Federal Reserve Board Oral History Project

Interview with

Edward M. Gramlich

Former Member, Board of Governors of the Federal Reserve System

Date: August 8, 2007

Location: Washington, D.C.

Interviewers: Lynn S, Fox, Sandra F. Braunstein, and David Skidmore

Federal Reserve Board Oral History Project

In connection with the centennial anniversary of the Federal Reserve in 2013, the Board undertook an oral history project to collect personal recollections of a range of former Governors and senior staff members, including their background and education before working at the Board; important economic, monetary policy, and regulatory developments during their careers; and impressions of the institution's culture.

Following the interview, each participant was given the opportunity to edit and revise the transcript. In some cases, the Board staff also removed confidential FOMC and Board material in accordance with records retention and disposition schedules covering FOMC and Board records that were approved by the National Archives and Records Administration.

Note that the views of the participants and interviewers are their own and are not in any way approved or endorsed by the Board of Governors of the Federal Reserve System. Because the conversations are based on personal recollections, they may include misstatements and errors.

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MS. FOX. Today is Wednesday, August 8, 2007. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. We are conducting an interview with Edward M. Gramlich, a former member of the Board of Governors. He served on the Board from November 5, 1997, to August 31, 2005. This interview is taking place at the Gramlich home in Washington, D.C. I am Lynn Fox, of the Board staff, and I am joined by Sandra F. Braunstein [director, Division of Consumer and Community Affairs] and David Skidmore, also of the Board staff.

Career as Member of Board Staff

MS. FOX. Governor Gramlich, thank you for speaking with us. I would like to begin by asking about your time as a staff member at the Board of Governors. You worked in the Research Division from 1965 until 1970. Would you speak about that experience and, in particular, about the monetary policy challenges of the 1960s?

MR. GRAMLICH. I often joke that when I came to the Board in 1997, I was both the newest Governor and the oldest Governor. I was the newest Governor because Roger W. Ferguson, Jr.,'s name has an "F" and that comes before "G," so he got confirmed before I did. Most of the time I was there I had the lowest seniority as Governor, but I had been at the Board back in 1965 to 1970, as you point out, so I knew a lot of the real old-timers that some of the other Governors had only heard whispers of.

I had come out of Yale graduate school, and I had done an econometric paper for my thesis. It hardly seems possible now, but in those days I was an econometrician. I got assigned to a new project that was just cranking up—to build an econometric model of the economy. We were doing it with a group of academics that included Franco Modigliani, who later won a Nobel Prize, and Albert K. Ando. The Board team was headed by a person whom the insiders know well but who never got much publicity. He was just wonderful. His name was Frank de Leeuw. He was a longtime staffer that everybody looked up to. He was really our leader. I cited him in a paper that I did on this a few years ago. Frank led a team that included Patric "Pat" Hendershott, Peter A. Tinsley, Roger Craine, and some others.

We basically built an econometric model of the economy that was the forerunner to [the] FRB/US model, which is what the Board uses now. The one place where FRB/US has gone way beyond what we did was that there are forward-looking expectations in the model. Ours was only backward looking. For example, if you were trying to figure out what people assume for expected inflation, you would take an average of previous inflation. That's the way we did it back then. Now they have much snazzier ways to do it, and it actually works better. The work on the model has continued, but we got it going.

By the way, just the other day, Ben Bernanke in his Jackson Hole speech referred approvingly to one of Frank's and my papers from this era.[1]

A few times in 1968 [and] 1969, that era, I made presentations to the Board and the Federal Open Market Committee (FOMC). We never actually used the model much for forecasting, because it wasn't that reliable and it couldn't beat use of the leading indicators and so forth. But it was good for studying the impact of policy changes. Our mouthpiece to the Board then was Lyle E. Gramley—he was a senior adviser, later became a Governor—and Daniel H. "Dan" Brill, who was head of the Research Division, another great man who, I think, history has forgotten about. They would try to promote the use of model building with the Board.

[1] Edward Gramlich amended this transcript in late August [2007] to add this reference to a speech the Chairman [Bernanke] gave on August 31[, 2007].

I never got into the real down-and-dirty policymaking of the [Federal] Open Market Committee. I was always more on the technical side. But we did have plenty of chances to interact with the Governors. I knew Governors George W. Mitchell, Sherman J. Maisel, and J. Dewey Daane fairly well. I knew William McChesney Martin, Jr., only vaguely, though I did play tennis with him once.

MR. SKIDMORE. What was it like for a young staffer to play tennis with Chairman Martin?

MR. GRAMLICH. Martin, I believe, was NCAA (National Collegiate Athletic Association) champ at Yale. He and Stephen H. "Steve" Axilrod used to play. They'd play every single day. FOMC or whatever, they were out there playing.

MR. SKIDMORE. Did you beat him?

MR. GRAMLICH. No, I didn't beat him. They were good.

MS. FOX. Were you recognized as someone with a good game?

MR. GRAMLICH. I have a moderate game. The first year I was at the Board, there was an economist named Anthony W. Cyrnak. Tony was a super tennis player and a good guy. We teamed up and were second in the Board doubles tournament that year, but we lost out to two guards. [Laughter]

MS. FOX. In the challenges of the late 1960s—the increases in inflation, particularly—what was the feeling among the staff about what was going on outside the building? Was the Board responding appropriately to what was going on?

