Mr. Chairman and Members of the Committee:

Several bills have been introduced to modify the present structure and method of operation of the Federal Reserve System. It would be very misleading to examine these one by one in an isolated context, and I cannot express too strongly my hope that this Committee will adopt the broad approach. It is the only one that can be fruitful.

What is the proper framework for examining the proposals? I submit that it is "What kind of central banking system does the United States really want, and do these proposed changes further this objective or hamper it?"

I am sure that we all want a central banking system which will assure our nation a smoothly functioning payments mechanism, provide a flexible supply of money and bank credit capable of accommodating the needs of economic growth while at the same time preventing inflation, and, finally, support the prestige and acceptability of the dollar throughout the world. The question, then, is how can these objectives be best achieved.

Being aware, on the one hand, of the fatal attraction to Government of temporary gains from the debasement of the currency, and, on the other, of the human distress in times of financial panic to which an inflexible monetary system had contributed prior to 1913, the Congress recognized that these objectives could best be achieved, in accordance with the basic philosophy of our form of Government, by an ingenious system of checks and balances not unlike those found in our Constitution. Accordingly, the Federal Reserve System was designed so that it would work, in the public interest, closely with the banking and business community but not dominated by it, and closely with the Federal Government, but one step removed from the daily pressures of political forces.
Mr. Swan's statement.

No central bank, however, has the right to be obdurately opposed to its Government. It can advise against bad fiscal policies and support sound ones. Moreover, it can try to educate the public on the importance of sound policies and on the consequences of unsound ones. But no central bank, in the final analysis, can or should block the Government from a course of action which the Government is firmly resolved to undertake notwithstanding advice to the contrary.

If a central bank is to be effective in carrying out the many delicate domestic and international responsibilities entrusted to it, what does it need in order to do the job? Obviously, the first thing it needs is public confidence in its integrity, its competence, and its objectivity. It must be the voice neither of an incumbent Administration nor of private interests, but it must have trusted access to the views of both, and there must be respect for its views on the part of both. It must be recognized by both as being more concerned with the basic soundness of the nation's economy than with short-range political or private objectives.

The two things I wish to emphasize are that the Federal Reserve not only must have a well-informed and objective point of view; perhaps even more important, it must be widely recognized as having such. Anything that raises persistent doubts in the mind of the public about this capability will impair the Federal Reserve's effectiveness.

It is in this light that the proposals to appoint the Secretary of the Treasury Chairman of the Board, to eliminate the Reserve Bank Presidents from the Open Market Committee, to retire the capital stock held by the member banks, to have the G.A.O. audit the Federal Reserve, and to subject the Federal Reserve to Congressional appropriations procedures, must be examined. Would they correct any real shortcoming of the Federal Reserve System and would they increase confidence in the System at home and abroad, or would they be regarded as an attempt to make the System highly responsive to short-run political pressures?
Mr. Swan's statement.

You have heard opinions from Board Members and other Presidents of Reserve Banks on these proposals, and I shall not offer my comments on all of them since the ground has largely been covered. However, I should like to comment specifically on the proposal to have the Federal Reserve Banks audited by the G.A.O. In my opinion, there are three issues involved. First, are the Federal Reserve Banks presently subjected to a close scrutiny of their expenses, and are they compelled to cease any expenditures or practices deemed inappropriate to the proper conduct of their responsibilities? Second, are the policy criteria established for judging the expenditures determined by men whose judgment is competent and whose integrity and prudence are unquestioned? Third, are the men who determine the policies accountable to any higher policy-making body which has authority to review their performance?

I hope that no one disputes that the Federal Reserve Banks are closely supervised and audited, and are required to observe the criteria established by their boards of directors and by the Board of Governors. This, then, takes us to the second issue, namely, whether the judgment both of the boards of directors and of the Board of Governors as to what constitutes a proper expenditure is sound.

But "sound" in relation to what? Obviously, "sound" in relation to the particular needs and responsibilities of a central bank, including the need for having close and direct relationships with many groups at the grass-roots level. I am not aware of significant evidence that either the Board of Governors or the directors of the Reserve Banks have permitted the Banks to be extravagant. Finally, the Board and the Reserve Banks certainly are accountable to a higher policy-making body, Congress, which in hearings such as these has full opportunity to review the activities of the System.

Audit by another agency would add another layer of supervision and cost. Moreover, it would inevitably lead to conflicts as to what types of activities and outlays are necessary to achieve the objectives of monetary policy
Mr. Swan's statement.

and to perform the operating duties of the central bank. The determination of expenditure policy, as these hearings have indicated, should not be a function of the G.A.O. In this connection, it is relevant to note that, in the case of Government agencies not having the degree of autonomy of the Federal Reserve System, G.A.O. audits have reference points established by Congressional action through the authorization and appropriations process to guide them. This is not the case with the Federal Reserve, nor should it be. A central bank, to be effective, must have a certain amount of independence and autonomy within the Government, and, by its very nature, this will involve occasional differences in the criteria by which certain expenditures will be judged.

Some of the expenditures and some of the differences in practices of the individual Federal Reserve Banks mentioned in these hearings are a reflection of the fact that the System does in fact have a certain degree of independence in exercising its judgment. In our operations, there is a real advantage in permitting regional variations which reflect both differences in underlying circumstances and the fact that twelve Reserve Banks are each trying continuously and competitively to develop more efficient and less costly operating procedures. But, even more important, they reflect the fact that the System is trying to keep in close touch with people at the grass-roots level, so that it may be well informed on regional as well as national problems and, at the same time, effectively inform the public of the significance of a healthy dollar for a healthy economy.

As a consequence, it is most difficult to visualize the System being placed under G.A.O. audit without the System's policy responsibilities being seriously threatened. (In reaching this conclusion, I have no question whatever about the integrity and technical competence of the G.A.O.) Thus, the proposal that the G.A.O. audit the Federal Reserve System is very closely linked with the one to bring the Board and the Banks under Congressional appropriations
procedures, because then Congress would establish the expenditures criteria
the G.A.O. would need. This, I believe, would undermine the independence of
the Federal Reserve and its ability to formulate and execute monetary policy
one step removed from the political arena. The prestige of the dollar and
confidence in our monetary policy would suffer a dangerous blow.

Over the past fifty years, we have developed a central banking structure
and a delicate but workable balance between independence and responsibility
to the Government that are highly respected at home and abroad. This, in turn,
has been a source of great strength for the dollar and for our economy as a
whole. In the absence of demonstrable and significant deficiencies, we should
not risk tampering with it.