1575

SHOULD THE FEDERAL OPEN MARKET COMMITTEE BE ABOLISHED OR CHANGED?

Howard H. Hackley
April 1971

SHOULD THE FEDERAL OPEN MARKET COMMITTEE

BE ABOLISHED OR CHANGED?

CONTENTS

SHOULD THE FEDERAL OPEN MARKET COMMITTEE BE ABOLISHED OR CHANGED?

I. INTRODUCTION

The Federal Open Market Committee is a unique agency of the Federal Government. Endowed by Congress with powers that directly affect the national economy and that indirectly affect every business and individual in the country, it nevertheless is an agency that has no offices of its own, no building, no employees, and no money, and that is composed partly of members who are not appointed by the President of the United States. It is peculiarly a product of historic evolution that reflects a compromise between a concept of centralized governmental control and a traditional political concept of regionalism or "federalism".

The Committee is an integral part of what is known as the "Federal Reserve System". That System consists of five elements: (1) the Board of Governors of the Federal Reserve System, a Government agency of seven members appointed by the President; (2) 12 regional Federal Reserve Banks that operate for public purposes under the general supervision of the Board of Governors; (3) several thousands of commercial banks that, as "member banks", own stock in the Reserve Banks and are subject to certain regulation and supervision by the Board; (4) a Federal Advisory Council consisting of 12 bankers elected by the boards of directors of the Reserve Banks; and (5) the Federal Open Market Committee consisting of the seven members of the Board of Governors and five "representatives" of the Federal Reserve Banks.

The Federal Open Market Committee - or FOMC - has been a statutory part of the System only since 1936. Yet it exercises what is now regarded as the most important power possessed by the System - regulation of Reserve Bank open market operations. When the Reserve Banks purchase securities in the market, the reserves of member banks are increased and the effect is to stimulate credit expansion. Conversely, when the Reserve Banks sell securities in the market, member bank reserves are absorbed and the effect is to induce credit contraction. Since the FOMC has authority to "direct" the Reserve Banks to take either action, it has the power at any time either to ease or to tighten credit conditions.

At the same time, the Board of Governors, under other provisions of the Federal Reserve Act, has power to ease or tighten credit by lowering or raising the "discount rate" charged by the Reserve Banks for credit extensions to member banks or by reducing or increasing the reserves required to be maintained by member banks of the System.

Over the years since 1936, when the present FOMC came into existence, there have been various proposals for changes in the distribution of authority between the FOMC and the Board in the area of monetary and credit control. Some have urged that the FOMC be abolished and that regulation of open market operations be vested in the Board; others have suggested the transfer of the Board's authority over discount rates and reserve requirements to the Committee; and still others have suggested changes in the composition of the FOMC.

The purpose of this paper is to describe and analyze such proposals, with particular attention to arguments for and against them as expressed in Congressional hearings and in replies to Congressional questionnaires. Representative Wright Patman, presently chairman of the House Banking and Currency Committee, has repeatedly introduced bills to transfer regulation of open market operations from the FOMC to the Board of Governors. The Board, or members of the Board, may be called upon to testify or express views with respect to such bills. It is hoped that this paper may at least provide some assistance in the formulation of such views.

Before considering various proposals for changes in authority over open market operations, it is important to have in mind the exact nature of provisions of present law with respect to such operations and the manner in which the present FOMC has evolved over the years.

PRESENT LAW

The composition and powers of the FOMC are set forth in section 12A of the Federal Reserve Act. The full text of that section is as follows:[1/]

> "SECTION 12A. FEDERAL OPEN MARKET COMMITTEE
>
> "(a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'Committee'), which shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected as hereinafter provided. Such representatives shall be presidents or first vice presidents of Federal Reserve banks and, beginning with the election for the term commencing March 1, 1943, shall be elected annually as follows: One by the board of directors of the Federal Reserve Bank of New York, one by the boards of directors of the Federal Reserve Banks of Boston,

1/ 12 U.S.C. § 263.

Philadelphia, and Richmond, one by the boards of directors of the Federal Reserve Banks of Cleveland and Chicago, one by the boards of directors of the Federal Reserve Banks of Atlanta, Dallas, and St. Louis, and one by the boards of directors of the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco. In such elections each board of directors shall have one vote; and the details of such elections may be governed by regulations prescribed by the committee, which may be amended from time to time. An alternate to serve in the absence of each such representative shall likewise be a president or first vice president of a Federal Reserve bank and shall be elected annually in the same manner. The meetings of said Committee shall be held at Washington, District of Columbia, at least four times each year upon the call of the chairman of the Board of Governors of the Federal Reserve System or at the request of any three members of the Committee.

"(b) No Federal Reserve bank shall engage or decline to engage in open-market operations under section 14 of this Act except in accordance with the direction of and regulations adopted by the Committee. The Committee shall consider, adopt, and transmit to the several Federal Reserve banks, regulations relating to the open-market transactions of such banks.

"(c) The time, character, and volume of all purchases and sales of paper described in section 14 of this Act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country."

In layman's language and without regard for details, the FOMC consists of the seven members of the Board of Governors and five members elected annually by the boards of directors of the 12 Reserve Banks. One of the Reserve Bank "representatives" is always the president of the Federal Reserve Bank of New York; the other four Reserve Bank representatives are Reserve Bank presidents elected in rotation by three groups of three Reserve Banks and one group of two Reserve Banks. No Reserve Bank may engage or decline to engage in open market operations under section 14 of the Federal Reserve Act except in accordance with regulations and directions of the Committee.

The pertinent provisions of section 14 of the Act with respect to purchases and sales of securities by the Reserve Banks are the following:[2/]

"SECTION 14. OPEN-MARKET OPERATIONS

"Any Federal reserve bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

"Every Federal reserve bank shall have power:

"(a) To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold;

"(b) (1) To buy and sell, at home or abroad, bonds and notes of the United States, bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System: Provided, That, notwithstanding any other provision of this Act, (1) until July 1, 1970, any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities either in the open market or directly from or to the United States; but all such purchases and sales shall be made in accordance with the provisions of section 12A of this Act and the aggregate amount of such obligations acquired directly from the United States which

---

2/ 12 U.S.C. §§ 353-356, 359.

is held at any one time by the twelve Federal Reserve banks shall not exceed $5,000,000,000; and (2) after June 30, 1970, any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities but only in the open market. The Board of Governors of the Federal Reserve System shall include in their annual report to Congress detailed information with respect to direct purchases and sales from or to the United States under the provisions of the preceding proviso.

"(2) To buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States.

"(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined;

* * * * *

"(f) To purchase and sell in the open market, either from or to domestic banks, firms, corporations, or individuals, acceptances of Federal Intermediate Credit Banks and of National Agricultural Credit Corporations, whenever the Board of Governors of the Federal Reserve System shall declare that the public interest so requires."

Certain technical considerations regarding the respective powers of the FOMC and the Board of Governors under present law should be noted at this point.

In the first place, although the first paragraph of section 14, as quoted above, literally provides that open market transactions in cable transfers, bankers' acceptances, and bills of exchange shall be subject to rules and regulations of the Board of Governors, it is clear that the regulatory authority of the Board in this area was superseded by section 12A of the Act, as amended in 1935, since that section explicitly provides that no Reserve Bank shall engage or decline to engage in open market operations under section 14 except in accordance with the direction of and regulations adopted by the FOMC. Similarly, the reference to rules and regulations of the Board still contained in section 14(b)(1) must be regarded as no longer applicable to purchases of securities in the open market.

There is still outstanding a regulation of the Board of Governors - Regulation B - [3] that purports to govern "open market" purchases of bills of exchange, trade acceptances, and bankers' acceptances. This Regulation was originally issued during the early years of the System when open market operations were subject to regulation by the Board. Since the 1935 amendments to section 12A of the Act, however, it is clear that Regulation B is now beyond the statutory authority of the Board. Nevertheless, the regulations of the FOMC itself provide that only acceptances and bills of exchange of the kinds made eligible for purchase under the Board's Regulation B may be purchased in the open market. [4] Consequently, Regulation B may be regarded as having been adopted by the FOMC and thus as having present validity.

Secondly, it is necessary to consider what is meant by the term "open market", since the FOMC's authority is to regulate open market operations under section 14 of the Act. Although that section is headed "Open-Market Operations", some of the purchases and sales authorized by the section are not required to be made only in the open market, e.g., transactions in revenue bonds and warrants.

3/ 12 C.F.R. Part 202.

4/ 12 C.F.R. § 270.7(b).

In 1915, the Board defined open market operations as meaning "all those transactions authorized by section 14 of the Act which involve dealings with persons or institutions - whether or not members of the Federal Reserve System - and which do not require the indorsement of a member bank."5/ Under this definition, transactions in revenue bonds and warrants could be regarded as open market operations, even though engaged in directly with the issuers of such securities. Indeed, the first transaction by the New York Reserve Bank was a direct purchase of notes from the City of New York and yet that transaction was described as an "open market" operation.6/ Today, however, open market operations are regarded as meaning transactions as to which the price is determined by a free and competitive "open" market as distinguished from transactions negotiated directly with the issuer of securities. This concept was plainly reflected in a 1942 amendment to section 14 that authorized purchases of Government securities either in the open market or directly from the United States.7/

There is still outstanding a regulation of the Board - Regulation E - 8/ dealing with the purchase of warrants by the Reserve Banks. Under the concept of open market operations just stated, that Regulation applies to warrants purchased directly from the issuer. If they are purchased in the open market, however, their purchase is subject to the

---

5/ Reg. T, Series of 1915; 1916 BULLETIN 15.

6/ 1915 Annual Report 164.

7/ Act of Mar. 27, 1942 (56 Stat. 180).

8/ 12 C.F.R. Part 205.

jurisdiction of the FOMC. As a matter of fact, the regulations of the FOMC provide that the Reserve Banks may engage in "open market" transactions in revenue bonds and warrants only if they are of the kinds made eligible for purchase under the Board's Regulation E.[9/]

Finally, the proviso in section 14(b)(1) of the Act contains temporary authority for the purchase and sale of obligations issued or guaranteed by the United States either in the open market or directly from or to the United States. To the extent that such transactions are engaged in directly with the United States Treasury, they do not constitute "open market" operations. Nevertheless, the proviso itself makes all such transactions subject to the provisions of section 12A of the Act and in this respect, therefore, the FOMC has jurisdiction not only with respect to open market purchases of such securities but also with respect to direct transactions in such securities with the Treasury Department.

EVOLUTION OF THE FOMC

Original Federal Reserve Act

Federal Reserve open market operations, regulated and directed by the Federal Open Market Committee, are regarded today as the major instrument by which the Federal Reserve System provides or absorbs member bank reserves and thus exercises a potent influence either for credit expansion or credit contraction. This was not always the case. The framers of the original Federal Reserve Act enacted in December 1913

9/ 12 C.F.R. § 270.7(c).

apparently had no such concept of open market operations. They made no provision for an Open Market Committee. They empowered the Federal Reserve Banks to buy and sell cable transfers, bills of exchange, bankers' acceptances, revenue bonds of States and local political subdivisions, and bonds and notes of the United States; but the objectives they had in mind did not include general credit regulation.

Two of the stated objectives of the original Act were to support the effectiveness of Reserve Bank discount rates and to facilitate transactions in foreign exchange and regulation of gold movements. Thus, the Report of the House Banking and Currency Committee stated:[10/]

> "It will have been observed that the transactions authorized in section . . . [13 of the Act] were entirely of a nature originating with member banks and involving a rediscount operation. It is clearly necessary to extend the permitted transactions of the Federal reserve banks beyond this very narrow scope for two reasons:
>
> "1. The desirability of enabling Federal reserve banks to make their rate of discount effective in the general market at those times and under those conditions when rediscounts were slack and when therefore there might have been accumulation of funds in the reserve banks without any motive on the part of member banks to apply for rediscounts or perhaps with a strong motive on their part not to do so.
>
> "2. The desirability of opening an outlet through which the funds of Federal reserve banks might be profitably used at times when it was sought to facilitate transactions in foreign exchange or to regulate gold movements.
>
> "In order to attain these ends it is deemed wise to allow a reserve bank, first of all, to buy and sell from anyone whom it chooses the classes of bills which it is authorized to rediscount. . . . Apart from this fundamental permission, it was deemed wise to allow the banks to buy coin and bullion and borrow or loan thereon and to deal in Government bonds. . . ."

10/ Report of House Banking and Currency Committee, Rep. No. 69, 63d Cong., 1st Sess. (Sept. 9, 1913), pp. 52, 53.

During the debates in the Senate, Senator Nelson similarly referred to these objectives:[11/]

"Section . . . [14 of the Act] relates to what we call open-market operations. The purpose of this section . . . is to confer upon the reserve banks the authority to go into the open market and buy foreign and domestic exchange, gold coin and gold bullion, bonds of the United States and of any State, county, or municipality, and short-time obligations of foreign Governments, and so forth. I need not go into details in respect to the provisions of this section any more than to say that the purpose in giving this power to the reserve banks is to enable them by this means to regulate the rate of discount and the supply of gold, and it may, to some extent, accomplish this. It is sufficient to say that it is the purpose of this provision in the bill to enable the banks to control by this system what are called the discount rates; if rates get too high, to cut them down; and it may be necessary to use these discount rates for the purpose of controlling the gold supply."

A third objective of the open market provisions of the original Act was to enable the Reserve Banks to encourage the establishment of an "open market" for commercial bills and bankers' acceptances such as then existed in Europe but apparently had not developed to any great extent in the United States. With respect to this objective, the Report of the Owen section of the Senate Banking and Currency Committee stated:[12/]

"One of the most important features of this bill is the establishment of what is called an open market for bills of exchange and bankers' acceptances such as has long prevailed in Europe, but which has not existed to any great extent in the United States. In Europe the various banks and private bankers carry on a very large scale commercial bills of exchange and acceptances based on actual commercial transactions of short maturities and which are regarded as self-liquidating. Such bills have behind them actual merchandise for which a purchaser has been found and these bills are held in their portfolios as almost the exact equivalent of cash, for the reason that the security of such bills is regarded as substantially perfect,

11/ 51 CONG. REC. 524.

12/ Report of Senate Banking and Currency Committee, Rep. No. 133, Part 2, 63d Cong., 1st Sess. (Nov. 22, 1913), p. 26.

their uniform and certain payment constant, and therefore there is an 'open market' for such bills maintained by the great public banks, such as the Bank of France, the Reichsbank, the Bank of Belgium, the Bank of Netherlands, the Bank of England, etc., at a very low rate of interest.

"It is now proposed that a constant market at a fairly uniform rate of interest be established in this country by establishing the Federal reserve bank with a large capital and large reserves and with the express power to discount for member banks commercial bills and acceptances of the qualified liquid class, and also to buy and sell in the open market such bills and bankers' acceptances as have been found merchantable and liquid by the experience of European banking systems. It is anticipated that the effect of this method will be to encourage banking houses to buy commercial bills of the qualified class, and in this way that we may greatly enlarge the market for the bills of manufacturers, merchants, and business men who are handling the actual commerce of the country."

Finally, a secondary purpose of the open market provisions was to enable the Reserve Banks to invest their idle funds and generate earnings. Although this purpose was not specifically alluded to during the debates on the original Act, Carter Glass, who had been chairman of the House Banking and Currency Committee in 1913, referred to this purpose during the debates on the Banking Act of 1935. At that time, after stating that one reason for the open market authority was to "enforce the rediscount rate", he said:[13/]

". . . The other reason for the . . . [authority] was to enable the Federal Reserve bank to use its surplus funds in order to insure its overhead expenses, and that was all."