MR. GRAMLICH. It was an interesting time in economics because it was the period where economists came onto the so-called natural rate of unemployment rule. Basically, the rule says, if you run the economy below the natural rate of unemployment, inflation will accelerate without limit. The academic basis for this was work by Milton Friedman and Edmund S. "Ned" Phelps. They both got Nobel Prizes. Franco and I were onto it in the model building. We used to talk about whether going below the natural unemployment rate—leading to explosive inflation—depended on the structure of coefficients.

When I gave a luncheon speech a few years ago, I said that I wrote a memo to the Board on this natural rate of unemployment and how it worked in our model.[2] By the afternoon of that day, somebody had gone on the website and mailed me the old memo. So that memo is there. It was about 1968 or 1969. The relevance of that for economists was that this was a time when unemployment was low. And as long as it stayed low, inflation would accelerate. And, indeed, that's exactly what happened.

MS. FOX. Did the Board have a number for the natural rate?

MR. GRAMLICH. Yes. And that's another issue. There's a man on the staff now, Athanasios Orphanides. He has argued in a very interesting paper that, in the late 1960s, the true natural rate was about 6 percent, but policymakers thought it was 4 percent. He also argued that in the 1990s it switched around. So the true rate was about 4 percent, and policymakers may have thought it was higher. I can't remember exactly what I thought the natural rate was at that time, but 4 percent or so would have been right. The unemployment rate by 1969 and 1970 had crept above that, and so I wouldn't have thought that policy would be an engine of inflation. But, according to Orphanides, it was.

There were two intellectual issues back in the 1960s. One was: Did the Fed understand the structure of the natural rate model? I think by the end of that period, they did. The second was: Did they have the numbers right? And there, Orphanides is probably right. I use "they"

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[2] Editor's note: The memo was "The Trade-Off between Inflation and Unemployment," Appendix A of the Board's December 10, 1969, *Current Economic and Financial Conditions,* also known as the Greenbook.

because I wasn't really part of this then. We would write our memos and send them on, but I wasn't really part of any discussion of this issue.

MS. FOX. Do you have any recollections about other parts of the government—the Council of Economic Advisers, for example—and what they were saying?

MR. GRAMLICH. This was the time of the Vietnam War, and so the Council—the chair of the Council was my thesis adviser, Arthur M. Okun—was trying to get the government budget reined in. This entailed two things. One was a tax increase, which eventually President [Lyndon B.] Johnson agreed to grudgingly. But it also meant predicting defense expenditures. One of the things I did, with a colleague named Harvey Galper, was a series on contract awards for defense spending. We wrote a paper back in the late 1960s. It showed that defense spending would be much higher than it was in the budget. We got a lot of attention for that paper. It was featured in *Businessweek* and other places. And, to my knowledge, I think the Board staff still uses a model something like the one we had. That paper was in the *Review of Economics and Statistics*.[3]

MR. SKIDMORE. Was there a suspicion on the part of [the] Board staff or Board members that the Administration was understating war spending, and this was having an economic effect?

MR. GRAMLICH. I was a little low on the totem pole to measure that. A lot of that kind of thing would have gone on in discussions between Brill and his top advisers in the Board. We wrote our papers and sent them on and talked about them, but I don't know what people were saying around the Board table.

MS. FOX. What made you leave the Board? Did you like the job?

[3] Harvey Galper and Edward Gramlich (1968), "A Technique for Forecasting Defense Expenditures," Staff Study 47 (Washington: Board of Governors of the Federal Reserve System).

MR. GRAMLICH. Oh, I loved the job, but it was the age of the big revolution. We were going to overturn society. A job opened up at the Office of Economic Opportunity [the agency that administered President Johnson's War on Poverty programs]. Robert D. "Bob" Reischauer mentioned it the other day as a very effective operation that got closed down. Incidentally, my bosses at OEO were Donald H. Rumsfeld, who was director; Richard B. "Dick" Cheney, who was the chief staff aide; and Paul H. O'Neill, who was our budget officer.

MS. FOX. Frank C. Carlucci was there, too.

MR. GRAMLICH. Carlucci followed Rumsfeld, yes. So we had famous bosses. At the time, Richard M. Nixon was all for that, because it was experimentation for getting rid of poverty. Later on they changed their mind and closed the agency.

MS. FOX. Was the agency formed in the Johnson years?

MR. GRAMLICH. Yes, Robert Sargent Shriver formed it. When the government turned over to Nixon, they tried to make it more experimental. That was actually good for economists. It was a good job, and I had a lot of fun there. After five years at the Fed, I had kind of petered out on model building. You can do model building for a while, but five years is a long time.

Before we leave that era, though, there is another important issue that did come up later in my Board career. It involves the discount rate. In 1965, the discount rate used to be a much more famous issue. It was the object of much more discussion than it is now. In 1965, when Martin was chair of the Fed, the [Federal] Open Market Committee felt that things were heating up, so the Committee raised the discount rate. President Johnson had a fit about it. He called Martin down to the LBJ Ranch and drove him around—this is legendary stuff—80 miles an hour, with beer cans flying.

