, Public Finance, Council of Economic Advisers, 9/81-6/82

Teaching Fellow, Harvard University, 9/78-8/81

Research Assistant, National Bureau of Economic Research 6/78-8/81

Employment Record continued-

Teacher Aide for the Learning Disabled, Lakeland School district, New York, 1/77-6/77

Salesperson, Gazelle Products, Waterville, Maine, 9/76-12/76

Owner/Operator, The Hot Dog Stand, Bath, Maine, Summers 1975 and 1976.

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.

Special Assistant to the President for Policy Development
The White House

Associate Director for Domestic Economic Policy, Office
of Policy Development, The White House

Senior Staff Economist for Tax Policy, Council of Economic
Advisers

Staff Economist, Taxation, Council of Economic Advisers

Junior Staff Economist, Public Finance, Council of Economic
Advisers

Published writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

Please see attachment

Political affiliations and activities: List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

Member, Wayland Town Republican Committee, Wayland, MA
1985-89

Chairman, 1988-89

PUBLICATIONS

The Growth Experiment: How the New Tax Policy Is Transforming the U.S. Economy. Basic Books, Inc., New York, 1990.

"Managing the Variability of the Social Security System With the Personal Income Tax", in Weaver (ed.) Social Security's Looming Surpluses, American Enterprise Institute, 1991 (forthcoming).

"The University and the Reemergence of Economic Individualism", in Hanson and Meyerson (ed.) Higher Education in a Changing Economy, American Council on Education, 1990.

"Did New York's Tax Cuts Work?" NY: The City Journal, Autumn 1990 with Ed Rubenstein.

"Let's Push Now for Capital Gains Tax Cut," USA Today, September 21, 1990.

"Envy is No Basis for Tax Policy," The Washington, Post, March 20, 1990.

"It's Time for Another Cut in Tax Rates," Forbes, March 5, 1990, pp. 82-86.

"Tax Induced Trading: The Effect of the 1986 Tax Reform Act on Stock Market Activity" The Journal of Finance with Paul J. Bolster and Andrew Mitrusi, June 1989.

"Budget Neutral Options to Encourage Charitable Giving", in The Future of the Nonprofit Sector, Jossey-Bass, 1989.

"The Massachusetts Miracle", Regulation, December 1988.

"High Risks, High Rewards", Currents, November/December 1988, pp.10-15.

"Massachusetts Miracle -- or Mirage?" The New York Times, October 5, 1988, p.A33.

"Turning Deficit into Surplus" The Boston Herald, October 2, 1988, pp.23-26.

"Supply Side Lessons for Deficit Reduction" Business Economics: The Journal of the American Association of Business Economists, October 1988.

"Better Child Care Cheaper," The Wall Street Journal, July 5, 1988.

"Socialism and the Supply Side in Sweden", The Wall Street Journal Europe, June 6, 1988.

"Who Managed the Massachusetts Miracle?" The Wall Street Journal, April 5, 1988.

"The Guru of Tax Cuts" The Sunday Times (London), March 20, 1988.

"Capital Gains" Tax Notes, January 25, 1988 with Jane Gravelle.

"Tax Cuts and Taxpayer Behavior: Alternative Explanations of Income Changes in the 1980s" in Tax Policy and the Economy Vol 2, Lawrence Summers (ed.) National Bureau of Economic Research, 1988.

"Cut Capital Gains Taxes" The Journal of Commerce, December 29, 1987.

"The Wrong Two Percent Solution" The Journal of Commerce, November 19, 1987.

"Estimating the Behavioral Response of Taxpayers to Changes in Tax Rates: 1982-1984 With Implications for the Revenue Maximizing Tax Rate" Journal of Public Economics July 1987.

"Federal Deductibility of State and Local Taxes: A Test of Public Choice by Representative Government", in Rosen (ed.) Fiscal Federalism, National Bureau of Economic Research: Cambridge", 1987.

"Capital Gains Taxes Under the Tax Reform Act of 1986: Revenue Estimates Under Various Assumptions", National Tax Journal, September, 1987.

