United States Senate
Committee on Finance
Hearing to Consider the Nomination of Joshua Frost to be an Assistant Secretary of the Treasury for Financial Markets
Tuesday, October 26, 2021

Questions for the Record

Senator Bob Menendez (D-NJ)

Our financial industry has a diversity problem, especially at the highest levels. The proportion of minorities in financial services drops by 75% from entry-level to the C-Suites. At the highest levels, 90% of the C-Suite is white. Women of color make up only 2% of executives despite being 21% of the entry level workforce. This is not just an optics problem. Lack of diversity leads to real issues in our financial system. Treasury Secretary Yellen has previously stated that "[i]f economists are mainly of one gender or race, they are likely to miss things that matter."

1. Do you believe the same holds true for executives and senior management of financial institutions?

    - **Answer: I agree. The findings from a broad body of academic research on this subject – specifically, that leadership teams that are diverse with respect to background and experience outperform those that are more homogeneous – are unambiguous.**

2. Do you agree that the lack of diversity at financial institutions means they may be more likely to miss things that matter, as Secretary Yellen described?

    - **Answer: I agree, for the reasons stated above.**

3. If confirmed, how would you help diversify regulated financial institutions?

    - **Answer: If confirmed, I will work with the Assistant Secretary for Financial Institutions, the Department's newly appointed Counselor for Racial Equity, and other colleagues around the Treasury Department to promote a financial system that better reflects the diversity of our country. I would work with my colleagues to support policies that lead financial institutions to hire and retain a more diverse workforce, create opportunities for diverse suppliers, and encourage more diverse representation at the board level.**

<u>Senator Mike Crapo (R-ID), Ranking Member</u>

Inflation, Investment, and Economic Growth

Mr. Frost, last week, Fed Chair Powell said, "Supply-side constraints have gotten worse…[T]he risks are clearly now to longer and more persistent bottlenecks, and thus to higher inflation."

I am deeply concerned that trillions of dollars of new social spending proposed by this administration will exacerbate inflationary trends by sending more dollars after a limited supply of goods and services.

If that happens, I believe the Fed could be constrained in its ability to address inflation through rate increases because of the large and growing deficits that this social spending requires.

However, persistent low rates could contribute to inflation even further.

1. How will financial markets respond to the rising inflation, growing budget deficits, and rate policy uncertainty stemming from this scenario?

    - **Answer: The President's infrastructure legislation, including investments in infrastructure, would be expected to result in a more productive economy in the long run. Upgrading our transportation infrastructure will allow more goods and services to be produced and enable U.S. firms to access new markets. As our digital economy continues to grow, people need reliable broadband in all corners of the country. Further, investing in our airports and ports will help decrease the supply-chain constraints that are leading to current pricing pressures. Therefore, I would expect financial markets, which are inherently forward-looking, to react positively to the long-run productivity benefits of the proposed legislation. I also agree with Secretary Yellen's stated view that these investments are not likely to result in an increase in inflation.**

      Currently, financial markets are not signaling concern over the budget deficit or long-term debt levels. The level and shape of the yield curve are not indicative of a market belief that this is a major issue today. With respect to interest rates, I respect the independence of the Federal Reserve to make those decisions based on its Congressional mandate to sustain full employment and stable prices

2. What effects would uncertainty in the financial markets have on business and public sector investment, as well as economic growth?

    - **Answer: In general, excessive financial market uncertainty can serve as a drag on investment and growth. This happens because firms are reluctant to invest or expand when there is greater uncertainty surrounding their prospects. When volatility increases, companies are less able to anticipate**

their long-run cost of capital, which can result in lower investment volumes. That is why, if confirmed, I would focus on managing the nation's debt in a regular and predictable manner at the lowest cost to the government. I will also work to make sure that market participants have confidence in a transparent and well-functioning Treasury market. I would also note that the Administration's proposed Build Back Better legislation is likely to result in a more productive economy and lower deficits in the long run.

On the other hand, in August, the Senate passed on a bipartisan basis the Infrastructure Investment and Jobs Act, which would provide more than $550 billion for traditional physical infrastructure.

3. Given that so many of our current economic problems stem from supply-side constraints, in order to promote economic growth, wouldn't financial markets take more comfort from a focus by the federal government on policies to promote investment in traditional physical infrastructure?

