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1ST STORY of Level 1 printed in FULL format.

Star Tribune

December 1, 1996, Metro Edition

SECTION: News; Pg. 27A

LENGTH: 2227 words

HEADLINE: turning TAIL;
Making pregnancy optional, new technology lets men feel they're off the hook

BYLINE: George Akerlof; Janet Yellen

BODY:

In 1970 a permanent cure to poverty in America seemed on the horizon. Federal poverty warriors appeared to be gaining ground, and decisions by state courts regarding abortion and by state legislatures regarding the availability of contraception seemed to be giving poor families the tools to control the number and the timing of their children.

The dream of eliminating poverty, however, has remained unfulfilled. Not only have U.S. poverty rates stayed stubbornly constant over the intervening 25 years; poor families have seen their lot worsen as huge increases in single-parent families, more and more headed by unmarried mothers, have led to the feminization of poverty.

Since 1970, out-of-wedlock birth rates have soared. In 1965, 24 percent of black infants and 3.1 percent of white infants were born to single mothers. By 1990 the rates were 64 percent for black infants, 18 percent for whites. Every year 1 million more children are born into fatherless families. If we have learned any policy lesson well over the past 25 years, it is that for children living in single-parent homes, the odds of living in poverty are great. The policy implications of the increase in out-of-wedlock births are staggering.

Searching for a reason

Efforts by social scientists to explain the rise in out-of-wedlock births have so far been unconvincing, though several theories have a wide popular following. One argument that appeals to conservatives attributes the increase to overly generous federal welfare benefits. But welfare benefits could not have played a major role in the rise of out-of-wedlock births because benefits rose sharply in the 1960s and then fell in the 1970s and 1980s, when out-of-wedlock births rose most.

Another popular explanation is that single parenthood has increased since the late 1960s because of the change in attitudes toward sexual behavior. But so far social scientists have been unable to explain exactly how that change came about or to estimate in any convincing way its quantitative impact. In recent work we have been able to provide both.

Star Tribune, December 1, 1996

Beyond the shotgun

In the late 1960s and very early 1970s, before Roe vs. Wade, many major states, including New York and California, liberalized their abortion laws. At about the same time it became easier for unmarried people to get contraceptives. This sudden increase in the availability of both abortion and contraception - we call it a reproductive technology shock - is deeply implicated in the increase in out-of-wedlock births.

Although many observers expected liberalized abortion and contraception to lead to fewer out-of-wedlock births, the opposite happened - because of the erosion in the custom of shotgun marriages.

Until the early 1970s, shotgun marriage was the norm in premarital sexual relations. The custom was succinctly stated by one San Francisco resident in the late 1960s: If a girl gets pregnant, you marry her.

Since 1969, however, the tradition of shotgun marriage has seriously eroded. For whites, in particular, the shotgun marriage rate began its decline at almost the same time as the reproductive technology shock. And the decline in shotgun marriages has contributed heavily to the rise in the out-of-wedlock birth rate for both white and black women. In fact, about 75 percent of the increase in the white out-of-wedlock first-birth rate, and about 60 percent of the black increase, between 1965 and 1990 is directly attributable to the decline in shotgun marriages. If the shotgun marriage rate had remained steady from 1965 to 1990, white out-of-wedlock births would have risen only 25 percent as much as they have. Black out-of-wedlock births would have increased only 40 percent as much.

What links liberalized contraception and abortion with the declining shotgun marriage rate? Before 1970, the stigma of unwed motherhood was so great that few women were willing to bear children outside of marriage. The only circumstance that would cause women to engage in sexual activity was a promise of marriage in the event of pregnancy.

Men were willing to make (and keep) that promise, for they knew that in leaving one woman they would be unlikely to find another who would not make the same demand. Even women who would be willing to bear children out of wedlock could demand a promise of marriage in the event of pregnancy.

The increased availability of contraception and abortion made shotgun weddings a thing of the past. Women who were willing to get an abortion or who reliably used contraception no longer found it necessary to condition sexual relations on a promise of marriage in the event of pregnancy. But women who wanted children, who objected to abortion for moral or religious reasons, or who were unreliable in their use of contraception found themselves pressured to participate in premarital sex without being able to exact a promise of marriage in case of pregnancy. These women feared, correctly, that if they refused sexual relations, they risked losing their partners.

Advances in reproductive technology eroded the custom of shotgun marriage in another way. Before the sexual revolution, women had less freedom, but men were expected to assume responsibility for their welfare. Today women are more free to choose - but men have afforded themselves the comparable option.

If she is not willing to have an abortion or use contraception, the man can reason, why should I sacrifice myself and get married? By making the birth of the child the physical choice of the mother, the sexual revolution has made marriage and child support a social choice of the father.

Many men have changed their attitudes regarding the responsibility for unplanned pregnancies. As one contributor to the Internet wrote recently to the Dads Rights Newsgroup, "Since the decision to have the child is solely up to the mother, I don't see how both parents have responsibility to that child."

That attitude, of course, makes it far less likely that the man will offer marriage as a solution to a couple's pregnancy quandary, leaving the mother either to raise the child or to give it up for adoption.

Before the 1970s, unmarried mothers kept few of their babies. Today they put only a few up for adoption because the stigma of unwed motherhood has declined. The transformation in attitudes was captured by the New York Times in 1993: In the old days of the 1960s, '50s and '40s, pregnant teenagers were pariahs, banished from schools and ostracized by their peers, or they scurried out of town to give birth in secret. Today they are supported and embraced in their decision to give birth, keep their babies, continue their education and participate in school activities.

Since out-of-wedlock childbearing no longer results in social ostracism, literally and figuratively, there is no longer a need to marry at the point of the shotgun.

Theory and facts

How well do the data fit the theory?

In 1970 there were about 400,000 out-of-wedlock births out of 3.7 million total births. In 1990 there were 1.2 million out-of-wedlock births out of 4 million total. From the late 1960s to the late 1980s, the number of births per unmarried woman roughly doubled for whites, but fell by 5 to 10 percent for blacks. The fraction of unmarried women rose about 30 percent for whites, about 40 percent for blacks. The fertility rates for married women of both races declined rapidly (also, of course, contributing to the rise in the out-of-wedlock birth ratio).

If the increased abortions and use of contraceptives caused the rise in out-of-wedlock births, the increase would have to have been very large relative to the number of those births and to the number of unmarried women. And that was indeed the case. The use of birth control pills at first intercourse by unmarried women jumped from 6 percent to 15 percent in just a few years, a change that suggests that a much larger fraction of all sexually active unmarried women began using the pill. The number of abortions to unmarried women grew from roughly 100,000 a year in the late 1960s (compared with some 322,000 out-of-wedlock births) to more than 1.2 million (compared with 715,000 out-of-wedlock births) in the early 1980s. Thus the data do support the theory.

Indeed, the technology shock theory explains not only the increase in the out-of-wedlock birth rate, but also related changes in family structure and sexual practice, such as the sharp decline in the number of children put up for adoption. The peak year for adoptions in the United States was 1970, the year of the technology shock. Over the next five years the number of agency adoptions was halved from 86,000 to 43,000. In 1969, mothers of out-of-wedlock children who had not married after three years kept only 28 percent of those children. In 1984, that rate was 56 percent; by the late 1980s it was 66 percent.

Unlike the other statistics we have mentioned, the shotgun marriage rate itself underwent only gradual change following the early 1970s. Why did it not change as dramatically as the others? For two reasons. The first is that shotgun marriage was an accepted social convention and, as such, it changed slowly. It took time for men to recognize that they did not have to promise marriage in the event of a pregnancy in exchange for sexual relations. It may also have taken time for women to perceive the increased willingness of men to leave them if they demanded marriage. As new expectations formed, social norms readjusted, and the shotgun marriage rate began its long decline.

In addition, the decreasing stigma of out-of-wedlock childbirth reinforced the technology-driven causes for the decline in shotgun marriage and increased retention of out-of-wedlock children. With premarital sex the rule, rather than the exception, an out-of-wedlock childbirth gradually ceased to be a sign that society's sexual taboos had been violated. The reduction in stigma also helps explain why women who would once have put their baby up for adoption chose to keep it instead.

One final puzzle requires explanation. The black shotgun marriage ratio began to fall earlier than the white ratio and shows no significant change in trend around 1970. How do we account for that apparent anomaly?

Here federal welfare benefits may play a role. For women whose earnings are so low that they are potentially eligible for welfare, an increase in welfare benefits has the same effect on out-of-wedlock births as a decline in the stigma to bearing a child out of wedlock. The difference in welfare eligibility between whites and blacks and the patterns of change in benefits rising in the 1960s and falling thereafter may then explain why the decline in the black shotgun marriage ratio began earlier than that for whites. Because blacks on average have lower incomes than whites, they are more affected by changes in welfare benefits. As a result, the rise in welfare benefits in the 1960s may have had only a small impact on the white shotgun rate but resulted in a significant decrease in the black shotgun marriage rate.

Policy considerations

Although doubt will always remain about the ultimate cause for something as diffuse as a change in social custom, the technology shock theory does fit the facts. The new reproductive technology was adopted quickly and on a massive scale. It is therefore plausible that it could have accounted for a comparably large change in marital and fertility patterns. The timing of the changes also seems, at least crudely, to fit the theory.

From a policy perspective, attempts to turn the technology clock back by denying women access to abortion and contraception is probably not possible. Even if it were, it would almost surely be counterproductive. In addition to probably reducing the well-being of women who use the technology, such measures could lead to yet greater poverty. With sexual abstinence rare and the stigma of out-of-wedlock motherhood small, denying women access to abortion and contraception would probably increase the number of children born out of wedlock and reared in impoverished single-parent families. On the contrary, efforts should be made to ensure that women can use the new technologies if they choose to do so.

Finally, if the technology shock theory does explain the rise in single motherhood, cuts in welfare as currently proposed would only further harm the victims. Such cuts would have little impact on the number of children born out of wedlock while impoverishing those already on welfare yet further. Instead, policy measures to make fathers pay to support their out-of-wedlock children would not only directly contribute to the well-being of children, but also tax men for fathering such children, thereby offsetting at least partially the change in terms between fathers and mothers.

