

## XI. SUMMARY AND CONCLUSIONS

The question as to the legal status of the Federal Reserve System is a many-sided question. It involves the question as to the status of each of its parts - the Board of Governors, the FOMC, the Federal Reserve Banks, and the Federal Advisory Council - in relation to the Federal Government. It involves the question as to where each of these parts of the System should be placed in the three "branches" of the Government. It involves the relation of each of these parts to the other parts of the System. Finally, it involves the nature of the System's "independence" within the Government - the bases of that independence, the merits of proposals for modification of that independence, and, inherently and fundamentally, whether the System's independence can be justified.

The principal purpose of this paper has been to present these questions objectively from both legal and historical viewpoints and with copious quotations, so that the reader may form his own conclusions. The following summary reflects only the writer's views, with which the reader is free to differ.

1. There is at least one proposition as to which there can be no dissent: the Board of Governors of the Federal Reserve System is an independent establishment of the Federal Government, "a part of the Government itself." This proposition was firmly established by the Attorney General in 1914. It was temporarily challenged in the late 1930's when the D. C. Government attempted to tax the Board's building and when the Bureau of Employees' Compensation questioned whether the Board's employees were employees of a Government agency; but those

questions have long since been laid to rest. The members of the Board are appointed by the President; the Board's employees are employees of the Federal Government; and the Board, under statutes of Congress, exercises what are clearly governmental functions.

2. The Federal Open Market Committee, like the Board of Governors, is an agency of the Federal Government, despite the fact that five of its twelve members are not appointed by the President of the United States. In the exercise of its statutory authority to regulate the open market operations of the Federal Reserve Banks, the Committee has control of one of the most important tools of monetary policy and unquestionably performs governmental functions.

3. The Federal Advisory Council is likewise an agency of the Federal Government even though none of its members is appointed by the President. Its legal status, however, is relatively unimportant, since it has only advisory powers.

4. Contrary to statements frequently made by members of Congress, Federal Reserve officials, and others, to the effect that the Federal Reserve is an "arm of Congress" and not in the executive branch, it is the writer's opinion that the Board of Governors and the FOMC are agencies in the executive branch of the Federal Government. Both are creatures of Congress but no more so than any of the old line "executive" Departments. The fact that the Board is required by statute to make annual reports to Congress is not conclusive; such a requirement applies also to agencies that are clearly in the executive branch of the Government. Although the Board and the FOMC, in issuing regulations, exercise quasi-legislative functions, they do not make laws; and, although the

Board, in passing upon applications by banks and bank holding companies, exercises quasi-judicial functions, the Board is not a court in a constitutional sense. Other agencies of the Government that are obviously in the executive branch likewise perform such quasi-legislative and quasi-judicial functions.

5. Although the Board and the FOMC legally are in the executive branch, they are not subject to direction or control by the President in the performance of their statutory functions. In this respect, they are like all other agencies in the executive branch, including the Executive Departments, except that Department heads, unlike members of the Board and the Committee, serve at the pleasure of the President. In addition, specific provisions of the Federal Reserve Act have the effect of insulating the Board from pressure or influence not only by the President but by the Congress as well.

6. The Federal Reserve Banks are corporate instrumentalities of the United States established and operated for public purposes and not for private profit. Although the stock of each Reserve Bank is wholly owned by its member banks and six of its nine directors are elected by the member banks, the operations of the Reserve Banks are in no way subject to direction or control by the member banks. On the other hand, the Reserve Banks are not parts of the United States Government in the same sense as the Board and the FOMC; and Reserve Bank employees are not employees of the United States. Whether the Reserve Banks are "agencies" of the United States is a debatable question; its determination for purposes of Federal statutes must depend largely upon the nature and intent of the particular statute involved.

