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Statement by

Arthur F. Burns

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

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I am pleased to have this opportunity to present the views of the Board of Governors on S. 2285, the "Federal Reserve Act Amendments of 1975."

Let me state emphatically at the outset that while this bill has been characterized as a "reform" measure, it would, if enacted, profoundly alter the premises underlying the Nation's central bank. In the Federal Reserve Act, Congress took great care to insure that the Federal Reserve would be an independent body insulated from political pressures or control. The foundation of that independence is the System's exclusion from the appropriations process. To make the System now dependent upon annual appropriations by Congress would materially compromise the independence of the Federal Reserve.

One may differ with the Board's judgments on monetary policy matters, and one may even believe that Congress erred in conferring such independence upon the Federal Reserve. But there should be no misunderstanding about the implications of this legislation: If Congress now sees fit, after more than 60 years of experience, to abandon the concept of a truly independent central bank, then Congress itself must be willing to assume both the burden and the responsibility of formulating monetary policy.

With this preliminary comment, let me now turn to the specific provisions of S. 2285. First, it would subject the expenditures of the Federal Reserve to the Congressional appropriations process, with a ceiling to be set on the amounts that could be spent by both the Board and the Federal Reserve Banks. Second, it would require Senate confirmation of the appointments of Federal Reserve Bank presidents. Third, it would require Senate confirmation of the President's appointment of the Chairman of the Board of Governors. Fourth, it would authorize each of the seven members of the Board of Governors to hire a personal staff. Fifth, and finally, it would require that the President's nomination of members of the Board give due regard to a fair representation of labor and consumer interests, in addition to financial, agricultural, industrial, and commercial interests -- as presently specified in the Act.

The thrust of S. 2285, taken as a whole, is to bring the Nation's central bank into the arena of intense political scrutiny and pressure. As I have already noted, this is a radical departure from the concept that was envisioned by the 63rd Congress which established the Federal Reserve System, and by every succeeding Congress since then.

A change in the basic structure of a government agency is justified when some major defect has been discovered in its structure. Such is not the case with the Federal Reserve. On the contrary, its structure has enabled it to serve the country well through the years, and there is no need to change it at the present time.

To be sure, Members of the Congress may, from time to time, be concerned about policy decisions of the Federal Reserve, but this of itself is surely no reason to force a restructuring of the institution itself. Policy judgments concerning money and credit, and their relation to employment and prices, are bound to differ. Congress has already established a procedure that enables it to review Federal Reserve policies -- namely, House Concurrent Resolution 133 adopted earlier this year. This procedure, I believe, is so far working well. I have already testified twice in response to that Resolution, and I will be testifying again before this Committee later this month.

The Federal Reserve System, as you know, was established more than 60 years ago. If a fresh start were made, the Congress might devise a structure similar to what we now have or perhaps move in a quite different direction. Before I joined the Board

of Governors in early 1970, I thought I saw all sorts of opportunities for change in the System. But I soon realized that the structure whose basic shape was devised by Woodrow Wilson, Carter Glass, and Robert Latham Owen worked quite well.

In establishing the Federal Reserve, Congress deliberately decided that the national interest required that the central bank be insulated from political pressures stemming either from the Congress or the White House. The Congress therefore endowed the Federal Reserve with the capacity to exercise, within reasonable restraints, its best judgment on how to protect the Nation's money and foster its effective use.

The maintenance of independent judgment by the central bank is essential if monetary policy is to play its proper impartial role in fostering economic growth and maintaining financial stability. The independence of the Federal Reserve neither is -- nor should be -- absolute. The System is duty-bound to implement the will of Congress expressed in legislation, and the Federal Reserve has been ever faithful to that duty. It is under the guidance of the principles set forth by Congress, especially in the Federal Reserve Act and the Employment Act, that the Federal Reserve has formulated and executed monetary policy. In doing so, it has

served as a vital non-political entity in a highly political environment.

Since the inception of the Federal Reserve System, the law has provided that the expenses of the Board are to be paid out of semi-annual assessments levied upon the 12 Federal Reserve Banks. This and other outlays of the Federal Reserve Banks are paid from earnings derived principally from Federal securities acquired through the System's open market operations. These operations are carried out pursuant to law and with the objective of maintaining sound economic and financial conditions. Spending of the Reserve Banks, in turn, is subject to review and supervision by the Board of Governors.

The operations of the Board and the Reserve Banks have been conducted in a highly responsible manner. As far as I know, policy decisions have not been influenced in any way or at any time by partisan considerations. Nor have they been influenced by the possibility that the budget of the Board or the Reserve Banks might be slashed because of Congressional displeasure with this or that monetary measure. The Federal Reserve's decisions have thus been governed by the Nation's permanent interest, no matter how unpopular they might be in the short-run.

In the Board's judgment, the requirement of S. 2285 that Congress mandate a ceiling on Federal Reserve expenditures is not aimed at control or reduction of public expenditures. Even the complete elimination of all Federal Reserve expenditures would amount to less than two-tenths of one per cent of the Federal Government's budget. The real aim of the proposed expenditure ceiling is to shift control over monetary policy, but not the responsibility for it, away from the Federal Reserve to Congress or its committees.