- George Akerlof and Janet Yellen, a husband-wife team of economists, are on leave from the University of California at Berkeley. Yellen is on the Board of Governors of the Federal Reserve System. Akerlof is a senior fellow at the Brookings Institution in Washington, D.C. They wrote this for the Brookings Review.

GRAPHIC: Illustration

LANGUAGE: ENGLISH

LOAD-DATE: December 3, 1996

34TH STORY of Level 1 printed in FULL format.

The San Francisco Chronicle

DECEMBER 25, 1995, MONDAY, FINAL EDITION

SECTION: BUSINESS; Pg. D3; LETTERS TO BUSINESSEXTRA

LENGTH: 620 words

HEADLINE: LETTERS TO BUSINESSEXTRA

BODY:

WHAT'S LEARNING CO.

ACTUALLY WORTH?

Editor -- I'm not embarrassed to admit I never got A's in my economic courses. That is why I can ask, with equal lack of embarrassment, the following: How can a company, such as Learning Co., highlighted on Friday, November 28, be worth $ 606 million when its only asset is seemingly the 240 people who work there?

What's to prevent them from cashing in their stock, walking to an empty building next door, doing the same thing they were the day before and again amassing another stock portfolio worth $ 606 million? George Fulford

Mill Valley

Editor's Response: Good question, although Learning Co. shareholders have 30 days before they can exercise their options.

UNDERAGE ENFORCEMENT

WOULD GO A LONG WAY

Editor -- How is it that nowhere in your piece on college boozing (BusinessExtra, December 11) did you mention the fact (so far as I know still true) that all 50 states prohibit those under 21 from drinking?

Surely strict enforcement of those laws would go a long way toward solving the problem of alcohol abuse among college kids.

If the bars, restaurants and stores knew they'd be busted and face huge penalties; if the colleges made drunkenness a suspendable offense for both students and Greek organizations; if the abusers knew they'd face jail time, fines and the aforementioned suspensions, I bet the problem would disappear fast.

Is this yet another example of folks preferring to spend money on studies instead of simply using the mechanisms already in place? Serena Bardell

San Francisco

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The San Francisco Chronicle, DECEMBER 25, 1995

FED IS CLUELESS

ABOUT ITS POLICIES

The interview with Federal Reserve Board member Janet Yellen, (BusinessExtra, December 11) underscored how clueless the Federal Reserve is when it comes to the impact of their policies on the average American worker.

Yellen states, ''All sectors of the economy seem quite healthy.''

This analysis is in direct conflict with Secretary of Labor Robert Reich's recent complaint that the average worker has derived little financial benefit from the current economic recovery.

It has been well-documented in the news media that the salary benefits of the recovery have been going to the greedy corporate executives who believe it is in the national interest to send manufacturing jobs overseas and or merge their companies through leveraged buyouts or hostile takeovers.

Yellen believes, absurdly, that everything is just great for the average American household.

She states, ''household wealth has also gone up enormously. We've had a trillion dollars in new stock market wealth in 1995.

''Of course, you also have to look at who's getting the wealth.

''We know less than we'd like to about that.'' Janet, read the research by Kevin Phillips.

Phillips has shown that 50 percent of the stocks and bonds in the United States are owned by the richest 1 percent of the population.

Phillips' figures are considered conservative by many people.

These figures are a strong clue that stock market wealth isn't accruing for most members of the middle class.

Populist Senator Ernest Hollings recently stated that Federal Reserve Board Chairman Alan Greenspan works for Wall Street, period.

Janet Yellen's economic views put her firmly in Greenspan's corner.

Tragically, for the declining middle class of America, the Fed's love affair with Wall Street is not about to end. Craig Thunem

Pacifica

Address all correspondence to Letters to BusinessExtra, San Francisco Chronicle, 901 Mission Street, San Francisco, Calif. 94103. Include your name, address and phone number. Anonymous letters will not be published. We reserve the right to edit letters for clarity.

LANGUAGE: ENGLISH

LOAD-DATE: December 25, 1995

35TH STORY of Level 1 printed in FULL format.

The San Francisco Chronicle

DECEMBER 4, 1995, MONDAY, FINAL EDITION

SECTION: BUSINESS; Pg. B1; OM ECONOMICS

LENGTH: 1229 words

HEADLINE: Breaking The Male Bastion

BYLINE: JONATHAN MARSHALL

BODY:

Though hardly a household name, Berkeley economist Janet Yellen is one of the nation's most powerful women.

Currently on leave from the University of California's Haas School of Business, Yellen is one of seven members of the Federal Reserve System's Board of Governors, where she helps steer the U.S. economy.

Yellen was appointed last year by President Clinton to fill a term ending Jan. 31, 2008. She is one of only two women in that traditionally male bastion of economic power. The other is Susan Phillips, a former professor of finance at the University of Iowa.

As a former teacher at Harvard University, the London School of Economics and the Haas School -- and as a former international economist on the Fed's research staff in the late 1970s -- Yellen is highly regarded by financial experts and academic colleagues. Her major research interests include unemployment, trade balances and economic reform in Eastern Europe.

The 49-year-old Yellen is married to another eminent economist, George Akerlof, whom she met in the late 1970s when both worked at the Fed. Akerlof works at both UC Berkeley and the Brookings Institution in Washington, D.C.

Yellen agreed to talk about her views on the economy and Fed policy.

Q. We are now well into the fourth year of the current economic expansion. How long do you think it will last?

A. It's unusual to have an expansion that lasts as long as the one we've had, but I don't see any fundamental reason it can't continue. All sectors seem quite healthy. Profit margins are healthy and we've had impressive productivity increases. Over the past year we successfully subdued the economy enough that we'd have sustainable growth. We've kept things on an even keel by tightening monetary policy the right way at the right time. We've been looking for a soft landing, where growth would subside to a sustainable rate so inflation wouldn't pick up. One never wants to declare victory, but things look pretty good.

Q. Household debt levels are rising fast and so are credit card delinquencies. Is there reason for concern that consumers are getting overextended?

A. It does concern me. Debt has been growing very fast relative to income. On the other hand, household wealth has also gone up enormously. We've had a trillion dollars in new stock market wealth just in 1995. Of course, you also have to look at who's taking on debt and who's getting the wealth. We know less than we'd like to about that. We've expressed concern in speeches to banks about credit standards, and instructed banks examiners to carefully examine credit standards and talk with banks about risks. On balance we feel most banks have strong capital positions.

Q. Short-term interest rates are currently running well above their long-run average. Is the Fed holding the monetary reins too tight?

A. Historical averages shouldn't be taken too seriously. The ''appropriate'' level of rates depends on what's happening in the economy. The economy is pretty strong right now; it's hard to say monetary policy is restricting it much. But if fiscal policy turned more restrictive, we might loosen.

Financial markets have been pleasantly surprised that inflation hasn't picked up. A year ago the markets were more pessimistic about inflation. But we've had a year of stable inflation and labor has been less aggressive in bargaining. Now the markets have a well-justified level of trust that Fed intends to keep a lid on inflation.

Q. A lot of economists argue that beyond some point -- often said to be around 6 percent -- unemployment can't fall without reigniting inflation. Are we running such a risk with the jobless rate now running around 5.5 percent?

A. The jury is out on that. I've been surprised by the moderate behavior of compensation growth given the level of unemployment. Inflation itself has come down less than it might have, because of widening profit margins. To me this means there is room for inflation to decline further.

Q. Is there any evidence, as some analysts claim, that the economy has become less sensitive to Fed policies?

A. The economy remains quite sensitive to interest rates. Just in the last year and a half you could see that in operation. The Fed decided to tighten the monetary reins in an attempt to brake the economy, to slow what would have been unsustainable growth in demand. We certainly saw an impact on residential investment, autos and consumer durables. The results are sometimes unpredictable, but in the end, monetary policy still works.

Q. What guides you in setting policy: measures of money, interest rates, employment data or other factors?

A. I look at everything. I try to understand what's operating on supply and demand. On the supply side, I look at indicators like capacity utilization and employment. On the demand side, I look at retail sales, orders for durable and capital goods, trends in government spending, trade data and residential investment. We have a staff with many Ph.D. economists who have their fingertips on quantitative relationships, plus we have large-scale simulation models of the economy. Another great strength of the Fed is collecting anecdotal information. All of the regional Fed banks report what they see going on around them, in their industries and labor markets.

Q. Does the Fed ever get pressure from the White House or Treasury?

A. There's been no pressure at all. This administration has had a policy of never commenting on what the Fed does. Q. We've been seeing a rash of mergers in the banking industry. Do you think this trend will continue?

A. Yes. In the United States we've had a somewhat artificial structure of banking based on laws against geographic expansion. As we get rid of those, it's natural to see consolidation take place. What's emerging are regional or even national banks. Part of their goal is to spread risks geographically, so banks are not so sensitive to economic developments in one part of the country.

We've been studying mergers for a long time, trying to figure out if they are necessary to achieve efficiencies through economies of scale. The answer is that economies are limited. Most research suggests efficiency can be obtained at the $ 100 million (in assets) level. Beyond that there's not much evidence of gain.

Q. Are banks in relative decline as other financial competitors grab market share?

A. If you look at holdings of assets, banks' share is declining. But when you look at profitability and fee-based business, they are extremely competitive. U.S. banks are very important in the derivatives business, but that doesn't show up as assets. Also loan guarantees don't show up as an asset but you earn a fee. If you securitize a loan or mortgage, it generates fees. So profitability has been quite good.

Q. Should banks be allowed to get into insurance and securities underwriting, or will that make oversight and regulation too difficult?

A. We have to worry about the safety and soundness of banks because they have deposit insurance, a government guarantee. But if securities underwriting is in a separate subsidiary of a bank holding company, it's certainly an appropriate activity for banks. I think the same argument holds for insurance. In theory, more competition benefits consumers.