Regulation by the Board

From the enactment of the original Act until March 1, 1936, when the present FOMC came into existence, all purchases and sales of securities by the Reserve Banks, whether in the open market or not, were subject to

13/ 79 CONG. REC. 11778.

regulation by the Board.[14/] During virtually all of this period, however, such regulations as were issued by the Board related only to transactions in revenue bonds and warrants, bankers' acceptances, and bills of exchange.

The first Board regulation in this area, issued tentatively on December 22, 1914, dealt with the purchase of municipal obligations issued in anticipation of taxes, i.e., "warrants".[15/] On December 31, 1914, the New York Reserve Bank purchased directly from the Comptroller of the City of New York $5 million of that City's tax anticipation notes. Although a direct purchase rather than an open market transaction, this transaction was referred to as the New York Reserve Bank's first "open-market operation" under section 14 of the Act.[16/] The Board's regulation regarding the purchase of warrants was formally issued as Regulation F on January 26, 1915.[17/] In 1916, it was redesignated as Regulation E and, with amendments from time to time, this regulation is still in existence.

During 1915, the Board issued regulations regarding both the discounting and the open market purchase of bankers' acceptances by the Reserve Banks.[18/]

14/ The first paragraph of the section authorized open market transactions in cable transfers, bankers' acceptances, and bills of exchange, "under rules and regulations prescribed by the Federal Reserve Board." Subsection (b) of the section authorized transactions in bonds and notes of the United States and in municipal revenue bonds and warrants, whether or not in the open market, but purchases of such securities were required to "be made in accordance with rules and regulations prescribed by the Federal Reserve Board."

15/ 1915 Annual Report 164.

16/ Ibid.

17/ 1915 BULLETIN 40.

18/ 1915 BULLETIN 45, 310, 434.

With respect to open market transactions in bills of exchange, the Board in October 1915 indicated that such transactions for the time being would be left to the discretion of the Reserve Banks. The Board stated:[19/]

". . . the Federal Reserve Board recognizes that the Federal Reserve Banks have the right to engage in open-market operations in bills of exchange and that the decision whether the Federal Reserve Banks should engage in such open-market transactions rests entirely with them, severally, and not with the Federal Reserve Board. Should the transactions engaged in by any bank assume very large proportions or develop along lines which would make regulation appear desirable, the Federal Reserve Board will exercise its right at any time to regulate such transactions, but at present the Board deems it best to leave each Federal Reserve Bank free to exercise the authority granted under section 14, with respect to bills of exchange, without governing or restricting regulations, ..."

In December 1915, however, the Board issued a regulation with respect to "general open-market operations" that dealt not only with bills of exchange but also with transactions in cable transfers, foreign bills of exchange, and foreign acceptances.[20/]

In 1916, the Board issued its Regulation B covering open market operations in bills of exchange, trade acceptances, and bankers' acceptances.[21/] With amendments made in subsequent years, this Regulation continues in effect today, although, as heretofore noted, the authority for its issuance by the Board is now subject to question.

Regulation of open market operations in U. S. Government securities apparently was not considered necessary during the early years of the

19/ 1915 BULLETIN 360.

20/ Reg. T, Series of 1915; 1916 BULLETIN 15.

21/ 1916 BULLETIN 532.

System. On December 18, 1914, shortly after the Reserve Banks began operations, the Board authorized the Reserve Banks

> ". . . to purchase Government bonds within the limits of prudence, as they might see fit."22/

It was not until 1933, after the Federal Reserve Act was amended to prohibit the Reserve Banks from engaging in any open market operations except in accordance with regulations of the Board, that the Board finally issued a regulation dealing with open market transactions in Government securities. 23/

It is important to note that the Board's regulations with respect to open market operations prior to 1933 were concerned only with the "eligibility" of municipal warrants, bankers' acceptances, and bills of exchange for purchase by the Reserve Banks; the regulations were not considered as having any direct impact upon member bank reserves or as affecting credit conditions.

As has been noted, open market transactions in Government securities were not substantial during the early years of the System. As late as 1920, Reserve Bank holdings of Government obligations were smaller than their holdings of bankers' acceptances. 24/ Nevertheless, it developed that it was the purchase of Government securities by the Reserve Banks in 1921 and 1922 that led to measures for the regulation of such purchases and eventually to the establishment of the present Open Market Committee.

22/ 1914 Annual Report 16.

23/ Reg. M, Series of 1933; 1933 BULLETIN 502.

24/ See Monetary Policy and the Management of the Public Debt, Joint Committee Print of Joint Committee on the Economic Report, 82d Cong., 2d Sess. (Feb. 1952), p. 282. This document is cited hereafter as 1952 Patman Questionnaire.

The first "open market committee"

During the First World War, the needs for Government financing led to a rapid increase in borrowings by member banks from the Reserve Banks on the security of U. S. Government obligations. After the end of the war, a period of "liquidation" resulted in a sharp decline in such borrowings by member banks. As a consequence, the earnings of the Reserve Banks also declined; and this led to purchases of Government securities. As stated in the Board's Annual Report for 1923,

> ". . . Some of the reserve banks, in order to assure themselves of sufficient earnings to meet their expenses and their dividend requirements, began to purchase considerable amounts of short-term Treasury securities."25/

Such purchases in large volume, however, led to unanticipated problems. One of these was an increase in the earning assets of the interior Reserve Banks at the expense of the earnings of the New York Reserve Bank. The resulting situation has been explained as follows:26/

> ". . . The market for these securities is in New York. When an outlying Reserve bank bought securities through a broker in the New York market, the seller would deposit the proceeds in his bank, which would use them to reduce its indebtedness at the New York Reserve Bank. In this way the purchase of securities by an interior Reserve bank would permit it to increase its earning assets at the expense of the earning assets of the New York Reserve Bank."

In somewhat different language, this situation was described by Dr. E. A. Goldenweiser during hearings on the Banking Act of 1935:27/

25/ 1923 Annual Report 13.

26/ Karl R. Bopp, The Agencies of Federal Reserve Policy, in University of Missouri Studies, Vol. X, No. 4, Oct. 1, 1935, p. 58.

27/ Hearings before House Committee on Banking and Currency on Banking Act of 1935, 74th Cong., 1st Sess. (Feb., Mar., Apr. 1935), p. 438. These hearings are cited hereafter as House Hearings on Banking Act of 1935.

"After the early period and after the liquidation of 1920 and 1921, the Federal Reserve banks found themselves with a very small volume of earning assets. There was in the market a large amount of Government securities, and so, quite naturally, in 1922, the Federal Reserve banks began to buy Government securities for the purpose of having enough earning assets to meet their expenses. That did not last very many weeks before it began to cause difficulties for this reason: That the market for Government securities and all securities, essentially, is in New York. So that when the Federal Reserve Bank of Kansas City - I am using that as an example - would, for instance, want to buy $10,000,000 of securities in the New York market, what it would do would be to draw a check in favor of a New York broker, the New York broker would deposit the check in a New York bank, and the New York bank would then get that much more gold through the gold settlement fund, put it to its account at the New York Federal Reserve Bank, and this bank would use that balance to extinguish that much of its indebtedness.

"So that the consequence of the banks in the interior buying Government securities was to reduce the earning assets of the New York Federal Reserve Bank which was not, of course, particularly pleasing to the Federal Reserve Bank of New York, and which did not change the total earning assets of the Federal Reserve System. So that one bank would be increasing its holdings at the expense of another bank, and the aggregate earning assets would remain constant."

In addition to the effect of such substantial purchases of Government securities by the Reserve Banks upon the earnings of the New York Reserve Bank, it developed that they also created some disturbance in the Government bond market. As stated by Dr. Goldenweiser: [28/]

"Furthermore, these purchases by the banks, the uncoordinated 12 Federal Reserve banks, were creating considerable disturbance in the Government bond market, and Parker Gilbert, who was Under Secretary at that time, was disturbed about that. It was not long before it was decided that open-market operations must be coordinated."

As a means of achieving such coordination, the Conference of Reserve Bank Governors (corresponding to the presidents of the Reserve Banks today) at a meeting in May 1922 established a "Committee on

28/ Ibid.

Centralized Execution of Purchases and Sales of Government Securities". This Committee originally consisted of the governors of the Reserve Banks of Boston, New York, Philadelphia, and Chicago. In October 1922, the governor of the Cleveland Reserve Bank was added to the Committee.29/ The purpose of this Committee was simply to execute decisions made by the individual Reserve Banks on their own initiative in a manner designed to avoid the disrupting effects of large competitive orders on the Government securities market.30/ However, in October of 1922, the Committee was asked to make recommendations to the Reserve Banks from time to time with respect to purchases and sales of Government securities, although such recommendations were not regarded as binding upon the Reserve Banks.31/

Federal Open Market Investment Committee

On March 22, 1923, the Federal Reserve Board, presumably acting under its statutory authority to regulate open market operations but without issuing any formal regulation, adopted a resolution setting up a Federal Open Market Investment Committee as a means of bringing about better coordination of open market operations with the discount operations of the Reserve Banks and their general credit policy.32/

29/ See 1952 Patman Questionnaire, p. 282.

30/ Ibid.

31/ Ibid. See also Bopp, supra note 26, at 59.

32/ 1923 Annual Report 15. See also 1952 Patman Questionnaire, p. 282.

The Board's resolution setting up the new Committee read as follows:[33]

"That the time, manner, character and volume of open market investments purchased by Federal reserve banks be governed with primary regard to the accommodation of commerce and business, and to the effect of such purchases or sales on the general credit situation.

"That in making the selection of open market purchases, careful regard be always given to the bearing of purchases of United States Government securities, especially the short-dated issues, upon the market for such securities, and that open market purchases be primarily commercial investments, except that Treasury certificates be dealt in, as at present, under so-called 'repurchase' agreement.

"In order to provide for the proper administration of the policy defined above, the board rules that on and after April 1, 1923, the present committee of governors on centralized execution of purchases and sales of Government securities be discontinued, and be superseded by a new committee known as the open market investment committee for the Federal reserve system, said committee to consist of five representatives from the Federal reserve banks and to be under the general supervision of the Federal Reserve Board; and that it be the duty of this committee to devise and recommend plans for the purchase, sale and distribution of the open market purchases of the Federal reserve banks in accordance with the above principles and such regulations as may from time to time be laid down by the Federal Reserve Board."

It is of interest to note here that the language used in the first paragraph of the Board's resolution was the precursor of language incorporated in section 12A of the Federal Reserve Act in 1933.

The five members of the new Committee were the same five governors of the Reserve Banks who had constituted the earlier Open Market Committee. The principal difference was that the new Committee was expressly created

33/ As quoted by Governor Benjamin Strong of the Federal Reserve Bank of New York at Hearings before House Banking and Currency Committee on H.R. 7895, 69th Cong., 1st Sess. (1926), p. 311.

by the Board itself and was made subject to the Board's supervision. Recommendations of the Committee were required to be submitted to the Board for its approval and these recommendations usually were followed by all of the Reserve Banks; but the Reserve Banks nevertheless retained the right to decide whether or not to follow the Committee's recommendations.[34/]

The Board's 1923 Annual Report to Congress contained one of the first explicit recognitions of the important impact of open market operations upon credit conditions. Among other things, it pointed out that open market operations were undertaken at the initiative of the Reserve Banks in contrast to discount operations at the initiative of member banks. The Annual Report stated:[35/]

> "The part that open-market operations may play in general credit policy is influenced by the fact that changes in the volume of securities held by the reserve banks have an effect on the volume of their discounts for member banks. The purchase of securities in the open market by a Federal reserve bank places funds in the hands of member banks which these banks may use in the repayment of borrowings from the reserve banks; the sale of securities, on the other hand, by withdrawing funds from the market may lead to additional borrowing from the reserve banks. The difference between discount operations and open-market operations is that the initiative in rediscounting lies with the member banks, while in the purchase and sale of securities the initiative may be taken by the reserve banks. The extent to which member banks borrow in order to replace the funds withdrawn by the reserve banks through the sale of securities is a measure of the demand for reserve bank credit. The sale of securities by a reserve bank may thus serve as a test of the degree of adjustment between the demand for reserve bank credit and the outstanding volume of such credit."

34/ 1952 Patman Questionnaire, p. 202.

35/ 1923 Annual Report 13, 14.

Referring to the newly established Open Market Investment Committee, the Annual Report observed:[36]

> ". . . This committee is now the agency through which transactions in furtherance of the system's open-market credit policy are carried out. In view of the influence which the open-market operations of any reserve bank in the general money market may have on the credit situation, the board regarded it as essential that the purchases and sales of securities by reserve banks should be made with primary regard to their broader consequences and in accordance with the credit policy of the system. . . ."

Later in 1923, there was established a "System open market account" in which participations in open market operations were allocated among the Reserve Banks.[37] One of the effects of this formalization of procedures was to establish the principle that open market operations were not to be conducted for the purpose of increasing Reserve Bank earnings. Any earnings that accrued from joint System operations thereafter were made available to the various Reserve Banks in accordance with their participations in the open market account.

Open Market Policy Conference

The Committee established in 1923 apparently gave rise to some problems. For one thing, it appears that some of the Reserve Banks not represented on the Committee were not entirely satisfied with all of the Committee's decisions. Moreover, it is likely that some of the Reserve Banks resented the predominating influence of the governor of the New York Reserve Bank.[38]

36/ *Id.*, at 15.

37/ *1952 Patman Questionnaire*, p. 282.

38/ See Bopp, *supra* note 26, at 60, 61.

On March 25, 1930, the Open Market Investment Committee was replaced by a new committee called the Open Market Policy Conference consisting of a representative from each of the 12 Reserve Banks. The new "Conference" in turn appointed an Executive Committee of five Reserve Bank representatives. The Board was authorized to call meetings of the Conference and to participate in its discussions. Each Reserve Bank, however, "retained as a formal matter the right to decide whether or not it would participate in transactions."[39/]

The Open Market Policy Conference functioned until 1933, when it was replaced by a statutory Federal Open Market Committee.

Banking Act of 1933

When the first Glass-Steagall bill[40/] was under consideration in 1932, the Federal Reserve Board opposed provisions of the bill that would have given statutory recognition to the existing Open Market Policy Conference. That bill would have created an open market committee consisting of the governor (corresponding to the present chairman) of the Federal Reserve Board and 12 additional members elected annually from among the officers of the several Federal Reserve Banks. In a letter to the chairman of the Senate Banking and Currency Committee dated March 29, 1932, Reserve Board Chairman Eugene Meyer wrote:[41/]

> "With respect to the section of the bill dealing with open-market operations, the board calls attention to the fact that there

39/ 1952 Patman Questionnaire, p. 203.

40/ S. 4115, 72d Cong., 1st Sess.

41/ Hearings before Senate Banking and Currency Committee on S. 4115, 72d Cong., 1st Sess. (Mar. 23-25, 1932), p. 403.

is already in existence an open-market committee on which each of the Federal reserve banks has representation. This has come about as the result of natural development. The board believes that it would be inadvisable to disturb this development by crystallizing into law any particular procedure. The board believes that nothing further is necessary or advisable at this time than an amendment clarifying its power of supervision over open-market operations of the Federal reserve banks and their relationships with foreign banks, as set out in the memorandum attached."

Both the Senate and House Banking and Currency Committees, however, ignored the Board's opposition and reported bills that would have added a new section 12A to the Federal Reserve Act providing for a Federal open market committee with authority to supervise the open market operations of the Reserve Banks and their relationships with foreign banks, but only in accordance with regulations to be prescribed by the Federal Reserve Board. Unlike the bill as introduced, the reported bills provided for a committee consisting only of 12 Reserve Bank representatives, without membership of the governor of the Board.

