Statement of J. Dewey Daane, Member,
Board of Governors of the Federal Reserve System
before the
Subcommittee on Domestic Finance
of the
Committee on Banking and Currency
House of Representatives

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Mr. Chairman and Members of the Committee:

As you know, I am the newest member of the Board of Governors, having been appointed by President Kennedy shortly before his death and having been sworn in last November 29. I am, however, not new in terms of intimate acquaintance with the Federal Reserve; in fact, excepting a relatively short period in the Treasury Department, I will this spring be rounding out 25 years of continuous service in the System. Nor am I exactly a stranger to inquiries such as this into the workings of the Federal Reserve System. I well remember one of my earliest substantive tasks after joining the Research Department of the Federal Reserve Bank of Richmond in early 1939 was to try to assist the President of that Bank in preparing his replies to questions addressed to him, and to other System officials, by Senator Wagner, then Chairman of the Senate Banking and Currency Committee. These questions were concerned with many of the same issues, such as that of the most appropriate role of the Secretary of the Treasury in relation to our central banking system, as are again raised by the proposed bills being considered by this Committee. I also participated in the appraisals conducted within the Federal Reserve as part of the more recent Congressional inquiries--in 1949 under the Chairmanship of Senator Douglas, and in 1952 the even more extensive review conducted under your Chairmanship.

It is my sincere hope that the careful review and findings in your 1952 Committee Report will not be passed over in a desire to make change in the Federal Reserve System for the sake of change. Over the past 25 years I have at first hand watched the System adapt, as it should always be ready to do, to the constantly changing financial environment in which it operates, but in the past decade certainly nothing has changed the basic principles of central bank action nor its need for some sort of insulation from partisan political pressures in order to serve most effectively the public interest--principles and needs which were so well recognized and underscored in what is known as the Patman Committee Report.

From the background of this experience and in order to avoid repeating testimony you have received from other Federal Reserve witnesses concerning the bills before you, let me comment generally about four of them: H.R. 3783, to retire Federal Reserve Bank stock; H.R. 9631, to revamp the structure of the Federal Reserve System; H.R. 9685, to require the System to pay over to the Treasury its earnings on Government obligations and seek appropriations to meet its expenses; and H.R. 9749, to require the Federal Reserve to use open market operations to support prices on Government obligations so as to assure yields of not more than four and one-quarter per cent.

Taken together, these bills would, I believe, tend to decrease the contribution that monetary policy can make toward achievement of a stronger economy. In part, the bills would run the risk of diverting monetary policy from its primary goal of meeting the needs of the economy as a whole to one of simply facilitating the management of the public debt. They would take from the presidents of the Federal Reserve Banks their most important function--participation in the formulation of monetary policy. And they would weaken the capacity of the System to maintain, year in and year out, the degree of independence from the budget and appropriations process which is needed to assure the long lasting value of the dollar against the short-lived pressures of budgetary developments. In my judgment these steps would inevitably reduce the strength and ability of the System to serve the public interest.

To the extent that I have been able to follow these hearings, I gather that these steps are advocated partly from fears of some that the Federal Reserve might one day attempt to block Government programs approved by the electorate, partly from a suspicion that Federal Reserve Bank presidents are banker-dominated, and partly from dissatisfaction with the process of monetary policy formulation.

Taking a closer look at these three main threads in the current inquiry, namely, the relationship and role of the Federal Reserve within the framework of Government, the allegation of banker domination, and the monetary policy process, it will come as no surprise to you that I do not find much to agree with in these bills.

First of all, whatever the theoretical possibilities may be of a basic conflict between the Federal Reserve and the Administration, the fact is that the relationship has been and is a harmonious one. In announcing his decision to reappoint Mr. Martin as Chairman of the Board of Governors, President Kennedy described the relationship in these terms:

> "As Chairman of the Board of Governors, Mr. Martin has cooperated effectively in the economic policies of this Administration and I look forward to a constructive working relationship in the years ahead.
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> "As you know, the Federal Reserve System is a fully independent agency of the United States Government but it is essential that there exist a relationship of mutual confidence and cooperation between the Federal Reserve, the economic agencies of the Administration, including especially the Secretary of the Treasury, and the President.
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> "Mr. Martin has my full confidence and I look forward to continuing to work with him and his colleagues on the Board in the interests of a strong United States economy."

The Federal Reserve System, after all, is a public institution. Its policies evolve within the framework of general Government policies. The primary goals of monetary policy are identical to those of Government economic policy; we, too, are governed by the Employment Act of 1946. Thus the principal objective of monetary policy is to make a maximum contribution to the attainment of the national economic goals of an adequate rate of growth, sustained high levels of production and employment, and reasonable price stability.

In recent years I have been in the Administration as a part of the Treasury Department and its policies, and I have also previously been on the other side of the fence as a part of the Federal Reserve and its policies. Both institutions clearly have been working towards the same dual objectives, namely, the attainment of a satisfactory rate of growth with maximum employment, and the elimination of a serious balance of payments problem.

From my experience both at the Treasury and the Federal Reserve it may be helpful to you if I comment somewhat further on the effective working relationships which now exist between these two agencies. There are, of course, shades of difference in view between the Federal Reserve System and the Treasury from time to time, but the same thing may be said within either the Federal Reserve or the Treasury, and in my judgment these differences are healthy. The fact of the matter is, that in the formulation of monetary policy, the Federal Reserve is as responsive to the needs of Government finance as it either should be or can be, and the Treasury, in turn, is acutely conscious of the problems which its debt management operations create for the monetary authorities. I am quite certain from my experience on both sides of the fence that it would be unreasonable to hope for any significant improvement in the technical coordination of monetary policy and debt management through the consolidation of these functions under a single head.