GRAPHIC: PHOTO,Yellen

LANGUAGE: ENGLISH

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The Complete Marquis Who's Who (TM) Biographies

LAST-UPDATE: June 27, 1995

Janet Louise Yellen

SOURCE: Who's Who in America, 50th Edition

LENGTH: 373 words

* * * * * * * * * * * * * * PERSONAL INFORMATION * * * * * * * * * * * * * * *
daughter of Julius and Anna Ruth (Blumenthal) Y.; married to George Arthur Akerlof, July 8, 1978; 1 child, Robert Joseph.
GENDER: Female
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CAREER: rsch. fellow MIT, Cambridge, 1974; cons. Congl. Budget Office, 1975-76, mem. panel econ. advisers, 1993-; rsch. affiliate Yale U., New Haven, 1976; mem. adv. panel in econs. NSF, 1977-78, 91-92; mem. Brookings Panel on Econ. Activity, 1987-88, 90-91, sr. adviser, 1989-; Yrjo Jahnsson Found. lectr. on macroecon. theory, Helsinki, 1977-78; mem. Coun. on Fgn. Rels., 1976-81.

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BA in Econs. summa cum laude, Brown U., 1967; PhD, Yale U., 1971

* * * * * * * * * * * * * * * * OTHER INFORMATION * * * * * * * * * * * *

CREATIVE WORKS: Author: (monograph) (with Arrow and Shavell) The Limits of the Market in Resource Allocation, 1977; assoc. editor Jour. Econ. Perspectives, 1987-91; contbr. articles to profl. jours.

AWARDS: Hon. Woodrow Wilson fellow, 1967, grad. fellow NSF, 1967- 71, Guggenheim fellow, 1986-87; grantee NSF, 1975-77, 90-94.

MEMBERSHIPS: Mem. Am. Econ. Assn. (adv. com. to Pres. 1986-87, nominating com. 1988-90), Phi Beta Kappa.

LANGUAGE: English

LOAD-DATE: August 29, 1996

LEVEL 1 - 2 OF 2 REFERENCES

Who's Who in American Politics

September, 1995

Janet L Yellen

PARTY: None

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PERSONAL: FEMALE Brooklyn, NY; Aug 13, 1946

LENGTH: 53 words

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OFFICES-HELD: Economist, Bd Gov, Fed Res Bd, 77-78; mem, Panel Econ Advisers, Cong Budget Off, formerly; sr adv, Brookings Panel Econ Activity, formerly; mem, Bd Gov, Fed Res Syst, 94 to present

LANGUAGE: ENGLISH

LOAD-DATE: September 26, 1995

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11TH STORY of Level 1 printed in FULL format.

The Washington Post

July 08, 1996, Monday, Final Edition

SECTION: A SECTION; Pg. A01

LENGTH: 2355 words

HEADLINE: At the Fed, a Power Struggle Over Information

BYLINE: John M. Berry, Washington Post Staff Writer

BODY:

Early this year a tremor shook the Federal Reserve Board's headquarters on Constitution Avenue: All four of the Fed's then-governors met with Chairman Alan Greenspan to insist that they be told what he and the staff were doing about a wide range of international economic matters, including contacts with foreign central banks.

The four board members were not complaining about policy. Rather, they were frustrated that no one was keeping them adequately informed about the staff's activities, including discussions with the Treasury Department and research on international financial issues. Two of the four also grumbled later about being excluded from the staff's preparation of domestic economic forecasts.

Such complaints almost never surface at the central bank. Powerful chairmen have run the show for at least the last half century, with the staff as their strong right arm.

Each governor, as board members are called, has one vote on policy matters, as does the chairman. But traditionally the chairman speaks for the institution and opposition to his view is not a small matter.

Historically, the lines of power at the Fed have been so clear that some years ago a departing senior staff member said he never had an interest in becoming a board member; it would have reduced his influence over the Fed's policies if he did, he said.

The role of the staff in Fed policymaking, and in particular its closeness to the chairman, has been a contentious issue at the central bank headquarters for years.

One reason is the sheer amount of power the Fed exercises over the U.S. economy; another is the institution's inherently cumbersome decision-making machinery.

Since the late 1970s the Fed has been the U.S. economy's balance wheel, adjusting interest rates up and down to squeeze out inflation while maintaining healthy growth. Inflation and unemployment now are at low levels, with no end to the expansion in sight.

The three top economic policy staff members, known as "the barons," prepare -- without participation by the board members -- the informational building blocks from which the Fed's policymakers shape their interest-rate decisions.

Edwin M. "Ted" Truman, director of the division of international finance, is the most senior of the trio. Michael J. Prell, director of the division of research and statistics, and Donald L. Kohn, director of the division of monetary affairs, have been equals since 1987. At that time, then-Fed Chairman Paul Volcker was afraid one would leave, so he reorganized the staff to promote both.

The barons serve at the pleasure of the chairman, while the six members of the Fed Board and the chairman are appointed by the president, with the approval of the Senate. To allow the seven to exercise their power without regard to short-term political concerns, the terms are for 14 years. The chairmanship carries a four-year term.

In interest-rate decisions, there is another set of players as well -- the presidents of the 12 regional Federal Reserve banks. The presidents, chosen by their respective boards of directors with the approval of the Fed Board in Washington, join the board in meetings of the Federal Open Market Committee. The committee, which meets eight times a year, most recently last week, sets targets for overnight interest rates on the basis of votes of the seven board members and a rotating group of five presidents.

To some within and outside the Fed, the power of the staff represents a challenge to the authority of the board members.

At a Senate Banking Committee hearing in March on whether to confirm Greenspan to a third term, Sen. Paul Sarbanes (D-Md.), who frequently spars with the chairman over both monetary policy and how the central bank is run, asked: "What do you say to the . . . observation that the Fed and the Board of Governors are staff-dominated, particularly as it may affect the members of the board, as opposed to the chairman?"

Greenspan replied: "[W]hile it may appear that I take action unilaterally with the staff, that is never done without consultation with each individual member of the Federal Reserve Board, because all of the authority of the Federal Reserve Board is within the board members themselves. I, as chief executive officer, have one statutory authority: I run the meetings."

A Staff Without Peer

As economists and managers, the barons are highly regarded, even by the complaining governors, as among the most able in government. Late last month at his swearing-in ceremony, Greenspan called them an "exceptional staff . . . which has no peer within the American government."

The barons each were paid $ 170,700 last year. Though those salaries are unusually high for federal employees, several Fed officials and some analysts with private financial firms said that each of the barons could earn much more money than that outside government. Greenspan's salary, meanwhile, is $ 133,600, one notch below that of a Cabinet official.

The four governors who complained -- Edward W. Kelley Jr., Lawrence B. Lindsey, Susan M. Phillips and Janet L. Yellen -- said in interviews that they did not intend to challenge Greenspan's authority or the barons' expertise; they just wanted to be informed.

"The criticism I have relates to the position the governors are left in," said one governor, who requested anonymity. "Information flowing through the barons to the governors is scanty. These are not people who work for me. They do not think their jobs are to inform."

But the governors eventually got their information.

Greenspan saw to it that Truman put the entire board in his loop. Since they lodged their complaint, information on international matters has flooded into the governors' offices.

Truman, 55, who received a PhD in economics from Yale University, has been in his job since 1977. He has an explosive temper, which he has unleashed in negotiations with foreign officials and sometimes on the Treasury Department.

"For an economist," said Jack Beebe, research director at the San Francisco Federal Reserve Bank, "he is an emotional man."

Truman has been, as he puts it, "on the circuit a long time" and knows senior officials in all the world's major central banks. "I can always pick up the phone and call someone, and vice versa," Truman said.

His knowledge and experience in international financial crises are so highly regarded by Greenspan that if there is an international meeting or issue that either the chairman or the vice chairman cannot deal with, Truman rather than a governor usually gets the assignment.

That role for Truman was underscored early this year. President Clinton was considering whether to nominate Greenspan for a third term and how to fill the vice chairmanship and another vacancy on the board. One name on the short list for the latter spot was Peter Kenen, an international economist at Princeton University.

Kenen, seeking to ensure that he would be able to use his international expertise if Clinton chose him, went to see Greenspan to ask. The answer was no.

"I was told that the representational role of the board in international matters were his and the vice chairman's and Ted's," Kenen said. "I could not expect to attend many international meetings on behalf of the board." Furthermore, he was told, the "close coordination" of international economic policy with the Treasury would be handled by the chairman and Truman.

"There were no hard feelings on either side, but I was taken aback by the reaction . . . [and] I felt what I could contribute was not getting due weight," Kenen said.

Kenen did not withdraw his name, but he told the White House he was a lot less interested than he had been. The issue became moot when Clinton chose White House budget director Alice M. Rivlin as vice chairman. She was nominated from the Philadelphia Federal Reserve district, which includes Princeton, and there can be only one board member from a district. Truman defended the current arrangement, saying, "One problem in the international area is that many of the issues involve negotiations with the Treasury, and it is very hard to have the board as a whole negotiate with the Treasury. The chairman has to have staff work for those negotiations."

Knowledge Is Power

There are some equally difficult issues swirling about the staff and its role that involve domestic considerations.

For example, then-Fed Vice Chairman Alan Blinder, who left at the end of his term in January to return to teaching at Princeton University, was plain about his unhappiness over the staff's role. Blinder was particularly upset over Prell's refusal to allow him to sit in when details of the staff's economic forecast are thrashed out. "There's an old admonition that we remember from grade school arithmetic: show your work," Blinder said in an interview before he left. "There's a staff reluctance to do that . . . I have pursued this, but it's been like knocking your head against the wall." Several other Fed governors have left the board in recent years taking shots at the power of the staff, including Wayne Angell, John P. LaWare and Martha Seger. Even former Fed governor Lyle Gramley, who once was a senior member of the Fed staff, has remarked, "The staff does not seem to think it important, nor even desirable, for governors other than the chairman to be well-informed on sensitive international matters."

In reality, however, many of the complaints about Truman, Prell and Kohn may be indirect complaints about the primacy of Greenspan. None of the Fed governors would say as much, but all lavishly praise the three senior staffers, which suggests the true focus of their complaints lies elsewhere.

The barons have outranked some of the board members at earlier points in their careers. While Truman was an associate professor at Yale University, he was a member of a faculty committee that conducted an oral examination of Yellen before she began her dissertation, and later he hired her to work on his division's staff.

When Phillips first met Prell after being appointed governor, she reminded him that he had once interviewed her for a job. "He had a look of horror on his face and asked, 'Did we offer you a job?' Well, they had," Phillips said with a laugh.