The Senate Committee's Report stated that this section of the bill would provide

". . . for the creation of a Federal open-market committee of 12 members to supervise the open market operations of the Federal Reserve banks and the relations of the Federal Reserve System with foreign banks, in accordance with regulations adopted by the Federal Reserve Board. This in effect legalizes and gives official recognition to the present open-market committee."[42]

The bill was reintroduced in the next Congress[43] and, in explaining the provision for an open market committee, the House Banking and Currency

42/ Report of Senate Banking and Currency Committee on S. 4412, Rep. No. 584, 72d Cong., 1st Sess. (Apr. 22, 1932), p. 14.

43/ H.R. 5661, 73d Cong., 1st Sess.

Committee merely quoted the above language from the Senate Committee's Report on the corresponding provision of the 1932 bill.[44/]

During the debates on the floor of the House, Chairman Steagall of the Banking and Currency Committee conceded that the proposed committee would simply give statutory recognition to the existing informal committee (i.e., the Open Market Policy Conference), but he explained that under the new law the Federal Reserve Board would have the responsibility of restricting open market operations by the Reserve Banks. Referring to the bill's provision regarding the committee, Mr. Steagall said:[45/]

> "Mr. Steagall. It has been worked out with the utmost care, and the purpose of the section is that the Federal Reserve Board shall have control of the open-market operations of Federal Reserve banks. This section makes it the duty of the Federal Reserve Board to regulate such transactions and restrict them in order to protect the people of the United States against the unauthorized use of credits by the Federal Reserve System.
>
> "Mr. McFadden. Will the gentleman yield?
>
> "Mr. Steagall. I yield.
>
> "Mr. McFadden. The gentleman knows that this open market is no new proposition.
>
> "Mr. Steagall. That is true; but this section places on the Board the duty and responsibility of restricting such operations and to no longer permit the banks to exercise free and unbridled power in the extension of such credits."

As enacted by the Banking Act of 1933,[46/] section 12A read as follows:

44/ Report of House Banking and Currency Committee on H.R. 5661, Rep. No. 150, 73d Cong., 1st Sess. (May 19, 1933), p. 2.

45/ 77 CONG. REC. 3932.

46/ Act of June 16, 1933 (48 Stat. 168).

"(a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'committee'), which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select one member of said committee. The meetings of said committee shall be held at Washington, District of Columbia, at least four times each year, upon the call of the governor of the Federal Reserve Board or at the request of any three members of the committee, and, in the discretion of the Board, may be attended by the members of the Board.

"(b) No Federal reserve bank shall engage in open-market operations under section 14 of this Act except in accordance with regulations adopted by the Federal Reserve Board. The Board shall consider, adopt, and transmit to the committee and to the several Federal reserve banks regulations relating to the open-market transactions of such banks and the relations of the Federal Reserve System with foreign central or other foreign banks.

"(c) The time, character, and volume of all purchases and sales of paper described in section 14 of this Act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

"(d) If any Federal reserve bank shall decide not to participate in open-market operations recommended and approved as provided in paragraph (b) hereof, it shall file with the chairman of the committee within thirty days a notice of its decision, and transmit a copy thereof to the Federal Reserve Board."

It is important to note that, while the Reserve Banks were prohibited from <u>engaging</u> in open market operations except in accordance with regulations of the Board, any Reserve Bank could <u>decline to participate</u> in such operations recommended by the Board simply by filing with the chairman of the Committee a notice of such decision within 30 days and by transmitting a copy of the notice to the Federal Reserve Board. It should also be noted that, although the 1933 law provided for the composition of the Committee and for the holding of meetings, it did not specifically indicate what functions were to be performed by the Committee. Apparently, the law was interpreted as authorizing the Committee to initiate policy recommendations with respect to open market operations but as authorizing the Board itself to make final decisions.

Banking Act of 1935

The major defect of the 1933 law was diffusion of responsibility between the Open Market Committee, the Federal Reserve Board, and the directors of the 12 Reserve Banks. This defect was described by Reserve Board Governor Marriner S. Eccles during House hearings on the bill that later became the Banking Act of 1935. He pointed out that, while the Committee could initiate open market policies, they could not be effectuated without the approval of the Board, and that, even if the Board approved them, the directors of the several Reserve Banks could refuse to implement them. In this connection, he said:[47/]

> "Under existing law open-market operations must be initiated by a committee consisting of representatives of the 12 Federal Reserve banks, that is, by persons representing primarily local interests. They must be submitted for approval or disapproval to the Federal Reserve Board, and after they have been approved by the Federal Reserve Board, the boards of directors of the Federal Reserve banks have the power to decide whether or not they wish to participate in the operations. We have, therefore, on this vital matter a set-up by which the body which initiates the policies is not in a position to ratify them; and the body which ratifies them is not in a position to initiate them or to insist on their being carried out after they are ratified; and still a third group has the power to nullify policies that have been initiated and ratified by the other two bodies. In this matter, therefore, which requires prompt and immediate action and the responsibility for which should be centralized so as to be inescapable, the existing law requires the participation of 12 governors, 8 members of the Federal Reserve Board, and 108 directors scattered all over the country before a policy can be put into operation.

47/ House Hearings on Banking Act of 1935, pp. 181, 182.

"It requires no further explanation to show that the existing machinery is better adapted to delay and obstruction than it is to effective operation, and that it results in a diffusion of responsibility which prevents the necessary feeling of complete authority and responsibility by a small group of men who can be held accountable by the Congress and the Nation for the conduct of this matter that is of national importance."

As introduced, the bill then before Congress would have vested control of Reserve Bank open market operations in a Committee consisting of three members of the Federal Reserve Board and two of the 12 Reserve Bank "governors". While Eccles conceded that this arrangement would centralize responsibility, he opposed it on the grounds that potentially it could give the Reserve Banks control of monetary policy and result in conflicts between the Committee and the Board. He said: 48/

"The proposal in the bill is to set up a committee of 5, 3 of whom shall be members of the Federal Reserve Board and 2 governors of Federal Reserve banks. This proposal would have the advantage of creating a small committee with undivided responsibility. It is not clear, however, that this arrangement is the best that can be devised for the desired purpose. The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of monetary policies, would under this proposal have to delegate its principal function to a committee, on which members of the Board would have a bare majority, while the governors of the banks would have 2 out of 5 members.

"From the point of view of the Board the disadvantages of this arrangement are that a minority of the Board could adopt a policy that would be opposed to one favored by the majority. It would even be possible for one member of the Board by joining with the two governors to adopt a policy that would be objectionable to the seven other members of the Board."

As an alternative, Eccles suggested that regulation of open market operations be vested in the Board, but with a requirement that the Board be required to consult an "advisory" committee of five Reserve

48/ Id., at 182.

Bank governors before adopting any policies with respect to such operations or with respect to discount rates or changes in member bank reserve requirements. Specifically, he urged: 49/

"Upon further study it would appear that the best way in which to handle this proposal would be to place the responsibility for open-market operations in the Federal Reserve Board as a whole and to provide for a committee of five governors of Federal Reserve banks to advise with the Board in this matter. The Board should be required to obtain the views of this committee of governors before adopting a policy for open-market operations, discount rates, or changes in reserve requirements.

"Such an arrangement would result in the power to initiate open-market operations by either a committee of the governors or by the Board, but would place the ultimate responsibility upon the Federal Reserve Board, which is created for that purpose. In this connection I should like to quote President Woodrow Wilson, who in his address to the joint session of Congress on June 23, 1913, said:

"The control of the system of banking and of issue * * * must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative."

Representative Hollister, who favored the bill as introduced, argued that under the bill the Board in fact would have indirect control over open market operations because selection of the governors of the Reserve Banks (whom the bill would call presidents) would be subject to approval by the Board: 50/

"Mr. Hollister. I want to bring out the change in control this bill will make, so I will take up for a few minutes section 205, which provides for the open-market committee, a committee of five, which is to be appointed and will consist, first, of the Governor of the Federal Reserve Board, who, in turn, serves at the pleasure of the President; next, two members of the Federal Reserve Board; and, next, two governors of the Federal Reserve banks, who, in turn, if the provisions of

49/ Id., at 183.

50/ Id., at 366, 367.

this bill should become effective, may fail of approval by the Federal Reserve Board at the end of a year, in the event, we will say, that they are unwilling to go along with what the Federal Reserve Board desires. That, of course, places the open-market committee and its operations entirely in the control of the Federal Reserve Board, does it not?

"Governor Eccles. You are discussing the provisions of the bill with reference to the operation of the open-market committee, as provided in the bill.

"In my opening statement, if you will recall, I stated that that provision of the legislation was not satisfactory, and that open-market operations should be placed with the same body that had the authority to fix discount rates and reserve requirements; that they were three functions of monetary control that should be together, in the same body, and that I felt that the Federal Reserve Board was the body charged with the public interest; and that it should, therefore, have that power and authority, subject, however, to securing the advice of a committee of 5 governors selected by the 12 banks. I made that suggestion in my opening statement. I suggested that, rather than having an indirect way of putting the Federal Reserve Board in complete control.

"Mr. Hollister. Your theory is that it might just as well take the whole thing right over and have no control whatever by the regional banks?

"Governor Eccles. I feel that the authority over open-market policy must be placed in a body that is charged with the responsibility that the present legislation gives to the governors, who are not even directors of the banks, the right to make open-market policies. The Board approves or disapproves of the policy, and then the 12 banks can either participate in the adopted program or they can refuse to do so, so that you have -

"Mr. Hollister (interposing). You say all of the 12 banks or each of them?

"Governor Eccles. Each or any.

"Mr. Hollister. And any of them might nullify what the others did.

"Governor Eccles. And what this proposed legislation is doing is putting the responsibility and the authority for open-market policy, discount rates, and reserve requirements, which are three instruments of monetary control, in the Federal Reserve Board."

Dr. E. A. Goldenweiser, head of the Board's Division of Research, supported the Eccles proposal. He argued that prior to 1933 the Board had at least implied authority to direct open market operations of the Reserve Banks just as it had final authority with respect to discount rates; that the 1933 amendment had limited the Board's authority by expressly permitting a Reserve Bank to refuse to participate in open market operations approved by the Board; and that the Eccles proposal would merely restore the situation that had existed prior to 1933. He felt that the proposal contained in the bill for a committee on which two of the presidents would serve as members would give the Reserve Banks more power than they had had before, contrary to the intent of the legislation to give more power to the Board. In this connection, he said:[51/]

> "I suggest that, if you modify that and give actual voting power to the representatives of the Federal Reserve banks in the committee that is going to determine the open-market policy, in my opinion, you will not be restricting new, additional powers requested by the Board, but would be giving the regional banks more power in this matter than they have had since the establishment of the System; because, even under the existing law, the committee cannot move without the approval of the Board.
>
> "If the committee makes a recommendation and the Board disapproves it, they cannot carry it out, and the Governors have no vote on the Board in passing on these recommendations of the committee. So that, as a matter of fact, the committee that is actually proposed in this bill, which the Governor has suggested to modify, would give the Governors of the Federal Reserve banks more power in the determination of open-market policies than they have ever had. Rather than the Board getting more power by this proposal that is now before you, the proposal that is now before you would only clarify and make perfectly plain and clear the power which probably existed in the Federal Reserve Act prior to the Banking Act of 1933. Whereas a committee in which the governors participated in voting, would give them more power than they have ever had before."

51/ Id., at 436, 437.

The House Committee was persuaded by the Eccles-Goldenweiser arguments. The Committee endorsed a new bill [52/] that would have given control of open market operations to the Board after consultation with an "advisory" committee of five Reserve Bank governors. The House Committee's Report closely followed the Eccles proposal. After pointing out the defects in the 1933 law, the Committee argued that responsibility for all monetary policy should be placed "squarely upon the Federal Reserve Board", an agency with a "national viewpoint" and whose members were appointed by the President. The Committee's Report stated: [53/]

> "Section 205 of the bill amends section 12A of the Federal Reserve Act so as to provide for an Open Market Advisory Committee consisting of 5 representatives of the Federal Reserve banks elected annually by the governors of the 12 Federal Reserve banks. It will be the duty of the committee to consult and advise with, and make recommendations to, the Federal Reserve Board from time to time with regard to the open-market policy of the Federal Reserve System and to aid in the execution of open-market policies. The Federal Reserve Board will be required to consult the committee before making any changes in the open-market policy, discount rates of Federal Reserve banks, or in the reserves required of member banks. After consulting with and considering the recommendations of the committee, however, the Federal Reserve Board will be empowered to prescribe the open-market policy of the Federal Reserve System, and this policy will be binding on all Federal Reserve Banks.
>
> "Having enlarged the duties of the Federal Reserve Board with regard to the economic objectives of monetary action and credit administration, it is essential that the Board be given the same definite responsibility and final authority with respect to the open-market policies of the Federal Reserve System as it already possesses with respect to the discount rates of the Federal Reserve banks and the reserves required of member banks.

52/ H.R. 7617, 74th Cong., 1st Sess.

53/ Report of House Banking and Currency Committee on H.R. 7617, 74th Cong., 1st Sess., Rep. No. 742 (Apr. 19, 1935), pp. 9, 10.

"Under the present law, open-market policies are formulated by the Federal Open Market Committee, which consists of the governors of the 12 Federal Reserve banks. The recommendations of the committee are subject to the approval of the Federal Reserve Board, and the boards of directors of each Federal Reserve bank retain the authority to refuse participation in the policy adopted. We have, therefore, an arrangement by which there is a policy-making body of 12, which has power to formulate policies, but not to put them into effect. We have the Federal Reserve Board, consisting of 8 members, who have the authority to approve or disapprove of the recommendations of the committee; and we have 108 directors of the Reserve banks, who have the final determination as to whether the policy is to be carried out or not. It would be difficult to conceive of an arrangement better calculated than this for diffusing responsibility and creating an elaborate system of obstructions.

"The amendment will cure this situation by placing responsibility for national monetary and credit policies squarely upon the Federal Reserve Board. It will eliminate conflicts of jurisdiction and policy because the final decision as to all matters affecting national policies would be vested in the Federal Reserve Board. The participation of Federal Reserve bank governors in the deliberations leading to the adoption of open-market policies will be preserved. Open-market operations may be initiated either by the committee of the governors or by the Board, but the ultimate responsibility for making a final decision and the power for adopting and carrying out national policies will be concentrated in a national body, as they properly should be in the public interest.

"The Federal Reserve Board is appointed by the President and confirmed by the Senate. It has a national viewpoint and has long been accustomed to considering matters as they affect the country as a whole, without regard to the special interests of any particular group or locality. It was created for the purpose of supervising and coordinating the activities of the 12 Federal Reserve banks 'in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole' (report of the Banking and Currency Committee of the House of Representatives on the original Federal Reserve Act, Rept. No. 69, 63d Cong., 1st Sess., p. 16). It is for this reason that the original Federal Reserve Act gave the Federal Reserve Board final authority over discount rates. Since open-market operations have in more recent years come to be recognized as a much greater factor in credit policy than discount rates, it is entirely consistent with the philosophy of the original Federal Reserve Act to vest in the Federal Reserve Board final authority with respect to the open-market policies of the Federal Reserve System."