This then leaves as the only significant question whether the public interest would be better served by placing the formulation of monetary policy under the domination or the detailed direction of the Secretary of the Treasury. I am convinced that this would be most unfortunate--not just for the Federal Reserve and for the Treasury in the first instance, but more importantly for the Government and the people of the country in the longer run. Both the Treasury and Federal Reserve naturally reflect two different viewpoints related to their own particular responsibilities which need to be fully reflected in their respective spheres. These responsibilities should not be centralized. In my view, it is greatly to the advantage of the Treasury that it is able to make its debt management decisions in the light of a monetary policy which is determined independently by men of high qualifications, rather than place itself in the dilemma of having to generate both monetary and debt management policies simultaneously, which would require it somehow to insulate its thinking on monetary policy in some way from its obvious and desirable zeal to finance the debt as economically as possible. I have seen at first hand in other countries the dangers involved in down-grading or subordinating monetary policy.

Again, from my own experience in serving two Secretaries of the Treasury, both of whom were able and conscientious public servants but already overburdened in terms of the tremendous responsibilities thrust upon them, I question whether as a practical matter it would be feasible for the Secretary of the Treasury to participate fully in the formulation of monetary policy. Some alternative involving delegation of authority would have to be developed and I do not believe this would be desirable.

The present arrangements for the coordination of monetary policy with the other economic policies of Government are, in fact, very effective. The changes that are proposed in these bills seem to me to offer little hope for improvement and to run the risk of serious mischief.

A second main thread in the current inquiry both puzzles and, I must confess, saddens me. It is the implication regarding the public service motivation of System officials, and specifically of the Presidents and Directors of the Reserve Banks. To me the Federal Reserve, no less than the Treasury, stands for all that is best in purposeful public service. In fact, I believe that much of the underlying strength of the System derives from the sense of constructive purpose, and the spirit of public service, which permeates all parts of the System. In my judgment anything that is destructive of that purpose and spirit, by innuendo or outright action, would be inimical to the public interest.

I speak with feeling on this point because in my lifetime I have never known a more selfless public servant than the President of the Federal Reserve Bank of Richmond, Mr. Hugh Leach, with whom I worked for 20 years, and who I believe was typical of the Federal Reserve Presidents in terms of his objectivity and dedication to the public interest, and complete freedom from any banker influence. His devotion to public duty was recognized not only in the immediate financial community but throughout the State of Virginia and the Fifth District. I thus find that any charge of banker domination is inconceivable--I also find it difficult to visualize the System obtaining the services of men of this quality if they are prohibited from sharing the responsibility for the formulation of policy.

The third and final thread in the inquiry on which I would like to comment briefly is the apparent criticism of the System, on the one hand, for not adopting the single criterion of the stock of money as its sole objective and measure, and, on the other hand, for being guided in the formulation of policy too much by short-run money market factors, rather than more basic longer-term economic and financial developments. Neither criticism is justified. As to those who would put money stock rigidly above all else, I think one of your preceding academic witnesses, Professor Samuelson, gave eloquent answer. Making the stock of money paramount and the sole objective and measure of monetary policy would be indeed a retrogression. It would ignore the fact that there is no optimum money supply nor sacrosanct rate of money supply growth--that money supply, in fact, may be permissive rather than causative.

The other charge, that of money market myopia, displays a lack of understanding of the policy formulation process and of the System's operations in the market. The policy formulation process does not simply focus on the day-to-day money market developments, and there has certainly been no overemphasis on such short-term factors in the setting of monetary policy. Let me illustrate my point by describing the economic intelligence we currently receive before and at a typical Open Market Committee meeting. It includes a 30 to 40 page written document and a total of about two hours of oral briefing, both of which concern such subjects as production and employment, incomes, trade, wages, costs, prices, construction, agriculture, credit, capital, money, savings, taxes, and the balance of payments. This list of briefing subjects certainly does not suggest an overemphasis on short-term money market factors in the discussions underlying the process of arriving at a decision regarding an appropriate monetary policy at any specific time.

Nor is one single guide to operations adopted in the policy process as has been alleged--the weaknesses of the various operational guides, such as free reserves, member bank borrowings, and various short-term interest rates are well recognized throughout the System. Those who criticize use of any of these operational guides fail to understand the distinction between the System's defensive and dynamic operations in the market. Because the purpose of defensive operations is to offset the effect on the level of reserves of various market factors they do not ipso facto constitute <u>changes</u> in the reserve level or in monetary policy. On the contrary, they simply neutralize the effects on reserves of these other factors, thereby keeping the road clear for those dynamic operations which are designed to achieve changes in the level of reserves in the light of longer run economic and financial objectives.

Two concluding observations relating to the main threads of this inquiry may be relevant.

First, as to the underlying question of the System's sense of responsibility within the Government there is obviously a clear need for the Federal Reserve to be closely atuned to the economic thinking of Government, and this is being accomplished by various arrangements at the technical and policy levels. Each President of the United States can be expected to develop informally his own particular method of communication within the Government, but whatever the variation in method the System's awareness and sensitivity in its relations with the Executive Branch are assured. Correspondingly, continuing inquiries of the sort being undertaken by this Committee assures that the System is at all times closely atuned to, and responsible to, the Congress as well.

Finally, coordinated monetary and debt management policies in the recent past have succeeded in assisting our balance of payments while accommodating record levels of borrowings at home--with an interest rate pattern not that suggested by bankers but one unique for a sustained expansion period. The impressive results seem to me to provide significant commentary on all three issues posed in this current inquiry.