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THE STATUS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL GOVERNMENT

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I. INTRODUCTION

The Federal Reserve System is a unique institution. Unlike central banks in other countries, it is not a single entity but a central banking "system" composed of several parts. Congress, in the original 1913 Federal Reserve Act, established a governmental body in Washington, the Federal Reserve Board; 12 regional Federal Reserve Banks; and a 12-man Federal Advisory Council selected annually by the directors of the Reserve Banks. In 1933, a fourth part was added in the form of the Federal Open Market Committee - at first a purely advisory committee but, since 1936, a committee with regulatory powers - composed of seven members of the Board, the president of the New York Reserve Bank, and four other Reserve Bank presidents in rotating order.1/

The Federal Reserve Board2/ determines monetary and credit policies and, in addition, has supervisory and regulatory powers in the banking field and in various other fields; it also exercises general supervision over the Reserve Banks and appoints three of the nine

1/ In a broader sense, the Federal Reserve System may be regarded as including member banks. Section 9 of the Federal Reserve Act provides that a State bank "desiring to become a member of the Federal Reserve System" may apply to the Board of Governors for the right to subscribe to stock of the Reserve Bank of the district. 12 U.S.C. § 321.

2/ Since 1936, the official title of the Board has been "The Board of Governors of the Federal Reserve System"; but it is still customary to refer to the Board by its old title.

directors of each Reserve Bank. The Reserve Banks are organized like private corporations; their stock is owned by commercial banks that are members of the System, although such stock ownership entitles a member bank only to a statutory dividend of 6 per cent per annum on paid-in stock and to the right to participate in the election of six of the nine directors of the Reserve Bank of its district. The Federal Advisory Council has only advisory functions. The Federal Open Market Committee exercises an important monetary power, regulation of the open market operations of the Reserve Banks.

The Federal Reserve is rendered unique by two major features. First, it involves a combination of public and private interests, with a regional base but with a central governmental supervisory authority. Second, it possesses an unusual degree of "independence" from control by both the Congress and the President.

These features of the Federal Reserve System have given rise to challenging questions regarding the status of the System and its component parts in the Federal Government. Among such questions are the following:

Are the Federal Reserve Board and the Federal Open Market Committee governmental agencies? Although the question seemingly requires an affirmative answer, this has not always been the case.

In what branch of the Federal Government are the Board and the FOMC - legislative, executive, or judicial? On July 28, 1971, a so-called "leak" from the White House suggested that President Nixon was planning to double the size of the Board in order to bring it "under the Executive Branch". 3/ Although denied by the White House almost immediately, this story implied that the Federal Reserve was not regarded as being within the executive branch.

What is the status of the Reserve Banks? Are they, like the Board, agencies of the Government? What is their relationship to the Board itself?

What is the status of the Federal Advisory Council?

What precisely is meant by the "independence" of the Federal Reserve System? In what respects is the System independent from the Congress, from the President, and from the Treasury Department? Are there any limitations upon this independence?

What are the arguments for and against proposals to restrict the System's independence? Such proposals include audit of the System by the General Accounting Office (GAO), payment of the System's expenses from appropriated funds, and subjection of the System to economic policy direction by the Congress or by the President.

3/ See The Washington Star, July 28, 1971; Washington Post, July 29, 1971; and American Banker, July 29, 1971. A Dow Jones news service story quoted a White House official as saying that "the President has under serious consideration legislative recommendations in which many of his principal advisers concur that would specifically bring the Federal Reserve into the Executive branch." The report was immediately denied by another "high White House official". The episode was described by Herbert Bratter in an article regarding the independence of the Federal Reserve that appeared in the Baltimore Sun for August 11, 1971, as follows:

> "After the initial 'leak' there must have been some communicating within the White House. A high White House official told the New York Times that the leaks were not an expression of presidential opinion; nor did the President consider bringing the Fed into the Executive Branch. Also the spokesman regretted that White House Press Secretary Ziegler's denial of the July 28 leak had not been more firm. The next day Mr. Ziegler without ambiguity backed down from the original story. . . ."

Finally, why should the Federal Reserve continue to enjoy its traditional "independence"? What are the arguments against such independence? What are those in support of it?

These questions are the subject of this paper. It discusses (1) the status of the Board and the FOMC as governmental agencies, (2) whether the Board and the FOMC are in the legislative or executive branch of the Government, (3) the legal status of the Reserve Banks and their relationship to the Board, (4) the status of the Federal Advisory Council, (5) the various attributes of Federal Reserve independence, (6) the many proposals to restrict the System's independence, and (7) the arguments for and against such independence.

An account of the manner in which the System has exercised its independence is beyond the scope of this study. The extent to which the System has been influenced or dominated by the President or the Treasury has varied from time to time. There have been confrontations between the Federal Reserve and the Treasury and there have been occasions on which the Board has acted directly contrary to the wishes of the President, as, for example, in December 1965 when the Board changed the discount rate over the objection of President Johnson. For an account of the ups and downs of Federal Reserve independence as a practical matter, the reader is referred to a comprehensive and excellent treatise on the subject by Dr. A. Jerome Clifford.[4/]

4/ A. Jerome Clifford, The Independence of the Federal Reserve System, University of Pennsylvania Press (1965). Among other things, Dr. Clifford gives an interesting account of the episode in January 1951 when President Truman dramatically attempted to intervene in the determination of monetary policies by the System and actually called a meeting of the Federal Open Market Committee at the White House. Id., at 242-245.