On the floor of the House, Chairman Steagall of the House Committee similarly argued that control of open market operations should be vested in the Board so that it would not be possible for one Reserve Bank to nullify policies adopted by the Board. He said:[54]

> "The purpose of the provision in the pending bill is to fix this responsibility definitely and to place it in the hands of the Federal Reserve Board, who are the servants of the people of the United States.
>
> "Under existing law there is no power to compel any bank to follow any policy, even though it may be approved by 11 Federal Reserve banks and the Federal Reserve Board.
>
> "As the law is now, it is within the power of 1 bank to nullify any policy adopted by the other 11 banks and the Federal Reserve Board.
>
> "It is a question of whether we shall have policies that affect the welfare of the Nation as a whole determined by the Federal Reserve Board, representing the people of the United States, or a confused authority resting partly in the hands of the bankers and partly in the Federal Reserve Board, without the power to put it in execution, and leave it in the power of 1 Federal Reserve bank to nullify the action of the Federal Reserve Board and 11 other Federal Reserve banks."

Representative Hancock likewise, after deploring the diffusion of responsibility under the 1933 law, felt that control of open market operations, as well as discount rates and reserve requirements, should be concentrated in the Board:[55]

> "It requires no further explanation to show that the existing machinery is better adapted to delay and obstruction than it is to effective operation, and that it results in a diffusion of responsibility which prevents the necessary feeling of complete authority and responsibility by a small group of men who can be held accountable by the Congress and the Nation for the conduct of this matter

---

54/ 79 CONG. REC. 7183.

55/ *Id.*, at 6738.

that is of national importance. The proposal in the bill is to constitute the Federal Reserve Board as the open-market committee with explicit direction in the form of a mandate as to its objectives in the exercise of this tremendous power. This proposal would have the advantage of creating a committee or authority with undivided responsibility. The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of monetary policies, would under this proposal be solely responsible in the execution of the will of Congress from whom such power is derived. Through exercise of this power depends to a large degree the country's economic, business, and social welfare. It is the first control in the sale and purchase of money which is the dynamo of commerce, industry, and agriculture.

"The placing of this authority in such a committee would also have the advantage of giving this important power to the Board which has under existing law the power of the rediscount rate and fixing the amount of reserves. These constitute the three levers of monetary control.

"Under the bill, however, there is a provision for a committee of five governors of Federal Reserve banks to advise with the Board in this matter. The Board will be required to obtain the views of this committee of governors before adopting a policy for open-market operations, discount rates, or changes in reserve requirements."

There were other members of the House, however, who believed that the Eccles proposal would give the Federal Reserve Board too much power over the Reserve Banks and that the Treasury (and the current political Administration) could therefore use the Federal Reserve to support the market for Government obligations. Thus, Representative Hollister declared:[56]

"One of the chief objections to this bill is through the open-market provisions by which the Federal Reserve Board is given power to compel Federal Reserve banks to enter into open-market operations on the buying side. When that is once passed, then we have put into the control of the Federal Reserve Board a most dangerous instrument. We have reached the point then where, if sufficient Treasury control is exercised on the Federal Reserve Board, the Federal Reserve Board

56/ *Id.*, at 6569.

in turn may compel the Federal Reserve banks of the country, which, of course, have the reserves and the excess reserves of the various member banks in their vaults, to keep on buying and buying and buying Government obligations, even though all wise bankers and all careful economists would have served notice long before that the Government might not continue to issue obligations of the nature they are compelling the banks to acquire."

Similarly, Mr. Wigglesworth declared: 57/

"What does title II provide in its present form? It increases the authority of the President over the Federal Reserve Board. It increases the authority of the Federal Reserve Board over the Federal Reserve banks. It provides for open-market operations, under the direction of the Federal Reserve Board mandatory insofar as the Federal Reserve banks are concerned. The net effect, as I see it, is to place the executive branch of the Government in a position to compel the Reserve banks to support the market for Government obligations, to compel the purchase of Government obligations or obligations guaranteed by the Government to the full extent of available resources. The danger is self-evident. It needs no emphasis in the light of the enormous deficits which we have been incurring each year, and which it appears likely we are to continue to incur for a number of years to come."

In the Senate, Chairman Eccles repeated his arguments for vesting control of open market operations in the Board. 58/ This time, however, he did not prevail. The Senate Committee reported a bill giving such control to a Committee consisting of the seven members of the Board and five representatives of the Reserve Banks - four to be elected by four groups of three Reserve Banks each and one to be chosen from the country at large. 59/

On the floor of the Senate, Chairman Carter Glass of the Senate Committee indicated that he had felt that there was no need to change the existing arrangement and that, if a change were made, the Reserve Banks

57/ Id., at 6964.

58/ Hearings before Senate Banking and Currency Committee on Banking Act of 1935, 74th Cong., 1st Sess., p. 314.

59/ Report of Senate Banking and Currency Committee on H.R. 7617, Rep. No. 1007, 74th Cong., 1st Sess. (May 13, 1935), p. 12.

rather than the Board should have a majority on the FOMC. Nevertheless, he defended the reported bill as a compromise:[60/]

"Some of us thought it was perfect folly to undertake to interfere with the existing arrangement. Were amazed to have it proposed that the Federal Reserve Board alone should constitute the open-market committee of the system. Let us consider that for a moment.

"Here is a board originally established and now operating as the central supervising power. The Government of the United States has never contributed a dollar to one of the Reserve banks; yet it is proposed to have the Federal Reserve Board, having not a dollar of pecuniary interest in the Reserve funds or the deposits of the Federal Reserve banks or of the member banks, to constitute the open-market committee and to make such disposition of the reserve funds of the country, and in large measure the deposits of the member banks of the country, as they may please, and without one whit of expert knowledge of the transactions which it was proposed to commit to them.

"As I have said, in order to produce a bill, in order to harmonize radical differences, concessions, even yielding of convictions, had to be made; so it was finally determined to constitute the open-market committee of the 7 members of the Federal Reserve Board and 5 representatives of the Federal Reserve banks. The Federal Reserve banks, which are the trustees of the reserve funds of all the member banks of the country, are graciously given this minority representation upon the open-market committee.

"Some of us were opposed to any alteration of the existing arrangement. Others thought that the representatives of the banks, whose money is to be used, whose credit is to be put in jeopardy, should have control of the committee and should have the majority representation. But in order to reconcile bitter differences there was yielding, and we have now proposed an open-market committee composed of all 7 members of the Federal Reserve Board and 5 representatives of the regional reserve banks.

* * * * *

"At any rate, some of us, without changing our convictions, yielded to those who desired to constitute this committee as we have constituted it--7 members of the Federal Reserve Board and 5 representatives of the banks. As a matter of fact, there never has been a time since the adoption of the open-market provision of the Federal Reserve Act when the Federal Reserve Board had not

60/ 79 CONG. REC. 11778, 11779.

> largely control of the matter; and I wish to call the attention of the Senate to this fact, too, which seems to have been ignored by persons who have been trying to seize all of this power, and to strip every Federal Reserve bank of local self-government--the fact that there is but one reservation in the existing law that any Federal Reserve bank had. They have to operate, if at all, under rules and regulations to be adopted by the Federal Reserve Board, and their only reservation is that any Federal Reserve bank desiring not to participate in an open-market operation may refuse to do so upon 30 days' written notice to the open-market committee."

Other senators, like LaFollette,[61/] opposed the Senate bill, but it passed the Senate with an FOMC of the kind proposed by the Senate Committee.

The Conference Committee followed the Senate proposal, but it eliminated the suggested representative-at-large. Instead, it agreed that the five representatives of the Reserve Banks should be elected by three groups of two Reserve Banks and two groups of three Reserve Banks, i.e., Boston and New York; Philadelphia and Cleveland; Chicago and St. Louis; Richmond, Atlanta, and Dallas; and Kansas City, Minneapolis, and San Francisco.[62/]

Just as Glass had apologized for the Senate "compromise", Chairman Steagall of the House Committee felt obliged to defend the Conference bill on the floor of the House. Noting that the House bill would have given sole control of open market operations to the Board (the Eccles proposal), he pointed out that, after all, the Reserve Bank representatives on the FOMC, the Reserve Bank presidents, would be appointed subject to the Board's approval and that the members of the

---

61/ Id., at 11914.

62/ House Report No. 1822, 74th Cong., 1st Sess. (Aug. 17, 1935), p. 50.

Board would have a majority of two on the Committee. He said:[63]

"Under the House bill a provision was incorporated setting up an open-market committee to direct and control the activities of the System in its open-market operations. Under the House plan the Federal Reserve Board, as constituted, would be given sole power to control open-market operations. Under the bill as reported by the conference committee, an open-market committee will be created, composed of the 7 members of the Federal Reserve Board, plus 5 representatives of the Federal Reserve banks to be selected by the banks.

"It will be remembered that the presidents of the Federal Reserve banks under the bill passed by the House and under the bill reported by the committee are to be approved by the Federal Reserve Board. Five members representing the banks will be added to the Federal Reserve Board to constitute the open-market committee.

"This means that we have fought out in this House, in the Senate, and in the conference the question of Government control of open-market operations, the rediscount rates, and the reserve requirements of the Federal Reserve banks, and as a result of this controversy we have a bill which writes into the law a safeguard that insures the investment of these powers in a Government-controlled board.

"The vote would be 7 to 5 if we assume that the 5 members representing the banks would go contrary to the 7 members representing all the people of the country or the public at large. The Senate bill had in it a provision requiring the appointment of 2 members of the 7 constituting the Federal Reserve Board to be experienced bankers. This provision was stricken out in conference.

"So we have written into this law the principle that the Government, the sovereign people of the United States, shall have control of the Board that dictates the vast powers of the Federal Reserve System.

"Something has been said about what was done in conference being a departure from the wishes of the House as expressed in the vote of the House on the bill. Let me say to the Members of the House that the open-market committee provided in the bill reported by the conference committee goes further in insuring Government control of the operations of the Federal Reserve System than the original bill that was submitted to the committees of the House and Senate by the present Governor of the Federal Reserve Board and by the administration.

63/ 79 CONG. REC. 13705, 13706.

"The bill submitted by the administration to the House and the Senate and introduced by the Chairman of the Committee on Banking and Currency in the Senate and the Chairman of the Committee on Banking and Currency in the House, proposed an open-market committee composed of 5 members, 3 of whom were to be members of the Federal Reserve Board and 2 of whom were to be governors of Federal Reserve banks, elected by the governors of the 12 Federal Reserve banks.

"Under the plan first proposed to the House, the Government would have had a majority of only one on the open-market committee, whereas under the bill embodied in the conference report the board will stand 5 to 7, giving the people of the country, as contra-distinguished from private banking interests, control by a vote of 7 to 5 instead of by a vote of 3 to 2--a majority of 2 rather than a majority of 1 on the open-market committee."

Representative Goldsborough, also a member of the Conference Committee, likewise defended the Conference agreement on the ground that the Board would have control. He observed that the seven Board members would be a cohesive body in Washington while the five Reserve Bank representatives would be "scattered all over the United States" and would not constitute a majority of the FOMC.[64/]

As amended by the Banking Act of 1935,[65/] the composition and powers of the FOMC created by the 1933 Act were completely changed. Under the 1933 Act, the Committee had consisted of one representative from each Reserve Bank; the Committee had power only to initiate and recommend policies; the final determination of policies rested with the Board; and, while a Reserve Bank could engage in open market operations only in accordance with regulations of the Board, it was free at any time to decline to engage in operations approved by the Board. The 1935 Act reorganized the Committee

64/ *Id.*, at 13710.

65/ Act of Aug. 23, 1935 (49 Stat. 705).

to include the seven members of the Board and only five representatives of the Reserve Banks; but the new Committee was given decisional instead of only advisory functions - decisional powers previously vested in the Board alone. Moreover, and most important, a Reserve Bank could neither engage nor decline to engage in open market operations except in accordance with "the direction of and regulations adopted by the Committee." For the first time, the individual Reserve Banks were deprived of all discretion with respect to open market operations.

As a matter of incidental interest, it may be noted that the 1935 revision of section 12A of the Act omitted the reference in the 1933 Act to regulation of the relations of the Federal Reserve System with foreign banks. This meant that authority to regulate such relations remained in the Board (under section 14(g) of the Act) and was not within the jurisdiction of the reorganized FOMC.

Under the 1935 Act, the new FOMC came into existence on March 1, 1936. Since that date, it has remained unchanged except for a regrouping of the Reserve Banks in 1942, as hereafter noted, for the purpose of election of Reserve Bank representatives on the Committee; but some important changes have been made in the authority of the Reserve Banks to engage in open market operations.

Changes since 1935

Prior to 1935, the Reserve Banks could purchase obligations of the United States either in the open market or directly from the Treasury. The Banking Act of 1935 provided that such obligations, as well as obligations fully guaranteed by the United States, could be bought and sold by the Reserve Banks "only in the open market".[66] On March 27, 1942, during the early months of World War II, section 14 was amended to permit the Reserve Banks to buy and sell obligations issued or guaranteed by the United States _either_ in the open market or directly from or to the United States, but they were authorized to make such direct purchases only until December 31, 1944, and only up to an aggregate amount of $5 billion.[67] This authority has been extended from time to time; and as of the present writing it will expire on June 30, 1971, unless it is again renewed.

In July 1942, three changes were made in the provisions of section 12A relating to the composition of the Committee and the election of the Reserve Bank representatives.[68] First, it was specifically provided that each such representative should be the president or first vice president of a Reserve Bank. Second, it was made clear that each Reserve Bank board of directors should have one vote in the election of Reserve Bank representatives. Previously, the Board's counsel had ruled that the vote of each of the nine members of each Reserve Bank board of directors should be counted in such elections. Finally, there was a rearrangement of the grouping of the Reserve Banks for purposes of such elections. This change deserves more detailed comment.

As has been noted, the 1935 Act had provided for the election of Reserve Bank representatives by five groups of Reserve Banks. One consisted of the Boston and New York Reserve Banks. However, since it

66/ Act of Aug. 23, 1935, § 205.

67/ 56 Stat. 180.

68/ All of these changes were made by the Act of July 7, 1942 (56 Stat. 647).

was considered important that the New York Bank, located in the country's financial center, should always be represented on the Committee, the president of the Boston Bank was always elected as an alternate and never as a member of the Committee. The 1942 amendment to the law recognized the practicality of the situation by providing for the permanent membership of the president of the New York Bank, with the first vice president of that Bank as his alternate, and by grouping the Boston Bank with the Philadelphia and Richmond Banks, so that the president of the Boston Bank would have an opportunity every third year to serve as a voting member of the Committee.

This change in the law was recommended by the Board. During hearings before the House Banking and Currency Committee, Chairman Eccles explained the reasons for the change:[69]

> "The Federal Reserve Bank of New York occupies a unique position with respect to the Federal Reserve System, the Treasury, and the banking system of the country. Its resources total approximately 40 percent of the aggregate of the 12 Federal Reserve banks. It is located at the money market and at the principal market for Government securities; its operations as fiscal agent of the United States and its transactions with foreign governments, foreign central banks and bankers, as well as its operations in foreign exchange, are in far greater volume than those of any other Federal Reserve bank. It is clearly in the public interest that the Federal Open Market Committee be given at all times the benefit of counsel of the Reserve bank possessed of this sort of experience and in current touch with such affairs.
>
> "It may be suggested that the advice of the Federal Reserve Bank of New York would be available even if it were not represented on the Federal Open Market Committee. Admittedly, regardless of the composition of the committee, the Treasury in discharging its responsibility respecting the Government securities market would still wish

69/ Hearings before House Banking and Currency Committee on H.R. 7158, 77th Cong., 2d Sess. (June 17, 19, 1942), pp. 2, 3.