"Capital Gains Rates, Realizations, and Revenues" in The Effects of Taxes on Capital Accumulation, edited by Martin Feldstein, pp.69-97, University of Chicago Press, 1987.

"Criticizing the CBO Analysis of ERTA's Effect on the Distribution of Income and Taxes", Tax Notes, May 4, 1987, pp.491-496.

"Individual Giving Under the Tax Reform Act of 1986", in The Constitution and the Independent Sector, Independent Sector and United Way Institute: Washington, March 1987.

"Rates, Realizations, and Revenue of Capital Gains" in Taxes and Capital Formation, edited by Martin Feldstein, Chicago: University of Chicago Press, 1987.

"Gifts of Appreciated Property: More to Consider" Tax Notes, January 5, 1987, pp.67-70.

"Revenue Response to the 1982 Personal Tax Cuts -- A Reply", Tax Notes, October 13, 1986.

"Misguided Capital Gains Levy" Wall Street Journal, September 10, 1986.

"Capital Gains Tax Rates and Tax Revenues", Testimony before the Senate Small Business Committee, The Congressional Record, June 4, 1986.

"Lessons of the 1981 Tax Cut", The Wall Street Journal, May 6, 1986.

"Tax Reform and Charitable Giving" in Philanthropy, Voluntary Action and the Public Good, Independent Sector and United Way Institute, March 1986.

"Revenue Response to the 1982 Tax Cuts", Tax Notes, March 17, 1986.

"The Effect of the President's Proposal on Charitable Giving", The National Tax Journal, March 1986.

"The 1982 Tax Cut: The Effect of Taxpayer Behavior on Revenue and Distribution" Proceedings of the National Tax Association, November 1985.

"Giving and Tax Cuts: Recent Experience" Tax Notes, September 16, 1985.

"Tax Reform and Charitable Giving", Testimony before the House Committee on Ways and Means, The Congressional Record, July 22, 1985.

"Simulating Non-Linear Tax Rules and Non Standard Behavior: An Application to the Tax Treatment of Charitable Contributions", Behavioral Simulation Methods in Tax Policy Analysis, edited by Martin Feldstein, University of Chicago Press, 1983.

"Alternatives to the Maximum Tax on Earned Income", Behavioral Simulation Methods in Tax Policy Analysis, edited by Martin Feldstein, University of Chicago Press, 1983.

"Is the Maximum Tax on Earned Income Effective?" National Tax Journal, June 1981.

Political contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.

None

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

Yes. Resignation from Harvard effective upon confirmation. My current employment with the Executive Office of the President also terminates upon the start of my employment at the Federal Reserve

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

None

3. Has anybody made you a commitment to a job after you leave government?

No

4. Do you expect to serve the full term for which you have been appointed?

Yes

Qualifications

I believe that my career as a professional economist has provided me with the tools, background, and insights necessary to make a significant contribution to the country as a Governor of the Federal Reserve System. I have been fortunate to have been able to participate in the formation of economic policy in two Administrations as well as conduct academic research and develop a university curriculum based on contemporary economic thought and policy.

As Special Assistant to the President for Policy Development, I have been responsible for developing policy and analyzing the range of microeconomic and macroeconomic issues facing the country today. In recent months, my primary mission has been to work with the Department of Treasury in developing a comprehensive banking and financial services reform package. This has exposed me to the cutting edge of thinking and policy creation in this important area of Federal Reserve responsibility. My three years on the staff of the Council of Economic Advisors and two years at the Office of Policy Development have provided me with a broad exposure to the process of policy formation in two Administrations.

My four and one half years on the faculty of Harvard University involved both research on key public policy issues and the development of comprehensive academic curriculum. The latter included the creation of a course on American Economic Policy with particular emphasis on the effects of monetary and fiscal policy. My academic research has been published in leading economic journals including the Journal of Finance and the Journal of Public Economics as well as in research volumes sponsored by the American Enterprise Institute and the National Bureau of Economic Research. This research has led to awards from both the National Tax Association and the Citicorp/Wriston Fellowship.

