

**Statement by**

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**Chairman, Board of Governors of the Federal Reserve System**

**before the**

**Committee on Banking, Currency and Housing**

**House of Representatives**

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I wish to thank the Chairman of the Committee for scheduling a meeting on short notice to accommodate the desire of the Board of Governors to testify on the proposed Federal Reserve Reform Act of 1976.

When I appeared here on March 18 to testify on the Committee Print of the Financial Reform Act of 1976, I devoted my statement mainly to the proposal for a Federal Banking Commission. I expressed the Board's opposition to the portions of that massive document that would have weakened the Federal Reserve System, and I urged the Committee to avoid the temptation of legislating hastily. At the same time I pointed out that there were major principles embodied in the Committee Print that the Board warmly endorses.

The bill now before your Committee -- H. R. 12934 -- is more modest in its scope than even Title V of the earlier proposal. It again bears the label of "reform" legislation, but it omits the one reform that the Board has repeatedly advised the Congress is most needed to improve the precision of monetary policy -- namely, provision for broader application of reserve requirements. Such a provision was wisely included in the earlier Committee Print. It is now inexplicably removed. Nor is this all. H. R. 12934

actually takes a contrary course on reserve requirements by repealing the provision in present law that makes membership in the Federal Reserve mandatory for national banks. Such a repeal can only weaken the execution of monetary policy. We were pleased to learn yesterday that this change was unintentional; but the very fact an error of this magnitude was made emphasizes a need for caution and care by all of us.

The principal explicit provisions of the proposed Act deal with the manner of appointment and terms of Reserve Bank presidents and of the Chairman and Vice Chairman of the Board of Governors, as well as with the size and composition of Reserve Bank directorates. It is not at all clear why these features of the Federal Reserve System have become the focal point for "reform." In all candor, this bill seems to me and my colleagues on the Board to propose change for the sake of change.

Before turning to the specific provisions of H. R. 12934, I want to invite your attention to its basic premises -- as set forth by Chairman Reuss when he introduced the bill. The premises appear to be as follows: First, the Nation needs a "better balanced" monetary policy; second, the Federal Reserve does not have sufficiently in mind the objectives of the Employment Act of 1946; third, the Federal

Reserve discriminates against women and minorities; and fourth, the Federal Reserve is controlled by the commercial banks.

We see no validity whatever in these premises. I must, add, however, that if sufficient evidence is ever adduced to persuade members of the Congress that there is truth in such charges, then far more drastic remedies will be required than the so-called "reforms" proposed in this bill.

As to the first two premises, we believe that our Nation is benefitting from a monetary policy that, besides being well balanced, is faithful to the objectives of the Employment Act. The Federal Reserve has been providing reserves to the banking system at a sufficient rate to facilitate a vigorous economic expansion, and at the same time we have been mindful of the need to prevent a new wave of inflation.

This policy has been marked by considerable success. The economy is again expanding at a good pace, the burden of inflation is subdued, and conditions in financial markets strongly favor continuance of expansion in output and employment. Interest rates are generally lower than at the trough of the recession. Savings flows to thrift institutions are very ample, and commitments of funds to the mortgage market are continuing to increase. Mortgage interest

rates are edging down. The stock market has staged a dramatic recovery. The liquidity position of our Nation's financial institutions and business enterprises is much improved. Medium-sized firms of less than the highest standing again have reasonable access to the public market for securities. And interest rates have come down even in the troubled market for State and local government securities, while the volume of new municipal issues has remained relatively large.

These facts indicate, I believe, that the course of moderation in monetary policy pursued by the Federal Reserve has significantly contributed to economic recovery. Our present objective is to stay on a course that will continue to support a good rate of growth in output and employment, while avoiding excesses that would aggravate inflation and create trouble for the future. It is our judgment that this represents a balanced monetary policy, and that the objectives of the Employment Act are being well served by that policy.

If I may digress for a moment, one of the curious arguments put forth in support of this bill is that in 1972 the Federal Reserve "unnecessarily opened the monetary floodgates" for partisan purposes, and that "catastrophic inflation" followed.

This charge is so shopworn and has been so thoroughly discredited that it should suffice to recall that early in 1973 the distinguished Chairman of this Committee congratulated the Federal Reserve System on the monetary policy it had pursued during 1972.

