

Selected Papers of Allan Sproul

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April 22, 1952

Honorable Wright Patman, Chairman
Subcommittee on General Credit Control and
Debt Management of the Joint Committee
on the Economic Report
House of Representatives
Washington 25, D.C.

Dear Mr. Patman:

In the course of the recent hearings of your committee there were certain recurring questions which were never definitely answered, so far as I know, and which perhaps cannot be definitely answered. Nevertheless, the fact that they were not answered or, perhaps, cannot be answered definitively and categorically, should not be taken to mean that they contain proof of argument by default or opposition.

I have in mind such questions as the following, which may not have been asked in exactly this form but contained this substance:

Is not the argument for an "independent" Federal Reserve System a denial of our democratic ability to function properly through the legislative and executive branches of the Government?

Why should monetary policy be treated differently from, say, foreign policy or defense policy, in terms of the administrative arrangements and relations with the Congress and the executive?

Hasn't the trend in all other countries been to "nationalize" the central banks where they were not already "nationalized" and to make them directly responsible to the "government" through the "Treasury"?

Does not the growing interest of governments in economic affairs, and their growing participation in such affairs, make this trend logical and necessary?

These are questions which compel thought and analysis, even though one may feel, as I do, that the right answer does not follow the lead of the questioning.

In the first place, I think it should be continuously borne in mind that whenever stress is placed upon the need for the "independence" of the Federal Reserve System it does not mean independence from the Government but independence within the Government. In performing its major task—the administration of monetary policy—the Federal Reserve System is an agency of the Congress set up in a special form to bear the responsibility for that particular task which constitutionally belongs to the legislative branch of the Government.

It is in no sense a denial of our democratic form of Government to have the Reserve System set up the way it is. It is rather an expression of the ability of our democratic powers to meet new or changing conditions. The Congress, as the sovereign power in this area, has developed a special means of performing a function with respect to which it has final authority, but which it cannot administer from day to day. The Congress has, of necessity, had to delegate some segments of its power to agencies of its own creation which, in turn, are responsible to it. The Federal Reserve System as one of these agencies attempts, as does the Congress itself, to maintain close relations with the executive branch of the Government, for the purpose of achieving a coherent and generally unified economic program. But that does not mean that physical merger of the Congress or its agencies with the executive branch of the Government is necessary or desirable.

It really takes us little way along the road to understanding to ask why monetary policy should be treated differently from foreign policy or defense policy in terms of administrative ar-

rangements. The form of the question implies that here are matters (defense policy and foreign policy) of greater importance to the country than monetary policy which are administered by the executive branch of the Government, through the State Department and the Defense Department, and not by an independent agency. No one, of course, would want to enter into a footless argument about the relative importance of policy in these areas to the citizens of the country—they are all of vital importance. It may suggest a difference between them, however, to remember that the Federal Reserve is trying to help guide, regulate, and to some extent control the functioning of the private economy, and primarily the domestic economy, whereas foreign policy and military policy, while they affect our private and domestic affairs, deal largely with our relations with other countries and governments. It is in the general area of regulation of domestic economic affairs that the Congress has found repeated use for “independent” agencies.

The underlying question is whether it is better to have the legislative branch in full and final control of the purse and the money of the country, directly and through an agency responsible to it, or whether these matters should be turned over to the executive branch for administration along with most other governmental affairs. The Constitution, insofar as its language may be applied to present-day conditions, leaves this matter with the Congress. Wisdom and experience support this early separation of powers. Over the years and within our Constitutional framework, the people have preferred to keep all aspects of the money power as the prerogative of their duly elected representatives in the Congress. The temptation to tamper with money for temporary gain or narrow purpose is always present, and particularly in times of economic stress. The power to do so should be kept where it can be most readily observed and its abuse most quickly punished. That place is not under the protective wing of the chief executive or hidden in one of the big departments of the executive branch of the Government.