Lindsey praised the barons in extravagant terms echoed by the other governors. "I think that the staff is a national treasure. Each in his own way is exceptional," he said.

Difficult Relationships

The new flow of international information has helped smooth the waters, but the sometimes difficult relationship between the governors and the barons remains, as even the barons agree. Prell, 51, is an intense, bearded man who can be irascible and abrupt but also pleasant, colleagues said. He holds undergraduate, master's and PhD degrees from the University of California at Berkeley and oversees his own staff of about 275, most of whom are professional economists.

His division's principal responsibility is analyzing and forecasting where the economy is headed. The staff forecast is formally updated in the Green Book, which goes to the Fed Board and to the 12 Federal Reserve Bank presidents before the meetings of the Federal Open Market Committee.

It was the closed-door preparation of the Green Book that so raised Blinder's ire. Yellen also expressed a strong desire to sit in on Prell's forecasting meetings.

Prell explained that he said no to both because he believes that all of the Fed officials with a say in setting policy must be assured that the Green Book forecast is the independent work of the staff. If board members began to sit in, Prell said, other officials could not be sure that the forecast had not been subtly shaped to lend support to a particular policy view.

Agree to Disagree

Significantly, Greenspan has never sought to participate in the staff meetings that eventually produce the Green Book forecast, presumably because he shares Prell's desire that policymakers discuss the forecast only after it is completed.

Lindsey, Yellen and Phillips all said they would like to know about what might happen if some of the key assumptions behind the forecast turn out to be wrong.

"I regard my role now as throwing up questions about why may we not have one of these alternative scenarios," Lindsey said.

Kohn's division produces the Blue Book. It gives the Federal Open Market Committee an analysis of financial markets and the likely impact of three interest-rate policy choices: raising them, lowering them, or leaving them unchanged.

Kohn stressed that neither the Green Book forecast nor the Blue Book's explanation of monetary policy alternatives ever limits what the FOMC policymakers can decide to do. The Green Book only "sets a standard" for discussion, he said.

The committee doesn't always agree with the staff conclusions. One governor said that Greenspan often disagrees with portions of the Green Book's outlook. And the 12 presidents come to the table with independent forecasts crafted with the aid of their own bank research staffs.

Kohn, 53, who earned a PhD from the University of Michigan, is the most easygoing of the barons and the only one likely to drop in on a governor to chat about a puzzling issue, several officials said.

He is the board's liaison with the New York Federal Reserve Bank, which almost daily buys or sells U.S. government securities to keep overnight interest rates close to the target set by the FOMC. Each business day at 11 a.m. Kohn participates in a conference call with officials at the New York Fed to decide how best to intervene to keep rates on track.

A new challenge to the staff could come with the arrival of Rivlin and Laurence H. Meyer, a St. Louis economist who has won awards for the accuracy of his forecasts.

Meyer may be able to read the economy's tea leaves as well as Greenspan or Prell, and Rivlin has run both the Congressional Budget Office and the Office of Management and Budget. Neither is likely to be very happy if they find themselves very far out of the loop.

GRAPHIC: Photo; Illustration, The Washington Post, WHO'S WHO AT THE FED? The power wielded by Federal Reserve staff members has at times unsettled members of the Board of Governors. Alan Greenspan, Chairman SENIOR STAFF: "THE BARONS" Edwin M. Truman Michael J. Prell Donald L. Kohn BOARD OF GOVERNORS Alice M. Rivlin, Vice chairman Edward W. Kelley Lawrence B. Lindsey Laurence H. Meyer Susan M. Phillips Janet L. Yellen ALAN GREENSPAN

LANGUAGE: ENGLISH

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14TH STORY of Level 1 printed in FULL format.

Investor's Business Daily

April 24, 1996

SECTION: Guest Editorial; Pg. A2

LENGTH: 816 words

HEADLINE: The Fed: Mission Impossible?

BYLINE: By VICTOR CANTO

BODY:

The Humphrey-Hawkins Act tells the Federal Reserve to aim for ''maximum employment, stable prices and moderate long-term interest rates.'' Sen. Connie Mack wants to change the law to give the Fed just one goal - price stability. Growth-hungry investors should think twice before opposing him.

The Florida Republican heads Congress' Joint Economic Committee. But one of his critics also holds a high position. Indeed, Fed Governor Janet Yellen's comments suggest she thinks she and her fellow central bankers are smarter than the market. In her view, the central bank should have a say in running the economy.

''Monetary policy is needed, and has succeeded, in smoothing the ups and downs of the business cycle,'' she told Congress, ''mitigating economic fluctuations and stabilizing output and employment in the U.S. economy.''

But the Fed isn't equipped to grow the economy, much less smooth its ups and downs. Nor can it stabilize output or change employment in the long run.

The central bank has just one real tool -its influence over the money supply. It can use this to try to control the quantity of money, or to try to control the value of the currency.

The first was the Fed's method of choice in the '70s. It led to the disaster of ''stagflation.'' The Fed has used the second method with some success in recent years, though even now it is continually changing its own target figures.

The Fed can affect inflation. Period.

Well, that's not entirely true. The Fed can affect economic growth - negatively. If the central bank were to boost the money supply much beyond demand, the markets would convulse - and growth would stall. An excess of money causes inflation. That pushes people into higher tax brackets and destroys incentives to work and produce. The result: slower growth.

The upper bound of economic growth, for the most part, is limited not by monetary policy but by fiscal policy. And that is not set by the Fed, but by Congress and the president.

Mack's proposal just recognizes this basic fact, and tells the Fed to focus on a task it actually has the tools to accomplish.

You can understand why Yellen wants the Fed to have other goals: They give the governors a reason for being. If the bank's sole duty is to monitor inflation, a computer could do the job relatively well. Just program it to reduce the supply of money if inflation increases, and increase the money supply if deflation looms.

Now, Mack doesn't want to replace the Fed with a computer, but existing econometric models could do the trick. One that has received a lot of attention comes from John Taylor of Stanford University.

Such ''price rule'' models have existed for years. The most famous of all is the gold standard, and it worked fairly well. Prices did swing from year to year when the dollar was gold-backed, but they were stable over the long run, because they swung around a fairly constant center.

Yellen believes these models can only be an aid, not a hard-and-fast rule to replace the governors' judgment. She argues that if, say, the stock markets crash, the Fed should be able to move to increase liquidity, as it did in 1987.

She's right - in part. Even following a price rule, the Fed needs to be able to cushion economic shocks, too. But it doesn't have to threaten price stability to do so. It has other useful levers, such as rules on what cash reserves banks must maintain, to steer institutions through rocky straits.

And reacting to a market shock is a long way from the Keynesian ''fine-tuning'' that Yellen claims the Fed can achieve. A market crash is both a clear signal and an event in and of itself. A bigger-than-expected jobs number, by contrast, may be caused by any number of factors - including bad data. The markets now often move on such releases not because of what the data say about the economy, but because of how the Fed might react to them.

The Fed governors should have the leeway to act when the market tells them to. We should not ask them to manage the entire economy. No one can know enough to do that.

It's an ominous sign when central bankers lay claim to such abilities. Yellen's belief that she and her colleagues can outdo the market in maximizing output or employment suggests that Fed policy could take a frightening turn in the years to come.

Neither Yellen nor the Fed has taken an official position on the Mack bill. But when a Fed governor believes she should be ''directed to pursue multiple objectives simultaneously,'' we must worry that the Fed may soon wander off its price rule. Cover your wallet and keep an eye on the inflation numbers - they may be rising soon.

Victor Canto is a principal in Laffer, Canto & Associates, a San Diego-based economic consulting firm.

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The Washington Times

April 11, 1996, Thursday, Final Edition

SECTION: Part A; COMMENTARY; Pg. A15

LENGTH: 1001 words

HEADLINE: Fine-tune pressures within the Fed?

BYLINE: H. Erich Heinemann

BODY:

Interest rates rose this winter, mostly on the theory that a rebound in the economy will prevent the Federal Reserve from easing policy.

Wall Street's twenty-something bond traders - those self-appointed "masters of the universe" - have it backward. Nations with the lowest long-term rates have the tightest monetary policies.

Fed policy has been tight for more than two years, and in response business activity has slowed substantially. In this setting, higher rates are likely to be self-limiting. Sales of autos and homes, which improved during the first quarter because of lower rates last fall, will probably resume their downward slide. Business people have already decided to curtail their investments in new plant and equipment in 1996. Increased financing costs would put an additional damper on their plans.

Rather, the force behind the rise in rates may be a concern that the Clinton contingent on the Fed -vice chairman Alice Rivlin and members Janet Yellen and Laurence Meyer - may push the central bank to "fine-tune" the economy. Fine-tuning refers to attempts to pump up the money supply to achieve short-run gains in employment.

With the presidential election just seven months away, pressure to speed up the economy is intense. However, schemes to fine-tune the business cycle fail and leave the country with a nasty brew of more inflation and fewer jobs. Even the threat of fine tuning could put more upward pressure on rates than a temporary bulge in business.

Ms. Yellen paid lip service recently to the conventional wisdom that stable prices should be the Fed's main goal. "There is no long-run tradeoff," she said, "between unemployment and inflation." But in a slap at Sen. Connie Mack, the Florida Republican who chairs Congress' Joint Economic Committee, she added it would be "wrong-minded" to conclude that controlling inflation should be the Fed's only goal.

Mr. Mack has introduced legislation to give the Fed a mandate for zero inflation. Despite the "temptation to use the Fed to fine-tune the economy," he said, "this kind of monetary manipulation has failed time and again. Ultimately, printing money can do nothing but affect prices. Using monetary policy to accomplish other goals courts disaster."

Gov. Yellen rejected this view. "I do not concede that uncertainties of economic forecasts and long variable policy lags necessarily doom our best efforts to failure. The record indicates that within limits 'tuning' works, even if it's not fine."

This is not an academic matter. Together with Gov. Lawrence Lindsey, Ms. Yellen dissented from the Fed's monetary targets for 1996. According to the minutes of the policy session on Jan. 30, the two "preferred somewhat higher (growth) ranges for M-2 and M-3. ... They believed the (Federal Open Market) Committee could readily explain that such an adjustment to the ranges did not represent a lessened commitment to its price stability goal or an increased emphasis on the monetary aggregates in policy formulation."