Over time, the Board realized that the real action in financial markets was taking place with the federal funds rate, not the discount rate. So they never changed the discount rate again. But they did let the federal funds rate go up, and the consequence was that the federal funds rate got above the discount rate. That is crazy to an economist, because the discount rate is supposed to be the lending rate of last resort. The weird thing was that the funds rate got above the discount rate and stayed that way for 35 years. That never got changed until I came back to the Board and we finally changed it.

I remember this incident very well. When I joined the Board, the discount rate was still below the funds rate. I went in to see Alan Greenspan and said, "You know how this happened. I know how it happened. It's crazy. Why don't we fix it?" Greenspan said, "Well, you know how it happened. I know how it happened. It's crazy. If you want to fix it, I'm all behind you, but I'm not going to fix it." So I then went on a campaign to fix it, and we got it fixed. If we hadn't, the Fed could never have made the discount rate change it made recently.[4]

MS. FOX. What did your campaign consist of?

MR. GRAMLICH. Well, first off, every economist agreed, and so there wasn't anything controversial about it. The resistance came because when the discount rate is held down, the Reserve Banks have to manage how much banks are borrowing. They built up a whole infrastructure to control bank borrowing, which you wouldn't need if you used a true lender-of-last-resort rate. Reserve Bank presidents agreed in principle but said, "My God, I've got to fire six people if we do this." Some went along immediately, some were grudging about it. But, eventually, we got it through.

[4] Editor's note: This sentence was added by Governor Gramlich during the editing process. The interview was conducted on August 8, 2007, and the discount rate change he is referring to presumably is the cut in the discount rate—with an unchanged federal funds rate—on August 17, 2007. For a discussion of this policy move, see Ben S. Bernanke (2015), *The Courage to Act* (New York: W.W. Norton), pp. 149–50.

MR. SKIDMORE. What would you say to a non-economist to explain why that was an important change?

MR. GRAMLICH. The logic of the discount window is that when the federal funds market is not functioning properly, there is a lender of last resort. Number one, you want to encourage the federal funds rate to function properly, and we do. All the time I was at the Board, it didn't work well—only on 9/11, when the Bank of New York got ripped out. In an emergency, you want to have banks able to go to the government for funding. But you want that to be rare. And you don't want it to be managed. You don't want to have the Reserve Banks sitting on the commercial banks and saying, "No, you can't borrow, because you didn't do this," or that kind of thing. But they were doing that at the discount window. Now it's a more automatic, market-oriented system. It's not a huge change, because discount borrowings, in the normal course of things, are very small. But at certain times it can matter. It's a much more automatic mechanism now.

MS. FOX. When you forged that change, did you do it with personal lobbying or research papers or what?

MR. GRAMLICH. Well, everything. You use what you've got. Brian Madigan, who I'm glad to see was promoted to division director, was very helpful, and also [William R.] Bill Nelson. They were strongly for it, and they wrote a number of papers. I didn't really have to lobby the Board members. I lobbied all the [Reserve Bank] presidents. I spent a lot of time with the presidents. I spoke at two of their dinners, and I met them on the side.

MR. SKIDMORE. Did you learn any lessons from that about how to get things done in the Federal Reserve? Is the lesson any different about how to get things done in any other bureaucracy?

MR. GRAMLICH. This was the only issue where I had to lobby the Reserve Bank presidents. The Fed, as you know, has an unusual structure, because you have the Board and the FOMC, and they have different responsibilities. But I've been doing that all my life—I was head of CBO (the Congressional Budget Office), and I was dean at a university. Lobbying is something that I've gotten used to over the years, and it's not unpleasant. I enjoy it.

Appointment to the Board of Governors

MR. SKIDMORE. What are your recollections about how you came to be appointed?

MR. GRAMLICH. I really don't know much about it, surprisingly. Just before I came to the Board, I had been chair of the Social Security Council during President William J. Clinton's Administration. And my name was in the papers a lot.

I had a fractured committee. There were some conservatives that wanted to throw out Social Security and some liberals that wouldn't make any change whatever, and I was in the middle. I came out with a compromise plan, so I was in the headlines a little bit, probably as much as I've ever been in my life until the subprime mortgage issue lately.

Honest to goodness, this was the next thing that happened. Alicia H. Munnell, from the Council of Economic Advisers, called me and said, "I have a question. And it's not involving Social Security." I said, "Okay, what?" She said, "Would you like to be on the Fed?" I said, "Sure." And that was pretty much it. I know that many of my colleagues have lobbied for their position heavily. I actually did zero lobbying. I believe Roger Ferguson did zero lobbying as well.

MR. SKIDMORE. Was it a no-brainer, or did you have to think about it?

MR. GRAMLICH. It was a little bit of a no-brainer, but that was partly for personal reasons. I had been a dean at Michigan for two or three years, and I had been director before then. I was burned out. The money-raising is hard, dealing with faculty issues is hard, and I was getting tired of it. I had chaired the Social Security Council at the same time, so not only was I tired of the dean's job, but I was exhausted. When the Fed called, I thought about being one of seven people making decisions—important decisions—and not having to deal with faculty summer allowances and things like that. It sounded pretty attractive. Our kids had just moved to Washington, and we had a grandchild. They still live in Bethesda. We now have four grandchildren out there. So there was a family attraction to coming to Washington as well.