7. Those who make the erroneous assumption that the Federal Reserve is not in the executive branch apparently believe that this is the basis for the so-called "independence" of the Federal Reserve. Actually, there is no connection; whether or not the System is in the executive branch has nothing to do with its independence. As an agency in the executive branch, the Board of Governors shares with other executive agencies freedom from direction by the President in the performance of its statutory functions; but the Board enjoys an additional degree of independence by virtue of specific statutory provisions enacted by Congress. Moreover, it should be emphasized again that, by virtue of other statutory provisions, the Board also enjoys a high degree of independence from the Congress itself. The bases for Federal Reserve independence are summarized below:

(a) The original Federal Reserve Act gave appointive members of the Board terms of 10 years, with the term of one member expiring every two years. The deliberate purpose was to give Board members a high degree of independence, to take them out of politics, and to preclude a new President from "packing" the Board. Since 1936, the seven members of the Board have been appointed for 14-year terms. Consequently, in the absence of deaths and resignations, a new President may appoint only two of the seven members during his first term of office.

(b) If a Department head acts contrary to the wishes of the President, he may be summarily dismissed by the President. Under the Federal Reserve Act, a Board member may be removed by the President only "for cause", which is understood to mean incompetence, neglect of duty, or malfeasance in office.

(c) Although the statement of economic policy contained in the Employment Act of 1946 applies to the Board and the FOMC as well as to other Federal agencies, specific economic policy goals or targets set by the President in his annual economic report to Congress are not binding upon the System. In other words, the President cannot direct the Board or the FOMC as to how they should use their monetary policy tools in order to achieve the objectives of the Employment Act.

(d) Employees of the Board are specifically exempted by the Federal Reserve Act from the classified civil service. This means that the Board's employees are not subject to the Classification Act or to regulations of the Civil Service Commission thereunder.

(e) One of the most significant reasons for the System's independence has been the fact that, unlike most Government agencies, it has not been dependent upon Congressional appropriations. Under provisions of the original Federal Reserve Act that have never been changed, all expenses of the Board are defrayed from assessments on the Reserve Banks// which, in turn, derive their earnings principally from purchases and sales of Government securities - earnings sufficient for the expenses of the Reserve Banks as well as those of the Board. Indeed, such earnings have been so sufficient that millions of dollars have been paid into the U. S. Treasury pursuant to voluntary action by the Board under provisions of section 16 of the Act. Moreover, section 10 of the Act since 1933 has expressly provided that funds of the Board shall not be regarded as "appropriated moneys"; and, consequently, the Board is not subject to many statutes of Congress that obviously apply only to agencies that operate with appropriated funds.

(f) While the funds of the Board derived from assessments on the Reserve Banks are not appropriated moneys, they were held by the Attorney General in 1914 to be "public" moneys and therefore subject to audit by the Treasury Department; and, after 1921, they were subject to audit by the General Accounting Office. In 1933, however, Congress provided that the Board's funds should not be regarded as "Government funds"; and, as a consequence, the Board has not been subject to audit by GAO since that time.

(g) Another important basis of Federal Reserve independence is a provision of the Federal Reserve Act, added in 1933, that authorizes the Board to determine the manner in which its obligations shall be incurred and its expenses paid and that makes the employment, compensation, leave, and expenses of its employees subject solely to the provisions of that Act and regulations of the Board. Because of these provisions, the Board is not subject to various Federal statutes relating to Government contracts and expenditures and to salaries, leave, and employment of Government employees.

(h) Finally, under a 1934 amendment to the Federal Reserve Act, the Board has "sole" control of its building and space therein - a prerogative of no little importance.

8. As a practical matter, the independence of the Federal Reserve is not unlimited. In the national interest, the monetary policies of the Federal Reserve and the fiscal policies of the Treasury must be coordinated; and there have been occasions, as during wartime, when Federal Reserve policies have been influenced strongly or dominated by the overall policies of the current Administration. Moreover, the System

is under continuous scrutiny by the Congress, which at any time can act to restrict the System's independence.

