

Research Department Federal Reserve Bank of San Francisco

May 9, 1975

The Sense of Congress

Federal Reserve Chairman Arthur Burns appeared before the Senate Banking Committee last week, to announce that monetary policy is now designed to promote an increase of 5 to 7½ percent in the M_1 money supply (currency plus bank demand deposits) over the next twelve months. This historic revelation of monetary plans was the highlight of a report called for under the terms of HConRes 133, a joint resolution expressing increased Congressional interest in the Fed's role in fighting the recession.

Congress in this resolution indicated its desire that the Federal Reserve attempt to reduce long-term interest rates and thereby expedite recovery from the recession. At first glance HCR 133 seems uninteresting, because these goals are already Federal Reserve goals. However, the subject is important because it represents an explicit Congressional attempt to become directly involved in Federal Reserve decision-making.

The Federal Reserve has been a creature of Congress since its inception. It was created by act of Congress in 1913. Furthermore, Federal Reserve officials frequently testify before Congressional committees on policy matters. However, until now Congress has done little to advise the Federal Reserve on the conduct of current monetary policy, in part because of the clear intent of the Federal Reserve Act to insulate monetary policy decisions from political

pressures. To insure this protection the members of the Board of Governors have overlapping 14-year terms of office. In addition, the budget of the Federal Reserve is not part of the Federal Budget. Clearly, the Federal Reserve thus far has been remarkably free of **direct** governmental influences.

Argument for guidance

Not all informed observers believe that the Federal Reserve **should** be free of Congressional guidance. One basic argument, put forward by the Congressmen favoring the new resolution, is that guidance is necessary to ensure a properly expansionary policy in the current recession. This argument gained strong support last winter when it appeared that the money supply was not growing fast enough to curb the recession. The M_1 measure of the money supply grew at only a 2-percent annual rate between July and February, although the growth rate then speeded up to 14 percent in March, helping to offset somewhat the force of the Congressional criticism.

Some economists have backed the Congressional attack, on the ground that low money-supply growth is an indicator of the (wrongful) thrust of current monetary policy. However, there is a question whether M_1 is the right measure of policy. Federal Reserve Chairman Arthur Burns has suggested that other monetary aggregates provide a better measure of the degree of ease in policy, and for further evidence he has

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pointed to the rapid decline in U.S. interest rates, to levels generally below those prevailing elsewhere.

A second argument for Congressional action to intervene in policy centers around the view that monetary policy should be regulated by legislative rules, not by the decisions of men. The argument is stated most succinctly in Milton Friedman's 1962 article, "Should There be an Independent Monetary Authority?" Friedman argues that with an independent monetary authority, it is difficult to determine who is accountable for government policy. He suggests that everyone accepts credit when things go right, but that no one accepts blame when they go wrong. Secondly, because of the dependence on human decisions, policy is capricious because policy **makers** change. Friedman adds that these pitfalls could be avoided through the use of a legislative rule, such as one ordaining a constant rate of increase in M_1 .

Nature of the resolution

The resolution can be examined in the light of these two arguments for a Congressional role in monetary policy. The crucial part of the resolution reads as follows:

"It is the sense of Congress that the Board of Governors of the Federal Reserve System and the Federal Open Market Committee

- (1) pursue policies in the first half of 1975 so as to encourage lower long term interest rates and expansion in the monetary and credit aggregates appropriate to facilitating prompt economic recovery; and
- (2) maintain long run growth in the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long term interest rates."

Chairman Burns pointed out in a recent Congressional appearance that the Federal Reserve is already required to pursue the goal of "maximum employment, production and purchasing power" as stipulated by the Employment Act of 1946. Thus, the two Congressional recommendations seem to follow from this earlier mandate.

However, the resolution goes on to add "The Board of Governors shall **consult** (our emphasis) with

Congress at semiannual hearings before the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Banking, Currency and Housing of the House of Representatives about the Board of Governors' and the Federal Open Market Committee's objectives and plans with respect to the ranges of growth or diminution of money and credit aggregates in the upcoming twelve months." This clause increases the potential impact of the resolution considerably, since it gives Congress scope to indicate approval or disapproval **prior** to the implementation of monetary policy. In this way the House and Senate Banking Committees may communicate their views of national needs to Federal Reserve officials, as they did at last week's Senate hearings.

Effects of the resolution

Does the resolution satisfy the two criteria for Congressional influence on monetary policy? First, the resolution might have little direct impact upon the course of monetary policy through the first half of 1975, apart from the influence already wielded by the Federal Reserve.

The resolution would encourage reduction of long-term interest rates and (hence) rapid recovery, but this intent generally parallels the Fed's desire to lower long-term rates and facilitate prompt economic recovery while still maintaining stable prices.

Although there is controversy among economists about **how** this may be done, the resolution does not direct itself to this matter. So the first argument for Congressional intervention in policy is not actually faced by the resolution.

Second, the resolution appears to frustrate Friedman's desire to make monetary policy a matter of rules rather than human decisions. The current decision-making process involving the Federal Open Market Committee would be replaced by a new process involving both that committee and two Congressional committees as well. This method seems to capture the **substance** of legislative involvement in the monetary-policy process, but it misses the **spirit** of policy through legislative rules. From the critics' standpoint, the responsibility for the course of monetary policy would not be made clearer, nor would the caprice of personality be removed.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/23/75	Change from 4/16/75	Change from year ago	
			Dollar	Percent
Loans (gross, adjusted) and investments*	84,801	- 1,030	+ 2,363	+ 2.87
Loans (gross, adjusted)—total	64,913	- 646	+ 1,358	+ 2.14
Security loans	1,174	- 344	+ 128	+ 12.24
Commercial and industrial	24,057	- 182	+ 1,053	+ 4.58
Real estate	19,562	- 26	+ 652	+ 3.45
Consumer instalment	9,799	- 5	+ 573	+ 6.21
U.S. Treasury securities	7,519	- 184	+ 1,743	+ 30.18
Other securities	12,369	- 200	- 738	- 5.63
Deposits (less cash items)—total*	83,873	- 861	+ 5,466	+ 6.97
Demand deposits (adjusted)	23,040	- 771	+ 982	+ 4.45
U.S. Government deposits	271	- 256	- 396	- 59.37
Time deposits—total*	59,441	+ 306	+ 4,907	+ 9.00
States and political subdivisions	7,402	+ 297	- 38	- 0.51
Savings deposits	19,408	+ 17	+ 1,447	+ 8.06
Other time deposits‡	29,091	- 29	+ 2,682	+ 10.16
Large negotiable CD's	15,814	- 51	+ 2,279	+ 16.84
Weekly Averages of Daily Figures	Week ended 4/23/75	Week ended 4/16/75	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves	35	23		45
Borrowings	38	1		379
Net free (+) / Net borrowed (-)	- 3	+ 22		- 334
Federal Funds—Seven Large Banks				
Interbank Federal fund transactions				
Net purchases (+) / Net sales (-)	+ 2,079	+ 2,583		+ 2,152
Transactions of U.S. security dealers				
Net loans (+) / Net borrowings (-)	+ 659	+ 1,303		+ 125

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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