    - **Answer: Investments in physical capital/public infrastructure, like the bipartisan Infrastructure Investment and Jobs Act, will serve as an important boost to the economy's long-run growth potential. I agree that there are supply-side constraints, and as I noted above, improvements to our country's physical infrastructure will be critical in staying competitive and providing confidence to our manufacturers and workers that the government understands these challenges. However, physical infrastructure upgrades alone will not ensure that our economy is on the path to sustained growth and full employment. We also need investments like those outlined in the Build Back Better Act. Financial markets have thus far responded well to the potential for these measures to grow the economy.**

Debt Limit #1

The debt limit represents a statutory limitation on the value of debt subject to the limit. Increasing the debt limit serves to facilitate fresh borrowing in order to fund past obligations made by Congress and signed into law by the President. Increasing the debt limit or suspending the debt limit for a fixed future period also facilitates increased borrowing to facilitate funding of new obligations made by Congress and signed into law by the President between the date at which the debt-limit increase (or suspension) was made and the date at which the new, higher, debt limit binds (under a suspension, there will be a new, higher limit at the date on which the limit is re-instated). The debt limit, and any changes in probabilities of it being breached, can have domestic and international financial and economic effects, and the position to which you have been nominated would confront such effects.

4. A debt limit increase or suspension is not exclusively limited to increasing debt-issuance authorization that would only facilitate fresh borrowing to pay obligations that have been made prior to the date of the increase or suspension. Do you agree? If not, fully explain why not.

- **Answer: Increasing the debt limit does not authorize new spending. It simply allows the government to finance obligations approved by Congress. Today, an increase in or suspension of the debt limit is necessary to allow Treasury to borrow to meet obligations resulting from laws previously enacted by Congresses and Presidents of both parties. I would add that if the federal government failed to honor all of its obligations, the financial and economic effects would be significant.**

Debt Limit #2

It is known that Treasury regularly makes projections of its near-term and longer-term operating cash balances and, in periods approaching binding of a statutory debt limit, regular (daily, and sometimes multiple times per day) projections about how much headroom is made available from so-called "extraordinary measures" to operate under a debt limit with available cash and incoming receipts, given incoming due obligations.

5. Will you commit to supplying Member of this Committee and their staff with regular updates of projections of cash holdings and extraordinary when asked?

   Answer: If confirmed, I commit to working with Members of this Committee and their staff to share information to assist the Committee in its oversight capacity. I appreciate the Committee's need for information regarding projections during debt limit impasses, and if confirmed, would look forward to working with the Committee on this issue.

6. Will you commit to ensuring that Members of the Committee and their staff have, upon request, at least as much projection information as Treasury supplies to the Federal Reserve Bank of New York?

   - **Answer: I would need to be fully briefed by Treasury staff on the exact nature of the information to which you are referring. As a general matter, I am fully committed to providing the Committee with information about the debt limit, consistent with applicable laws, procedures, and practices. If confirmed, I would look forward to working with you to facilitate the Committee's ability to perform its important oversight role.**

Treasury officials regularly meet with financial market participants, officials from the Federal Reserve Bank of New York, officials from the Board of Governors of the Federal Reserve System, and often others, in the New York Fed's Treasury Market Practices Group. When Treasury nears a debt limit that may bind, that Group typically engages in discussions of views about effects on markets, most prominently on markets related to Treasury securities. Indeed, in a September 2, 2021 meeting of the Group which you attended on behalf of Treasury, the debt limit was discussed. In that, and several prior meetings of the Group, relevance of a Group 2013 "white paper" on "Operational Plans for Various Contingencies for Treasury Debt Payments" was noted. That report, as the September meeting minutes reveal "focuses on operational

practices associated with a delayed payment on Treasury debt, in order to reduce the adverse consequence of such an even on the markets for these securities." The report is, in effect, one of the contingency plans we would expect Treasury, the Fed, and others to have in place to provide a roadmap of steps to take in the event of significant market disruption caused by an inability to provide timely payment on U.S. Treasury obligations—where, notably, the cause could be a cyberattack, a superstorm that disrupts systems, breach of a debt limit, or other contingencies. Such a contingency plan is something that, in a prior debt limit scare during the Obama administration, neither Treasury nor Fed officials would acknowledge.

7. Do you commit, if confirmed, to share contingency plans formulated by Treasury to confront adverse contingencies that could affect market functioning in markets for Treasury securities, if asked by Member of this Committee?