I believe that this combination of academic and practical experience in the realm of public policy qualifies me to meet the intellectual and decision making challenges faced by a Governor of the Federal Reserve System.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

None

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

None

3. Describe any business relationship, dealing or financial transaction (other than taxpaying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

None, except employment

4. List any lobbying activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

"Capital Gains Tax Rates and Tax Revenues", Testimony before the Senate Small Business Committee, The Congressional Record, June 4, 1986

"Tax Reform and Charitable Giving," Testimony before the House Committee on Ways and Means, The Congessional Record, July 22, 1985

5. Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.

I will make any divestment, as required; and alter or sever any relationships, as required.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None

NAFCU

NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
P.O. BOX 3769 WASHINGTON, DC 20007
(703) 522-4770

May 6, 1991

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the Board of Directors and members of the National Association of Federal Credit Unions, I want to lend our support to the nomination of Lawrence Lindsey to the Board of Governors of the Federal Reserve System. In Dr. Lindsey's capacity as Associate Director for Domestic Economic Policy of the White House Office of Policy and Development, NAFCU has had a variety of opportunities to discuss economic and policy issues of direct consequence to our nation's 14,000 credit unions. On these occasions we have been most impressed by his acute understanding of both the micro and macro processes which define our nation's economy. We believe Dr. Lindsey's experience and impressive accomplishments within academia, the private sector, and now as a special assistant to the President amply qualifies him for this most critical position.

Mr. Chairman, I want to thank you and your distinguished colleagues for this opportunity to comment on Lawrence Lindsey's nomination to the Board of Governors of the Federal Reserve System. If NAFCU may be of any further assistance during these crucial nominating proceedings, please call upon us.

Sincerely,

John M. Stanton

John M. Stanton
Chairman

JMS:smb

THE WHITE HOUSE

WASHINGTON

May 22, 1991

Dear Ms. Breneman:

Attached please find the questions submitted by Senator Riegle and my answers to those questions. I have adhered to the format outlined in Senator Riegle's letter of May 13.

Thank you for your attention. I look forward to hearing from the Committee.

Sincerely,

Lawrence B. Lindsey

Lawrence B. Lindsey
Special Assistant to the President
for Policy Development

Ms. Lory Breneman
Chief Clerk
Committee on Banking, Housing, and
Urban Affairs
United States Senate
534 Senate Dirksen Office Building
Washington, DC 20510-6075

Q1. In your view, how should the Fed conduct monetary policy? What should the Fed target and what should it take into consideration in changing its targets?

A1. Monetary policy should be directed at achieving the objectives of high employment, sustainable growth, and price stability. As a practical matter, monetary policy influences these objectives only indirectly, and with some lag. Therefore, the Fed should monitor other economic data in gauging whether or not policy is on the right track.

In particular, trends in nominal GNP should be watched closely. Monetary policy has its most immediate impact on the overall dollar volume of spending. The decomposition of nominal spending growth between real output growth and price increases tends to be determined more by underlying economic conditions that are not easily influenced by monetary policy. The goal for nominal GNP growth, in turn, is determined by the three principal objectives mentioned above.

I would also attach a good deal of importance to the behavior of the money stock, especially M2. Nominal GNP has tended over time to follow the trends in M2 growth and M2 is a variable that the Federal Reserve not only can influence over spans of a few months, but can monitor on a very current, weekly basis. M2 thus provides a reasonably good, if indirect, indicator of trends in nominal GNP which might not become evident until much more data becomes available.

In highlighting nominal GNP and M2 as key indicators, I do not mean to imply that these should be the only things considered in a decision about policy. A full range of information about the condition of labor and capital markets must be taken into account. In particular, the yield curve in the credit market, the level and rate of change of commodity prices, and movements of foreign exchange rates, are all useful in assessing the efficacy of policy changes.

Q2. Do you believe the Fed has adequate tools to revive the economy in the near-term and control inflation in the longer-term?