> to confer with the Federal Reserve Bank of New York. Thus as a practical matter the New York bank would be inevitably drawn into discussions regarding Government financing as well as open-market operations. But advice obtained unofficially is a different matter from full-fledged participation in the committee's work. Sound policy dictates that participation by the New York bank be through its representative on the Federal Open Market Committee rather than on a voluntary or unofficial basis."

A final change in the law, although not related to the composition of the FOMC, should be mentioned in order to complete the picture. As has been noted, a 1942 amendment had authorized the Reserve Banks, under regulations of the FOMC, to buy and sell obligations issued or fully guaranteed by the United States either in the open market or directly from or to the United States; but such direct purchases and sales could be made only for a temporary period and only up to a specified aggregate amount. In 1966, the law was amended to authorize the purchase and sale - but only in the open market - of obligations issued or guaranteed by any agency of the United States.[70] This authority, originally of a temporary nature, is now permanent and it is not subject to any limitation as to amount.

Resumé

In the early years of the System, the effect of open market operations of the Reserve Banks upon the money supply and credit conditions was not clearly recognized. While the Board had authority to regulate such operations, it exercised that authority principally for the purpose of defining the eligibility of municipal warrants, bankers' acceptances, and bills of exchange for purchase by the Reserve Banks. In general, it left to each Reserve Bank discretion as to the volume

70/ Act of Sept. 21, 1966 (80 Stat. 825).

and timing of open market operations; and it placed no restriction upon operations in U. S. Government securities.

After the First World War, when borrowings by member banks from the Reserve Banks declined, Reserve Bank purchases of Government securities in order to increase earnings gave rise to problems and, in 1922, led to a realization that such transactions had an impact upon monetary and credit policies. The Reserve Banks themselves - and not the Board - then initiated measures to coordinate such transactions by the organization of a System "open market committee" of five Reserve Bank governors. In 1923, the Board intervened by replacing that committee with one over which it asserted some supervision; and, in 1930, the committee was expanded to include representatives of all Reserve Banks, but final authority over open market operations remained in the Board.

In 1933, this nonstatutory committee was superseded by a statutory committee of Reserve Bank representatives. Regulation of open market operations was specifically vested in the Board and the committee's function was purely advisory; but the Reserve Banks could refuse to engage in open market operations deemed desirable by the Board.

In 1935, the Reserve Banks were prohibited from either engaging or declining to engage in open market operations except in accordance with regulations and direction of the Committee; but it was now the Committee, rather than the Board, that was given authority to regulate and direct such operations. The Committee was reorganized to consist of the seven members of the Board and five Reserve Bank representatives elected annually by the boards of directors of specified groups of Reserve Banks. In 1942, the grouping of the Reserve Banks for this purpose was changed so that the president of the New York Reserve Bank would always be a member of the Committee.

Such has been the historical development of the FOMC. It is time now to turn to the question that is the subject of this paper: is the present arrangement for regulation of Reserve Bank open market operations the most logical and desirable? Should the FOMC be abolished and its functions vested in the Board? Conversely, should all monetary policy functions, control of discount rates and member bank reserve requirements, as well as open market operations, be vested in the FOMC? Or, if neither of these alternatives is desirable, should any changes be made in the present composition of the FOMC?

TRANSFER OF OPEN MARKET AUTHORITY TO THE BOARD

Background

As has been noted, in 1935 Marriner Eccles argued strongly that regulation of open market operations should be placed in the Board and his arguments prevailed in the House, but the Senate rejected them and the Banking Act of 1935 vested such regulation in the Open Market Committee. Since then, there have been others, principally Representative Patman, who have urged, like Eccles, that the FOMC should be abolished and its functions transferred to the Board.

In 1938, the House Banking and Currency Committee held hearings on a bill [71/] introduced by Mr. Patman that, among other things, would have

71/ H.R. 7230, 75th Cong., 3d Sess.

transferred regulation of open market operations to the Board. During these hearings, the proposal was supported by former Senator Robert Owen[72/] and by Reserve Board Governor Eccles.[73/]

In 1961, the Commission on Money and Credit agreed that open market policies should be determined by the Board.[74/]

In 1964, hearings were held by Mr. Patman on "The Federal Reserve System After Fifty Years"[75/] and one of the bills on which the hearings were based would have vested open market authority in the Board.[76/] Four years later, Patman sent a questionnaire to members of the Board, the Secretary of the Treasury, the CEA, and a number of academic, bank, and research economists, inviting comments on another bill[77/] with the same objective. Mr. Patman has introduced similar bills in each succeeding Congress, including the present one.[78/]

72/ Hearings before House Banking and Currency Committee on H.R. 7230, 75th Cong., 3d Sess. (Mar., Apr. 1938), pp. 80, 224. These hearings are cited hereafter as 1938 House Hearings.

73/ Id., at 449.

74/ Money and Credit: Their Influence on Jobs, Prices, and Growth, a Report of the Commission on Money and Credit (Prentice-Hall, 1961), p. 90. This Report is cited hereafter as CMC Report.

75/ The Federal Reserve System After Fifty Years, Hearings before Subcommittee on Domestic Finance of House Banking and Currency Committee, 88th Cong., 2d Sess. (Jan.-Feb. 1964). These hearings are cited hereafter as 1964 Hearings on Federal Reserve.

76/ H.R. 9631, 88th Cong., 2d Sess.

77/ H.R. 11, 90th Cong., 1st Sess.

78/ H.R. 11, 92d Cong., 1st Sess. Unlike earlier such bills, the current one provides that open market operations, "as well as all other actions and policies of the Federal Reserve banks and the Board in the field of monetary affairs, shall be conducted in accordance with the programs and policies of the President pursuant to the Employment Act of 1946 and other provisions of law."

In general, the two principal arguments in support of abolishing the FOMC and transferring its authority over open market operations to the Board are the following:

(1) The members of the Board, appointed by the President with the advice and consent of the Senate, represent the "national interest", whereas the presidents of the Reserve Banks, appointed by boards of directors of which two-thirds are elected by commercial banks, in effect represent private interests and should not be allowed to participate in the formulation of national monetary policies; and

(2) Responsibility for determination of monetary policies should not be divided between two agencies, with the FOMC regulating open market operations and the Board determining Reserve Bank discount rates and prescribing member bank reserve requirements.

These arguments were briefly stated by the Commission on Money and Credit in its 1961 Report as follows: 79/

"As to the Board's powers, three points should be made. First, the distinction between the Board and the Federal Open Market Committee has outlived its usefulness. The exercise of the System's three main powers should be complementary and governed by the same considerations, that is, by the same people in the same forum. This has come about in practice and is desirable. Second, the decisions of the Board are exercises of public regulatory authority, and there should be no ambiguity about where the responsibility for them lies: it belongs exclusively in the hands of public officials. Third, the quality of the deliberations over the use of these powers gains from the advisory participation of the Reserve bank presidents in the discussions. Their experience and counsel are needed and

79/ CMC Report, p. 90.

> should continue to be available. There may well be others whose advice would be helpful too, and the channels of access to the Board can be profitably extended."

A secondary administrative argument for placing control of open market operations in the Board is that the Board, unlike the FOMC, can meet daily in Washington and thus can give continuous consideration to open market policies and can act promptly in emergency situations.

Representation of the national interest

The seven members of the Board of Governors are public officials appointed by the President, with the advice and consent of the Senate, for terms of 14 years. The Board is an "independent establishment of the Federal Government" and is an agency of Congress and responsible directly to Congress.

The presidents of the 12 Reserve Banks, on the other hand, are appointed by the boards of directors of the several Reserve Banks; and each such board of directors consists of nine members, of whom six are elected by the commercial banks that hold stock in the Reserve Bank and the other three are appointed by the Board of Governors. Although the Reserve Banks are organized under Federal law for public purposes, their stock is privately owned and they are not generally regarded as "agencies of the United States" like the Board of Governors.

These differences between the Board and the Reserve Banks and between the members of the Board and the presidents of the Reserve Banks have been the basis for the principal argument for vesting open market authority in the Board. In brief, the argument is that the five Reserve Bank presidents who are members of the FOMC do not, like the members of the Board, clearly represent "the national interest", and, whether factually the case or not, that they are vulnerable to the charge of being influenced, at least potentially, by private interests in their participation in the formulation of open market policies.

In 1935, Reserve Board Governor Eccles argued that open market operations were "the most important single instrument of control over the volume and cost of credit in this country" and that authority over such operations "must be vested in a body representing the national interest", i.e., the Federal Reserve Board.[80/] Thus, he opposed a bill to vest open market authority in a committee of three Board members and two Reserve Bank governors because "the Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of monetary policies, would under this proposal have to delegate its principal function to a committee, on which members of the Board would have a bare majority, while governors of the banks would have 2 out of 5 members."[81/]

Adopting the Eccles arguments, the House Banking and Currency Committee gave the following reasons for vesting control of open market operations in the Board:[82/]

> "The Federal Reserve Board is appointed by the President and confirmed by the Senate. It has a national viewpoint and has long been accustomed to considering matters as they affect the country as a whole, without regard to the special interests of any particular group or locality. It was created for the purpose of supervising and coordinating the activities of the 12 Federal Reserve

80/ House Hearings on Banking Act of 1935, p. 181.

81/ Id., at 182.

82/ Report of House Banking and Currency Committee on Banking Act of 1935, Rep. No. 742, 74th Cong., 1st Sess. (Apr. 19, 1935), p. 10.

banks 'in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole' (report of the Banking and Currency Committee of the House of Representatives on the original Federal Reserve Act, Rept. No. 69, 63d Cong., 1st sess., p. 16). It is for this reason that the original Federal Reserve Act gave the Federal Reserve Board final authority over discount rates. Since open-market operations have in more recent years come to be recognized as a much greater factor in credit policy than discount rates, it is entirely consistent with the philosophy of the original Federal Reserve Act to vest in the Federal Reserve Board final authority with respect to the open-market policies of the Federal Reserve System."

On the floor of the House, Chairman Steagall of the House Committee explained that the purpose of the House bill was to place responsibility "in the hands of the Federal Reserve Board, who are servants of the people of the United States."[83/] As has been noted, the House agreed with Eccles and Steagall; but the Banking Act of 1935 nevertheless gave authority over open market operations to a Committee consisting of the seven members of the Board and five representatives of the Reserve Banks.

In 1938, Representative Patman charged that the Reserve Bank representatives on the FOMC did not really represent "the people's interest".[84/] He said:

". . . Take today the Open Market Committee, the most important committee in America. The banks have five representatives on it, and the Government has only five representatives on it at this time. They are there. They are sitting there to control, you might say, the economic affairs of this entire Nation, but they are not charged with doing it in the people's interest. They are doing it, those five, in the interest of their own banks, of their own depositors and stockholders. I am not

83/ 79 CONG. REC. 7183.

84/ *1938 House Hearings*, p. 56.

> criticizing them. They are carrying out their duty and their obligation to the people that they owe a duty and obligation to, but let us take them off of the Board and place on the Board only people who are charged with the duty of promoting the general welfare, although it might conflict with the bankers' welfare."

At that time there were two vacancies on the Board, so that the FOMC consisted of five Board members and five Reserve Bank presidents - a fact that played into the hands of Mr. Patman. Former Senator Robert Owen also took advantage of this circumstance in supporting Mr. Patman's bill:[85/]

> ". . . At the present time the privately owned banks can veto any act of the Federal Reserve Board in the matter of open-market operations, because they have five private citizens as members of the open market committee against five public functionaries on the Federal Reserve Board. The Federal Reserve Board cannot move."

During the 1938 hearings, Mr. Eccles again suggested that the Reserve Bank presidents reflected private rather than public interests and so should not be members of the FOMC:[86/]

> ". . . The bank representatives on the Open Market Committee are not the appointees of the President, nor are they the representatives of Congress at all. They are selected in the first instance by private bankers and business people, and they therefore represent less of a public interest, possibly, than the Board. At least they would be required, if anything, to represent less of a public interest in their point of view, and maybe because of that situation they would act differently. I have felt very strongly that the function of the Open Market Committee should be confined exclusively to members of the Federal Reserve Board, who are the representatives of Congress in dealing with these monetary and credit problems."

In 1961, as has been noted, the Report of the Commission on Money and Credit, in support of transfer of open market authority from the FOMC to the Board, argued that "the decisions of the Board are

85/ *Id.*, at 80.

86/ *Id.*, at 474, 475.

exercises of public regulatory authority, and there should be no ambiguity about where the responsibility for them lies: it belongs exclusively in the hands of public officials."[87/]

Three years later, Representative Reuss followed the Eccles-Patman theme during 1964 Congressional hearings, as indicated in the following interchange between Reuss and Reserve Board Chairman Martin:[88/]

> "Mr. Reuss. As things are, the most important monetary function of the United States of America; namely, the credit arrangements that are handled by the Open Market Committee, are handled by a committee made up of the seven public officials, the members of the Board, plus five essentially private persons who are not publicly appointed, the presidents of five of the regional Reserve banks.
>
> "I think this is an improper way to conduct public business for the reason that it is quite possible that the judgment and decision of the majority of the public officials, members of the Board of Governors, might be overruled by essentially private people - that is to say, a four-man majority of the Board of Governors might feel that credit should be tightened, let us say at a particular time, but it would be subject to being overruled if the private people on the Committee, the presidents of the banks, felt otherwise.
>
> * * * * *
>
> "So I am disappointed to find you opposing what seems to me a necessary reform. And since I find your reasons as set forth in your paper here inadequate, I would like to find out what other reasons you may have that are not set forth in your paper.
>
> "I say they are inadequate to me because the only reason you set forth in your testimony is that you want liaison with the 12 banks. I am all for liaison, and it is great to have them in the room there and keep them current on what the Open Market Committee does. But I would like you to address yourself to the proposition I am making - that this is essentially a governmental function, and should not be exercised by private people - any more than, let us say, we should take tax policy away from Congress and the Secretary

---

87/ CMC Report, p. 90.

88/ 1964 Hearings on Federal Reserve, pp. 37, 38.

of the Treasury and give it to, let us say, the president of the American Bankers Association, which I don't think you or anybody else would advocate.

"Mr. Martin. No. I think this is one of the basic and cardinal points in the development of the System right from the start.

"If you look at the original hearings, we didn't have an Open Market Committee until the Banking Act of 1935. You had this struggle between banker domination or other private domination, and political domination. And I think that the present Open Market Committee has been a compromise between these two concepts, the intention being not to have either private bankers or political leadership influence the decisions of the Committee, but to get a broadly based combination of private and public judgment.

"Mr. Reuss. Well, that is not really a fair description of what happens, is it? In fact, the private interests can overrule the public interests. And that is a pretty poor compromise, it seems to me.

* * * * *

"Mr. Martin. The point I am trying to make, Mr. Reuss, is that this is a very ingenious blending of public and private activity."

During these hearings, a number of witnesses - mostly economists - agreed with Reuss that the Reserve Banks should not be represented on the Committee. 89/

In 1968, a questionnaire sent out by Representative Patman that included questions as to the FOMC brought forth some replies substantially along the same lines. 90/ A typical response was the following by Professor Leo Fishman of West Virginia University: 91/

"Other organizational changes provided for in H.R. 11 also appear to be consistent with the main purpose of the bill. Abolition of the Federal Open Market Committee, for example, would

89/ Id., at 937 (Allan Meltzer), 1022 (Henry H. Villard), 1024 (Harry A. Johnson), 1102 (Eli Shapiro), and 1310 (John Gurley).