    - **Answer: While I cannot speak to the Obama Administration's practices regarding contingency planning, if confirmed, my intention would be to ensure that Treasury is as transparent as possible regarding its plans for confronting adverse contingencies.**

8. Do you commit, if confirmed, to report to this Committee if you are instructed by anyone to, in turn, instruct officials or staff of the Federal Reserve System, including the Federal Reserve Bank of New York, to refrain from sharing with Members of this Committee any information about Treasury's cash positions, projected cash positions, or projections regarding aspects of "extraordinary measures?"

    - **Answer: If confirmed, I would urge Treasury to work in as transparent a manner as possible and would not instruct others to refrain from sharing information in a manner consistent with applicable laws, procedures, and practices.**

Capital Markets / Securities Regulation

Mr. Frost, the Administration continues with an odd belief that, somehow, private market participants do not fully understand and price-in risks presented by climate change. The belief, further, is that those fallible market participants must face more regulations and controls from the perceived infallible federal regulators, who somehow know risks better than others.

9. If you agree with the Administration's stance on additional federal financial regulations for climate change, can you provide detailed examples of exact markets and industries and companies where private-sector actors do not adequately understand risks that somehow federal regulators know more about?

    - **Answer: I agree with Secretary Yellen and the FSOC that "climate change is an emerging and increasing threat to America's financial system that requires action." The steps identified by the FSOC in its recent report, including filling climate-related data and methodological gaps and enhancing public climate-related disclosures, are important in helping the public and**

private sectors better understand the unique nature of climate risk. I believe it is important that Treasury work with Congress on these important issues. The FSOC's climate report notes disclosure challenges in a number of specific financial sectors on pages 86 and 87 of the report (available at https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf).

Senator John Thune (R-SD)

Inflation is at a thirteen year high. Prices of more and more goods and services are increasing. Combined with supply-chain bottlenecks, labor shortages, and ultra-easy fiscal and monetary policies, there's a growing recognition that inflation will be with us well into next year or longer. Republicans warned that pouring $1.9 trillion into the economy earlier this year would fuel inflation, but the White House dismissed increasing price pressures as "transitory" – despite inflation forecasts having been revised up several times already. Now Democrats want to push another multi-trillion dollar partisan spending bill onto the economy.

1. Do you regard this inflationary increase as transitory, as Secretary Yellen has proclaimed, or is rising inflation a persistent problem our economy will be dealing with for months, and possibly years, ahead?

    - **Answer: I agree with Secretary Yellen's view, which is widely held by most economic forecasters, that the inflation outlook remains transitory as the economy pivots from a steep recession back into recovery. The pandemic led to a drastic shift in consumption patterns towards goods and away from services. The pandemic has also disrupted global supply chains and kept some workers on the sidelines. As the vaccination rate improves and cases recede, I expect these factors to reverse, bringing inflation rates lower.**

Senator Rob Portman (R-OH)

You have deep contacts at the New York Fed, which is responsible for purchasing debt that the Treasury Department sells. At the Treasury Department you will oversee the desk which sells these securities.

1. Can you detail which safeguards you will put in place to ensure these transactions remain lawful and are not subject to any conflict of interest?

    - **Answer: I take the independence of the Federal Reserve very seriously and would pledge to never undermine this independence. I know that you and this Committee are committed to assuring the independence of our nation's central bank, and I want to assure you that I share that commitment. I also support the rigorous controls Treasury has in place regarding the conduct of its auctions of Treasury securities. If I have the honor of being confirmed, I commit to you that I will fully embrace the role to which I have been nominated and will respect the independence of the Federal Reserve in its monetary policy formulation and implementation.**

Senator James Lankford (R-OK)

1. According to estimates from the Congressional Budget Office, debt held by the public will reach $35.827 trillion in the year 2031, climbing to over 106% of GDP at that time. While interest rates may be low now, with such a significant debt burden, even small increases in interest rates will mean trillions in debt servicing costs.

    a. At what point will our nation's ever-climbing national debt threaten our ability to prudently and responsibly fund essential services and protect our national security?

        - **Answer: The current level of debt as a share of GDP are primarily the result of the combination of 1) fiscal policies undertaken by previous Congresses and Presidents of both parties, and 2) necessary emergency actions taken to protect American families and our economy from the impacts of COVID. While the emergency actions taken were a critical part of the government's response to the pandemic, I agree that it is imperative that we ensure that our country is on a path to long-term fiscal sustainability.**

          Necessary steps on this path include investments in the productive capacity of our economy and prudent steps to offset the costs of those investments.

    b. Do you agree that such significant levels of borrowing, fueled further by my colleagues' efforts to spend trillions more, carries significant risks?

