Testimony of Robert D. Auerbach

Professor of Public Affairs

Lyndon Baines Johnson School of Public Affairs, University of Texas at Austin

before the

Subcommittee on Domestic Monetary Policy and Technology

Committee on Financial Services

U.S. House of Representatives

October 4, 2011

“Audit the Fed: Dodd-Frank, QE 3, and Federal Reserve Transparency”

INTRODUCTION

Thank you Chairman Ron Paul, Ranking Member William Lacy Clay and members of the subcommittee for this opportunity to testify on transparency at the Federal Reserve. My name is Robert Auerbach. I am a Professor of Public Policy at the Lyndon B. Johnson School of Public Affairs at the University of Texas in Austin. On two separate occasions I had the honor to serve as an economist on the staff of this Committee (1977-81 and 1992-1997) and my 2008 book, Deception and Abuse at the Fed: Henry B. Gonzalez Battles Alan Greenspan's Bank details the oversight investigations that I staffed while serving Committee Chairman Henry S. Reuss in the late 1970's and Committee Chairman/Ranking Member Henry B. Gonzalez in the 1990's. I have also served as an economist in the U.S. Treasury's Office of Domestic Monetary Affairs during the Reagan Administration and at the Federal Reserve System.

The Fed is the powerful central bank of the United States that controls the money supply, regulates the banking system and, since 1962, makes loans to foreign countries without Congressional authorization. [1] The historical record summarized below, describing Federal Reserve officials blocking transparency and individual accountability, including destroying source records of its policymaking committee since 1995, leads to the following suggested remedies:

- **Independent Inspector General**: The Inspector General of the Federal Reserve should not be appointed by the chairman of the Federal Reserve Board as is currently the case. The IG should be a Presidential nominee whose credentials, abilities and independence are examined during a Senate confirmation process.
- **Preserve Transcripts**: The Federal Reserve should stop destroying the source transcripts and should stop turning off the recording system at its policy making committee, the Federal Open Market Committee (FOMC). This practice was approved in 1995 by an unrecorded vote of the FOMC directed by then-Chairman Alan Greenspan. [2]
- **Provide Minutes to Congress**: The minutes of the boards of directors meetings at the Federal Reserve's 12 district banks and the transcripts of the meetings of the Federal Reserve Board of Governors and of the FOMC, should be sent to the House and Senate banking committees within six months of the meetings. Trained archivists at the National

---

[1] Auerbach, Deception and Abuse at the Fed, pp. 69 - 73.
[2] Auerbach, Deception and Abuse at the Fed, pp. 103 - 104.

Archives and Records Administration should edit those records to remove prescribed items in cooperation with the Federal Reserve.

- **Senate Confirmation of Bank Presidents**: The 12 Federal Reserve regional bank presidents who are eligible to vote on the money supply as members of the FOMC should be confirmed by the Senate. The presidents wield enormous power as members of the FOMC and they should be fully vetted in the confirmation process. I want to commend full committee Ranking Member Barnie Frank for addressing the regional bank presidents' role on the FOMC with H.R. 1512, although rather than removing them from the FOMC as proposed in the bill I would recommend Senate confirmation.

FED AUDITS

Chairman Ron Paul and Senator Bernie Sanders deserve great praise for their leadership in enacting the current Government Accountability Office (GAO) audit of the Federal Reserve as part of the Dodd-Frank Act. The Senate unanimously approved, by a 90 to 0 vote, the Sanders amendment to require disclosure of the recipients of the Fed's emergency loans. Hopefully this Congressional action set a precedent for fuller continuing audits of Federal Reserve operations.

In 1976, House Committee on Banking, Finance and Urban Affairs Chairman Henry Reuss proposed a GAO audit of the Fed. The Fed orchestrated a massive lobbying campaign using the officials of private banks to lobby to stop the audit bill.

