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Statement by

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before the

Committee on Banking, Housing and Urban Affairs

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I am pleased to be here to discuss the issues surrounding reform of the Federal Reserve System. Committees of the Congress often hear from the distinguished Chairman of the Federal Reserve Board and less frequently from other members of the Board. I believe it is also appropriate for you to hear occasionally from the Presidents of Reserve Banks. We do play a role in the pluralistic decision-making process of the Federal Reserve System and direct interchange between the Congress and us can be beneficial.

Before commenting on the specifics of S.2285, I would like to make some remarks on what I believe to be the philosophy behind it. Over the years I have given considerable thought to the question of where the Federal Reserve fits into the political process. I have summarized these thoughts in a paper which was sent to the Committee in advance of these hearings. The paper is entitled, "The Fed in a Political World." If agreeable, I would like to have this paper incorporated in the record.

If I read the motivation behind S.2285 accurately, you have in mind two concerns: first, strengthening the role of Congress in overseeing monetary policy; second, strengthening decision-making within the Federal Reserve. These are both laudable objectives. They are so important that Congress and the Federal Reserve must work together to accomplish them.

#### Relationship between Federal Reserve and Congress

With respect to the first objective, I have the feeling that this kind of cooperation is in danger of not taking place. The danger I see is the

development of an adversary relationship with the Fed believing that Congress is continually nibbling away its "independence" and the Congress believing that the Fed is building a stone wall against change. The way out of this, of course, is for both of us to consider what relationship between Congress and the Federal Reserve is in the best public interest.

Central to this relationship is the "independence" of the Fed--a term used with considerable looseness. The Fed is independent from the Executive, not the Congress. The history of executive abuse of money was extensive even at the time of the Constitutional Convention. The power to create money was made independent of the executive by placing it in the Constitutional domain of the Congress. As the nation evolved into a modern, industrial society, it became clear that Congress did not have the timely flexibility or technical knowhow to conduct monetary policy. Congress then delegated monetary policy to the Federal Reserve. However, Congress wisely saw the possibility that even the legislature might be susceptible to short-run partisan influences where money is concerned. It sought, therefore, to insulate the Fed from its creator sufficiently so that the Fed could exercise independent judgment. Congress did this in the public interest, not the Fed's or anyone else's.

Permitting independent judgment to be exercised through delegated authority, however, means that the Fed is still accountable to the Congress. The question we address here today is how Congress can oversee the Fed without damaging the insulation which protects the central bank's ability to make unpopular decisions in the short-run that will prove wise in the long-run.

Two basic approaches have been proposed: one is through budgeting and auditing; the other is to set basic goals and then expect the Fed to meet

the goals or explain why not. The second approach is that of the Concurrent Congressional Resolution requiring the Fed in consultation with the Congress to set monetary targets. I believe this is far preferable to the budgeting and auditing approach because it gets directly at the basic business of the Fed--monetary policy, allows a direct input by the Congress, and still keeps intact the insulation that permits independent judgment. The other approach, in contrast, is indirect, may divert attention to a myriad of details and away from the basic issues, and allows too many people to get between the Fed and the Congress. In short, I believe you would be doing yourselves, the Fed, and, most important, the public, a disservice by becoming involved in over-seeing details of Federal Reserve activities.

#### Federal Reserve Decision-Making

One of the checks Congress placed on the independent judgment of the Fed is a decentralized structure--7 Governors, not one, and 12 semi-autonomous regional banks. In recent years there has been a tendency toward more centralization of decision-making in the Fed. We are conscious of this and are studying ways to balance the gains of central coordination and the advantages of decentralized decision-making. The Conference of Reserve Bank Presidents is currently addressing itself to this question. As Chairman of the Conference, I intend to push hard to get this study completed and the findings implemented. John Gardner touched on the reason several years ago. "In an organization with many points of initiative and decision, an innovation stands a better chance of survival; it may be rejected by nine out of ten decision makers and accepted by the tenth. If it then proves its worth, the nine may adopt it later." With the Federal Reserve under such great pressure

to perform in this fast-paced economy, it stands much more chance of coming up with a breakthrough idea under this arrangement than under one in which all authority is centralized.

Specifics of S.2285

With this as background, I would like to comment briefly on specifics of the proposed legislation.

I favor confirmation by the Senate of the Chairman of the Federal Reserve Board. The office of the Chairman has substantially more responsibility than those of other members of the Board of Governors. It is appropriate, therefore, that the Senate should have the opportunity to evaluate nominees for each office separately.

I also favor making the Chairman's term approximately coterminous with that of the President of the United States. The Fed is accountable to Congress, but it must also coordinate with the President. Combination of these two provisions would give proper balance to the respective responsibilities of the President and Congress.

I accept the proposal to give "due regard" to consumers and labor in selecting members of the Board. I would be opposed, however, to providing mandatory representation for specific interest groups. Ideally, Board members should have a broad view of the public interest with a knowledge of economics and financial institutions. A Board composed of representatives of various interest groups in adversary roles would not be in the public interest.