A2. One must be careful not to expect too much of a single policy tool, and the Federal Reserve should not be expected to be able to fine-tune the economy's performance, ensuring continuous healthy growth and consistently stable prices. Over the long run, monetary policy can be viewed as influencing primarily the price level, with real activity being more a function of such variables as population and labor force growth, technology, and growth of the capital stock -- what economists refer to as "supply" factors. However, in the short run, Federal Reserve actions can have a substantial influence on the aggregate demand for goods and services, and, when there are significant recessionary tendencies in the economy and rising slack is diminishing inflationary risks, monetary policy can be used effectively to help revive sustainable growth. The response of the financial markets and the economy to Federal Reserve actions may not always be the same, but I see no reason to think that the System's policy tools are inadequate to perform these broad functions.

Q3. How confident are you that the recession will end soon? Why?

A3. One can never be absolutely confident of any economic forecast, and thus it is important that policymakers constantly monitor developments and be prepared to change course. That said, I believe that one can cite some indications that the economy is in the process of bottoming out. Consumer spending seems to have firmed in the past few months, since the dropback in oil prices has reversed some of the prior erosion of purchasing power; lower interest rates evidently have stimulated a rise in home sales and housing starts; and inventory positions have been trimmed, notably in the motor vehicle sector, where production is rising currently after two quarters of sharp decline. These developments certainly do not ensure a quick upturn in business activity, but they have been important elements in past economic turnarounds and clearly are a hopeful sign in the present context.

Q4. Excluding social security, which is funded separately, and interest costs, which are caused by deficits, federal spending as a percent of GNP declined in the 1980s, despite the defense buildup. If tax cuts didn't cause the deficit to soar, what did?

A4. There is no question, as I say in The Growth Experiment, that the deficits of the 1980s would have been smaller had the 1981 tax cut not been passed. The combination of demand side and supply side effects from the tax rate reductions were not sufficient, in the aggregate, to fully recoup the revenue which was lost by reducing tax rates.

Quantifying the extent to which the tax cuts contributed to the rising deficits is a complicated task, as your question implies. In The Growth Experiment, I took the 1980 share of GNP allocated to taxes, defense spending, interest, and non-defense non-interest spending as a baseline. I then compared the actual share of GNP in each category in each of the years 1981-1987 with the 1980 level. In order to account for the effect of the added interest costs involved, I assumed that the government borrowed to make up the difference and paid the prevailing interest rate on the amassed debt. Thus, I allocated to tax cuts any interest that was owed as a result of the tax share of GNP falling below its 1980 level. Including these tax-cut-induced interest costs, the total cost of the tax cuts amounted to $130 billion of the $529 billion added deficit during the 1981-1987 period. Using this analysis produces the conclusion that the great majority of the rise in the deficit was attributable to increased defense spending.

While I feel that this "share of GNP method" is the best approach to estimating the contributions of various factors to the rise in the deficit, I fully realize that there are other approaches. Of course, the best approach to fiscal policy is not necessarily to focus on a given number of deficit or surplus as optimal. Instead, national welfare is best served if a level of public spending on each program is selected so that the benefit of the last dollar spent at least equals the cost, including excess burden, of each dollar raised. Setting fiscal policy in line with that criterion will be the challenge of the 1990s.

Q5. You've written that the expansion in the 1980s "revitalized" the economy. But annual income growth of low and moderate income families, the bottom 60% of the income distribution, was anemic -- less than 1% per year. Only the rich did well. Should we be happy with those results?

A5. Senator, I completely share your concern about the slow pace of real income growth for low and moderate income families in America. In my opinion, we should be neither happy nor complacent about the results. In The Growth Experiment, I argued in Chapter 16, entitled "Fairness for Families", that moderate income working families, and particularly working women, are still overtaxed, in spite of the substantial tax rate reductions of the 1980s.

To help tackle this problem, I recommended in Chapter 19 that we increase the personal exemption to $6000 for taxpayers and $3000 for dependents and couple it with a more generous child care deduction. In addition, being particularly concerned with the affordability of housing for middle income families, I recommended the substitution of limited deductibility of home mortgage interest payments (up to $10,000) for all taxpayers, for the current rules allowing full deductibility for those who itemize. Under current law, itemizers tend to be more well to do, thus skewing the benefits of the home mortgage interest deduction toward the upper end of the income scale.