Evidence of the lobbying campaign came from minutes of the board of directors of each of the 12 district Federal Reserve Banks. Chairman Reuss requested minutes from district bank meetings from 1972, 1974, and 1975. After a six-month delay with letters back and forth and meetings between Chairman Reuss and Federal Reserve Chairman Arthur Burns, the minutes arrived at the Congress. One response to the Reuss request for records was given by a St. Louis Fed President, as reported on the transcript:

> "I would also think that if this involves a lot of work, which it will, needless work, that someone on Mr. Reuss' Committee, a friendly individual should know what we're being called upon to do. Because I think this can be used against Reuss if we react intelligently and as I see it in the St. Louis case, it's appalling how skimpy or meaningless our minutes are, I'm sure we did this with great wisdom knowing that a man named Reuss would ask for them. The minutes are really terribly shallow. Tell nothing."[3] (Emphasis added)

[3] November 16, 1976 FOMC transcript, p.17.

Chairman Reuss' delivered a floor speech in 1976 detailing the evidence of the Fed's orchestrated lobby against the audit bill entitled: "What the Secret Minutes of the Federal Reserve Banks Meetings Disclose". The speech led to the passage of the Federal Reserve Reform Act of 1977 which brought Fed Bank directors under the federal government conflict of interest laws.

Despite this victory, the Fed won the first round on the audit effort. Chairman Reuss's audit bill could not garner enough support to pass out of the Committee. It was shunted to the Government Operations Committee where it passed in 1978, but only after glaring no-audit barriers on any Fed operations connected to monetary policy or international transactions were added.

In the Fed's monetary policy operations billions of dollars can be made from inside information from leaks of Fed policy. It is very difficult to police these leaks of inside information. One necessary step to stop leaks is to severely limit the interest rate policy information in the Federal Reserve to a few people. This has not happened. Many hundreds of Federal Reserve employees -- over 500 employees -- are directly involved in the secret meetings or in preparing information that has been discussed at these meetings.

The House Banking Committee received information in 1997 about non-Federal Reserve employees at Federal Reserve meetings where inside information was discussed. Congressmen Gonzalez and Maurice Hinchey asked Greenspan about the apparent leak of discount rate information and the presence of these people at Federal Reserve meetings. Greenspan was forced to admit that some non-Federal Reserve people had attended Federal Reserve meetings where the Federal Reserve=s future interest rate policy was discussed.[4] Greenspan included a 23-page enclosure listing hundreds of people at the Board of Governors in Washington, D.C. and in the 12 Federal Reserve Banks around the country who have access to at least some secret Federal Reserve information about non-public Federal Reserve interest rate policy.
Names of Avisiting scholars@ were listed who had attended pre-FOMC meetings at three Federal Reserve Banks. Greenspan also wrote:

> At the Federal Reserve Bank of Kansas City, over the 3-year period, a total of 28 foreign central bankers have attended 16 different Board of Directors meetings, including the

[4] Greenspan letter of April 25, 1997.

discussion and vote on discount rates. Those attending included Acentral bankers from Bulgaria, China, the Czech Republic, Hungry, Poland, Romania and Russia. [5]

At the December 19, 1989 FOMC meeting Greenspan warned about the ill effects of continuing leaks from the FOMC's supposedly secret meetings and said that "we're beginning to look like buffoons":

> [. . .] I would like to raise again a problem that continues to confront this organization with continuous damaging and corrosive effects, and that is the issue of leaks out of this Committee. We have two extraordinary leaks, and perhaps more, in recent days: in which John Berry at The Washington Post in late November had the time and content of a telephone conference; previous to that we had The Wall Street Journal knowing about telephone conferences and knowing a number of things that could only have come out of this Committee.
>
> As best I can judge from feedback I'm getting from friends of ours the credibility of this organization is beginning to recede and we're beginning to look like buffoons to some of them. [. . .] [6]

FOMC RECORDS

In 1976 two threats to Fed secrecy created high anxiety at the Federal Reserve Board of Governors. First, David Merrill, a law student at Georgetown University, brought a legal action challenging the 45-day delay in releasing the "Directive" on monetary policy.[7] It is a short report on policy actions that were authorized at the FOMC meeting. The Federal District Court agreed with Merrill. The Fed appealed up to the Supreme Court which remanded it back to the district court. Lacking funds for further extensive adjudication Merrill could not pursue the case. The Fed has all the money it needs or can order from the Bureau of Engraving and Printing to hire private law firms and fight any legal action.