At his Senate confirmation last week, Mr. Meyer gave his priorities for the Fed: price stability, full employment and economic growth. Stable prices come first, he said, because they are "the singular goal for monetary policy in the long run. ... There is no long-run tradeoff between unemployment and inflation." At the same time, Mr. Meyer asserted that the "Phillips Curve" has the "best predictive power on inflation."

British economist A.W. Phillips found that in England from 1851 to 1957 there was an inverse relation between unemployment and the change in money wages. Economists have generalized that finding to justify efforts to trade higher inflation for more jobs. While such a link may have existed in Britain in the 19th century, it is not true of the U.S. economy at the end of the 20th. As Mr. Mack observed, trading inflation for employment is a Faustian bargain, where everybody loses.

The modern American version of the Phillips Curve is the idea that it works for short periods but not for long ones. This is the basis of Ms. Yellen's statement that "there is no conflict whatever between pursuing price stability as the primary long-run goal while simultaneously operating to help stabilize the economy's real economic performance." Her fatal flaw is that there is no way for anyone to know where the short run ends and the long run begins.

Meanwhile, Fed policy-makers must grapple with serious problems of their own making. During 1991, '92 and '93, monetary policy was very easy. Total bank reserves, the raw material for the money supply, rose at an annual rate of almost 14 percent. Since the first quarter of 1994, the Fed's official measure of reserves has dropped an average of about 4 percent. Rapid growth of "retail sweep accounts" - a complex technique that results in a reduction in reserve totals - makes these data appear weaker than they really are. Even so, money is still tight.

The rapid swing from ease to restraint naturally set off shock waves in financial markets and the economy. In 1994, concern about possible future inflation dominated the market, and interest rates rose sharply. Now the worry is that money is too tight and the risk of recession is rising. In calling for a more generous money target for 1996, Mr. Lindsey, who does not share Ms. Yellen's fascination with fine tuning, was apparently reacting to these latter concerns.

The Fed will have to walk a tightrope in months leading up to the election. Policy-makers must back away from excessive restraint, which would only lead to recession. They must avoid a new round of experiments with fine-tuning, which would surely backfire. It won't be easy.

H. Erich Heinemann is chief economist of Heinemann Economic Research, a division of Brimberg & Co., institutional brokers in New York.

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The Washington Post

March 26, 1996, Tuesday, Final Edition

SECTION: FINANCIAL; Pg. C01

LENGTH: 751 words

HEADLINE: Fed's Goals to Be at Issue At Confirmation Hearings

BYLINE: John M. Berry, Washington Post Staff Writer

BODY:

Against a background of low unemployment, low inflation and an economic expansion entering its sixth year, Federal Reserve Chairman Alan Greenspan and two other Fed nominees are expected to breeze through confirmation hearings today.

But if there is little suspense about Fed policy in the short run, the nominees -- White House budget director Alice M. Rivlin for vice chairman and St. Louis economist Laurence B. Meyer to fill another vacancy on the Fed board -- likely will be questioned closely about their views on what the central bank's long-term goals should be.

Banking Committee Republicans, including Sen. Connie Mack of Florida, want to make price stability the Fed's sole long-term goal, and Mack has introduced legislation to that effect.

In contrast, some committee Democrats, including Sen. Paul S. Sarbanes of Maryland, argue that the Fed's current legal mandate to pursue "maximum employment, stable prices and moderate long-term interest rates" should not be changed to eliminate the focus on jobs.

Greenspan has testified repeatedly that he believes the Fed's primary goal should be price stability and he has indicated general support for Mack's bill. Rivlin and Meyer have not made public their views on the issue.

Like the chairman, several other Fed officials also have indicated they would prefer having a singular legal mandate to keep inflation low and would be prepared to have their performance judged on that basis.

As William J. McDonough, president of the New York Federal Reserve Bank, said in a speech last week, "The benefit of a declared inflation goal is that it puts the focus of public oversight where it belongs -- on how well the central bank is doing its job -- and settles the issue of what that job should be.

"I am increasingly convinced that in a democracy, a central bank can maintain price stability over the intermediate and long term only when it has public support for the necessary policy. Numerical goals for monetary policy may help a credible monetary authority maintain and build upon that support," McDonough said.

The Fed bank president suggested that the Fed should have an inflation target in a 0.5 percent to 2 percent range, because price experts say official inflation indexes overstate changes in the cost of living by that much. The target should be in the "upper end" of the range to make sure Fed policy could not cause a destructive decline in prices, he said.

But not all Fed policymakers agree about having an inflation target. For instance, former vice chairman Alan S. Blinder, who resigned in January to return to teaching at Princeton University, was outspoken in his opposition to eliminating the mandate to maximize employment. And earlier this month, Clinton's only other appointee on the Fed board, Janet L. Yellen, also publicly opposed such a change.

In a speech here to the National Association of Business Economists, Yellen said she agreed that "the appropriate primary long-term goal for the Federal Reserve should be price stability," but she quickly added that "it does not follow that the Fed should focus exclusively on inflation."

"In my view, monetary policy is needed, and has succeeded, in smoothing the ups and downs of the business cycle -- mitigating economic fluctuations and stabilizing output and employment in the U.S. economy. . . . Stabilization of output and employment is a second appropriate goal for the Federal Reserve," Yellen said.

Mack's bill, which would let the Fed set its own inflation target and decide how long it would need to achieve it, is ambiguous on whether the central bank should take other factors, such as unemployment, into account in setting policy once the target has been achieved.

Nevertheless, Yellen expressed concern that a future Fed might be too single-minded if the law is changed. "A quantitative target solely for inflation could undercut adequate attention to real variables [such as unemployment] in the short run," she cautioned.

The confirmation hearings for Rivlin and Meyer will begin while the Fed's top policymaking group, the Federal Open Market Committee, is meeting to consider whether to make a change in short-term interest rates. Greenspan, who was appointed by Clinton to a third, four-year term at the helm of the central bank, will appear before the Senate committee shortly after noon. Before he testifies, the Fed will announce whether the FOMC chose to make a change in rates, but analysts expect none.

GRAPHIC: Photo, ALAN GREENSPAN JANET L. YELLEN (Photo ran in an earlier edition)

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LOAD-DATE: March 26, 1996

19TH STORY of Level 1 printed in FULL format.

Investor's Business Daily

March 14, 1996

SECTION: The Economy Briefs One; Pg. B1

LENGTH: 521 words

HEADLINE: Population Growth Slows

BODY:
America's population growth will slow to the lowest rate since the Great Depression as the nation ages in next half-century. New Census Bureau estimates call for a nation of 400 million people by 2050, but predict the lowest growth rate since the 1930s. The nation's median age of 34.1 in 1995 was a record high. But it is expected to climb to 35.7 by 2000 and 38.7 by 2035, according to the report, ''Population Projections of the United States.''Report: Fewer Workers, More Retirees ComingThe Census report said that as the baby-boom generation ages, leaving fewer people in the prime childbearing years, the country's growth rate will slow. Between 1995 and 2000, annual growth is expected to be 0.88%. But this will slow to 0.63% annually between 2040 and 2050. The so-called dependency ratio, the number of people under age 18 and over 65 compared to those of working age, was 63.7 in 1995. It will grow to 68.2 in 2020, and 79.9 by 2050.U.S. Policy Toward China Gets A Boost From RubinTreasury Secretary Robert Rubin defended the Clinton administration's policy of engagement with China, saying it helped both countries. ''(China) is going to be largest economy in the world one day,'' Rubin said. ''We need to foster a policy of engagement.'' Rubin is set to meet with China's finance minister in Japan this weekend to discuss trade issues. The U.S.' deficit with China jumped last year by 15% to $ 33.8 billion, second only to the U.S. shortfall with Japan. Lindsey: Fed 'Pushing' The Envelope Of GrowthFed Gov. Lawrence Lindsey said the drop in unemployment to 5.5% means the Fed is properly ''pushing the envelope'' of growth without triggering higher inflation. ''I think that's the right thing to do,'' he said. ''We believe in maximum sustained growth without inflation, so what we want to do is keep the economy as revved as possible while feeling out there as best we can for signs of inflation.'' Overall, though, Lindsey said U.S. is likely to post ''below average'' growth this year while avoiding a recession.Yellen - Fed Shouldn't Just Focus On InflationThe Federal Reserve shouldn't be limited solely to fighting inflation as some Republican legislators advocate, Fed Gov. Janet L. Yellen said. She said she opposes proposals in Congress to limit the Fed solely to fighting inflation. ''Monetary policy is needed, and has succeeded, in smoothing the ups and downs of the business cycle, mitigating economic fluctuations and stabilizing output and employment in the U.S. economy,'' Yellen said.Jobs And Output Should Be Fed Targets: YellenYellen added that a boom and bust economy, with people uncertain they can hold a job, ''diminish welfare, impede business and household planning and create uncertainty which is harmful to investment.'' She said, ''Stabilization of output and employment is a second appropriate goal for the Federal Reserve,'' after its No. 1 priority of containing inflation. That clashes with Fed Chairman Alan Greenspan's view that the Fed's sole goal should be to keep prices stable.

LANGUAGE: ENGLISH

Investor's Business Daily, March 14, 1996

LOAD-DATE: March 14, 1996

37TH STORY of Level 1 printed in FULL format.

Banking Policy Report

November 6, 1995

SECTION: Volume 14, Number 21; Pg. 19

LENGTH: 614 words

HEADLINE: Regulators See Megamergers Preserving Competition

BODY:

The megamerger boom in the banking industry is unlikely to diminish competition for banking services or be harmful to consumers, according to the Federal Reserve Board and other regulatory agencies.

"The picture that emerges is that of a dynamic U.S. banking structure adjusting itself to the removal of long-standing legal restrictions on geographic expansion, technological change and greatly increased domestic and international competition," said Federal Reserve Board Gov. Janet L. Yellen. She testified with other regulators at a hearing October 17 before the House Banking Subcommittee on Financial Institutions and Consumer Credit. Subcommittee Chairwoman Marge Roukema (R-N.J.) called the hearing to investigate reports that the megamerger boom would diminish consumer access to basic banking services.