There are many reasons for the low growth of real family incomes in recent decades. Some are demographic, some economic. I believe that the measures I proposed in The Growth Experiment, while not a panacea, will go far to meeting the needs of low and moderate income working families in America.

Q6. The Administration proposes that deposit insurance premiums for banks be capped at 30 basis points. If we assess banks immediately to replenish the fund and cover what could be very high losses in the next few years, we run the risk of further weakening the banking system in what is already a difficult time. But if we have a cap and set the cap too low, we increase the risk unnecessarily that taxpayers will eventually foot part of the bill for bank failures. A recent analysis by the CBO suggests that banks do have the capacity to pay more than 30 basis points, if necessary. Do you support the Administration's 30 basis point cap, and, if so, by what analysis do you choose 30 basis points rather than some other number?

A6. There clearly is a trade-off involved here, as your question quite correctly notes. Unfortunately, even before one gets to the difficult political judgment about the appropriateness of placing an additional burden on the taxpayers, one is confronted with the impossibility of predicting the precise effects of any given premium level on the deposit insurance fund. No static comparison of the present level of bank earnings with alternative insurance charges -- even if performed at a detailed, disaggregated level -- can yield a reliable estimate of the effects on either the banking system or the insurance fund. It is to be expected that a significant change in the cost structure of banking, such as would be involved in a major further increase in premiums, would prompt a variety of adjustments in liability structures and the pricing of loans, deposits and other banking services. The competitive effects on banks vis-a-vis other financial intermediaries and markets would affect, in turn, the growth of the insurance base and thus the net revenue to the insurance fund. In the worst case, higher insurance premiums would increase the number of bank failures enough to add significantly to costs faced by the fund. There is no model that can simulate all of these variables.

Under the circumstances, I think the best that can be done is to recognize a couple of simple and obvious facts. First, our financial markets are sufficiently competitive that a hike in insurance costs probably cannot be passed through fully to bank customers. That competitive limitation on the pass-through of additional costs probably is particularly relevant to the minority of banks that are not now in a strong position, with deep capital and healthy earnings; this suggests that the adverse effects on the banking system of a large increase in deposit insurance premiums might be greater than any simple aggregative analysis would imply. Second, deposit insurance premiums have only recently been raised sharply from what they were just a couple of years ago, and we have not had an opportunity to observe the impact of that change; it would seem prudent to assess that experience before going very much further. Whether 30 basis points is just the right number to set as the cap, I don't think anyone can say. But I believe there is a virtue in setting some cap, to provide the banking industry, and investors and others who must assess its prospects, with a measure of certainty about the operating environment for at least a span of time.

Q7. At a recent hearing, Paul Volcker pointed out that the argument for merging banking and commerce depended on an assumption that capital market imperfections prevented the economically optimal flow of capital into banking. He doubted that and questioned whether nonfinancial firms would want to make portfolio investments in banks without trying to capture other benefits that the firewalls were designed to prevent. Do you disagree?

A7. This is, to be sure, a complex issue, and I understand Chairman Volcker's concerns. However, I would approach the question somewhat differently. In a sense, the existing limitations on the ownership of banking firms by commercial enterprises are themselves a capital market imperfection, impeding a flow of investment into the banking industry. It is quite possible that, if the barrier were lowered, commercial firms would be inclined to make such investments. It seems to me a reasonable approach to leave this question to be answered by the market, so long as we are comfortable that we have erected adequate firewalls and other protections to avoid abuses or undesirable access to the federal safety net, as the Treasury proposal seeks to do. If commercial firms choose not to avail themselves of this opportunity, we'll end up in essentially the same position we're in now, having lost nothing. If they do choose to invest, then we may find that the resulting firms, by being able to provide a broader range of services, can more effectively meet the needs of the public; whether such economies of scope actually would be realized is uncertain, but again would be something for the market to determine.

Q8. You opposed the 1986 changes in capital gains taxation, and in a 1987 article projected sharp reductions in revenue from that source. Your projection for 1987 was 40% below actual receipts, and you were 50% low for 1988. Has that caused you to revise your thinking about the revenue effects of changes in capital gains tax rates?