It would obviously be impossible for Congress to determine an expenditure ceiling for the Federal Reserve without first examining individual items of expenditure. Congress would thus be forced to address itself to such questions as the level of resources needed to formulate and implement monetary policy, the size of the Board's domestic research staff, the size of its international finance section, the scope of its legal and regulatory staffs, and so on. Similarly, the budgets of the individual Reserve Banks would be subject to review and change, with the obvious possibility that some regions would be favored or disciplined more than others. Clearly, political influence could be brought to bear on the System by reducing or threatening

to reduce the funds available to it, or by ordering a diversion of funds from one function or Bank to another.

In assuming any such responsibility, Congress should ask itself whether it is ready and willing to undertake the highly complex and politically perilous task of shaping the course of monetary policy. Much the wiser course for Congress, I believe, is to confine itself to general oversight of the Federal Reserve -- a function that Congress is already taking quite seriously.

As I suggested earlier in my testimony, Congress should legislate only when there is a need to correct a defective condition. There is nothing about the Federal Reserve that at the present time requires drastic legislative treatment, such as is proposed in S. 2285. The fact is that the Board and the Federal Reserve Banks have managed their operations in a financially conservative manner, and especially so in recent years. In the relatively few cases where an expense item has seemed questionable to the Board, prompt action has been taken to avoid a recurrence. Any responsible analysis of Federal Reserve expenditures will show that they have been reasonable in light of the System's rapidly growing workload, the increased duties imposed by Congress, and the rise in the cost of doing everyday business.

While the work of the Federal Reserve in the fields of monetary policy and bank regulation is well-known, a large part of System resources is devoted to activities which are of lesser interest to the general public but which are nevertheless essential to assuring a smoothly operating financial system. These services include check clearing, distribution of coin and currency, wire transfer of funds, and processing of savings bonds, besides the huge task of acting as the Federal Government's fiscal agent and banker.

The Federal Reserve's growing expenses in providing these services have been held down by substantial and continuing improvements in productivity. Thus, while the measurable output of the Federal Reserve System has approximately doubled in the past eight years, this has been accomplished with only a 41 per cent increase in System personnel. Here are some examples of this increased efficiency:

The Federal Reserve Banks now process over 46 million checks daily, up from 22 million in 1967. If we operated at the productivity level of 1967, the staff requirement would be 48 per cent (or 3025 employees) larger than it is now.

Demand for currency and coin services has increased 36 per cent since 1967, while the number employed in performing this function has grown only 18 per cent -- or half as much.

The number of U. S. Treasury checks processed by the Federal Reserve Banks has increased 109 per cent since 1967. The staff required to handle this job on behalf of the Treasury has increased only 43 per cent in the same period.

The number of Federal tax deposits handled by the System for the Internal Revenue Service has increased 180 per cent since 1967. Despite this increase, the Federal Reserve Banks have reduced their employment in this area by 5 per cent.

Similarly, the number of entries in the accounts of member banks handled by the System has increased since 1967 by 106 per cent. Again, despite this increase, productivity improvements have made possible a reduction of our staff in this area by 24 per cent.

The System continually seeks to improve the efficiency of its operations. Significant improvements of productivity are again being achieved this year, and the prospects for 1976 and beyond are excellent. In fact, the total number of individuals employed by the System will be somewhat lower in 1976 than in 1974, despite a projected 10 per cent increase in the measurable volume of our output.

In addition to working on productivity improvements, the System frequently reviews its operations with the aim of eliminating or reducing expenditures without, however, allowing the quality of its services to suffer. The System remains fully attentive to the needs of the public, the financial community, the Treasury and other Government agencies.

The real issue raised by S. 2285, however, is not efficiency or economy of operations. It is demonstrable, as I have indicated, that we are operating both efficiently and economically. The real issue is the independence -- within the bounds of national economic goals established by Congress -- of this Nation's central bank, and its ability to formulate judgments that are free from the pressures of the shifting tides of politics that Congressional expenditure control could impose.

This Committee also has before it a related proposal that would subject the Federal Reserve to an audit by the General Accounting Office. With your permission, I will indicate the Board's thinking in opposition to this proposal by inserting into the record the testimony on GAO audit presented by Governor Mitchell at a hearing of the House Banking Committee earlier this year. In summary, the Board believes:

First, that an audit by the GAO of the Federal Reserve's accounts and expenditures would be a needless duplication of present efforts and would result in unnecessary additional expenditures.

Second, that to authorize the GAO to audit Federal Reserve policies, including the processes by which those policies are reached, would unwisely inject a third party into the sensitive area of monetary policy.

Third, the passage of House Concurrent Resolution 133 has completely altered the context in which the question of GAO audit must be considered. This resolution already provides for a review of Federal Reserve policy by the responsible committees of Congress. An audit such as that provided for in S. 2509 would, to say the least, be literally superfluous.