MR. SKIDMORE. Anything notable about the political process or your interaction with the President or the Treasury Secretary as the nomination moved forward?

MR. GRAMLICH. It was pretty trivial. Lawrence H. "Larry" Summers was deputy secretary of [the] Treasury, and I knew Larry. I had discussed his papers, and he had discussed mine. I met [Robert E.] Rubin. It was the absolutely most cursory interview anybody could imagine. He asked me a few questions, I answered them, and that was that. I met Gene B. Sperling, who was the President's person and also from Ann Arbor. All we ever talked about was Michigan football. And that was it. I could have been a raving Communist, and nobody would have discovered it.

Handling the Board's Consumer Financial Services and Community Development Issues

MS. BRAUNSTEIN. You became known at the Board as the consumer Governor. Did you have that as an agenda for yourself, coming into the Board?

MR. GRAMLICH. It is accurate that I was the consumer Governor, but it wasn't really an agenda. I got into the consumer business because, when I first came, the Board was understaffed. There were two new Governors, and a lot of the oversight committees were open. I had the choice of, gee, do I want to manage the Reserve Bank accounts, or do I want to regulate commercial banks, or what? There were various committees that weren't that attractive to me. I got in trouble, by the way, with the *American Banker* when I first came. I was an academic, and I knew nothing about banking. I admitted that to the *American Banker,* and there were a bunch of horrified bankers. After that, I learned to keep my mouth shut about my distaste for banking. But I didn't ever lose the distaste, and it seemed to me that the consumer issues were far and away the most interesting going. I willingly stepped on[to] that committee. Alice M. Rivlin was chair, but she was only there a short time before I became chair. I was chair for most of the time I was there. I must say, the issues would keep coming. Every one was fascinating, and I loved it.

MS. BRAUNSTEIN. Let's talk about housing and predatory lending, particularly the HOEPA (Home Ownership and Equity Protection Act of 1994) rules and how that came about and your role in regulatory changes under HOEPA and HMDA (Home Mortgage Disclosure Act of 1975).[5]

MR. GRAMLICH. HOEPA required that the Board hold hearings periodically on home equity lending. We had four hearings, which you organized. I chaired the morning sessions. These were sessions where people would come and explain their problems and so forth. These were serious problems, and there were ways that we could fix them.

One thing we did was change the points and fees test that triggers HOEPA coverage to include single-premium credit insurance. Pretty soon after that, virtually all banks stopped issuing single-premium credit insurance, the predatory lending instrument of choice at the time.

[5] HOEPA was enacted in 1994 as an amendment to the Truth in Lending Act (TILA) to address abusive practices in refinances and closed-end home equity loans with high interest rates or high fees. Refinances or home equity mortgage loans meeting any of HOEPA's high-cost coverage tests require special disclosure requirements and restrictions on loan terms, and consumers with high-cost mortgages have had enhanced remedies for violations of the law. HMDA requires mortgage lenders to report annually about the geographic distribution of their applications, originations, and purchases of home-purchase, home improvement loans, and refinancings.

That was a very striking success from the HOEPA hearings. We also lowered the trigger that determines when a loan gets HOEPA protection. That was a little bit less striking. We lowered it from 10 to 8 points, the most allowed by the law. All the banks cut their lending rates 2 points. We nudged them down a bit, but it didn't have a strong impact. I wrote about HOEPA in my book.[6] There are ways to use some of the HOEPA provisions to get at these adjustable-rate mortgages in the subprime market. If I were still at the Board, I'd be bugging you about some of those. The main thing we did with HOEPA in that time was single-premium credit insurance.

MS. BRAUNSTEIN. You used to say that your intent was to "shine a light on the industry" to force a change in industry practices.

MR. GRAMLICH. I think we did change practices in that case. The other light we shone was with the HMDA mortgage disclosure statute. When it initially passed, it just had the banks reporting their mortgage loans. Then I believe the Fed, in the late 1980s, got the idea: "Well, we ought to put in mortgage denial rates."

MS. BRAUNSTEIN. And also the race and gender of borrowers.

MR. GRAMLICH. Yes. The Congress did that. Denial rates did differ by race, and this was something that the civil rights people would use in trying to enforce fair lending. What happened in the 1990s was, as usury laws disappeared, banks began pricing credit and not denying loans; they'd just charge higher rates. So a few of us—Glenn B. Canner and Robert B. "Bob" Avery were involved—decided we ought to get the banks to record if they had high-priced loans and the incidence of that by race. And, of course, the Board proposed that. The banks never thought we were serious about it. With all these laws, you put out your initial regulations, and there's a long comment period. You go through the comments, and then you go

[6] Editor's note: Edward M. Gramlich (2007), *Subprime Mortgages: America's Latest Boom and Bust* (Washington: Urban Institute Press).

final. We had this HMDA proposal out there for some years. I think the reporting requirements went into effect in 2004.