A8. The 1987 article to which you refer, "Capital Gains Taxes Under the Tax Reform Act of 1986: Revenue Estimates Under Various Assumptions," was a technical piece on tax simulation issues relating to capital gains. A total of 14 separate revenue estimate series were constructed reflecting differing assumptions on the nature, timing, and magnitude of taxpayer response to the 1986 tax rate changes, including a "baseline" or no-tax-change estimate.

You are correct to note that the estimates, which were based on an another work of mine, "Capital Gains Rates, Realizations, and Revenues", were well below the actual level of revenue collected. Methodologically, the revenue estimating process can be separated into two parts. First, a baseline revenue estimate was generated based on assumptions about the likely rate of growth of capital gains realizations and receipts. This baseline assumed no changes in tax law and consequently, no tax-induced changes in taxpayer behavior. Second, different sets of behavioral assumptions were applied to the baseline to see what effect they had on the expected level of realizations and the consequent impact on tax revenue. A careful review of this process and the data that has emerged since the paper was written indicates that the principal reason for the discrepancy between predicted revenue and actual revenue can be found in the first step: creating a baseline revenue estimate. By and large, the discrepancy does not seem to be caused by the behavioral assumptions used.

At the time the paper was written in early 1987, the latest detailed tax model data available was the 1983 Individual Tax Model File Public Use Sample. In order to create a baseline level of capital gains for later years, an average annual rate of capital gains growth of 9.6 percent was assumed. (A detailed description of the assumptions appears on pages 495-497 of the paper.) In fact, realizations grew at an annual rate of 18.2 percent, nearly twice as fast as predicted, and my estimate of baseline realizations for 1987 was reached in 1985. Thus the forecast baseline level of capital gains was out of date long before the tax law change was implemented.

Given the data we have available today, I would conclude that of the 14 sets of assumptions examined in the paper, the one that best fits our experience seems to have been the Prospective version of the Auten-Clotfelter model, which was particularly effective at predicting the enormous behavioral response in 1986 to the prospect of higher capital gains tax rates the next year. In light of these results, the answer to your question is yes. I have revised my thinking on the revenue effect of capital gains tax cuts somewhat. The "Auten-Clotfelter" behavioral model implies a revenue maximizing capital gains tax rate of 21%. By contrast, the model I used as the "Lindsey" model in the paper implied a revenue maximizing tax rate of 18%. I would thus revise upward my estimate of the revenue maximizing tax rate for capital gains.

Q9. The Industrial Bank of Japan late last year published a book entitled The New Global Age: Japan's Position in the World, which analyzes the world economy and political situation in the post Cold War era.

This book claims that the Reagan Administration tax cuts, which were "designed to promote savings, stimulated consumption instead and exacerbated the shortage of funds to meet investment needs." Higher U.S. interest rates, this book contends "made the strong dollar a reality and contributed to the introduction of foreign capital to make up for the fiscal deficit. The policy also deprived American industry of price competitiveness and invited the hollowing-out of the manufacturing industry."

Do you agree with this analysis of the Reagan Administration economic policies done by IBJ and if not, where do you differ?

A9. The actual effects of the Reagan Administration tax cuts on the U.S. manufacturing industry have been more complex than this statement suggests. I do agree that, by contributing to the vigor of the recovery from the recession in the early 1980s, the tax cuts did increase money demand above the levels we otherwise would have experienced. This was coupled with the effect of the tax cuts in making investment in plant and equipment more attractive. Thus, for both demand side and supply side reasons, America was the premier nation in the world in which to invest. The increased demand for U.S. dollar-denominated investments in turn, placed upward pressure on the value of the dollar in foreign exchange markets. And, as the question notes, this resulted in a decline in the international price competitiveness of U.S. produced products. This was a major factor in the decline in the U.S. trade position during that period.