        - **Answer: As I noted above, it is imperative that we put our country on a path to long-term fiscal sustainability. At the same time, it is important to invest in our nation's productive capacity, and I believe that right now the risks of doing too little to address long-running structural concerns outweigh the risks of doing too much.**

2. Some of my colleagues have suggested that because interest rates are currently low, we should not worry about deficit spending and, in fact, some have used it as the rationale for drastic increases in spending without any concern to how it will be financed in the future.

    a. Do you agree with their view – that low interest rates eliminate any concern of deficit spending?

        - **Answer: Real interest rates are at quite negative levels, and nominal interest rates are very low when compared to history. While interest rates are likely to rise over time, the projection is also that rates will remain low by historical standards. This outlook is supportive of my view that additional investment in improving the productive capacity**

of our economy is likely to be seen by investors in Treasury debt as a source of strength, rather than as a threat.

b. Are you concerned about our current trajectory of continuing to run up our national debt without any plan for reduction in the future, while merely hoping that interest rates remain low?

- **Answer: As I noted above, it is imperative that we put our country on a path to long-term fiscal sustainability. It is also important to make investments in our nation's productive capacity.**

Senator Todd Young (R-IN)

1. According to the *New York Times*,[1] you played an important role in the Federal Reserve's quantitative easing (QE) measures following the 2008 financial crisis. Given your knowledge and experience on this topic, I want to ask you about current QE efforts by the Federal Reserve and the relationship those strategies may be having on the skyrocketing inflation Hoosiers – and all Americans – are currently facing.

   In an effort to stabilize the economy in the wake of COVID-19, the Federal Reserve began engaging in QE through purchases of government bonds and other assets. Since January 1, 2020, the Federal Reserve has added over $4 trillion to its balance sheet, doubling the size of its holdings since the start of the pandemic.[2]

   a. Can you please describe the relationship between QE and inflation?

      - **Answer: The Federal Open Market Committee has stated that it "seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run" while seeking to ensure that "longer-term inflation expectations remain well anchored at 2 percent." As one of the tools to meet its statutorily defined mandate, the Fed has been purchasing Treasury securities and agency mortgage-backed securities in an effort to ensure that "substantial further progress has been made toward its maximum employment and price stability goals." As these asset purchases proceed, if they led to interest rates being too low for a given set of economic and financial conditions, there could be upward pressure on rates of inflation.**

   b. Do you believe the elevated levels of inflation we are currently experiencing can be attributed more to QE from the Federal Reserve or instead to other policies from the Biden-Harris administration, such as massive spending?

      - **Answer: I agree with Secretary Yellen's view that the rate of inflation would be expected to be moderately higher as the economy transitions between a steep recession and a healthy recovery, and that the outlook remains that inflation is transitory. The spending during the pandemic has been important to provide support to American businesses, communities, and households.**

   c. Are there any lessons that can be learned from the Federal Reserve's response to the pandemic and the current inflationary environment we are in now?

      - **Answer: I believe that the Federal Reserve's response has been robust and timely given the challenges faced and the magnitude of the pandemic's effect on the economy. There is little evidence that the**

[1] https://www.nytimes.com/2011/01/11/business/economy/11fed.html
[2] https://www.americanactionforum.org/insight/tracker-the-federal-reserves-balance-sheet/

policies employed by the Fed had an outsized impact on inflation. As I noted above, I agree with Secretary Yellen's view that the rate of inflation would be expected to be moderately higher as the economy transitions between a steep recession and a healthy recovery.

2. Professor Larry Summers, the former U.S. Secretary of the Treasury under President Clinton, the former Director of the National Economic Council under President Obama, and the Charles W. Eliot University Professor at Harvard, issued the following series of tweets on October 25, 2021:

   "Yesterday on @CNN w @jaketapper, @SecYellen said I was wrong about my assertion we are more at risks of losing control of inflation than at any time in my career. She expressed confidence that inflation is decelerating and will be back to target levels by the end of next year. I hope she is right but I think it's much less than a 50/50 chance. When the Administration formulated its budget in February, it expected 2 percent inflation in 2021, I was warning about inflation. Their forecast is no longer operative. In May and June, @SecYellen expressed confidence that inflation would be back to the 2 percent range by late 2021 or early 2022. Now this forecast is no longer operative. In @CNN interview, @SecYellen asserts twice that inflation has decelerated. This is a bit misleading as the 3 month and 12 month CPI inflation rates are both around 5 percent on an annual basis. And the trimmed mean and median inflation rates that exclude aberrant sectors (which used to be a stable of Administration's rhetoric) are now accelerating. The TIPS market is suggesting inflation in 3 percent range over 5 years and more next year. Breakeven inflation over 5 years is up 40 bps in the last month. Expectations data are even more disturbing. This is part of why my alarm is increasing and Treasury should be as well. Given lags in indices, housing inflation is almost certain to soar in coming months. With super tight labor markets, rising strike activity and real wages having declined, increases in wage inflation are likely as well. I actually believe the gap between Treasury and Fed statements and the everyday experience of business and consumers in terms of inflation has widened in recent months. Until the Fed & Treasury fully recognize the inflation reality, they are unlikely to deal with it successfully."[3]

   a. Do you agree with Professor Summers' analysis and conclusions as set forth above, why or why not?

      - **Answer: As I noted above, I agree with Secretary Yellen's view that the rate of inflation would be expected to be moderately higher as the economy transitions between a steep recession and a healthy recovery, and that the outlook remains that inflation is transitory. The pandemic saw a drastic shift in consumption towards goods and away from services, while also disrupting the production and distribution of**

[3] https://twitter.com/LHSummers/status/1452698999656534018

goods. These effects of the pandemic have raised goods inflation over the past year. The consensus expectation, which I agree with, is that these price pressures will abate in the near term as the pandemic recedes and return to levels that are consistent with the Federal Reserve's target.

3. The Federal Reserve of San Francisco recently released an analysis suggesting that President Biden's $1.9 trillion American Rescue Plan contributed to the inflationary crisis we find ourselves in today.[4] In fact, the Federal Reserve's key measure of inflation, the personal consumption expenditure price index, is on track to hit a 40-year high.[5]

    a. Given these facts, do you have concerns that another massive injection of money into the economy, particularly through President Biden's revised Build Back Better Act, will only perpetuate the rapid inflation we have seen this year? Please answer yes or no. If your answer is "no," please explain.

        - **Answer: No. As I noted above, I agree with Secretary Yellen's view that the rate of inflation would be expected to be moderately higher as the economy transitions between a steep recession and a healthy recovery, and that the inflation outlook remains that inflation is transitory. The Build Back Better proposals would expand the productive capacity of our economy by raising labor participation rates and improving productivity. They also entail expenditures that are critical in unlocking our nation's growth potential.**

4. According to Federal Reserve survey data, consumers,[6] business,[7] and markets[8] all expect inflation to remain at elevated levels in the future.

    a. What steps should the Biden-Harris administration take to curb inflation before it is too late?

        - **Answer: As I noted above, I agree with Secretary Yellen's view that the rate of inflation would be expected to be moderately higher as the economy transitions between a steep recession and a healthy recovery. Elevated inflation rates have been driven by the effect of the pandemic on our consumption patterns and the workforce. Ending the pandemic is central to bringing down inflation rates. In the short term, as COVID-19 cases recede, inflation rates should follow. Over the longer term, it is important to make investments in our nation's productive capacity, and I believe that the risks of doing too little to**

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[4] https://www.nytimes.com/2021/10/18/business/economy/fed-inflation-stimulus-biden.html
[5] https://gop-waysandmeans.house.gov/brady-families-fall-further-behind-as-bidenflation-pushes-prices-to-highest-in-30-years/
[6] https://www.newyorkfed.org/microeconomics/sce#/inflexp-1
[7] https://www.atlantafed.org/research/inflationproject/bie
[8] https://fred.stlouisfed.org/series/T5YIE

address long-running structural concerns outweigh the risks of doing too much.

b. If confirmed to this position, what specific actions would you take during the first sixty days of your tenure to address the current economic crisis brought on by this administration?

- **Answer: If I am fortunate enough to be confirmed, I will work to serve our nation by supporting the President's and Secretary Yellen's priorities in leading the Office of Financial Markets. This includes making sure we have regular and predictable Treasury debt auctions at the lowest cost to the government, ensuring that Treasury market participants have confidence in a fair and well-functioning market, addressing the transition from LIBOR, and addressing the challenges posed by the rapidly growing and changing markets for digital assets.**