The second attack on the Fed's secrecy was Congressional consideration of the "Government in the Sunshine Act" that was signed into law September 13, 1976. That law

[5] Greenspan letter to Chairman Gonzalez, April 25, 1997, p. 2.

[6] Chapter 9, "Valuable Secrets and the Return of Greenspan's "Prophetic Touch" in Deception and Abuse at the Fed .

[7] The secret meetings at the Board of Governors in Washington D.C. revealed great alarm about transparency at the Arthur Burns Fed. This response was revealed in the FOMC transcripts Burns left upon his death in 1987 to the President R. Gerald Ford Library on the University of Michigan campus. The archivists of the National Archives and Records Administration lightly edited the transcripts.

required that: "The agency shall make promptly available to the public, in a place easily accessible to the public, the transcript, electronic recording or minutes of the meeting." The Fed frantically tried to protect itself from such transparency and individual accountability. Fearing the new legislation and the pending legal action for the disclosure of their records, Federal Reserve Chairman Arthur Burns led the Federal Reserve Open Market Committee in a 10 to 1 vote to discontinue transcripts of its meetings in 1976. That vote began the official 17-year Fed lie asserting that no transcripts were being maintained of FOMC meetings.

In 1992 I returned to the Banking Committee staff of then-Chairman Henry B. Gonzalez. Chairman Gonzalez and I could not believe that the most powerful central bank in the world, operating in our great democracy, had no complete records of its policy making committee, the FOMC. On October 19, 1993, Chairman Gonzalez convened a Fed oversight hearing focusing on transcripts. Seventeen officials of the Fed, seven members of the Board of Governors and ten of the twelve presidents of the Federal Reserve District Banks, testified in the Banking Committee chamber. Chairman Greenspan sat in the center of the long row of Fed officials. Prior to the hearing, Chairman Gonzalez sent the witnesses specific instructions that they reveal details of what records are kept by the Fed of their meetings.

A top Fed staff person, who would become vice chairman of the Board of Governors, explained on a confidential FOMC conference call four days before their Congressional testimony that Greenspan clearly intended to mislead Congress about written records of the FOMC: "The Chairman is not highlighting these transcripts ...We're not waving red flags." [8]

Jim McTague, now the Washington editor of Barron's, wrote about Greenspan's testimony: "In a performance that would have made professor Irwin Corey weep with admiration Mr. Greenspan avoided drawing attention to the existence of transcripts ..." Corey famously performed as a double-talking comedian.[9]

Several days after the hearing, the Cleveland Fed broke the silence and misdirection and informed the Congress of the deception. Chairman Greenspan then sent a letter admitting that transcripts existed. He claimed to have had memory problems. I led a group of Republican and Democratic staff to the Board of Governors where Fed staff showed us 17 years of neatly typed transcripts around the corner from Chairman Greenspan's office. Under pressure from this

---

[8] FOMC conference call transcript, October 15, 1993, p. 20.
[9] "Greenspan Has Himself to Blame for Fervid Interest in Transcripts," American Banker, December 1, 1993, p. 24.

Gonzalez investigation the Fed ended its 17-year lie by again issuing the transcripts but only with a 5-year lag, too long to establish timely individual accountability.

In 1995 Greenspan held a non-recorded vote of the FOMC – no finger prints – to destroy the source FOMC transcripts. I was informed by the Fed Vice Chairman Donald Kohn that this destruction would continue and that it was legal.[10] Previously these source records had been sent to the National Archives.

That same year the shredding machines at the Fed destroyed the source FOMC records when Fed officials bypassed the Congress and voted $5 billion to support the Mexican peso. That loan was collateralized by revenue from Mexico's oil industry. When the loan authorization was sent to the New York Federal Reserve Bank and was public information the peso stopped falling. The loan to Mexico that had been authorized was then not needed and was not made.