In December 2003, I was visited by a bunch of bankers. About 30 bankers came to see me and said, "Hey, Governor Gramlich, we've been reading through these HMDA regulations, and you're requiring us to report the interest rate." I said, "Yes, that's right. It's been out for comment for two years." They said, "Well, you're not serious!" And I said, "Yes, we're serious. This has been out for comment for two years." These are bank presidents. They had been failed by their staff because this was out there, and we knew it would be dynamite. But there was never much of a murmur. It kind of sailed through.

There was never really much controversy in the adoption of it, and now, of course, it is highly controversial. There are something like 200 banks out there with pretty dramatic racial disparities in the incidence of high-priced loans. The final shoe hasn't dropped on this. But we knew it would be big. It was a mystery to me that there wasn't more reaction to it. I just don't think they thought the Board would follow through. But we did.

MS. BRAUNSTEIN. You were integrally involved in both HOEPA and HMDA in deciding the direction and the policy and really getting into the weeds. Is that stepping outside the role of what was traditionally the role of Governors?

MR. GRAMLICH. That's what I'm used to. That's the way you do it in universities. It wouldn't have occurred to me to do it any other way. I was interested in the issues, and there were some live issues. And they were tricky. I didn't have all the legal background, so we often had the lawyers there, too. To me, it's the right way to do it.

MS. FOX. It's a little bit of a distraction from the consumer question directly, but could you characterize how the other Board members worked or the staff worked in that regard?

Would you consider it an activist place compared to other government agencies or to universities?

MR. GRAMLICH. It seemed to me, in my time at the Board, it wasn't that different. Edward W. "Mike" Kelly, Jr., used to get into pretty detailed management of what the Reserve Banks were doing. First Laurence H. "Larry" Meyer and then Roger got heavily into Basel II, and Susan S. "Sue" Bies got heavily into Basel II and other regulatory issues. So it didn't seem to me that I was acting out of character for the Governors there at the time. It may have been that, in a prior age, the Governors were different, but when I was there, we had pretty hands-on Governors.

MS. FOX. What was your role with the Chairman on consumer issues?

MR. GRAMLICH. The consumer issues weren't his favorite. And that was pretty obvious. But whenever we had something big, I would take it to him. If it were really big, J. Virgil Mattingly, Jr. [the Board's general counsel], and I would take it to him [laughter], because he trusted Virgil. He didn't trust me. Most of the things we got through. The one thing we didn't get through him was the thing that came out in the *Wall Street Journal* the other day about Fed supervision of the nonbank mortgage subsidiaries of bank holding companies. I'm delighted to see that somebody down there has drunk the magic elixir, and that the Fed has now changed its tune on that.

These were big issues—the HMDA thing, reporting racial disparities, and so forth. These are the kinds of things that one could imagine the Chairman having some trouble with. And so we would be ready. I mean, we had everybody covered. Usually Virgil and I would make the final pitch. If you propose these things, you want to get them through. On the consumer issues, I usually got some help from the general counsel.

MS. BRAUNSTEIN. I want to turn to CRA (the Community Reinvestment Act of 1977).[7] There were some major changes and a different kind of interagency process.

MR. GRAMLICH. Typically, you like to get all four banking agencies going together. And, in general, we did that. But there was an interesting episode when [James E.] Gilleran was head of OTS (Office of Thrift Supervision). He went public with his own stripped-down version of CRA. The other three agencies hung together, and that took a lot of talking. Scott Alvarez [Board general counsel] was very helpful in that process, and maybe others—I don't know who all talked to the other agencies. But we hung together. OTS has come around, and they're now in sympathy with us.

We modernized CRA. A law like that needs some fine-tuning, because the assessment areas change. And when banks are doing innovative lending, there are definition changes and so forth. That was a good interagency process, with the exception of that one episode.

MS. FOX. Do you think it's valuable to the process to have multiple agencies?

MR. GRAMLICH. I thought you were going to ask about CRA. I love CRA. Multiple agencies you can go around and around on. To me, there would be some logic in having a single banking supervisor with common regulations and so forth. The argument is, if you have multiple regulators, then the banks can shop around and get a better deal. But these regulations never changed that much, as far as I'm concerned, so I think that argument is a little overrated. Britain has gone over to having just a single bank regulator. I suppose I'd favor that. On the other hand, the present system works, and there's an argument: If it ain't broke, don't fix it.

[7] CRA encourages depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations.

MS. BRAUNSTEIN. You were a member of the NeighborWorks board.[8] Would you talk about your experiences there?

MR. GRAMLICH. I loved NRC. It's now NeighborWorks America. It's a classy operation. It has affiliates in probably 250 cities, and they've been effective in putting up homes, reconditioning neighborhoods, getting responsible buyers, and so forth. They've created a lot of new housing over the years and have good numbers. I've often cited those in my speeches, and when I didn't, Carolyn Welch [Board staff in the consumer division] did it for me. Whenever I would go to some town, Carolyn would write up what the local group had done. It's also been impressive on the other side, now that the big problem is not so much getting people in homes but keeping them there. One group that we funded, Home Ownership Preservation Initiative, in Chicago, has done a particularly fine job.