Natural Development

Yellen said the on-going trend toward consolidation in banking is the result of natural and beneficial market forces. Moreover, she added, the Fed and other regulatory agencies are determined, in the merger and acquisition approval process, to preserve the benefits of competition for consumers of banking services and to maintain the safety and soundness of the banking system.

"The recent wave of large mergers and merger announcements reflect to a large degree a natural response to new opportunities for geographic expansion as legal restraints are removed," she said. "The industry is moving away from a legally fragmented banking structure toward a nationwide banking structure. Rapid technological changes and global competition in corporate banking are almost certainly a motivating factor for the very large banks."

Yellen's reassurance is noteworthy because the Fed is the primary federal bank agency ruling on major bank consolidations, and its decisions are important in formulating standards for bank expansion.

"It is certainly possible that some customers have been disadvantaged by some mergers," she said. But "market developments and the removal of geographic restrictions on banks have significantly lessened the chances for anticompetitive effects."

Competition Endures

Yellen said the banking system has a built-in process of rejuvenation that helps it sustain a healthy level of competition even in periods of fast-paced consolidation.

"The increased pace of bank mergers since the early 1980s has greatly reduced the number of U.S. banking organizations, and resulted in a substantially higher nationwide concentration of banking assets at the 100 largest banks," she said. "However, concentration in local banking markets, which is normally considered most important for the analysis of possible competitive effects, has remained virtually unchanged. In addition, there continues to be new bank entry, and there is a continuing increase in the number of banking offices. This illustrates that the U.S. banking structure is highly dynamic, and that sweeping generalizations are extremely difficult to make."

Economies of Scale

So far the Fed has uncovered no evidence that the wave of bank mergers on average have produced significant gains in efficiency, Yellen said, "However," she added, "in recent years, there appear to have been some cases of improvements in efficiency, and our staff work does suggest the potential for such savings if well-managed entities acquire and modify the operations of highcost organizations."

Yellen urged Congress to remain calm about the unprecedented consolidation now reshaping the U.S. banking industry. "Bank consolidation to date has not reduced competition in any meaningful way," she said, "and we see no reason why it should begin to do so."

LANGUAGE: ENGLISH

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The American Banker

March 2, 1995, Thursday

SECTION: WASHINGTON; Pg. 2

LENGTH: 248 words

HEADLINE: 2 Governors Dissent on CRA Grounds As Fed Approves Northern Trust Deal

BYLINE: By JARET SEIBERG

DATELINE: WASHINGTON

BODY:

In a highly unusual move, two Federal Reserve Board governors dissented on Community Reinvestment Act grounds from the central bank's decision late Wednesday to give Northern Trust Corp. of Chicago permission to acquire a Florida institution.

Fed Vice Chairman Alan Blinder and Gov. Janet Yellen, both appointed by President Bill Clinton, wrote in a two-page dissent that the central bank should have delayed action on Northern Trust's bid for Beach One Financial Services Inc. of Vero Beach, Fla.

Northern Trust, the parent of Chicago Bank, is under investigation by the Justice Department for violating the fair-lending laws from 1992 to 1994.

"We believe it is wise to wait a short while for more pertinent information," the two wrote.

The two wrote that within the next few months the bank should be resolving its dispute with the Justice Department and filing a Community Reinvestment Act status report with the Fed.

"These two pieces of information, we believe, would put the board in a much better position to make a determination," the two wrote.

The dissent elated community activists. "It is significant that the two newest Fed governors are starting to express a view to the board, which is something we have been waiting for," said Allen Fishbein, general counsel of the Center for Community Change.

But banking analysts were more sedate. "It is an indication of sensitivity," said Karen Shaw, president of ISD/Shaw Inc. "But, the application has progressed."

LANGUAGE: ENGLISH

LOAD-DATE: March 1, 1995

93RD STORY of Level 1 printed in FULL format.

The American Banker

January 6, 1995, Friday

SECTION: WASHINGTON; Pg. 3

LENGTH: 1051 words

HEADLINE: Newest Fed Governor, After Five Months on Job, Says She's Liberal - But Keeps Cards Close to Vest

BYLINE: By JARET SEIBERG

DATELINE: WASHINGTON

BODY:

Janet Yellen, the Federal Reserve Board's newest governor, is supposed to come from a different tradition than her Republican- appointed colleagues.

Supporters have said she's one of President Bill Clinton's new Democrats - liberal on social issues and conservative on economic ones.

But, in her first five months at the Fed, Ms. Yellen has remained quiet and noncombative, declining to stake out controversial positions publicly.

In fact, she appears to have adopted many of the Fed's long-standing views on regulatory issues.

Unlike fellow Clinton appointee Alan Blinder, who caused a stir early last fall after discussing publicly the Fed's role in preventing unemployment, Ms. Yellen has not made headlines.

Even on an issue the President has singled out as a priority - community reinvestment reform - Ms. Yellen so far has not differed from her colleagues.

For example, the former University of California business professor voted in September to give Barnett Banks permission to buy a Florida thrift, despite a continuing Justice Department fair-lending probe.

"I'm somewhat disappointed that (Ms. Yellen and Mr. Blinder) have not sought out new ground from some of the holdovers on the board, especially given the public comments of some members of the board," said Allen Fishbein, general counsel to the Center for Community Change.

Several board members, including Lawrence B. Lindsey, have questioned the wisdom of parts of the Community Redevelopment Act reform package.

Ms. Yellen, in her first wide-ranging interview since taking office in August, said the public should not misinterpret her silence on CRA issues.

"I consider myself a liberal," she said. "I am concerned about the cities. I just think it is inappropriate to be staking out a position."

She said she will speak out once she's considered the comments filed on the most recent CRA revisions. Until then, she said she wants to keep an open mind.

She and the other governors, contrary to the belief of some CRA activists, do not take CRA complaints lightly, she added.

"The board always takes CRA protests seriously," she said. "They are not ignored."

Fed governors receive a confidential assessment of a bank's Home Mortgage Disclosure Act data and an analysis of its CRA performance before voting on an application, she said.

Community activists said it is too early to know where Ms. Yellen stands on CRA.

"The jury is still out," said John Taylor, president of the National Community Reinvestment Coalition.

He said Ms. Yellen has made several encouraging comments, telling community activists that she believes CRA is an important part of the regulatory system. Hopefully, those comments will turn into action, he said.

"The sense I got with her is that she clearly is trying to learn and do some on-the-job training," Mr. Fishbein said. "That may explain why she's been quiet."

But, he said he is surprised that Ms. Yellen has not defended CRA and fair-lending issues when they have come up at Fed meetings.

Ms. Yellen also has adopted the board's consensus view on a host of other issues, including regulatory consolidation, derivatives, Glass- Steagall Act reform, and mutual fund sales.

For example, while the Clinton administration wanted to strip the Fed of some of its bank regulatory powers, Ms. Yellen said these powers are vital to the central bank's monetary policy mission.

"It is surprising how much you learn from the regulatory environment that is helpful in monetary policy," she said.

For example, as the Fed has tightened the money supply, bankers have told her that they are easing credit terms, effectively mooting the central bank's interest rate hikes.

"Is that relevant to us on the monetary side?" she asked. "Absolutely."

On the derivatives front, Ms. Yellen echoed the view of several Fed governors who have said regulators have a hard time accounting for risk.

"Risk can only be evaluated in the context of a bank's complete holdings," she said. "The problem is, how do you judge the risk of a portfolio? This is not just a matter of sending in bean counters."

Regulators also must determine how to respond to institutions that calculate risk exposure differently, she said.

Ms. Yellen, agreeing with Fed Gov. Susan M. Phillips and others, said additional legislation on derivatives is not needed because there is no evidence yet that banks are abusing the complicated financial instruments.

Ms. Yellen also sticks to the Fed's consensus view on Glass-Steagall reform, saying separately capitalized holding companies should be freed from the 10% cap on their underwriting activities.

"I think I am reasonably comfortable with that," she said.

But, repeating Fed Chairman Alan Greenspan's view, a final resolution of whether the cap stays or goes must be left to Congress, she said.

"I would not be comfortable seeing regulators adopt rules that effectively repeal Glass-Steagall," she said.

Ms. Yellen adheres as well to the Fed's view on the sale of mutual funds and other investments, saying she supports letting banks expand into new businesses provided there are adequate safeguards.

Ms. Yellen stressed several times during the interview that she is just learning about many of these regulatory issues, noting that she didn't encounter these questions during her career as an economist.

That career began when the Yale University doctor of philosophy served as an assistant professor of economics at Harvard from 1971 to 1976, before joining the Fed as an international economist.

She left the central bank in 1978 to teach at the London School of Economics before joining the faculty at Berkeley.

She found out she was in the running for the Fed post while vacationing in Hawaii. She said it took Treasury Department officials a week to track her down.

"I was far from a phone and didn't tell anyone where I was going," she said with a smile.

Less than a month later, the President formally nominated her, she said.

That Ms. Yellen's first major interview comes five months into her 14- year term shouldn't surprise anyone, Emory University professor George J. Bentson said. Most new governors avoid the spotlight, added Mr. Bentson, a member of the Shadow Financial Regulatory Committee.

"That is pretty much the way they do it," he said.

GRAPHIC: Yellen, photo

LANGUAGE: ENGLISH

LOAD-DATE: January 5, 1995

97TH STORY of Level 1 printed in FULL format.

The Associated Press

December 7, 1994, Wednesday, BC cycle

SECTION: Business News

LENGTH: 1056 words

HEADLINE: Economists: Neighbors, Not Wardens, Hold Keys to Cutting Crime

BYLINE: By AMANDA BENNETT

BODY:

Three years ago, Minnie Green's Washington, D.C., neighborhood was thick with drug dealers. "You couldn't walk the streets. They went from one side of the street to the other. They didn't care, and it seemed the police wouldn't do anything."

The neighbors organized. They patrolled at night and took down license-plate numbers of cars cruising for drugs. Today, three major drug busts later, she says children play safely in the streets: "People feel so free now."

Adds Alpha O. McPherson, president of another active Washington community group: "If you want to save your community...you have to put the line in the sand and organize to stop these bad folks."