90/ Compendium on Monetary Policy Guidelines and Federal Reserve Structure, a Subcommittee Print of Subcommittee on Domestic Finance of House Banking and Currency Committee, 90th Cong., 2d Sess. (Dec. 1968). Cited hereafter as 1968 Compendium.

91/ Id., at 165.

virtually eliminate the influence of Federal Reserve bank presidents on national monetary policy. This is as it should be. These presidents are appointed by the board of directors of their respective Federal Reserve banks, which are owned by the member banks in their district. There is no reason why they should play an important role in the determination of national economic policy, nor is there any true statutory basis for their exercise of such a role. . . ."

Officials of the Federal Reserve System - Board members and Reserve Bank presidents - have vehemently denied that representatives of the Reserve Banks on the FOMC are dominated by the boards of directors of the Reserve Banks or are in any way influenced by "private" or "banker" interests.

For example, a joint response by the Reserve Bank presidents to one of Representative Patman's questions in 1952 stated that the "directors of the Reserve Banks do not have a direct role in policy formulation in the Open Market Committee."[92/] President Johns of the St. Louis Reserve Bank stated:[93/]

"In this connection I wish to emphasize strongly a point upon which there seems to be considerable misunderstanding. The presidents of the Federal Reserve banks naturally are in close contact with the commercial bankers in their districts. This fact is interpreted by some people as meaning that the presidents reflect commercial-banking opinion and apparently that such opinion necessarily is at odds with the public interest. In my opinion, the Reserve bank presidents' views are not unduly influenced by the commercial bankers he works with daily. Rather, these intimate contacts provide him with a 'feel' for conditions as they exist in his district and enable him to make a greater contribution to System policy consideration. Also, I do not believe that commercial-banking opinion is necessarily at odds with the public interest. I believe that it may well be as patriotic and as publicly oriented as any other opinion. Furthermore, the very fact that the presidents

92/ 1952 Patman Questionnaire, p. 675.

93/ Id., at 678, 679.

are in regular contact with commercial bankers gives them better insight into the practical administrative problems of monetary-policy implementation. Lack of such contact would seem more likely to result in unrealistic approaches to policy formulation rather than to more objectivity. The System has taken great pride in the fact that it does not employ the 'ivory tower' technique in formulating policy, but that it seeks to obtain as much evidence and informed opinion as possible before taking action."

President Alfred Hayes of the New York Reserve Bank said in 1964:[94/]

"I reject as imaginary, and as unfounded in my experience, the theoretical argument that suggests that the member banks are able to make felt in the Open Market Committee a narrow partisan interest that influences the six directors of the Reserve banks whom they elect and in turn the presidents who are elected by the directors, and, thereby, the Committee itself. Such an argument is fallacious, not only because the bankers, even if they wanted to, could not by such a means exert leverage on the presidents for this purpose, but also because it cynically assumes that the presidents, whose appointments must be approved by the Board of Governors, are men of such little scruple that they would violate their oaths of office as members of the Committee, by subordinating the public good to the private interest. The presidents and the staffs of the Reserve banks are public servants in the finest sense of the word."

During the same hearings, Reserve Board Governor J. L. Robertson frankly conceded that it might appear that the Reserve Bank presidents were influenced by private interests but he maintained that such was not the case:[95/]

"On the face of it you would certainly take it for granted that the System is subject to banker influence. Whenever you have a majority of the directors of the Federal Reserve banks elected by the commercial banks that are members of the System, and you have the President selected, as you indicated, by them, you would think certainly he is going to speak for them.

94/ 1964 Hearings on Federal Reserve, p. 520.

95/ Id., at 119.

"I think a very good case can be made in logic. This relates of course to the proposition that the Federal Open Market Committee operations should be transferred to the Board, which hasn't been raised here this morning but is contained in this bill. I think a very good case can be made for that proposition; namely, that this is so important a function that the decision should be made by a body composed exclusively of people who are 100 per cent Government officials - men who are appointed by the President with the advice and consent of the Senate, and are, therefore, in the fullest sense of the word Government employees.

"A very good case can be made for that. But I must say that on the basis of my observation of open market operations over the past 12 years, I do not believe that any Federal Reserve bank President could have been more objective if he had been an employee of the United States rather than the Federal Reserve. It has been amazing to me to see the extent to which they have remained objective.

"And I think the traditions within the System are such as to assure real effort on the part of every individual to remain impartial and objective, and avoid any conflict of interest."

President Charles Scanlon of the Chicago Reserve Bank asserted that the Reserve Bank presidents had always "considered themselves representatives of the public and not spokesmen for the commercial banking community or any other special interest group."[96/]

As frequently stated by System officials, the Reserve Bank presidents clearly have regarded themselves as "public servants" and as not representing any private interests. As members of the FOMC, a statutory agency, they subscribe to the oath of office prescribed for all officers of the United States. The uncomfortable fact remains that they are not appointed by the President but are elected by the Reserve Bank boards of directors and that two-thirds of the directors of each Reserve Bank board are in turn elected by private commercial banks.

96/ *Id.*, at 757.

Determination of monetary policies by a single agency

The second principal argument for transfer of open market authority from the FOMC to the Board is that all tools of monetary policy should be in the hands of a single agency. The Board has authority over Reserve Bank discount rates and member bank reserve requirements. It is illogical that another agency, the FOMC, should have authority to regulate open market operations; and the division of responsibility between the two agencies could give rise, at least theoretically, to intolerable conflicts. For example, five members of the Board might agree that credit conditions should be tightened by an increase in discount rates or reserve requirements, but the policy of a majority of the Board could be nullified if the two other Board members and the five Reserve Bank representatives on the FOMC should decide to ease credit conditions by buying securities in the market.

The possibility of such a conflict was cited by Mr. Eccles in 1935 when he urged that open market authority be vested in the Board rather than in a committee composed partly of Reserve Bank presidents:[97]

> "The placing of this authority in such a committee would also have the disadvantage of giving one important power, the power of open-market operations, to the open-market committee, while other fundamental powers are vested in the Board. These powers could be utilized to nullify the actions of the open-market committee. For example, the committee might adopt a policy of easing credit, while the Federal Reserve Board would be in a position to tighten credit, either by raising discount and bill rates or by increasing member-bank reserve requirements. Also the Board, through its power of prescribing regulations for open-market operations, could conceivably interfere with the carrying out of the policies of the committee. While it is not contemplated that such extreme situations would occur, it does not seem desirable to amend the law in a manner that might result in such unreasonable developments."

97/ House Hearings on Banking Act of 1935, pp. 182, 183.

Such a possible conflict was again referred to by Mr. Eccles in 1938, when he supported Representative Patman's proposal to abolish the FOMC and transfer its functions to the Board:98/

"The second, and perhaps the more important, consideration is that the Board of Governors has full authority over changes in reserve requirements, discount rates, margin requirements, and maximum interest rates on time deposits. To have one of the most important instruments of credit policy in the hands of a different body from the Board, which has authority over the other instruments, could result in a policy adopted by the Board being nullified by the committee. To be sure, the Board has a majority of the committee, but this means that the Board, in order to make its policy prevail against the unanimous opposition of the bank representatives on the open-market committee, must be unanimous itself. The Board might, for example, reduce reserve requirements and thereby increase excess reserves. It might conceivably do so by a vote of 5 to 2. The open-market committee might be opposed to an increase in reserves, and by combining the five votes of the presidents with the two minority votes of the Board, might decide to reduce the open-market portfolio by an amount sufficient to offset the decrease in reserve requirements. Whether this course of events is probable or not, it is certainly possible under the existing law. In my opinion, it should not be possible."

Others have pointed out the lack of logic in dividing monetary responsibilities between the Board and the FOMC. For example, Professor Harold Barger observed in 1964:99/

"Discount policy and member-bank reserve requirements are already in the hands of the Board of Governors. It is illogical that the management of open-market operations, an equally important aspect of monetary policy, should be located elsewhere; that is, in the Federal Open Market Committee. . . ."

Officials of the Federal Reserve have themselves conceded that the present division of monetary authority is illogical, but they have argued that in practice no actual conflicts have resulted. Thus, in

98/ 1938 House Hearings, pp. 478, 479.

99/ 1964 Hearings on Federal Reserve, p. 1355.

1952, Reserve Board Chairman Martin said: 100/

> "It may be urged, of course, that it is illogical to distribute credit regulation authority over two separate though interlocking bodies and that, in the interests of a single national credit and monetary policy and for practical administrative reasons, the determination of open market policy, as well as the determination of discount rates and changes in reserve requirements, should be vested in the same agency of the Government. It may also be urged that authority over open market operations, along with all other authority to regulate credit, should be vested in the Board of Governors of the Federal Reserve System as the agency primarily charged with responsibility for credit policies and, therefore, the agency to which the public looks for leadership in the formulation of such policies. For other reasons, it might be urged that these authorities should be vested in the Open Market Committee."

Nevertheless, Mr. Martin went on to point out the advantages of the present arrangement and to say that in "practice the open market policies of the Open Market Committee and the credit policies of the Board have been coordinated and the existing arrangement has worked satisfactorily." 101/

Similarly, the Council of Economic Advisers in 1952 recognized the possibility of conflict between the monetary policies of the Board and those of the FOMC, but it felt that such conflicts were unlikely: 102/

> ". . . Since the Board constitutes a majority of the Open Market Committee, it can control the committee, provided it is unanimous. If the Board is not unanimous, and if the bank representatives do not side with the majority of the Board, decisions can be made which are not consistent with actions taken by the Board with respect to discount rates and reserve requirements.
>
> "As a practical matter, however, the coordination of views is such that there is little opportunity for a policy conflict of this sort. The Board, as a regular practice, maintains close contact with the executive officers of the Reserve banks and gives full

100/ <u>1952 Patman Questionnaire</u>, p. 294.

101/ <u>Ibid</u>.

102/ <u>Id</u>., at 852.

consideration to their views on all phases of credit policy. An additional factor which undoubtedly makes for increased harmony of views is that the appointment of the top executive officers of the Federal Reserve banks is subject to the approval of the Board before they can assume their respective bank posts."

Administrative considerations

In 1938, Marriner Eccles advanced two reasons of an administrative nature for which regulation of open market operations should be lodged with the Board instead of the FOMC. During hearings on a Patman bill to transfer such regulation to the Board, Mr. Eccles said:[103/]

"Broadly, it seems to me, there are two important considerations in this connection. One is that the open-market committee should be in a position to act promptly in an emergency, and it is not always possible to assemble a committee from all over the country at a moment's notice. Furthermore, the problems before the committee should be constantly studied and discussed by the body charged with the responsibility of making decisions, and yet this is impossible when the members are scattered."

Whether these arguments should be given great weight is a matter of judgment.

As to the first - that the FOMC, unlike the Board, cannot always act promptly in an emergency - it may be answered that in practice the FOMC has always been able to meet emergency situations, either by special meetings or by "telephone conference hook-ups". On the other hand, experience in recent years, particularly since the expansion of open market operations in 1962 to embrace operations in foreign currencies, has demonstrated that critical emergencies do develop that require prompt action by the Committee. It is seldom feasible to assemble members of the Committee "from all over

103/ 1938 House Hearings, p. 478.

the country at a moment's notice"; and telephonic conferences, quite apart from possible legal objections, are not always satisfactory.

The second of the administrative considerations mentioned by Mr. Eccles is more difficult to answer. The Board is in a position to have daily meetings if necessary. Consequently, it can give continuous consideration to discount rates and reserve requirements - matters within its jurisdiction. Policy decisions in these areas do not have to be made frequently; and it has been said that such decisions are not as important as those relating to open market policy. Is it not illogical, then, that decisions with respect to the most important of monetary policies must be made by an agency that does not sit continuously with the ability to consider such decisions on a day-to-day basis? Under existing circumstances, the Committee meets only at three- or four-week intervals, and in the interim open market operations must be conducted by the New York Reserve Bank in accordance with its interpretation of the "directive" approved by the Committee at its last meeting.

THE CASE FOR THE PRESENT ARRANGEMENT

Summary

The present arrangement under which open market regulation is vested in the FOMC has continued in existence for more than 35 years. Despite arguments for transferring such regulation to the Board and despite Mr. Patman's perennial bills to that end, Congress has shown no inclination to make such a change. Perhaps inertia alone has been the main reason for which no change has been made; but defenders of the present arrangement have advanced forceful arguments in support of their position.

First, they have contended - although this argument has not been emphasized in recent years - that vesting of open market authority in a committee partly composed of Reserve Bank presidents affords protection against the possibility of political pressure.

Second, they have made the argument, closely related to the first, that participation of Reserve Bank presidents in regulation of open market operations reflects the traditional and basic concept of the Federal Reserve System as a "regional" System, under which the determination of national monetary policy benefits from a "unique" combination of regional and national, as well as private and public, points of view. Conversely, they contend that removal of the Reserve Bank presidents from such participation would not only impair the regional concept but would so downgrade the Reserve Banks as to make it difficult to obtain the services of qualified Reserve Bank presidents.

Finally, they argue that, whatever may be its logical defects, the present arrangement has "worked well".

Protection from political pressure

One of the major issues in connection with consideration of the original Federal Reserve Act was whether the System should be controlled by private interests - by the banks that contributed their assets to the establishment of the System - or by the Federal Government alone. The outcome was a compromise. President Wilson (contrary to the views of Carter Glass and others) decided that the Federal Reserve Board should not consist of bankers; but the Act provided that six of the nine directors of each Reserve Bank should be elected by commercial banks.

The same issue was still alive when the present FOMC was established in 1935. In the House, Representative Hollister opposed provisions that would have vested open market authority in the Board on the ground that, "if sufficient Treasury control is exercised" on the Board, the Board could "compel" the Reserve Banks, holding the reserves of the member banks, "to keep on buying and buying and buying Government obligations."[104/] Representative Wigglesworth felt that the net effect would be "to place the executive branch of the Government in a position to compel the Reserve banks to support the market for Government obligations . . . ."[105/] And Senator Glass, after noting that the Government had never contributed a dollar to the Reserve Banks, observed that it was proposed to authorize the Board "to make such disposition of the reserve funds of the country . . . as they may please . . . ."[106/] It was with obvious reluctance that Glass agreed to the Senate's proposal to place open market authority in a committee on which the members of the Board outnumbered Reserve Bank presidents by seven to five.

In 1952, a report of an _ad hoc_ subcommittee of the FOMC regarded the status of the Committee as one designed to shield it from "certain governmental and political pressures":

> "(134) In many respects, the Federal Open Market Committee is unique both in the form and the substance of its organization. In form, it is a completely independent organization, specifically set up by statute, with exclusive power of decision with respect to the

104/ 79 CONG. REC. 6569.

105/ _Id._, at 6964.

106/ _Id._, at 11778.

matters delegated to it. Its composition is designed to insure, to the full extent that legislation can insure, that its members will not only be fully competent, but will also be immune to outside pressure. It is neither an appendage of the Federal Reserve Board nor a creature of the Federal Reserve banks, but a completely independent body, each member of which, as an individual, whether he be a Governor from the Board or a president from a Federal Reserve bank, reports to no one. His actions are a matter of public record but each member sits as an individual, bound only by his oath to execute the law. The responsibilities delegated to the Committee are of almost incomparable import.

"(138) This unique structure of the Federal Open Market Committee was hammered out after long experience and intense political debate. Like other components of the Federal Reserve System, it exemplifies the unceasing search of the American democracy for forms of organization that combine centralized direction with decentralized control, that provide ample opportunity for hearing to the private interest but that function in the public interest, that are government and yet are screened from certain governmental and political pressures since even these may be against the long-run public interest."