INVESTIGATIONS OF FED OPERATIONS

Congresswoman Carolyn Maloney joined Chairman Gonzalez in an investigation from 1995 to 1997 of the Fed's more than 50 contracted airplanes that were delivering paper checks across the country. The investigation found evidence of corruption in this system typified by the "backup plane" at Teterboro Airport. The Fed paid for this contracted plane that people at that Fed facility called the phantom plane because it was not present at Teterboro much of the time. We also uncovered evidence of nearly nonexistent in-house audits. Officials covered losses in the airplane fleet operations by transferring money from the Fed's employee pension fund.

The Reno Justice Department refused the Gonzalez request to investigate the extensive corruption found in the management of the airplane fleet and referred the Gonzalez inquiry to the Fed's Inspector General. The IG told me he did not know if he had jurisdiction because the fleet was managed by the Boston regional Fed Bank.

That weak dodge is consistent with my prior experience and underlies the importance of changing the structure of the Fed's IG. The Fed's Report to Congress and the Dodd-Frank law grant the Chairman of the Federal Reserve the authority to appoint his own Inspector General who is charged with investigating the Fed bureaucracy and who also serves as the IG for the new Consumer Financial Protection Bureau. This is a clear conflict as Chairman Bernanke can

---

[10] A letter from then Vice Chairman Donald Kohn to Robert Auerbach September 1, 2001. Included in Auerbach, "Stop the Fed From Shredding Its Record," Huffington Post, December 9, 2001.

"prohibit the Fed's Inspector General from carrying out or completing an audit or investigation or from issuing a subpoena ...": [11]

Another Gonzalez investigation began in 1997 when the Congress received information about alleged corrupt accounting at the cash section of the Los Angeles branch of the San Francisco Federal Reserve Bank that includes vaults containing cash and coins. The GAO assisted the Gonzalez's investigation. During the investigation Chairman Greenspan informed Ranking Member Gonzalez that the Federal Reserve knew that nearly $500 thousand that had been stolen from Fed vaults by Fed employees from 1987 to 1996.[12] The Gonzalez/GAO investigation indicated this was an understatement.

The following selections are from the September 30, 1996 published report of an excellent GAO team that investigated the cash section at the Los Angeles Branch of the Federal Reserve in coordination with a Gonzalez investigation. The report indicates how desperately the Fed operations need a complete competent audit. It is a matter of national security:

A bank had brought a deposit of $432,000 to the Fed and Fed employees mistakenly entered the transaction as $8,640,000. When Fed employees in the cash department counted the deposit they discovered an $8,208,000 mistake "they overrode the system control in the cash inventory system and forwarded the money for further processing. Although this error was corrected when the problem was detected at the end of the day, this resulted in an erroneous entry being made in the L.A. Bank's ledger for $8,640,000 that increased the cash in the vault amount and the depository institution's account. L.A. Bank officials had no explanation for why this occurred."

The GAO also reported: "We found that the October, November, and December 1995 monthly currency activity reports of the L.A. Bank were prepared and reported incorrectly. We confirmed that the reported receipts from currency deposited in the L.A. Bank by depository institutions (receipts from circulation) were not taken from the L.A. Bank's cash inventory

---

[11] Section 1081 of the Dodd-Frank Wall Street Reform and Consumer Protection Act states that, "…the Chairman of the Board of Governors of the Federal Reserve System shall appoint the Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection. The Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection shall have all of the authorities and responsibilities provided by this Act with respect to the Bureau of Consumer Financial Protection, as if the Bureau were part of the Board of Governors of the Federal Reserve System."