However, I do not agree that this led to a "hollowing out" of our manufacturing industry. We devoted a larger share of GNP to gross business fixed investment, in real terms, during the 1980s as we did in the late 1970s. In part, this was made possible by the capital inflow from abroad. Moreover, while the share of real manufacturing output in GNP dipped in the recession of 1982 as in other recessions, it recovered to the 22 percent share of GNP experienced in the late 1970s, and by 1988 had reached 23 percent of GNP. This share was higher than the U.S. had experienced for many years. U.S. manufacturing productivity soared during this period, rising more than twice as fast as European manufacturing productivity and nearly equalling Japanese productivity gains.

Clearly the adjustments experienced by U.S. manufacturing industries during the 1980s were painful. However, I believe that we have emerged from the decade with our industries well positioned to compete internationally. The rapid rise in U.S. exports in recent years is testimony to the revival of our international competitiveness.

Q10. In your book published last year entitled The Growth Experiment: How the New Tax Policy is Transforming the U.S. Economy, you state that the tax cuts of the early 1980's "made the U.S. once again the leader of the world economy."

One of your colleagues from Harvard, Professor Benjamin Friedman takes a different view of the tax and economic policies of the Reagan Administration in his book entitled Day of Reckoning. He contends in that book that the tax cuts of the early 1980's led to our massive budget deficits which we finance in part by foreign borrowing. These budget deficits, in his view, contributed to our massive trade deficits. As a consequence whereas in the early 1980's we were the largest creditor nation in the world, we are now the largest debtor nation. He contends this development will undermine our nation's political and economic leadership role. He states for example on page 13 of his book:

> "World power and influence have historically accrued to creditor nations ... Over time the respect and even deference, that America had earned as a world leader will gradually shift to the new creditor nations that are able to supply resources where we cannot, and America's influence over nations and events will ebb."

Why do you contend then that the policies of the Reagan Administration have given the U.S. leadership of the world economy?

A10. I fully share your concern about the size of the U.S. budget deficit and the desirability of increasing our nation's saving rate. There is no question that our economy would be better off today had we saved and invested more in the past; there is no question that we will be better off in the future if we invest more today.

My former colleague Benjamin Friedman, to whom you referred in your question, and I debated at the University Club here in Washington last July. To the surprise of most of those present, Ben and I agreed on virtually everything. We had similar estimates of the supply and demand side effects of the Reagan tax cuts, their effect on the economy, and policy prescriptions for the economy today. Specifically, we agreed on those aspects of the 1980s which were successful, and those which were not.

You are correct in noting the deterioration of the net creditor position of the United States during the 1980s. The key question is whether the capital imported during the 1980s was wisely used. Gross private domestic investment rose as a share of GNP during this period. Some of this capital inflow also financed public sector capital formation, in the form of defense capital purchases and R&D. It remains an open question whether these investments were cost effective.

At the same time, there are other indicators of economic performance which suggest that the U.S. did quite well in the international context during the 1980s. I think that a contrast of our performance, particularly with that of Europe, indicates that we have much of which to be proud.

For example, during the Reagan Administration (1981-1989), America's GNP growth averaged 2.9. percent. By contrast, the big four European economies averaged only 2.3 percent growth. This performance was a switch from the 1970s when European growth was slightly more than ours and the 1960s when European growth averaged nearly a full percentage point faster than ours annually.

Particularly impressive was the fact that during the 1980s not only did manufacturing's share of GNP go up, but America's share of the world's industrial output also rose. U.S. manufacturing productivity rose more than twice as fast as Europe's and nearly as fast as Japan's. I think that this speaks well of the investments we made in our manufacturing infrastructure during this period.

The level of unemployment is also a very important indicator of the performance of economic policy. During the 1960s and 1970s American unemployment rates typically ran at twice European levels. During the 1980s, American unemployment rates fell below and stayed below European levels for the first time. America created twice as many new jobs as Europe and Japan combined during this period.

This does not mean that everything was perfect during the 1980s. But, there are many aspects of our economic performance of which we have every right to be proud. It also does not mean that we have the right to be complacent about our economic future. We must act to increase our nation's saving rate, improve our educational standards, and increase the productivity of our nation's workers. The Federal Reserve can help in this task by pursuing policies which will provide a stable, non-inflationary environment, conducive to saving, investment, and capital formation.

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