As noted earlier in this paper, the fact that the five Reserve Bank representatives on the FOMC are not appointed by the President of the United States but are elected by the boards of directors of their Reserve Banks has been cited as an argument against the present arrangement. To the contrary, this fact might be cited as a means of protecting the Committee from Presidential influence, i.e., from "political" pressure.

This argument is weakened, however, by the fact that seven of the 12 members of the FOMC (the members of the Board) <u>are</u> appointed by the President. Moreover, the "independence" of the Board itself has been securely established; although its members are appointed by the President, they are appointed for 14-year terms and may not be removed by the President except "for cause". History has demonstrated that the functions exercised by the Board, including authority over Reserve Bank discount rates and member bank reserve requirements, are not subject to control by the President or subject to "political" influence. It is by no means clear, therefore, that open market operations would be more subject to political control if regulation of such operations were vested in the Board instead of the FOMC.

The "regional" concept

The most frequent argument advanced in support of the present arrangement is that it is in keeping with the concept of a regional Federal Reserve System with a unique mix of private and public interests and avoidance of undue centralization of power. It is argued that the participation of the Reserve Bank presidents in the formulation of open market policies brings to the deliberations of the Committee the viewpoints of different areas of the country. If open market authority should be vested solely in the Board, it is argued that the regional character of the System would be destroyed and that the Reserve Banks and their presidents would be downgraded.

In 1949, responding to the so-called Douglas Questionnaire, President Allan Sproul of the New York Reserve Bank argued that the Federal Open Market Committee "most nearly meets the requirements of our national plus regional central banking system" and that in the Committee the System had developed a method "for conducting policy deliberations that is uniquely in tune with our political and economic institutions." He noted that, while the Government was directly represented through the Presidential appointees on the Board of Governors, regional interests and "the lessons of experience 'in the field,' are represented through the rotating membership of the Federal Reserve bank presidents."[107/]

Reserve Board Chairman Martin stated the "regional concept" argument in 1952 as follows:[108/]

> "The present arrangement, however, under which open market operations are placed under the jurisdiction of a committee representing the Reserve Banks as well as the Board is consistent with the basic concept of a regional Federal Reserve System. It provides a means whereby the viewpoints of the Presidents of the Federal Reserve Banks located in various parts of the country, with their technical experience in banking and with their broad contacts with current credit and business developments, both indirectly and through their boards of directors, may be brought to bear upon the complex credit problems of the System. It promotes System-wide understanding of these problems and closer relations between the Presidents and the Board in the determination of System policies. In practice the open market policies of the Open Market Committee and the credit policies of the Board have been coordinated and the existing arrangement has worked satisfactorily."

The joint response of the Reserve Bank presidents to the Patman Questionnaire in 1952 echoed the views expressed by Chairman Martin and, in at least one particular, repeated literally language that had been used by Mr. Sproul in 1949:[109/]

> "The Federal Open Market Committee brings together, with statutory responsibilities for the exercise of the most important instrument of credit policy - the direction of open market operations - men of diversified background who are devoting their full time to the problems of the Federal Reserve System and who are in touch not only with Government views in Washington but also with private views and opinions throughout the country. The assignment of the authority over open market operations to the Committee has been an evolutionary development.

107/ Monetary, Credit, and Fiscal Policies, Joint Committee Print of Joint Committee on the Economic Report, 81st Cong., 1st Sess. (Nov. 1949), p. 163. This document is cited hereafter as 1949 Douglas Questionnaire.

108/ 1952 Patman Questionnaire, p. 294.

109/ Id., at 672, 673.

"The Federal Open Market Committee in its present form has worked well for a number of years. It provides a method for conducting policy deliberations that is uniquely in tune with our political and economic institutions. It is a body in which Government is directly represented through the Presidential appointees to the Board of Governors, and regional interests and the lessons of experience 'in the field' are represented by the Reserve bank presidents. It is an organization in which responsibility for the determination of reserve requirements and approval of discount rates might properly be lodged."

Particular Reserve Bank presidents expressed similar views as to the desirability of maintaining the regional nature of the System. Thus, President Johns of the St. Louis Reserve Bank said: 110/

"The desirability of the regional characteristics of the Federal Reserve System thus seems clear. Much of the System's strength stems from this factor. And the official record of the decisions and votes of the Open-Market Committee demonstrates the fact that the regional characteristics do not result in or reflect selfish sectionalism. Such divisions as have occurred on open-market policy have not been commonly between the five bank representatives and the seven board representatives as two distinct groups but between shifting groups, each of which may contain both presidents and board members. The differences reflect the individual committee members' analyses, interpretations, and viewpoints. In actual practice, even on matters of reserve-requirement policy, for which statutory authority rests solely in the Board of Governors, and on discount policy, there is consultation between the presidents and the board, demonstrating full recognition of the principle of considering regional factors of difference and also demonstrating the fact that regional representation is a source of strength."

During 1964 hearings before the House Banking and Currency Committee, President Bopp of the Philadelphia Reserve Bank argued that to abolish the FOMC would "change the basic character of the System." 111/ President Hayes of the New York Reserve Bank felt that abolition of the

110/ Id., at 678.

111/ 1964 Hearings on Federal Reserve, p. 422.

existing form of the participation by the presidents in the work of the Committee would impair the effective functioning of the Committee. 112/

And President Deming of the Minneapolis Reserve Bank made the following statement: 113/

> "The proposals of H.R. 9631 to which I address myself here would, as I have said, effectively destroy the regional character of the Federal Reserve System. They would, in effect, take from bank Presidents their voice in monetary policy deliberations, and in so doing would make the continuing regionalism of the System without meaning. . . ."

Governor George Mitchell of the Board of Governors opposed Representative Patman's proposal to transfer open market authority to the Board: 114/

> "My reason for favoring a continuation of the Open Market Committee more or less as presently constituted is not primarily negative, however. I think that regional representation from men whose day-to-day business activities keep them in touch with industrial, commercial, and banking developments in the major centers of the Nation brings to the committee qualitative judgments and insights that aggregative statistics will always lack."

Former Reserve Board Chairman Eccles, Representative Patman, and others who have proposed that open market authority be vested in the Board have recommended that the Board should nevertheless be required to consult a "committee" of the 12 Reserve Bank presidents before adopting open market policies. The Reserve Bank presidents, however, have insisted that participation by them in such an advisory capacity would not be satisfactory. The thought has also been expressed that such a modification in

---

112/ Id., at 528.

113/ Id., at 690.

114/ Id., at 1181.

the role of the Reserve Bank presidents would so downgrade them that it would be difficult to persuade qualified men to serve as Reserve Bank presidents.

Unquestionably, the Reserve Bank presidents regard their voting membership on the Open Market Committee as their most important responsibility. Former President Wayne of the Richmond Reserve Bank told a Congressional committee in 1964:[115/]

> "In my personal judgment, Mr. Chairman, the most important and most significant responsibility which I have faced throughout the year is attempting to arrive at a considered judgment in terms of my service on the Open Market Committee, or in connection with the Open Market Committee. This attempt to arrive at the best judgment of which I am capable, as to a policy posture which is in the best interests of the country, is, in my view, the most significant responsibility."

President Hayes of the New York Reserve Bank presumably spoke for all the presidents when he said:[116/]

> "I believe that to abolish the present form of the presidents' participation in the work of the Committee would be to impair the effective functioning of the Committee, even if the Presidents were to act as consultants to the Committee. Advice received from advisers who have no direct responsibility for action is of a different quality, and in my judgment less valuable, than advice received from those who participate in the action taken and thus have a direct responsibility for its consequences. I greatly fear, moreover, that the removal of the presidents from the Open Market Committee, and their exclusion thereby from a sense of direct participation in the shaping of an important part of national economic policy, would make it more difficult to attract imaginative and resourceful people to a career in the Federal Reserve banks, and would thus in time weaken the System through the gradual erosion of the quality of Federal Reserve bank officers and employees."

115/ Id., at 411.

116/ Id., at 528.

As indicated by Mr. Hayes, if the presidents had no voting participation in the formulation of open market policies, it is likely that they would not have a feeling of direct responsibility and in time would lose interest in the proceedings of the Committee. Former President Bryan of the Atlanta Reserve Bank said that, if he knew that he had actual responsibilities, he would keep an eye on economic affairs "probably with a greater degree of attention than might prevail if I had only an advisory responsibility." 117/ During the 1964 hearings, the following colloquy took place between President Ellis of the Boston Reserve Bank and Representative Brock: 118/

"Mr. Brock. And would you have the same incentive to make the same deep evaluation that you have today if you did not have an Open Market Committee on which the bank presidents had a vote?

"Mr. Ellis. If I were sure that I were never going to be expected to vote and participate in those deliberations, there would be no particular point in my going. I could send an economist from the staff."

Former President Bopp of the Philadelphia Reserve Bank felt that removal of the presidents from the FOMC not only would reduce the attractiveness of the presidencies of the Reserve Banks but would result in "deterioration in the quality of the managements and of the services performed by those banks." 119/ Conceding that the presidents could of course provide the Board with their advice if open market authority should

117/ Id., at 490.

118/ Id., at 417.

119/ Id., at 423.

be transferred to the Board, President Deming of the Minneapolis Reserve Bank nevertheless said:[120/]

". . . To be sure, Reserve bank Presidents would still be available as advisers to the newly constituted Federal Reserve Board. But an adviser is not the same as a participating member of the Federal Open Market Committee - either in the Committee room or back in the district.

"My point is simply this: Reserve bank Presidents, by virtue of the positions they occupy and the talents they bring to their tasks, can and do make significant contributions to the economic welfare of the country; but they will be able to continue effectively doing so only if they remain as they are, voting participants in monetary policy deliberations."

And President Irons of the Dallas Reserve Bank stated:[121/]

"The proposed elimination of the Federal Open Market Committee and the transfer of its powers, duties, and functions to the Federal Reserve Board, would represent a significant change in the System's structure.

"This proposal would virtually eliminate the regional participation in the formulation of credit policy. Moreover, it would weaken the prestige and the position of the Reserve banks. I believe it would make it more difficult to obtain competent men to serve as directors of the Reserve banks. In addition, it would tend in time to deprive the Board of Governors of firsthand information for [sic] the Reserve bank presidents and, through them, from the directors of the Reserve banks regarding economic and financial developments and trends in the various parts of the country."

Professor Ross M. Robertson agreed that transfer of open market authority to the Board "would certainly spoil one of the real rewards of being a Reserve bank President".[122/] Another professor, Edward J. Kane,

120/ *Id.*, at 690.

121/ *Id.*, at 846.

122/ *Id.*, at 1360.

felt that such a change in the existing arrangements would deprive the post of Reserve Bank president of "its most glamorous responsibility."123/

All of these arguments assume that the regional nature of the Federal Reserve System is something that should be preserved. It should be noted, however, that there are at least some who feel that the "regional concept" is something of an anachronism and that the Reserve Bank presidents should not have a voice in the determination of national monetary policies. For example, Professor Norman F. Keiser stated in 1968:124/

> "Many of the recommendations for reform within the Federal Reserve have concerned the makeup of the Federal Open Market Committee. In particular, since the Reserve bank presidents serve on this committee, the issue has turned on how much power the regional bank presidents should have on the FOMC and also the extent to which regional interests *per se* should be represented on the FOMC. It would seem that the need for regional emphasis has passed, that open market operations are national rather than regional, and that it is questionable whether the Reserve bank presidents (who are neither appointed by, nor accountable to, the Congress or the President) should have any vote at all. [Footnote omitted.]"

It "works well"

The final argument in support of the present allocation of open market authority, and the one that is perhaps the hardest to answer, is that for over 35 years the present arrangement, whatever its logic, has worked reasonably well and should not be changed except for some compelling reason.

In 1949, Reserve Board Chairman McCabe told a subcommittee of the Joint Committee on the Economic Report that, while there had been differences of opinion as to the most desirable distribution of credit

---

123/ *1968 Compendium*, p. 344.

124/ *Id.*, at 350.

policy functions within the System, it was his "considered opinion that the present arrangement works very well" and that, unless future experience should reveal a greater need than then existed for changing the duties or composition of the Open Market Committee, he would not recommend any change.[125/] Similarly, President Sproul of the New York Reserve Bank pointed out that the Committee had survived the tests of nearly 15 years and had "worked well".[126/]

In 1952, Reserve Board Chairman Martin told the same subcommittee, then under the chairmanship of Representative Patman, that there seemed to be no compelling reason in the public interest "for disturbing the present arrangement"; and the Reserve Bank presidents, in a joint answer to the subcommittee, expressed the view that the Committee in its existing form had "worked well for a number of years".[127/] On the basis of the replies to the questionnaire, Mr. Patman's subcommittee concluded that, while the present arrangement was historical rather than logical, it served a useful purpose and the subcommittee saw "no reason to disturb it."[128/]

Twelve years later, when Mr. Patman held hearings on a bill[129/] that would have transferred open market authority to the Board, Chairman Martin referred to and endorsed the 1952 conclusion of Patman's subcommittee

125/ 1949 Douglas Questionnaire, p. 68.

126/ Id., at 163.

127/ 1952 Patman Questionnaire, pp. 294, 672.

128/ Report of Subcommittee on General Credit Control and Debt Management of Joint Committee on the Economic Report, 82d Cong., 2d Sess. (June 1952), p. 54.

129/ H.R. 9631, 88th Cong., 2d Sess.

that there was no reason to disturb the existing arrangement.[130/] Reserve Board Vice Chairman J. L. Robertson, while conceding that those who advocated a change had the best of the argument from a logical viewpoint, nevertheless agreed that the existing arrangement had "worked over the years."[131/] President Johns of the St. Louis Reserve Bank felt that the existing arrangement had "worked especially well since the procedure was changed to enable all the Presidents of the banks to participate in the meetings of the Committee."[132/] And President Hayes of the New York Reserve Bank said:[133/]

> "I do not believe in changing things that are working well simply because they may appear to some to be illogical, or because they might under other conditions work badly. In my view, the Federal Open Market Committee as now constituted is working well; it provides a forum for any necessary reconciliation of the points of view of persons located at the seat of the Government and of others (the Presidents) intimately familiar with economic developments in all regions of the country. The latter are not, in the exercise of their judgments, partisans of the narrow or selfish points of view of any particular segment of the economy or of any particular geographical area; rather they speak and they vote for what they believe to be the interests of the Nation as a whole. For these reasons I am firmly persuaded that it would be a mistake to change the composition of the Committee."

In 1968, Mr. Patman invited views on a new bill that, again, would have vested open market authority in the Board. Chairman Martin once again referred to and approved the opinion expressed by the Board in 1952 that the existing arrangement had "worked satisfactorily".[134/] And a private

130/ 1964 Hearings on Federal Reserve, p. 14.

131/ Id., at 121.

132/ Id., at 294.

133/ Id., at 528, 529.

134/ 1968 Compendium, p. 46.

banker, Tilford C. Gaines, of Manufacturers Hanover Trust Company of New York City, agreed that the system had "worked well and there is no apparent reason why it should be changed."[135/]

It must be admitted, as argued by those who favor changing the present arrangement, that five of the 12 members of the FOMC are not Presidential appointees whereas the Board of Governors consists exclusively of Presidential appointees; that the Committee meets only every three or four weeks while the Board sits continuously; that the Committee has vastly important authority to influence national monetary policy while the Board has other monetary policy powers that might be exercised in a manner that would conflict with the decisions of the Committee. Nevertheless, it is difficult to deny that this seemingly illogical division of monetary authority has in fact "worked well". Procedures have evolved under which Reserve Bank presidents who are currently voting members of the Committee participate, on a rotating basis, in daily telephone "calls" with the open market desk at the New York Reserve Bank. Emergency situations are met by means of telephone "conference hookups" in which all members of the Committee participate. Membership of the Reserve Bank presidents has enabled the Committee, in reaching policy decisions, to take advantage of the close contact of the presidents with economic conditions in their several districts. And in no case so far has the theoretical possibility of conflict between policies of the Committee and those of the Board become anything more than a theoretical possibility.