9. Of the various proposals that have been made over the years for changes in the Federal Reserve System, some would significantly diminish if not destroy the System's independence from the President. Thus, the President's ability to control the Board would be increased if he were given power to remove Board members at pleasure, or if the number of Board members were reduced and the length of their terms were substantially shortened, or if the Secretary of the Treasury were again made an ex officio member of the Board, or if the economic targets set by the President were made mandatory upon the System.

10. One proposed change in the law - that the term of the chairman of the Board as chairman be made approximately coterminous with that of the President - might actually enhance the Board's influence in the determination of national economic policies without lessening the Board's independence.

11. The Federal Reserve's independence from Congress would be substantially reduced if the System should be made dependent upon Congressional appropriations, if it should be subjected to audit by the General Accounting Office, or if the System should be obliged to operate under a specific statutory economic policy mandate. To a lesser degree, the flexibility of the System's operations would be hampered by repeal of present provisions of law under which the Board's employees are exempted from the classified civil service and the Board is given sole discretion as to the manner in which its expenses are incurred and as to the employment, compensation, and leave of its employees.

12. Adoption of proposals to abolish the Federal Open Market Committee and transfer regulation of open market operations to the Board of Governors, to change the procedure for the selection of Reserve Bank directors, or to retire Reserve Bank stock now owned by the member banks might not affect the independence of the System. On the other hand, by eliminating participation by the Reserve Bank presidents in the formulation of monetary policies and by minimizing the corporate relationship between the member banks and the Reserve Banks, adoption of such proposals could give the impression, both at home and abroad, that the System was being "nationalized" and at the same time tend to impair the traditional strengths of the System - its unique blending of governmental and private interests and its combination of regional administration with centralized supervision.

13. In the final analysis, the underlying and fundamental question is whether the independence of the Federal Reserve System is justifiable. On the one hand, there are those who contend that such independence is ridiculous; that there is no sound reason why the Federal Reserve should not, like other Federal agencies, be subject to appropriations and GAO audit; and that determination of monetary policies by the Federal Reserve without control by the President and the Congress is "undemocratic", frustrating, and contrary to the overall national interest. On the other hand, those who defend the System's independence argue that the country's "central bank" must be free from all political pressures because its decisions in the long-run public interest may be politically unpopular.

On balance, and despite the views of Representative Patman, it is the writer's opinion that the degree of independence presently enjoyed

by the System is about right. At the same time, this conclusion would not rule out the adoption of the proposal that the terms of the chairman and vice chairman of the Board should be made generally coterminous with the term of the President; nor does the writer believe that the System's independence would be seriously threatened by transfer of regulation of open market operations from the FOMC to the Board of Governors, by a change in the method of selection of Reserve Bank directors, or by retirement of Reserve Bank stock. In any event, maintenance of the System's independence should not be regarded as incompatible with the continuation of informal procedures designed to coordinate monetary policies of the Federal Reserve with fiscal policies of the Treasury. The System, in its own interests, cannot afford to operate in "splendid isolation".

Perhaps the best expression of the writer's opinion was contained in the 1952 Report of a Subcommittee of which Representative Patman served as chairman. That Report said:

"The final aim, of course, is not that the Federal Reserve System should be independent, but that the country should have a sound economic policy. The independence of the Federal Reserve System is a relative, not an absolute, concept. It is good insofar as it contributes to the formulation of sound policy, and bad insofar as it detracts from it. Measured by this standard, the Subcommittee is inclined to believe that a degree of independence of the Board of Governors about equal to that now enjoyed is desirable. Many of the policies which the Federal Reserve must advocate to maintain the soundness of the dollar during times of inflationary pressures are unpopular; yet it is necessary that they have a strong advocate in order to avoid a built-in inflationary bias in the economy. This end is best served by endowing the Board of Governors with a considerable degree of independence - thereby enhancing its bargaining power in the determination of over-all policy. But, the Board of Governors, like all other parts of Government, must play as part of a team, not as an outside umpire, and must ultimately abide by the decisions which are made by Congress."