It may be instructive in this regard to compare the role of the Congress with respect to debt management with its role in relation to monetary policy during the past three or four decades. It is significant, I think, that the Congress, at fre-

quent intervals, has conducted comprehensive and useful inquiries into the conduct of monetary policy by the Federal Reserve System. It has not made similar inquiries into debt management; even during the investigations of this committee, which have been most far-reaching, debt management has been considered only in its broadest aspects and, essentially, only when it has become intertwined with credit policy. Yet debt management is a concern of the Congress, particularly under present-day conditions. To be sure there are specific acts of the Congress which authorize whatever is done in the name of debt management, but the economic ramifications of the decisions taken with such legal authority are generally unobserved or unexamined. There seems to have been a gradual and more or less tacit acceptance of the assumption that debt management is a function of the executive branch of Government with which the Congress need not concern itself once it has passed the enabling legislation. That is what might happen to monetary policy if it became imbedded in the executive branch of the Government. That would, I think, be a disservice to the country. The inquiry of this committee, and other Congressional investigations which have preceded it, would seem to provide a clear-cut demonstration of the contributions which can be made to the nation's economic welfare by arrangements which lead the Congress to appraise performance of its own agent from time to time.

The particular forms and administrative arrangements which have worked in foreign countries for the administration of monetary policy are not a usable guide for us. In most such countries, of similar economic maturity and with similar economic systems, the "government" comprises both the executive and legislative branches in one responsible body or parliament. The executive must explain and justify policy from day to day, and is exposed to legislative questioning and the possibility of legislative repudiation without the protection of a fixed term of office. The trend of relationship in such countries between governments and central banks has been a process of evolution. No matter what their beginnings the central banks have evolved as "public" institutions. Changes from private ownership to public ownership, where

they have occurred, have quite often confirmed what had already happened. They have been changes of form rather than of substance and have usually tended to perpetuate some independence (as I would define independence) for the central bank rather than to snuff it out.

It is more useful, as a guide, for us to observe that in most of these countries, and certainly in the economically more mature countries, central banking is regarded as a field requiring special technical competence and continuity of management rather than complete subordination to the government of the day. The head of the central bank in these countries is not brought directly into the government and does not necessarily change with changes in the government. The central bank is still a place where views on economic matters and monetary policy can be independently developed and candidly put forward no matter what the precise relations to the government may be. It is chiefly in the countries which are less advanced economically, where monetary policy is likely to be less developed, and where the central bank is primarily the fiscal agent of the government, that central bankers are political appointees responsible to and changing with each new executive.

I come back to the conclusion that neither our form of government nor the experience of foreign countries requires or recommends the placing of the Federal Reserve System in the executive branch of the Government. It is the pursuit of a doubtful logic and of neatness in administrative chart making which suggests this solution of our problem. The fact that there have been unfortunate differences of opinion between the Treasury and the Federal Reserve during recent years does not require the Congress to abandon its agent to the executive branch in order to bring about a better coordination of powers. It has already been pointed out that the Congress, through its specialized committees, reviews from time to time the manner in which the powers it has delegated to the Federal Reserve System are exercised. If, in the course of such reviews, the Congress finds that relationships between its delegated agent and the executive branch of the Government are not what it wishes them to be, it has remedies at

hand. It can define more fully and more clearly what it expects these relationships to be, an approach which recommended itself to the Douglas Subcommittee of the Joint Committee on the Economic Report when it reviewed the problem.

On the basis of my experience which now comprises over thirty years in the Federal Reserve System at two Federal Reserve Banks, and attempting to make allowance for the bias which such long association can foster, I believe that the Federal Reserve System is an expression of an adaptable creative government. The System is by no means perfect; it needs improvement. But it can provide a competent mechanism, and a continuity of able personnel, which will enable us to cope with the day-to-day intricacies of monetary policy, while remaining responsive to the general economic purposes of the Government. The inquiry of your committee, and the Congressional investigations which have preceded it, provide a demonstration, I believe, of the advantages of continuing the existing direct relationship of the Federal Reserve System to the Congress, which causes the Congress to undertake periodic comprehensive appraisals of System performance.

If there is still time and if you think it would serve a useful purpose, I would like to have this statement added to my testimony before the committee.

Yours faithfully,

Allan Sproul