It's been a great organization, and I've been delighted to be part of it. One personal note: My father is a charity-minded guy. He retired early and worked on housing. I always knew that, but I never knew what he did as a volunteer. The NeighborWorks board position came with being the chair of the Board's Consumer and Community Affairs Committee. When I took that over, George Knight was the NeighborWorks director, and when he was explaining what NRC did, I had this light go on: "Oh, my God. That's what my father's been doing all these years." He's been part of the Rochester organization. So it was nice to make that connection.

Evolution of the Fed

MR. SKIDMORE. You have experienced Board culture in two eras. What has changed, and what things have been constant?

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[8] NeighborWorks is a national nonprofit organization created by the Congress to provide financial support, technical assistance, and training for community-based revitalization efforts in affordable housing, small business development, and job training programs.

MR. GRAMLICH. Let me change the focus on that, because I think there's a bigger point. I got into this last fall when I was asked by a group at Hillsdale College, which is in the Bible Belt of Michigan, to do a paper on the Fed. Of course, there are people who see the Fed as unwanted interference with the free-functioning economy. I thought I would tweak them a little bit by putting the word "evolution" in the title. So the title of the paper is, "The Evolution of the Fed."[9]

If you read Allan H. Meltzer's book and go back to the early part of the 20th century, the monetary policy reasoning of the Fed was disgraceful. It's the only way to describe it. They didn't even have the right sign. Whether the Fed contributed a lot to the Great Depression or just screwed up badly, we could debate. But it did screw up badly. And it could have contributed a lot. Then, as the economy was trying to come out of the recession in 1936, the Fed screwed up royally again. Governors were giving these idiotic statements about monetary policy, and it shouldn't have been the case. That was a time when the Keynesian revolution was beginning, and academic economists understood a little bit of how the economy operated. But the Fed was just off there in space, doing what Meltzer, everybody else who's looked at it, and I thought was a terrible job.

So we get to the postwar period, which is when I was at the Board, and see the onset of the Great Inflation. We've talked about that already—we had the estimate of the natural unemployment rate wrong. We didn't really misunderstand the model. I think that criticism is overblown. But still, policy wasn't effective. There was the Vietnam War and there were other factors, but the Fed could have done a better job. When you look at the Fed now, it's this finely tuned machine. This, by the way, is not only true at the Fed, but it's true around the world.

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[9] Editor's note: Edward M. Gramlich (2016), "The Evolution of Thinking about Federal Reserve Monetary Policy," presentation at Hillsdale College, 2006 Free Market Forum (October 27–29).

Twenty-five years ago, the average rate of inflation in developed economies was in the double digits. Now it is 1 or 2 percent. So over this last 25-year period, central banks have learned how to control inflation, which is their fundamental job, to protect the currency. The inflation-targeting central banks contributed a lot, and others contributed a lot—Paul A. Volcker and Greenspan contributed a lot. There were a lot of "parents," if you will. Right now, issues that we don't worry about—that we used to have to worry about a lot—are, number one, controlling inflation and, number two, controlling the economy.

The main historical reaction I have—and this is over the broad sweep of history—over the Fed's roughly 100 years is that you set up these central banks and, by golly, they learned how to do their job. That would be the fundamental message I would stress. It's true in this country, but it's also true in other countries—we have no monopoly on this success. I think there are a lot of reasons for that. One is that the Fed, at least in recent years, has been very good at opening up the links to academics. We've always had a lot of academic economists in for conferences and hired good graduate students, et cetera. So there's been a strong link. And if there are trends in academics, they'll be understood at the Fed. There's a lot of international discussion, and innovations that work in some countries are adopted by others. The process side of this is right, but the outcome side of this is really right. That's an important lesson.

MS. FOX. Imagining the problem, studying the problem, and learning from history have improved. How do you feel about the decisionmaking process? Is that something that evolves as well?

MR. GRAMLICH. I think it probably has, although I know less about that. I was at the Governors' table for eight years, and we had some evolution there, mainly in the form of transparency in the FOMC statements and so forth. That, I'm sure, others will discuss. It's something I strongly agreed with.

But I thought the process was good from the moment I came, to be honest. The Greenbooks are very good, and the Bluebooks give you a good description of what the options are. Anybody can go through there and figure out what the high points are and what to say in the [Federal] Open Market Committee. And we all did that.

The process is a little formal. Alice Rivlin used to bemoan the fact that when somebody would say something crazy, she would never get a chance to call them on it. But I gather Ben S. Bernanke has changed that, and when people say things that are a little out of line, you can intervene using something economists do at their conferences: They have one-handed interventions and two-handed interventions. A two-handed intervention is on the point just raised. For a one-handed intervention, you want to make a new statement about something. Economists have been doing this for some years, and I gather Bernanke has adopted that. I think Alice would be pleased. That's probably the one process thing that I could have suggested at the time I was there, but points that were important got made and got discussed.

Sometimes we may not have done the right thing, but it wasn't because the discussion wasn't adequate. It was because there was a hard issue, and we may not have known what to do.

Central Bank Involvement in Banking Supervision and Consumer Affairs

MS. FOX. The Board has an enormous range of responsibilities in the consumer area and with banking supervision and running the payments system. Is it a good thing?