Before leaving this matter of budget control and GAO audit, I would like to quote from a report that was issued after extensive study and long deliberation by a Congressional committee.

That report said in part:

"The independence of the Federal Reserve System is based, not on legal right, but on expediency. Congress, desiring that the claims of restrictive monetary policy should be strongly stated on appropriate occasions, has chosen to endow the System with a considerable degree of independence, both from itself and from the Chief Executive, . . . It is naturally limited by the overriding requirement that all of the economic policies of the Government -- monetary policy and fiscal policy among them -- be coordinated with each other in such a way to make a meaningful whole. The independence of the Federal Reserve System is desirable, not as an end in itself, but as a means of contributing to the formulation of the best over-all economic policy. In our judgment, the present degree of independence of the System is about that best suited for this purpose under present conditions."

That quotation is taken from a report issued in 1952 by a distinguished Subcommittee of the Joint Committee on the Economic Report. The statement is just as valid today as when it was written.

Let me now turn briefly to the other parts of S. 2285.

The Board has no objection to the provision that would subject the President's choice of the Chairman of the Board of Governors to Senate confirmation. As this Committee is aware, Board members are appointed for a 14-year term. The term of Chairman is for four years, but he may be reappointed. At present, Board members are named, subject to Senate confirmation, only as Board members. The President designates one of the seven members of the Board to be Chairman. This selection is not now subject to Senate confirmation.

In my own case, this Committee knew when I appeared before it on December 18, 1969, that I would be designated Chairman of the Board of Governors. In effect, then, the Senate confirmed my nomination both as a Board member and as Chairman. But the Senate did not have the opportunity to intervene when I was redesignated as Chairman in January 1974. I see no difficulty whatever with the suggestion that the Congress should have the right to review the qualifications of the person designated as Chairman each time that designation is made.

Next, the Board would have no objection to broadening of the areas to be considered by the President in the appointment of Board members provided it be clearly understood that, in discharging their responsibilities, Board members continue to represent the public interest as a whole and not a particular constituency. We do not think it wise to emphasize a narrowness of background in the selection process. Board members should be qualified to deal with the many complex and sensitive problems that face the Board. These problems require a good understanding of government finance, money markets, banking operations, and credit problems. Board members must be able to weigh the effects that their decisions may have upon labor, consumers, agriculture, housing, industry, commerce, and all other areas affected by their actions.

Let me turn next to the proposal for Senate confirmation of Federal Reserve Presidents. This provision would lessen the interest of some, perhaps many, of the best qualified persons for these important quasi-government positions. At the least, it would represent an unnecessary hurdle in an already thorough selection process. Senate confirmation might also tend to subject the post to political influences. Since these positions are geographically spread around the country, they could become subject to the type of influence that was once exercised when postmaster appointments

were subject to Senate confirmation. That, I submit, would contravene the basic purpose of the Federal Reserve Act.

The last provision in the bill to which I wish to address myself would authorize each Board member to hire a personal staff at salaries he deems appropriate, providing the total compensation of his staff did not exceed four times his own annual salary as a Board member. The underlying premise of this provision seems to be that the creation of such personal staffs will enhance the independence of Board members and encourage diversity of opinion.

I am compelled to take issue with this premise. The qualities of independent thought and expression do not depend upon the availability of a personal staff. Rather they are qualities that must inhere in the individual Board member. No amount of staff assistance will convert an unimaginative or compliant Board member into a vigorous independent advocate of new policies. And a Board member who has the ability and interest to express his own thoughts forcefully will not be less independent or provocative by the lack of a large personal staff. During my time on the Board, we have been extremely fortunate in having as Board members highly able and thoughtful men who have brought a diversity of experience and viewpoint to the Board. Our deliberations have never lacked the expression of differing points of view.

We are also fortunate in having a highly professional, highly competent staff -- men and women who are available to assist all members of the Board. The technical resources of our staff are enormous, and it would be practically impossible -- as well as unnecessary -- for each Board member to attempt to duplicate these resources within his personal office. To the extent that individual Board members need personal assistants for the performance of their official duties, they already have them. And I might add that the members of the Board's staff are never reluctant to express their own views. Both I and my Board colleagues defend the independence of our staff members as vigorously as we defend the independence of the Federal Reserve itself.

In conclusion, S. 2285, in its key aspects, would weaken the Federal Reserve's ability to reach dispassionate judgments in behalf of our country's betterment. The freedom, within the context of national economic policy laid down by the Congress, to arrive without fear or favor at decisions best calculated to serve the Nation's over-all interest is the Federal Reserve's most precious asset. And it is the Nation's guarantee of an unbiased hand on the monetary rudder.

Consequently, although the Board does not object to every provision of the legislation under discussion, we see no clear need to adopt any of it. Indeed there are strong reasons, as I have indicated, for opposing its key provisions. The world's history is littered with the economic wreckage caused by political domination of the monetary function. Your predecessors in the Congress acted wisely in providing a design for the Federal Reserve that insulated it from politics. The Board urges you not to overturn a structure that has stood so well the test of time and experience.

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