[12] Federal Reserve Board of Governors Chairman Alan Greenspan letter to Ranking Member Gonzalez, December 5, 1996.

records (in other words, independently determined) but rather 'forced' to ensure that the currency activity reports agreed with the daily balance sheet for the last day of the month." "The reports were prepared incorrectly at the direction of the L.A. Bank's management. L.A. Bank officials stated that the practice of forcing the reports to agree had been in place for some time." "We found that problems in currency reporting are linked to the limitations in the design of the underlying cash inventory system." "The L.A. Bank's inability to precisely summarize currency activity from its cash inventory records raises serious questions about the integrity of its accounting and internal controls." "We attempted to perform a comprehensive review of the L.A. Bank's internal controls and accounting practices over the money flowing through the Bank. Our efforts to perform a comprehensive review were substantially limited by the L.A. banks inability to provide the information needed for such a review.[...] we requested that the Bank provide us with [. . .] a general ledger history of all of the activity in its general ledger cash accounts for October through December 1995" [The bank did not provide the] general ledger of cash transactions because Bank officials stated that it would take them 3 weeks." [13]

This excellent GAO report demonstrates that the agency is capable of conducting exemplary audits of Fed operations if it is not constrained by statutory limitations and as long as experienced staff lead the investigations. The Fed vault facilities are a crucial part of the nation's payment system and should be a national security priority with full accountability to the Congress. The Fed banks contain uncirculated currency and coin transferred from the Bureau of Engraving and Printing. They also receive cash from banks throughout the country. The cash sections and vaults of the Federal Reserve District Banks and branches need to be investigated and audited with personnel who are experienced in central bank operations, independent of Fed officials and instructed to make thorough audits.

ACADEMIC INDEPENDENCE

Future GAO audits should target the massive number of Fed payments to academics who are not employed at the Federal Reserve. A Gonzalez investigation found that the Federal Reserve sent money and provided other benefits to economists throughout academia who specialize in monetary and financial subjects, and who were not employees of the Federal

---

[13] "Federal Reserve Banks, Inaccurate Reporting of Currency at the Los Angeles Branch, "Report to the Ranking Minority Member [The Honorable Henry B. Gonzalez], Committee on Banking and Financial Services," House of Representatives. GAO/AIMD-96-146, September 30, 1996. See also "EMBEZZLING FED MONEY AND FALSIFYING ACCOUNTING RECORDS," Deception and Abuse At the Fed," pp. 55-60.

Reserve. The Fed itself employed over 500 economists so the need to make all these outside payments is highly questionable.[14] Some academics received checks from a number of (up to five) district Fed Banks. Reuters reported Milton Friedman's views on this problem in 1993: "the Fed's relatively enhanced standing among the public has been aided 'by the fact the Fed has always paid a great deal of attention to soothing the people in the media and buying up its most likely critics' Recognizing that the Fed employs 'probably half of the monetary economists in the U.S. and has visiting appointments for two-thirds of the rest' he [Friedman] saw few among the academic community who were prepared to criticize the Fed policy." [15]

CONCLUSION

The current GAO audit of the Federal Reserve is a historic step towards greater transparency at the central bank. The Fed has a long history of fighting outside audits as various Fed officials have complained that they would constitute an infringement on central bank independence. In fact, the Fed's mythical flag of independence from politics, a favorite Fed mantra to avoid individual responsibility, is merely a shield intended to protect the institution from being forced to act in a more transparent fashion. Ongoing audits do not infringe on the Fed's independence which is protected in a myriad of ways, including self-funding and terms for members of the Board of Governors of 14 years. Board of Governor members can only be removed by impeachment and that has never happened.

Their long terms and very little chance of being impeached should allow independent votes. It has not prevented the fact that monetary policy has been very poor in periods such as the 1970's and since October 2008. I have been writing and speaking about the Federal Reserve's present misguided policy since 2009. [16]

Complete GAO audits and the other improvements I have described are essential for establishing a timely authentic record of policy actions and individual responsibility for the powerful unelected officials at the nation's central bank.

---

[14] After the chapter in my book, "When 500 economists are not enough," was published on Huffington Post, , September 7, 2009, Ryan Grim followed up with an up to date article: "Priceless: How the Fed Bought the Economics Profession," September 7, 2009.

[15] Reuters interview reported July 7, 1993.

[16] **"**The Bernanke Fed Is in a Deep Hole With a $1.6 Trillion Time Bomb**,"** Huffington Post/AOL, August 29, 2011.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Robert D. Auerbach	

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☐ No

6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

7. Signature:

Robert D. Auerbach

Please attach a copy of this form to your written testimony.