MR. GRAMLICH. Well, it is definitely a unique thing. If you look around the world, independent central banks usually just do monetary policy. It is unique that the Fed is such a full-service operation. I was never bothered by it. I actually thought it made sense to have the

Board take a fairly active role in consumer affairs, which is truly unique around the world. We had a good staff, and we had people who were trained to think of cost–benefit, and these issues were generally about credit, after all. I thought we were effective.

Subprime Lending and Monetary Policy in the Early 2000s

MR. GRAMLICH. Now, on the issue of the day—we had this episode in early 2000, where we took the funds rate down to a very low level for a two- or three-year period, and we did it for good economic reasons. Greenspan was quoted in the *Wall Street Journal* the other day as saying at the time, "We're doing some damage here. I don't know what it is, but we are doing some damage." The reporter [Greg Ip] said that statement was confirmed by another person. Well, that other person was probably me, because Greenspan did say that. He was right, and the damage we were doing was in the subprime mortgage market. It gave banks an opportunity to go into these teaser-rate loans and other things that have big payment shocks and are leading to the big foreclosure problem.

I'm giving the luncheon talk at the Kansas City Fed's Jackson Hole conference, and one of the things I'm saying is, "G*ddamn it. We have to fix this problem, and we have to fix the problem before the next cycle."[10] This is a case where I'd rather it all be in one agency—I mean, subprime mortgage and monetary policy don't automatically go together, but in this case they did. I think the package that the Fed came out with on July 17 is wonderful, and, if implemented, will correct a lot of the problems. In this case, I'm glad that the Fed's sitting on it, and I'm not sure anybody else would have.

[10] Editor's note: Edward M. Gramlich (2008), "Booms and Busts: The Case of Subprime Mortgages," in *Housing, Housing Finance, and Monetary Policy,* proceedings of a symposium sponsored by the Federal Reserve Bank of Kansas City (Kansas City, Mo.: FRB Kansas City, August 30–September 1, 2007), pp. 257–65.

MS. FOX. In hindsight, looking at that low interest rate period and the kind of credit expansion it generated, what could the Fed have done differently at that time to avoid the spillover?

MR. GRAMLICH. As I say in my book, I think the big problem is supervising all of the lenders. The Fed couldn't have done a huge amount about that, because over 50 percent of the loans are made by independent lenders that are basically beyond its legal authority. The only way to do that is what the Board is thinking of now—getting all the supervisors to come together, along with the states, and get a good supervisory regime. We could have thought of that, but it never occurred to me to do that. I didn't think we had the authority. We could have conceivably done some good by supervising bank affiliates, but they aren't the big problem. The big problem is the unsupervised lenders. I don't think there's a huge amount we could have done about that. Some of the Senators want to blame all this on the Fed. I think they're just off base.

Terrorist Attacks on the United States on September 11, 2001 (9/11), and Chairing the Air Transportation Stabilization Board

MR. SKIDMORE. On September 11, 2001, where were you?

MR. GRAMLICH. I was in Tucson, Arizona, speaking at a conference that was arranged by a former student. I had gotten in late the previous night. That was a Tuesday morning, as you know. I woke up about 7:30. It's a three-hour time difference, so 9/11 had already happened. They were showing it on the TVs. I believe that day I was the first Governor out of the blocks in saying that the Fed would make available the credit necessary to cover any difficulties. It was known that the Bank of New York was out of commission by that time. Other than that, I didn't have much to do with it. I couldn't get back to D.C. Finally, by the weekend, I jointly rented an SUV with three other people at the conference, and we drove back. It took 37 hours, with no stops.

Later on, 9/11 played a big role in my life, because the Congress formed the Air Transportation Stabilization Board to issue loan guarantees to airlines that suffered losses due to the terrorist attack. It was set up with Greenspan, or his designate, as the chair. I felt Greenspan had enough other things to worry about, and the loan guarantees were kind of interesting, so I volunteered to head the board. I had earlier volunteered to head the steel loan board and the oil and gas loan board. Airlines were far and away the most exciting.

The first request we had was from America West, which was in the middle of a big financial restructuring project just when 9/11 hit. The CEO there, William Douglas "Doug" Parker, seemed like he knew what he was doing. We gave them a loan, and they survived. They've now merged with U.S. Air, and they're doing well. We had another 15 or so applications, most of them kind of minor.

Treasury was represented on the board by Peter Fisher [Treasury undersecretary for domestic finance] in the early days, and Brian C. Roseboro later on. And the Transportation Department was on the board. Kirk Van Tine [general counsel] was the main person for Transportation. It was interesting, because I was what economists call the median voter. Transportation almost always voted "yes" on these things, and Treasury almost always voted "no." So how the Fed voted was key. Daniel E. "Dan" Sichel [Board staff senior economist], my good buddy and former student, was my staff guy.

The biggest challenge was United Airlines. And that was very big, indeed. This all happened on my 65th birthday. My son-in-law works in New York State as one of the leading scientists in their natural heritage program. I'm a birder. There's a rare bird that lives only in the top of the Catskills, so the 65th-birthday present was that Tim, my son-in-law, was going to get a tape for this bird, and we were going to go up and find it. And we did that. The loan board meeting on United was the day before. Roseboro, at the time, was the Treasury delegate. Once the job was delegated, the top guy no longer had control. We had a vote on United, and it went down, 2–1. Well, J. Dennis "Denny" Hastert [R-IL] from United's congressional district heard about this, and he went to John W. Snow, who was Secretary of the Treasury. They began to beat up on Roseboro big time—I mean, big time—lots of calls and so forth. They tried to get the Fed to change, but we weren't under them, so that was pretty hopeless. Dave, you were involved in this, as I remember, writing the press release.