135/ *Id.*, at 235.

But for those, like Patman and Eccles, who have argued that regulation of open market operations should be vested in the Board, the question remains one of principle: that the Federal Government's most potent tool of monetary policy should be exercised by an agency composed exclusively of "public officials" who are free from the charge, however untrue it may be in fact, that they represent private interests or are "beholden" to banker-dominated boards of directors by which they are elected.

TRANSFER OF ALL MONETARY AUTHORITY TO THE FOMC

Two alternatives with respect to authority over open market operations have so far been discussed: transfer of such authority to the Board and retention of that authority by the FOMC. A third alternative must be considered, i.e., transfer of the Board's monetary powers to the FOMC.

Some of those who have extolled the advantages of a Committee that reflects a "regional" concept and involves a blend of private and public interests have proceeded, quite logically, to the conclusion that, if regulation of open market operations by such a Committee is desirable, it would be desirable also for other monetary policy tools, e.g., reserve requirements and discount rates, to be in the hands of that Committee. Concentration of all monetary powers in the Committee incidentally would accomplish the same objective that prompted Eccles in 1935 to suggest that open market authority be vested in the Board, i.e., avoidance of potential conflict between two agencies with authority in this area.

Strangely enough, the first proposal for transfer of additional monetary powers to the FOMC apparently was made in a joint report submitted to Congress on December 31, 1940, by the Board of Governors, the presidents of the Reserve Banks, and the Federal Advisory Council. Among other things, that report recommended that authority over member bank reserve requirements be transferred from the Board to the FOMC.[136/]

In 1949, in their joint response to the Douglas Questionnaire, the Reserve Bank presidents proposed that authority over Reserve Bank discount rates as well as reserve requirements be transferred from the Board to the FOMC. After referring to the 1940 special report just mentioned, the presidents said:[137/]

> "The credit powers of the Federal Reserve System are not isolated or unrelated powers, and the decisions made and the actions taken with respect to these powers need to be properly coordinated if they are to be consistent and effective. Accordingly, the power to approve rediscount rates established by the Federal Reserve banks, the power to change member-bank reserve requirements, and the power to conduct open-market operations should be lodged in a single body rather than divided as at present between the Board of Governors and the Open Market Committee.
>
> "In placing such authority and responsibility in a single body the Open Market Committee becomes the logical choice by the nature of its membership, which includes both the entire Board of Governors and five Reserve bank presidents. The composition of this committee gives assurance of proper coordination of national and regional considerations. Moreover, Reserve bank representation on this committee gives added assurance that the practical experience of the Reserve banks in carrying out central banking operations will be given consideration in the determination and execution of Federal Reserve credit policies."

136/ 1940 Annual Report 69. It might be noted that the report also recommended that reserve requirements be made applicable to "all banks receiving demand deposits regardless of whether or not they are members of the Federal Reserve System."

137/ 1949 Douglas Questionnaire, p. 162.

In a separate response, President Sproul of the New York Reserve Bank urged that authority over margin requirements and all other general credit policies, including international financial policy, be vested in the FOMC. After noting that FOMC regulation of open market operations had "worked well", he said:[138/]

> ". . . Personally, I continue to believe we should recognize the full potentialities of what is, actually, an extraordinarily successful innovation in the methods of democratic administration and policy formation. The practicality of a policy-making group including representatives of the Board of Governors and the Federal Reserve Banks has proved itself. Such a body should have not only the powers mentioned in the attached document, but also ultimate responsibility over margin requirements and all other general aspects of credit policy, including the System's role in international financial policy. The regulatory duties under these various powers would continue with the staff of the Board of Governors and the Federal Reserve banks. The major gain would lie in bringing together in one group representative of the whole System, all significant policy formation; in bringing together authority for the exercise of powers which must be exercised in concert, which cannot be exercised in isolation."

Another respondent to the questionnaire, Eliott V. Bell, then New York State Bank Superintendent, asserted that "a case could be made for concentrating all Federal Reserve System powers with respect to credit policy in the Open Market Committee which provides a broader basis of representation, although still leaving a majority voice to the Board."[139/]

In their joint answer to the Patman Questionnaire in 1952, the Reserve Bank presidents again recommended the transfer of authority over discount rates and reserve requirements from the Board to the FOMC. They

138/ Id., at 164.

139/ Id., at 313.

said: 140/

"Although the present allocation of responsibility over the various instruments of credit control has proved workable and satisfactory, greater assurance of coordination in the use of those instruments in the future could be achieved by placing the fixing of reserve requirements and the approving of discount rates in the hands of the Federal Open Market Committee."

OTHER PROPOSALS

Three alternatives for regulation of monetary policies have now been mentioned: (1) retention of the present arrangement, under which open market policies are determined by the FOMC and discount rates and reserve requirements are determined by the Board; (2) abolition of the FOMC and transfer of its open market authority to the Board; and (3) transfer of the Board's authority over discount rates, reserve requirements, and margin requirements to the FOMC. All of these alternatives have assumed no change in the present composition of the FOMC or the Board. To complete the picture, it is necessary to mention briefly some other proposals that would involve changes in the composition of the Board or the FOMC.

As noted earlier, in tracing the evolution of the present FOMC, the bill that eventually became the Banking Act of 1935 originally provided for an Open Market Committee consisting of three members of the Board and two governors (now presidents) of the Reserve Banks. This proposal was short-lived. The House rejected it in favor of the Eccles proposal that open market authority be vested in the Board; and the Senate prevailed in its proposal that such authority be lodged in a Committee consisting of

140/ 1952 Patman Questionnaire, p. 673.

the seven members of the Board and five representatives of the Reserve Banks.

In 1949, Reserve Board Chairman McCabe, while opposing any change in the existing arrangement, expressed the view that, if any change were to be made, it would be desirable to place not only open market authority but all powers of the Board in a reconstituted Board to consist of three members appointed by the President and two Reserve Bank presidents who would serve as full-time members of the Board for rotating terms of one year each. In describing this proposal, Mr. McCabe said:141/

> "If any change were to be made in this regard, I would prefer to consider an amendment to the law to place authority over open-market operations, and of all powers and authorities vested in the Board of Governors, in a reconstituted Board (which would be known as the Federal Reserve Board) consisting of three members appointed by the President with the advice and consent of the Senate, and the presidents of two of the Federal Reserve banks, making a Board of five full-time members. The terms of the three members appointed by the President would be 12 years, so arranged that one term would expire every 4 years. The present requirement that a member shall be ineligible after the completion of a full term should be eliminated, except that no one should be eligible for appointment for a term or the unexpired portion thereof if he would reach 70 years of age before the end of the term.
>
> "The two members chosen from the presidents of the Federal Reserve banks would each serve for a period of 1 year in accordance with a system of rotation among the 12 Federal Reserve bank presidents which would be written into the law. The two president members of the Board would be required to give their full time to the work of the Board. To be eligible for service as a member of the Board, a president of a Federal Reserve bank should have served as an officer of the bank for at least 2 years.
>
> "Such a proposal would terminate the existing arrangement under which authority over instruments of credit policy are divided between the Board of Governors and the Federal open-market committee. It

141/ 1949 Douglas Questionnaire, pp. 68, 69.

would preserve the present advantages of having presidents serve on the open-market committee, and would be in harmony with the regional character of the Federal Reserve System, which contemplates that the coordination, supervision, and final determination of national credit and other major policies would be in the hands of a supervisory governmental body located in Washington. Because of the importance of the New York money market, provision should be made for participation of the president of the New York Federal Reserve Bank in the consideration of open-market policies and operations."

How the two Reserve Bank presidents would be able to serve as full-time members of the Board and yet discharge their Reserve Bank functions at the same time was not made entirely clear. Moreover, such an organization might be subject to even more serious objections. Commenting on this proposal in 1951, Dr. E. A. Goldenweiser said: 142/

". . . At first glance this proposal looks like a good compromise. Two questions, however, arise: Would it not emphasize rather than eliminate the undesirable conception that different members of the Board have different constituents rather than that all represent the people as a whole? There would be 'public' members and 'bank' members, an arrangement that is not likely to lead to smooth operation. Moreover, there would be constant shifting of membership, not conducive to continuity of the members' education or of the Board's policies."

Dr. Goldenweiser's own suggestion was that all Federal Reserve powers be vested in a single executive, the "Governor" in effect of the System: 143/

"If a change is to be made, the most desirable arrangement would seem to be one resulting in a concentration of final authority and responsibility in one high-ranking executive, the Governor. He should then be required to seek advice constantly from his technical staff, to consult the presidents of the Federal Reserve Banks on frequent and regular occasions as well as whenever major changes in policy are contemplated, and to meet once or twice a year with representatives of different economic groups for a general review of monetary problems

142/ E. A. Goldenweiser, AMERICAN MONETARY POLICY (McGraw-Hill, 1951), p. 306.

143/ Ibid.

and policies. Such an arrangement would combine regular contact with technicians, Federal Reserve executives, and the public with definite location of authority and responsibility in the head of the System."

Although former Reserve Board Chairman Marriner Eccles consistently advocated that the FOMC be abolished and its open market authority be transferred to the Board, he put forward a rather surprising alternative proposal in 1949. During hearings before the Douglas Subcommittee of the Joint Committee on the Economic Report, Eccles suggested that the Board should be abolished and that all Federal Reserve powers be vested in the 12 Reserve Bank presidents, but with the presidents to be appointed by the President of the United States. Eccles explained this proposal as follows: 144/

"If, however, it is believed preferable for national credit and monetary policy to be determined in part by some of the presidents of the Reserve banks, then the presidents of all 12 Reserve banks should be constituted the monetary and credit authority, and they should take over the functions of the Board of Governors, which body should be abolished. The governmental responsibility of such a body should be recognized by requiring their appointment by the President of the United States and their confirmation by the Senate; their salaries should be fixed by Congress, to whom they should report. May I point out that if the presidents of the Reserve banks can, in addition to performing their manifold duties as chief executive officers of these very important institutions, take on in addition the principal functions of the Federal Reserve Board, it must be that these functions do not justify a full-time seven-man Board, and this would be another reason for abolishing it, and substituting a part-time Board composed of the 12 presidents.

"You would have to add, of course, an administrator and a proper staff in Washington, and you would possibly have to add committees made up from the 12.

"I am offering this seriously. This is not a counterproposal. This is a serious proposal based upon the experience that I have had in Washington over a long period of time."

144/ Hearings before Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report, 81st Cong., 1st Sess. (Sept., Nov., Dec. 1949), pp. 221, 222.

Perhaps because of its extreme nature, this proposal by Mr. Eccles has never been given serious consideration by Congress.

At the other end of the spectrum - the modest end, consideration could be given to changes in the present arrangement that would not eliminate either the FOMC or the Board or alter their respective powers, but that would simply modify provisions of present law as to the rotation of service of the Reserve Bank presidents as voting members of the FOMC.

Under existing law, the president of the New York Reserve Bank is always a member of the Committee. The other four Reserve Bank representatives are elected annually as follows: one by the boards of directors of the Boston, Philadelphia, and Richmond Reserve Banks; one by the directors of the Cleveland and Chicago Banks; one by the directors of the Atlanta, St. Louis, and Dallas Banks; and one by the directors of the Minneapolis, Kansas City, and San Francisco Banks. Under this arrangement, New York is represented every year; Cleveland and Chicago every other year; and the other Reserve Banks only every third year.

This statutory rotation procedure might be changed, for example, to provide for the representation of the San Francisco Bank, the third largest, every other year instead of every third year; or, in a more "democratic" manner and without regard for size, to provide for representation of each of the Reserve Banks (except New York) every third year. It is questionable, however, whether much would be gained by such minor changes. It seems likely that any proposals for such changes in the law would lead only to more drastic proposals for reallocation of authority over open market operations.

SUMMARY AND CONCLUSIONS

From the foregoing review of the history of regulation of Federal Reserve open market operations, at least two safe conclusions may be drawn:

(1) The present arrangement has been in existence for more than 35 years, and, despite many suggestions for changes in the arrangement, Congress has never given serious and active consideration to any of such suggestions. Barring unforeseen developments, it seems most unlikely that any changes in the arrangement will be considered in the near future.

(2) If any change in the arrangement should be considered, it is probable that it would take the form of abolition of the FOMC and transfer of open market authority to the Board. It seems unlikely that the principal alternative proposal, i.e., to transfer monetary powers of the Board to the FOMC, would receive general support today.

If the last of these conclusions is sound, the sole question, as a practical matter, is whether arguments for transfer of open market authority to the Board outweigh those for retaining such authority in the FOMC. The question is one as to which, as has been seen, there have been sharp differences of opinion.

To summarize the arguments for abolition of the FOMC and vesting of open market authority in the Board:

1. Regulation of open market operations, the principal tool of monetary policy, should be exercised by a body composed exclusively of "public officials", i.e., persons appointed by the President with the advice and consent of the Senate. However well the present arrangement

may have worked over the years, this important power of national policy should not be lodged, even in part, with individuals elected by Reserve Bank boards of directors of which six out of nine are in turn elected by private commercial banks. Although the Reserve Bank presidents that are currently voting members of the FOMC take the oath of an "officer of the United States" and regard themselves as "public servants", they are nevertheless always vulnerable to the charge that they represent private rather than public interests.

2. It is illogical for authority over monetary policy to be divided between the FOMC and the Board. Even though no such conflict has developed in practice, it is possible that the open market authority of the Committee could be exercised in a manner directly contrary to the exercise of the Board's authority with respect to discount rates and member bank reserve requirements. This potential for conflict, with disturbing and confusing effects upon the national economy, should not be allowed to continue.

3. Open market authority should be vested in an agency, like the Board, that can meet daily and can act promptly in an emergency, rather than in an agency, like the FOMC, that is composed partly of members from various parts of the country who have other duties and who meet to consider open market policy only at three- or four-week intervals.

The arguments for retaining open market authority in the FOMC may be summarized as follows:

1. Participation by the Reserve Bank presidents in the policy decisions of the FOMC preserves the basic concept of a regional Federal

Reserve System and protects the System from the dangers of political influence and undue centralization of power. The presidents bring to the deliberations of the Committee a familiarity with regional and local economic conditions that provides a valuable contribution in the formulation of national monetary policy.

2. If the Reserve Bank presidents had only an advisory role in the determination of open market policies, the prestige of the presidents and of the Reserve Banks would be so impaired that it would be difficult to attract qualified individuals to serve as Reserve Bank presidents. In net effect, the basic strength of the System - its regional concept - would be destroyed.

3. Despite the seeming lack of logic in the present arrangement, it has worked well for many years and there is no compelling reason for changing that arrangement.

Such are the arguments on both sides of the question. In a sense, they come down to a choice between logic and practice. Logically, the present arrangement should be changed; practically, there seems to be no sound reason for change. In the end, of course, the question is one of judgment: does logic require a change in the structure of the Federal Reserve System or should an arrangement that has "worked" for over 35 years be changed unless it is demonstrably contrary to the public interest?