That's just what economists George Akerlof and Janet Yellen think, too. The professors of economics at the University of California at Berkeley, who are husband and wife, have designed a complex economic model that they say shows that neighborhood action holds the key to crime fighting.

"We are trying to emphasize the important role communities play - the idea that there is a broader society that has input" into controlling crime, says Dr. Yellen, who, since helping develop this theory, has become a governor of the Federal Reserve Board.

Mainstream economists believe that crime is a rational economic choice: Criminals choose crime when the benefits exceed the costs. When governments increase the "cost" of crime by increasing the certainty of punishment, they argue, crime will fall.

The Akerlof-Yellen model begins with the mainstream assumptions about the criminals' choices. But it comes to a sharply different conclusion about deterrence. A more effective way to increase the cost of crime, Drs. Akerlof and Yellen say their model shows, is to cut a community's willingness to tolerate it.

Up to a certain crime level, they argue, communities inadvertently cooperate with criminals by looking the other way instead of reporting crime to the police. "Up to that point, crime pays," they write in their paper applying their model to gang behavior. Eventually, though, when crime gets too bad, communities begin to cooperate with the police instead, and crime drops. They call the line at which that switch takes place the "cooperation-noncooperation boundary."

They find that crime seeks its own equilibrium in classic economic fashion as criminals - rationally - try to keep their crime level high enough to give them maximum profits but low enough not to trigger the community's ire. Crime can be controlled if ways can be found to lower that cooperation threshold, the two economists argue.

They maintain that after a certain point, more prison building may cause the threshold to rise if the community perceives punishments to be too harsh. "I would go pretty far in saying that people's perceptions of the fairness of the justice system can have really big effects on the crime rate," says Mr. Akerlof. "In our model, if people think that the legal system is not fair, then they stop cooperating with the authorities and the crime rate is going to go way up."

Proponents of community activism say the economists' work provides rare academic support for their efforts. "It's a radically different look" at crime, says Roger Conner, executive director of American Alliance for Rights and Responsibilities, a Washington-based group that, among other things, supports neighborhood organizing against crime. "Their work, which is theoretical, and my own work, which is on the streets and practical, are completely consistent."

For example, he says the model helps him understand why antidrug loitering laws will work if the community welcomes them but will be counterproductive if the community perceives them to be unfair and won't help police enforce them.

The role of the community in crime fighting received little economic attention until the Akerlof-Yellen model. George Kelling, a professor at Northeastern University and a fellow at Harvard's John F. Kennedy School of Government who specializes in criminal justice, says economists have been much more interested in crime's effect on the economy or crime's response to an increase in the number of police officers.

Meanwhile, Prof. Kelling adds, there has been a polarization in the crime debate: One side argues for police, penalties and prison space; the other focuses on the root social causes of crime and supports education, job training and drug rehabilitation.

Dr. Yellen says that she and Dr. Akerlof were looking for a way to bridge the gap between the traditionally adversarial crime-fighting positions. "We were trying to find some common ground," she says.

It won't be easy. Both sides find something to hate in the model. Intangibles like cooperation thresholds are "just political guff," says Morgan Reynolds, director of criminal-justice studies at the National Center for Policy Analysis, a Dallas-based think tank. He says his research shows clearly that crime drops as rates of imprisonment go up.

On the other side of the debate but taking issue with the model is Jerome Miller, president of the National Center on Institutions and Alternatives in Alexandria, Va., and a proponent of addressing the economic and social causes of crime. He characterizes the assumptions behind the model as "a white man's think-tank view of crime - the view that criminals are different from the rest of the community."

Still, both sides also find things to agree with. "If they are saying that high rates of incarceration bring about not only diminishing returns but negative returns I would heartily agree," says Mr. Miller. Meanwhile, John DiIulio, a professor of politics and public affairs at Princeton University who favors more imprisonment, says he thinks the Akerlof-Yellen model supports increasing use of prisons.

Some say that the model's appeal lies precisely in its ability to offer something to both sides. To be effective, community activism does require sufficient police to back up citizens and swift penalties once offenders are caught. At the same time, community vigilance is seen as a cheaper and more humane way of deterring crime than raising prison terms.

"It's an argument that both sides ought to be able to buy," says Jeffrey Roth, a senior fellow at the Urban Institute. "If you are committed to using prisons, it works - and also if you aren't."

LANGUAGE: ENGLISH

LOAD-DATE: December 7, 1994

1ST STORY of Level 2 printed in FULL format.

The American Banker

May 2, 1996, Thursday

SECTION: WASHINGTON; Pg. 2

LENGTH: 372 words

HEADLINE: Fed, FDIC Officials Dispute Dire Forecast For Small Business

BYLINE: By BILL McCONNELL

DATELINE: WASHINGTON

BODY:

Small-business lending will not be crimped by the banking industry's rapid consolidation, regulators told lawmakers Wednesday.

"I am optimistic about the outlook for small-business credit," said Federal Reserve Board Governor Janet Yellen at a hearing before the House Small Business Committee.

Ms. Yellen disagreed with dire predictions for small-business lending made by Fed economists in March. The economists showed bank lending to small business declined 34% from 1989 to 1994, and warned it could drop another 32% during the next five years. Ms. Yellen criticized those predictions as being based on insufficient information.

In support of her upbeat forecast, she said the number of bank commercial loans of $1 million or less increased more than 7% between June 1994 and June 1995.

Agreeing with the rosy forecast, Andrew C. Hove Jr., Federal Deposit Insurance Corp. vice chairman, asserted that the decline in small-business lending has already been reversed. "The strength of the banking industry over the past three years has been accompanied by increased lending to small businesses," he said.

Mr. Hove said the viability of community banks - the biggest source of small-business loans - will not be threatened by consolidation. In three of the last six years, banks with assets of less than $100 million enjoyed above-average profits, he said.

Lawmakers were skeptical, however.

Rep. John LaFalce, D-N.Y., predicted the wave of mergers will greatly thin the ranks of community banks willing to lend to small businesses. "Out-of-state bank holding companies show lower rates of small-business lending than local institutions," he said, citing the Fed report.

Troubled by Ms. Yellen's disagreement with the Fed economists, Small Business Committee Chairwoman Jan Myers asked the central bank to prepare a more detailed analysis of small-business lending.

P. James Dowe Jr., president of Bangor Savings Bank in Maine, asked lawmakers to double the limit on commercial lending by thrifts to 20% of assets. Frank A. Suellentrop, chairman of the Community Bankers Association of Kansas, urged Congress to pass pending regulatory relief bills, which would ease many consumer protection and compliance rules.

GRAPHIC: Yellen, photo

LANGUAGE: ENGLISH

LOAD-DATE: May 1, 1996

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7TH STORY of Level 1 printed in FULL format.

Banking Strategies
(formerly The Magazine of Bank Management)

September, 1996 / October, 1996

SECTION: INTERVIEW; Pg. 55

LENGTH: 3005 words

HEADLINE: To the Limits of the Law

BYLINE: BY STEVE KLINKERMAN

HIGHLIGHT:
A Banking Strategies interview with Janet Yellen

BODY:

While the proposed Glass-Steagall reform legislation debated in Congress this year would have fallen well short of true regulatory modernization, Federal Reserve System officials still were quite encouraged by the prospect of a reasoned expansion of banking powers and a reduction of burdensome regulations.

Under the bill proposed by Rep. James A. Leach (R-Iowa), chairman of the House Banking Committee, banks would have gained the freedom to affiliate with non-insurance financial companies such as brokerage firms. Certain laws forcing banks to seek regulatory approval for all sorts of corporate decisions also would have been eased.

What is more, the Fed stood to gain additional stature in the regulatory community, along with a legislative validation of its view on how banking companies should be organized and regulated. Rep. Leach supported the central bank's contention that new and potentially more risky banking activities should be housed in separate bank holding company subsidiaries, with the Fed acting as the umbrella supervisor of the parent companies.

So from many perspectives, the legislation's defeat made life more difficult for the Fed, both in its role as an advocate of progressive regulation, and as the aspiring master architect of banking's future corporate and regulatory structure.

While acknowledging that "proceeding from here is going to be a challenge," Janet L. Yellen says the Fed still hopes to gain ground in modernizing and streamlining its regulatory practices. A member of the Board of Governors, she also defends the apparent majority stance among Federal Reserve officials on what constitutes banking's optimal corporate structure.

In an interview with Banking Strategies, Ms. Yellen says the Fed is optimistic that more of banking's internal risk management procedures can be incorporated into regulation, simplifying oversight and rewarding well-managed banks with greater leeway in self-governance. And she has hopes of cutting some of the red tape surrounding the applications and approvals process.

The economist joined the Board of Governors in August 1994, following a 14-year tenure at the University of California at Berkeley. She completed a doctorate in economics at Yale University in 1971.

While conceding that sequestering new activities in separate subsidiaries drives up costs and probably slows over-all corporate responsiveness, Ms. Yellen says loading up federally-insured depositories with myriad nontraditional lines of business would give banks unfair competitive advantages while compromising the risk profile of the Bank Insurance Fund.

Ms. Yellen also makes a case for significant Fed involvement in bank regulation, and for the continued widespread availability of deposit insurance -- even at the price of heavier regulation.

Banking Strategies: What are the major issues facing depository institutions? Where can the Federal Reserve help, and where should it be involved?

Yellen: Depository institutions are facing competition from many kinds of financial institutions operating in less-encumbering regulatory environments. Banks have to gain stance in evolving market arenas if they are to maintain their competitiveness.

For the Federal Reserve, that means we need to usher banks into new areas in ways that are consistent with law and the dictates of safety and soundness, and to support modernizing legislation. We were disappointed that the Glass-Steagall reform bill wasn't passed. We feel there is a range of activities banks could pursue that would broaden their ability to serve customers in a way that would be perfectly consistent with safety and soundness. Proceeding from here is going to be a challenge.

Banking Strategies: You can only go so far within the current legal framework.

Yellen: That's right. We also supported the regulatory relief provisions wrapped in the Glass-Steagall package. But we still are trying to go as far as we can on our own. We are systematically reviewing every one of our regulations, trying to see what we can do to reduce regulatory burdens.

