

THE FEDERAL RESERVE SYSTEM AFTER FIFTY YEARS

Statement of

KARL R. BOPP

Before the
Subcommittee on Domestic Finance
of the
COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

January 30, 1964

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PRESIDENT, FEDERAL RESERVE BANK OF PHILADELPHIA
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SUBCOMMITTEE ON DOMESTIC FINANCE
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Thursday, January 30, 1964

Mr. Chairman and Members of the Committee:

My name is Karl R. Bopp. I have been a member of the staff of the Federal Reserve Bank of Philadelphia since September 1941 and President since March 1, 1958. Before I came to the Bank I was on the faculty of the University of Missouri. It is a privilege to appear before you to testify on several of the bills that are before you relating to the Federal Reserve System. My introductory statement is brief. Although there might be some advantage to the Committee to hear the full statement before you raise questions, please do not hesitate to interrupt me at any point if you prefer to do so.

H.R. 9631:

I begin with H.R. 9631, "A bill to increase to twelve the number of members of the Federal Reserve Board, and for other purposes."

Section 1 would reorganize the Federal Reserve Board by increasing its size, reducing the term and tenure of its appointed members, and changing its structure and composition.

With respect to *size*, the bill would increase the membership from seven to twelve, including the Secretary of the Treasury as Chairman. It

seems to me that a board consisting of eleven members who devote their entire time to the business of the Board would be unwieldy. Chairmen of the Board of Governors who have expressed their view on the matter of size have favored a reduction rather than an enlargement from the present number. Certainly membership on the Board would be less attractive as one of eleven or twelve than as one of seven or five.

As to *term* and *tenure*, the bill would reduce the term from fourteen years to four and would make tenure of appointive members subject to removal by the President. An appointive member would be ineligible for reappointment for four years. Since the *maximum* term is four years, average tenure would be shorter and turnover would necessarily be rapid; there could be little continuity except that provided by the staff. An individual without independent wealth and income would be forced to give thought to his next position almost from the time he began to learn about the responsibilities of membership; and his next position would necessarily become a matter of increasing concern as the end of his term approached, since even top performance would not qualify him for another term.

The bill would change the *structure* and *composition* of the Board. It would make the Secretary of the Treasury Chairman. This would place on the Secretary a new responsibility that is inconsistent with an existing responsibility. As Secretary, he is the largest borrower in the world by a wide margin. As borrower he appropriately desires the lowest borrowing cost possible. As Chairman of the new Board, he would head the agency with the largest single portfolio of government securities, an agency whose primary concern is to promote credit conditions appropriate to the entire economy, including but not limited to the Government. The sad experience of many countries, including our own, with putting these conflicting responsibilities in the hands of a single individual leads me to conclude that it should not be done.

An additional difficulty would be occasioned by having the Secretary serve as Chairman of the Board. He would rarely find time actually to attend meetings. This, at any rate, was the experience before 1936 and I would anticipate no change. Unfortunately, this is a function that should not be delegated.

The bill would provide also for a Vice Chairman, designated by the President from among the appointive members, who would be the active executive officer of the Board. It is probably desirable to have a chief executive officer but the brevity of the maximum term would militate against efficiency and continuity of operations.

In describing the qualifications of appointive members, the bill requires fair representation of certain specified interests and of geographic divisions. I would prefer the law to specify that every member be qualified and selected to represent the public interest and that residential qualifications be eliminated.

Section 2 would create a Federal Advisory

Committee to replace the present Federal Advisory Council. The proposed Committee would be so large that its deliberations would likely be too time consuming to hold able members or its results would likely be perfunctory.

Section 3 would transfer the powers, duties, and functions of the Federal Open Market Committee to the new Board. To abolish the Federal Open Market Committee would change the basic character of the System. It would eliminate the most important opportunity for public service and hence seriously reduce the attractiveness of the presidencies of the Federal Reserve Banks, with resulting deterioration in the quality of the managements and of the services performed by those banks. I continue to agree with the view expressed by the Patman Subcommittee in 1952 that "the present arrangement serves a useful purpose and (that there is) . . . no reason to disturb it."

Section 4 would direct the Comptroller General to make an annual financial and management audit of the Board, the Reserve Banks and their Branches. Chairman Martin has described present auditing procedures which, by deliberate design, are independent of operating management. President Bryan submitted a statement to the Patman Subcommittee in 1952 which demonstrates that this change would not produce the desired results. It would reduce the authority of the directors, who are a driving force to increase efficiency. It would divert the attention of management from continuous and occasionally bold new efforts aimed at promoting efficiency to the negative approach of concentrating on avoiding risks.

H.R. 9685:

This bill would subject the Board and the Reserve Banks to appropriations by the Congress.

The supplementary statement by President Bryan, to which I have already referred, demonstrates that this change would not achieve either better monetary policy or greater operational efficiency.

The Congress could expose the country to the hazard of seriously interrupting our payments mechanism by subjecting the Reserve System to Congressional appropriations. An efficient system of payments: collection of checks, provision of currency and coin, is indispensable to sustained economic growth. Interruption in the smooth flow of checks or inability to secure cash could cause panic. To assure that there would be no such interruption in these functions—which vary widely and at times unpredictably—the System would either (1) have to be given wide discretionary authority by the Congress, or (2) would have to defend a budget of sufficient size to meet maximum possible needs. Grant of wide discretionary authority would defeat the purpose of subjecting the System to Congressional appropriations. Budgets designed to meet maximum needs, on the other hand, would tend inevitably to increase costs. Experience with the severe coin shortages in recent years demonstrates that deficiency appropriations are no dependable solution.

H.R. 3783:

The bill would retire Federal Reserve Bank stock and substitute certificates of membership. As a

purely *logical* proposition a Federal Reserve Bank could operate not only without capital stock and surplus but with a very large deficiency (*i.e.*, with liabilities far in excess of assets). The reason is that the only logical needs for assets are to secure earnings and to meet the claims of creditors as they arise. Since earnings are now far in excess of expenses, fewer earning assets would still be adequate to meet this need. The two large liability accounts are for Federal Reserve notes and member bank reserve deposits. There is no possibility that these accounts, which now total about \$50 billion will fall below, say \$30 billion—or even \$40 billion. Logically, no assets are needed to meet claims that will never be made, hence the Reserve Banks could operate logically with liabilities far in excess of assets. I develop this logic of the case to indicate that meaningful living involves more than logic.

Reserve Bank stock is a means of tying member banks and bankers more closely to the System. It provides a business-like method for electing six directors. Dividends on the stock are a partial offset against the lower earnings of member banks which result from their higher effective reserve requirements. Elimination of stock would make some observers restive because they would view it as indicative of a movement toward basic monetary changes such as nationalization of the banking system. There is no demonstrated need or prospect of benefit to offset these advantages of the change.