As to "catastrophic inflation," the fact is that the inflation started in the mid-1960's and was mainly caused by the large deficits, continued year after year, in the Federal budget. As a result of the excess demand created by a persistently loose fiscal policy, a spiral of wages and prices got under way in the private sector and the rate of inflation began to quicken. During 1972-74, moreover, the underlying forces of inflation were augmented by special factors -- the devaluation of the dollar, shortages of agricultural products, and soaring energy prices, all of which pushed up the general price level.

The third premise underlying the legislation before us is that women and minorities "have been badly discriminated against" by the Federal Reserve. Again, this charge is not based upon fact. The representation of women and minorities in the Federal Reserve System is significantly larger than in the Federal civilian service. We fully recognize a moral as well as a legal commitment to the principle of equal employment opportunity.

We have tried hard in recent years to appoint qualified women and minority group members to the boards of directors of the Reserve Banks. We have achieved some but not enough success in these efforts. We now have six women serving as members of Reserve Bank Branch Boards, including one -- at the San Antonio Branch -- who chairs the board. There are also thirteen directors in the System drawn from minority groups, including two who serve on boards of head offices. I can assure the Committee that our efforts to add women and members of minorities to our highest posts are thoroughly sincere, that they will be pursued energetically, and that we would welcome suggestions of the names of highly qualified individuals.

The final premise of H. R. 12934 is that the Federal Reserve is so dominated by bankers that it is a "wholly owned subsidiary" of the commercial banks. I trust that serious observers of the Federal Reserve will dismiss this charge for what it is -- an empty slogan. It is perfectly true, of course, that the Federal Reserve is in some of its functions a bankers' bank. Indeed, Congress created it for just that reason -- that is, to serve as a source of liquidity for our Nation's banking system and to hold the reserves of member banks. It is also true that the member

banks elect six of the nine directors of each Reserve Bank. But the charge that these relationships result in control of the Federal Reserve System by bankers is absurd.

The control of the Federal Reserve resides firmly with the Board of Governors. The Federal Reserve Act empowers the Board to exercise supervision over the Federal Reserve Banks and to suspend or remove any officer or director of a Reserve Bank. The Board has exclusive responsibility for changes in reserve requirements, margin requirements, and banking regulations. True, changes in the discount rate originate at the Reserve Banks; but they require explicit approval by the Board of Governors, and we examine every discount rate proposal with utmost care. Open-market decisions are made by the Federal Open Market Committee (FOMC), which consists -- as you know -- of the seven members of the Board and five Reserve Bank presidents. This structure of the FOMC avoids complete centralization of monetary policy decisions in Washington, but the Board Members are plainly in the majority on that body and the Chairman of the Board serves also as Chairman of the FOMC. Thus, responsibility for decision-making rests preponderantly with the seven members of the Board of Governors.

So much for the underlying premises of H. R. 12934. I would like now to turn to the specific proposals of this bill for "reforming" the Federal Reserve -- and presumably for curing its alleged shortcomings.

This Committee is already aware of the Board's position on the proposal that Reserve Bank presidents be appointed for a six-year term by the President of the United States, subject to confirmation by the Senate. The Board believes that this provision would turn these offices into political plums, and that an atmosphere of partisanship would thus be injected into the formulation of monetary policy. It is erroneous to compare these appointments either to those of Board Members or, as some have done, to Federal judgeships. Federal judges hold lifetime appointments, and their independence from transitory political considerations is thus assured. Board Members are appointed for a 14-year term, which provides them a substantial measure of independence. Moreover, the Board functions as a deliberative, collegial body in an atmosphere in which partisan considerations are shunned. This has a very significant leavening effect even though Board Members are appointed by the President and confirmed by the Senate. A like remark could not be applied to Reserve Bank executives who are

geographically separated and who would hold office for a much shorter term under the proposed bill.

Furthermore, the provision of H.R. 12934 regarding the appointment of Reserve Bank presidents would weaken, perhaps to the point of nullifying, the ability of the Board of Governors to fulfill its statutory responsibility of exercising guidance and control over the Federal Reserve Banks. Under present law a Reserve Bank president who does not manage his bank satisfactorily may be removed from office through action taken by the Board of Governors. Under the method now proposed for appointing Reserve Bank presidents, it would be extremely difficult for our Board to remove a Presidential appointee. The practical effect would therefore be to exempt these positions from the strict supervisory controls that we at the Board have developed over the years. The net result might be to limit the improvements of productivity that our Banks have been steadily achieving in handling currency, clearing checks, carrying out fiscal functions in behalf of the Treasury, and in their other activities.