Banking Strategies: What are the primary opportunities?

Yellen: We're studying ways to streamline the process of submitting applications and obtaining approvals, particularly for banks that are well-capitalized and -managed, and which have either satisfactory or outstanding ratings for compliance with the Community Reinvestment Act.

Another priority is keeping current with progressive risk management practices in the industry. We certainly see that risk management methods, models and techniques are rapidly advancing. We want to understand these practices and maintain an open mind about incorporating them into supervision and regulation.

For example, we're about to publish final rules on the regulatory use of internal bank models assessing trading risks. That's a novel approach. It shows a willingness on the part of the regulators to work with the industry -- to gear our own capital standards and supervision to risk management techniques banks themselves are using daily.

We're not stopping at that. In the draft of our pre-commitment concept, on which we currently are soliciting comment, we try to create incentives for banks to figure out on their own how much capital they need to cover losses in trading accounts. We would give banks the freedom to decide for themselves, based on self-assessments of exposures and risk management capabilities.

Banking Strategies: Can this approach be expanded beyond its proposed initial application?

Yellen: It is a question mark for other areas. One requisite of the pre-commitment approach is an ability to evaluate the market value and prospective performance of a portfolio, assessing gains and losses and the variability of returns. Capital requirements are based on that analysis, and banks commit themselves to maintaining capital levels specified by their own models.

But in the case of loan portfolios, the assets can't be valued. And that's a big difference. Loans are not like exchange-traded derivatives and tradable securities, on which we can obtain market values every day. That impedes the assessment of gains and losses and the variability of returns, and as such is an obstacle. I'm not going to rule out the possibility that someone could figure out how to extend the pre-commitment approach to illiquid loans, but at this point I don't see how that could be done.

Banking Strategies: One issue in banking efficiency is corporate structure. There is serious disagreement on whether trading and many other types of cutting-edge financial services activities should be folded into the main bank, or housed in separately capitalized subsidiaries.

There are those people who very strongly contend that housing high-risk activities in separate subsidiaries doesn't enhance safety and soundness and does pose a burden. On the other hand, there are those people who say separate subsidiaries help protect depositories and prevent market disparities arising when banks use deposits to fund high-risk units that compete with non-banks having higher funding costs.

What's your take? What is the ideal corporate structure that assures safety and soundness but at the same time assures maximum flexibility and economy of operation for the banking industry?

Yellen: You've asked a very difficult question, and I don't think there's a clear-cut answer to be had.

In terms of allowing banks to engage in new activities, it seems to me that we ought to try to maintain a level playing field. I worry about the potential competitive inequities that could arise if banks were permitted to carry new activities under their depository charters. The advantages would include a lowered cost of capital and the implied extension of the safety net to new and potentially more risky activities.

To be sure, there's a consequence for efficiency and competitiveness when activities are compartmentalized in separate subsidiaries. The holding company structure can raise the cost of engaging in new activities and maybe prevent -- given the firewalls that we would envision -- some of the synergies that could spring from a more tightly-integrated organization.

The Federal Reserve is sensitive to this issue, and our position on separate subsidiaries isn't totally rigid.

But under the holding company structure, there's less chance that banks will take advantage of the safety net and become unfair competitors in new activities. And there is greater insulation between depositories and higher-risk affiliates.

Of course, all of us understand that a holding company in practice is a single organization. If a separate subsidiary engages in risky activities and gets in trouble, it is possible that detrimental public and market reactions could spill over to the bank affiliate, even though it is a legally distinct entity in sound condition. The affiliates are all part of the same entity. They all have the same name on the door.

Banking Strategies: Confidence is confidence on both sides of the aisle. If the public loses confidence in a banking affiliate . . .

Yellen: . . . the mistrust can extend to the bank as well. We understand that having new activities undertaken in separately capitalized subsidiaries of holding companies doesn't completely insulate the bank. That is why we think banking organizations also should have umbrella supervision.

Banking Strategies: Should this responsibility necessarily fall to the Federal Reserve?

Yellen: Currently, the Fed is the umbrella supervisor of all bank holding companies. I can envision reorganizing things so that responsibilities among the various regulatory agencies are carved up in a different way, so I don't want to make it sound like this is a unique and perfect arrangement and could never, ever be different. But do I think there ought to be a supervisor, an umbrella supervisor of holding companies? Yes, I do.

I also think it is very important that the Federal Reserve play a role in bank supervision, even if that role varies somewhat from today's definition. Bank supervision ties in with monetary policy. And it ties in with the ultimate responsibility of the central bank, which is guaranteeing the stability, liquidity and efficiency of the financial system. Every once in a while, the Federal Reserve is called on to handle a systemic crisis. I don't believe we could adequately perform that function without the hands-on expertise and knowledge of the banking system that stems from the discharge of supervisory responsibilities.

The other thing I would say is that we have a slightly different approach to regulation than other agencies. Because we have responsibility for monetary policy, we are constantly looking at the role of the banking system in supporting economic growth. It's naturally our perspective that banks should take risks.

Under an alternative regulatory mindset that says "I don't want any bank to fail on my watch," you lose the perspective that it is the function of the banking industry to assume and manage risks by making loans that facilitate economic growth.

When regulation is made too tough because of worries about bank failures, it can have repercussions on the entire economy. We saw that in the credit crunch of the early 1990s.

Banking Strategies: How do we arrange things so that the dispersion of regulatory oversight and self-governance privileges matches the dispersion of risk profiles in the banking industry, as opposed to the one-size-fits-all approach that we often see?

Yellen: That's a really tough issue. Superficially, for example, a loan is a loan is a loan. But a group of banks having nominally similar portfolios can have sharply differing risk profiles. In an ideal world, they ought to hold very different amounts of capital. But under our current system, capital standards on a portfolio of triple-A bonds can be the same as for a portfolio of junk bonds, because we aren't differentiating.

I think we're making small, gradual steps in the direction of prescribing capital standards that do reflect varying gradations of risk, coming down hard in terms of supervision for banks managing their affairs comparatively less adroitly.

I'm not saying progress is universal, but look at the internal models on trading risk. This is a good example of where we are going. We are trying to gear what we do off what the banks themselves do, working with the banks' own models. There are rewards for banking organizations that have good models and manage things properly. There are penalties if your model is lousy.

Increasingly with respect to applications and approvals, well-capitalized and -managed institutions will find the procedures they go through less burden-some. For them, certain things will be automatic.

Generally speaking, I think it is important to reward good practices. But it's not easy. It really isn't.

Banking Strategies: What's your general outlook for charter expansions and modernizing legislation?

Yellen: Even though the Glass-Steagall reform package stalled, there seems to be a general legislative consensus that things can be done to streamline regulation and make it less burdensome. But even within the limits of what the law currently says, we are making a great effort on our own to streamline things. We'll go as far as we can.

A suggestion has been made that we reconsider our own regulations that limit the proportion of revenues banks can derive from Section 20 subsidiaries involved in underwriting, and we'll have to think about the possibilities there. The Comptroller of the Currency has had considerable success in allowing national banks to become involved in insurance and other activities.

Ultimately, Congress has an important role to play. I'd like to think that when there are large chunks of things that are either utterly uncontroversial or obviously constructive, that somehow or another, those proposals eventually will become law.

The last legislative push got wrapped up in some pretty contentious politics. But if you ask me what is my forecast, I think all the forces are moving in the same direction, and that is to expand bank powers so long as safety and soundness is not compromised. I don't know how the journey will work out precisely.

Banking Strategies: There are those bankers, such as Norwest Corp. chairman Richard Kovacevich, who are quite vocal in saying, "Why don't we scale back the safety net, so that when it comes time for lawmakers to consider liberalizing charters and streamlining regulation, they won't be hamstrung by the issue of deposit insurance and the government's implicit backing of the banking system."

Yellen: My sense is that Dick's view is not the majority view. If banks were offered a choice -- either keep things the way they are and get deposit insurance and the regulations that go with it, or give up insured deposits and get rid of a lot of the regulations -- I think most banks would keep things the way they are.

I have the sense that most bankers feel deposit insurance is very important, that the insured deposit is a valuable core product.

On top of that, you have a very difficult public policy question which has to do with systemic risk and the stability of the financial system. Deposit insurance was introduced both to protect individual depositors and to prevent panics surrounding individual banks from spreading throughout the financial system.

Would we be better off as a country giving that up? I don't think it is obvious that we would be. We would have to think through very carefully what implications the reduction or elimination of deposit insurance would have for systemic risk. The Depression taught us a lesson. I'm not sure we should get rid of a system that has served us well in terms of assuring the stability of our financial system.

Banking Strategies: What are the most promising and important risk management priorities in the banking industry?

Yellen: When you look at the large trading crises occurring over the past few years, the Barings situation, the recent losses at Sumitomo, in virtually every case the problem stemmed from improper internal controls. While some episodes involved the use of sophisticated financial instruments and strategies, it was the unsophisticated stuff -- lax controls, poor policies and procedures -- that sparked trouble.

The lessons are simple yet powerful. You don't let the person doing the trading keep the books. You establish risk limits, backed up by proper oversight and controls and a robust organizational structure. It's not so much having the team of rocket scientists building risk control models and making sure you don't insert an error in line 9,022 of the program, it is controlling people in the organization and guarding against the possibility that an errant officer could incur and conceal $ 1 billion of trading losses.

My sense of the state of the practice is that it is very good. I feel the industry has come a long way. I feel the supervisors have come a long way. Increasingly, our emphasis is on the organization, making sure that the internal controls are there.

Beyond that, the technologies for measuring, monitoring and controlling risk are also advancing. Not all institutions are using these tools, and they're not all engaging in the riskiest and fanciest kinds of activities, but my goodness, the technology in this area has evolved enormously.

Banking Strategies: Are you optimistic about the future of the banking industry?

Yellen: Yes, I know there are concerns about increased competition from nonbank financial organization. But it seems to me that a growing portion of bank profitability comes from activities that don't show up on balance sheets. In many fee-based products and services, American banks are highly competitive. I understand that banks are anxious to get into new activities. But overall, I think banking is doing quite well.

GRAPHIC: Photos 1 through 3, no caption, Photographs by Mike Mitchell

LANGUAGE: ENGLISH

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