I caution against providing staff assistance to members of the Board through legislation. Staff assistance should be an internal management decision based on need and not made inflexible by amending the Federal Reserve Act. From my vantage point, Governors now have wide latitude in determining their own staff needs.

I am opposed to Senate confirmation of Presidents of Reserve Banks. The apparent advantages of this proposal are strengthening the position of the Presidents within the System and making them more accountable to Congress. Although I am sympathetic to the motivations behind this proposal, I frankly don't see how Senate confirmation would contribute much to either. As for strengthening the Presidents, there may be some small psychological gain from Senate confirmation, but it is dwarfed by the supervisory authority of the Board over budgets, salary, and performance evaluations. As for accountability, Presidents are now available for Congressional testimony and stand ready to cooperate with Congress in the public interest. Senate confirmation would not alter this.

More seriously, I see potential harm coming from confirmation. On the whole, the men who serve as Presidents of Reserve Banks are capable and perform well. They have been chosen because of their competence and dedication. To subject them to confirmation runs the risk of politicizing their appointments in the way local postmasterships used to be. I believe the kind of "political clearance" that could easily become part of the Senate confirmation process risks lowering the quality of the Presidents by reducing the number eligible and willing to serve.

I most strongly oppose placing a Congressional ceiling on Federal Reserve expenditures. A ceiling on expenditures would come dangerously close to Congress running the Federal Reserve System in such detail that our flexibility would be impaired and our operations opened to partisan and short-run political pressures. There is no prudent, practical way I know of for setting a budget total without a line-by-line review of what's in the total. I can think of a no more devastating blow to the nonpartisan functioning of the Federal Reserve than to subject it to the Congressional appropriations process.

Managerial efficiency has not suffered from exemption from the appropriations process. At the Philadelphia Bank we have made a special study of productivity of System operations. We have computed a unique index of operational output and productivity. This index shows that productivity in the Federal Reserve has increased continuously in recent years, and at a rate of improvement twice that of the private economy. While employment in the System has grown over the last several years, output of the System--including services related to issuance of Treasury debt, distribution of new currency and coin, and services to the rapidly growing payments mechanism of the nation--has grown more rapidly. Output growth has slowed somewhat in the last year as a result of the nation's recession. That, combined with special programs of the System to accelerate improvements in efficiency, are currently leading to declines in System employment, a trend that we expect to continue through at least 1976. A more complete version of our analysis is available to the Committee and if agreeable I should like to introduce it for the record.

Let me now turn to a related proposal, S.2509, having to do with GAO auditing of the Federal Reserve. I can understand why Congress, in a post-Watergate world, would want a financial audit. The real issue is how auditing would relate to monetary policy. Even if an audit were to exempt monetary policy, I see a practical problem: how does one draw the line in an organization so thoroughly involved in money management between a purely financial audit and one that includes monetary policy. Suppose the GAO were auditing the Trading Desk at the New York Reserve Bank? How can the GAO effectively separate simply auditing the "books" from saying something about the implementation of monetary policy? Almost any comment dealing with which security is bought or sold, when or with whom stands a good chance of trespassing on policy.

Or, suppose the GAO is auditing the Credit Discount department of a Reserve Bank? Almost any statement about amounts lent, to whom, at what rate, whether for seasonal needs, adjustment needs, emergency needs, etc., gets into the area of monetary policy.

I have had a fair amount of exposure to disputes between line managers and auditors of what constitutes a pure audit recommendation and a managerial recommendation. These disputes are minuscule compared to the disagreements that would surround what a GAO auditor should see and recommend. So, while in theory a financial audit of the Federal Reserve may be appealing to you, in practice I don't see how a line of separation can be drawn excluding monetary policy. Therefore, I do not favor the GAO audit proposal.

#### Some Positive Proposals

I have tried first to state some general principles and then to apply them to the specifics of S. 2285. Some of the provisions of the Bill are acceptable to me; others are not. In order to be as constructive as possible, I'd like to sum up by suggesting some positive steps that would accomplish the dual purpose of the Bill.

1. I suggest that Congress concentrate on making the Concurrent Resolution the vehicle for overseeing Federal Reserve policy. Experience so far has been good; a cooperative spirit has been established and the future seems promising.
2. Congress should further encourage the Fed to make as much information as possible available as promptly as possible. We have been making more information available sooner, and additional steps can be taken.



3. As I indicated, I recommend against detailed involvement of Congress in Federal Reserve Budgets. However, if you feel compelled to be more fully apprised of activities outside of the area of monetary policy, let's explore other ways to do that. For example, I can envisage a session annually at which the Fed would present the overall dimensions of expenses and operations.
  
4. Finally, I repeat my opening comment. It is healthy for you to seek the views of a number of individuals in the Fed, including the Reserve Bank Presidents, and it is rewarding for us to have the opportunity to contribute.

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