MR. SKIDMORE. Yes, I was.

MR. GRAMLICH. We issued one release Friday morning.[11] I can't recall exactly what it said, but something to the effect that the loan board voted 2–1 against United, and that's that. But we kept getting all these calls, and my kids were really impressed, because here I was up in the top of the Catskills, dissing the Speaker of the House and the Secretary of the Treasury in successive phone calls. [Laughter] It was kind of heady, actually. But we stuck to our guns. United did not get its loan. Roseboro deserves the real profile in courage—it was the right thing to do. America West had a valid case, where their financing was messed up by 9/11. United didn't. Their financing was messed up by their basic problems and not 9/11.

MR. SKIDMORE. That Friday morning, staff had a conference call with you. Later you told us exactly where you were during that cell phone conversation.

MR. GRAMLICH. On top of a big rock. The Board had a telephone answerer [Denise Redfearn] who would say, "Oh, Mr. Gramlich! Oh, blah blah blah blah." She was very effusive. I called in to that meeting, and you were all sitting in my office waiting. It was raining, and I found a spot on the rock where I could get a little reception, and then I slipped and fell. The

[11] Editor's note: U.S. Department of the Treasury (2004), "ATSB Decision on United Air Lines," press release, June 17.

phone almost went off the rock, and I dived for it, and I got it and put it to my ear. There was a lot of fluttering about, and the secretary at the Board was going crazy: "Oh, Governor Gramlich! Are you okay?" That kind of thing. It turned out that the reception, when I grabbed the cell phone and was lying there, was even better. So I conducted this call in the rain, laying on this stupid rock for about half an hour, getting sopped. But we got it done. [Laughter] It was a little dramatic.

MR. SKIDMORE. On the topic of the loan boards, did you draw lessons from your experience as an economist about the wisdom of government intervention?

MR. GRAMLICH. I wrote a paper on it. I think loan boards have some use, because the Congress is going to want to intervene when some industry has a problem, and to throw money at it. I like the structure where you put it up to agencies like the Fed and [the] Treasury and so forth and have economists look at it cross-eyed and see if support is merited. You could take a free-market position about this, but I think that, given the congressional imperative, a loan board actually makes a good bit of sense.

Relationship between the Board and the Press

MS. FOX. You mentioned working with Dave on press releases. In retrospect, what are your views about the interesting relationships between the Board, which has a secret, and the press, who want to know it?

MR. GRAMLICH. I had a little trouble with this when I first got to the Fed because, as an academic, you can talk all night and nobody gives a damn. So I was used to being a little overgarrulous. When you get to the Board, you say half a word and it goes out on every wire service. I had a few rough moments in the break-in period. I got used to it. I think I was a little more forthcoming with the press than some of my colleagues, but I don't see the problem with that. I think we can tell them some of the things we're thinking about.

At one point, there was an issue. And, to this day, I know I'm guilty, but I don't know how guilty I was. David M. "Dave" Wessel used to cover the Fed. He had moved on, but whoever was covering the Fed was off, and so he came back for one of the December meetings. He got wind from somewhere that we were going to think about lowering rates. He called me for confirmation on a Sunday morning. I play tennis on Sunday morning. I had walked into the house, I had my tennis stuff on, and Wessel's on the phone. He said he had heard whatever, and I said something like, "You know?" or something like that. It was the wrong response. I should have pledged "No comment" and hung up. Of course, Wessel had a story in the Monday *Journal* that caused a lot of foofaraw. Lynn had to come in and admonish me. I think that was the worst mistake I ever made. I talked about it to Wessel later on, and he said, "You weren't the problem there." I don't know who was.

MS. FOX. That happened to more than one person. Dave Wessel would say, "I'm calling to confirm such and such," and the respondent would say, "How did you know?" or something that was, in a sense, a confirmation.

MR. GRAMLICH. Yes. It was not only me, but I did do wrong.

I had some others that were kind of funny. When I first got to the Board, in 1998, there was a conference in Pittsburgh on international capital markets. Russia was defaulting, and, as you know, the international system was at some risk. I was the luncheon speaker. The conference was behind, so they went to lunch late. I was supposed to meet with the press after lunch. Well, the microphones were all set up. A local professor saw the microphones, went in, and had a press conference. He started banging on the Fed for lowering rates; that was when we first lowered rates in 1998.

After I finished my lunch, I went in there. There was a cub reporter in Pittsburgh covering the press conference, and when the local professor had talked, the cub reporter had put it on the wires as Gramlich. When I walked in, the cub reporter asked his buddy, "Who's this?" "This is Gramlich." And then, "Oh, sh*t!" So he went out and issued a retraction. Markets went up and down, like that! It was not my fault, but it happened. When I got back to the Board, everybody was asking, "What in the world happened up there?"

MR. SKIDMORE. Thank you very much.