It should also be noted that while the Reserve Bank boards of directors play a part in choosing Bank presidents, in actual practice the Board of Governors has the decisive voice in their

selection. In filling vacancies of Reserve Bank presidencies, the Board of Governors has frequently turned down recommendations of Reserve Bank boards. But we do not merely wait for recommendations by the Bank boards. On the contrary, we typically make thorough evaluations of possible candidates on our own.

I have already commented on the charge that the Federal Reserve has been guilty of discrimination. To write into the Federal Reserve Act a provision that Class C Reserve Bank directors are to be selected "without discrimination" is to imply that the Federal Reserve has refused, solely on the basis of race or sex or national origin, to accept particular candidates for directorships who otherwise were fully qualified. We resent any such implication, and we cannot believe that it conveys the true sentiment of the Congress. If the Congress as a whole had any doubt about the Board's commitment to equal opportunity, it would not have assigned to us in 1974 the responsibility to write regulations prohibiting discrimination in the granting of credit -- a responsibility that was enlarged just two weeks ago.

We see no difficulty in the provision for increasing the number of Class C directors from three to six. But with respect to the requirement that the Board of Governors give "due consideration to the interests of labor, education and consumers," we are

concerned that singling out certain favored interests may have the effect of excluding others. Why, for example, should not due consideration also be given to the interests of retired persons, or investors, or professional men and women, or the clergy?

In my earlier testimony I commented on the proposal to make the quarterly hearings on monetary policy a matter of statute. The Board welcomes these oversight hearings on monetary policy, and we have actually proposed additional oversight hearings on bank regulation and supervision; but we see no need to write such provisions into law.

In this connection, we object to the requirement that the expected impact of monetary policy be expressed in terms of effects "on statistical measures of employment, production and purchasing power." As I have indicated on earlier occasions, such a formulation assumes a procedure by the Federal Open Market Committee that does not now exist and that could not be brought into existence in any meaningful way. And we especially object to the provision that we try to forecast interest rates over a 12-month period. Such a requirement could cause investors and consumers to act to their detriment on the assumption that such forecasts had some measure of validity. I must warn this Committee

that any effort by the Federal Reserve to carry out such a provision might well cause a dangerous boom on the stock exchanges if we forecasted a decline of interest rates, or a collapse of both the stock and bond markets if we forecasted a rise of interest rates.

I have already alluded to the proposal requiring monetary policy to be governed by the objectives of the Employment Act. Need I say again that we fully observe the Employment Act in formulating our policies? This is what we work at every day. All of our energies are devoted to it. We could not be more mindful of it. Moreover, the statement of policy in the Employment Act already covers the Federal Reserve; it is carefully worded and there is no need to repeat it in summary form in new legislation.

In summary, the Board opposes the provision for Presidential appointment and Senate confirmation of Reserve Bank presidents. We oppose also the narrow criteria for selection of Class C Reserve Bank directors, and the requirement that the System provide explicit projections of employment, production, the price level, and interest rates.

We have no objection, however, to making the term of the Chairman and Vice Chairman of the Board of Governors roughly coterminous with that of the President, or to Senate confirmation of the Chairman, or to enlargement of Reserve Bank directorates from 9 to 12 members, or to broader representation on those boards, or -- for that matter -- to reaffirming the objectives of the Employment Act.

I noted at the beginning -- and I feel the point deserves emphasis -- that if the members of Congress should find that the premises underlying H. R. 12934 are valid, then far more drastic remedies than any proposed by this legislation would be necessary. But I also find it hard to believe that the members of Congress or the members of this Committee really think that the Federal Reserve is unmindful of Congressional objectives, or that we are responsible for the havoc wrought by inflation and recession, or that we are a racist organization, or that we are dominated by commercial bankers. Certainly no facts have been advanced to support such notions, and anyone who is familiar with the Federal Reserve should know these charges are untrue.

In conclusion, although the Board sees no difficulty with some parts of the legislation under discussion, we also see no

clear need to adopt any of it. Indeed, as I have indicated, there are strong reasons for the Committee to reject some of its key provisions. Your predecessors in the Congress acted wisely in providing a design for the Federal Reserve that insulated it from politics. This Committee has already rejected efforts to weaken a structure that has stood so well the test of time and experience, and we urge you not to begin a process of erosion by adopting legislation for which no need has been demonstrated.

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