In a very real sense, the hero - or the villain - of this piece might be regarded as Representative Wright Patman of Texas. Since 1938, he has been the System's principal critic and the chief proponent of measures to curb the System's independence. He has advocated both measures that would make the System subject to greater control by Congress and measures that would bring the Federal Reserve under more effective direction by the President. The status of the Federal Reserve was the subject of a questionnaire addressed by Mr. Patman to the chairman of the Board and other Government officials in 1951, of Congressional hearings held by him in 1964, and of another questionnaire in 1968. Without these efforts by Mr. Patman, much of the material upon which this paper is based would have been lacking. Over a period of many years, he has compelled the System to be mindful of its status and alert to criticism of its independence.

II. THE BOARD AS A GOVERNMENT AGENCY

It is clear beyond any question that the Board of Governors of the Federal Reserve System is a Government agency, a part of the United States Government.

The Report of the House Banking and Currency Committee on the original Federal Reserve Act stated:[5/]

> ". . . The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization

5/ Report of House Banking and Currency Committee on H.R. 7837, 63d Cong., 1st Sess., Rept. No. 69 (Sept. 9, 1913), p. 18. [This Report is hereafter referred to as House Report on Original Act.]

created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. . . ." (Underscoring supplied.)

On the floor of the House, Carter Glass, then chairman of the House Committee, described the Board as follows:[6/]

". . . Overseeing the whole new system of Federal reserve banks, as a capstone of the scheme, is created a Federal reserve board, consisting of seven members. . . .

* * * * *

"In the Federal reserve board, which the bill reported by your committee provides, there will not be discovered any of the defects which were essential features of the Aldrich bill. No capital stock is provided; no semblance of acquisitiveness prompts its operations; no banking incentive is behind, and no financial interest can pervert or control. It is an altruistic institution, a part of the Government itself, representing the American people, with powers such as no man would dare misuse. . . .

* * * * *

". . . This Federal reserve board is distinctly a Government institution, ..." (Underscoring supplied.)

Other members of Congress made statements to the same effect during the debates on the original Act. Thus, Representative Bathrick referred to the Board as "wholly a governmental body"[7/] and Senator Shafroth declared that the "Federal reserve board is the governmental part of this system".[8/]

The original Act expressly provided that employees of the Board should be appointed without regard to the provisions of the

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6/ 50 CONG. REC. 4644, 4645.

7/ Id., at 4704.

8/ Id., at 6024.

Civil Service Classification Act of 1883, but authorized the President to place such employees in the classified service.9/ This exemption would have been unnecessary if the Board had not been regarded as a Government agency and its employees as employees of the United States Government.

Shortly after the System began operations in late 1914, the Attorney General of the United States expressly held that the Board was "an independent board or Government establishment". Question had arisen whether the Board's accounts should be audited by the auditor for the Treasury Department or by the auditor authorized to audit accounts of independent Government boards and establishments. The Attorney General concluded that the Federal Reserve Board was not a bureau, office, or division of the Treasury Department but constituted instead an independent board or Government establishment. In this connection, he stated:10/

> "That the Federal Reserve Board is a 'board' or 'establishment' of the Government within the meaning and intent of those words as used in the fifth paragraph of section 7 of the act of July 31, 1894, is plain from the provisions of the Federal reserve act and the explanation of the status of the board contained in the reports accompanying the original bills in Congress. This conclusion is sustained by reason and analogy, when reference is had to the considerable number of boards or establishments of far less general or national scope which have been so esteemed and uniformly treated. (See Report of Joint Commission to Inquire into Executive Departments, October 9, 1893. House Reports, 1st sess., 53d Cong., Report No. 88.)

9/ Federal Reserve Act, § 11(l); 12 U.S.C. § 248(l).

10/ 30 *Op. Atty. Gen.* 308 (1914).

> "Consideration of the history of the Federal reserve bank act, of the general scheme of the whole act, of the functions to be performed by the Federal Reserve Board, and of the method of their performance, leads me to the clear opinion that the board is an independent board or Government establishment."

In 1923, the Comptroller General of the United States relied on this opinion of the Attorney General in reaching a decision that funds collected by the Board by assessments on the Reserve Banks were public funds subject to statutory restrictions imposed upon the expenditures of such funds.[11/] Reaffirming that position in 1924, the Comptroller General stated that the Federal Reserve Board owed its existence to the Federal Reserve Act "which instituted the board as a governmental instrumentality to perform a function of government in exercising control over the Federal reserve banks as prescribed in the acts of Congress."[12/]

The only case in which a court has referred to the status of the Board as a Government agency was Emergency Fleet Corporation v. Western Union Telegraph Company in 1928.[13/] In that case the Supreme Court of the United States held that the Emergency Fleet Corporation was a department of the Government and therefore entitled to priority and special rates from Western Union. In reaching this conclusion, the Supreme Court referred to the Federal Reserve Board as one of several "independent departments" of the Government.

11/ 3 Decisions of Comptroller General 190 (1923).

12/ 3 Decisions of Comptroller General 468 (1924).

13/ 275 U.S. 415.

When the bill that became the Securities and Exchange Act of 1934 was under consideration, the House Committee on Interstate and Foreign Currency stated in its Report that "all speculative credit should be subjected to the central control of the Federal Reserve Board as the most experienced and best equipped credit agency of the Government." (Underscoring supplied.) 14/

When President Roosevelt in 1941 vested the Board of Governors with authority to regulate consumer credit, one of the "whereas clauses" in his Executive Order stated: 15/

> "Whereas it is appropriate that such credit be controlled and regulated through an existing governmental agency which has primary responsibilities with respect to the determination and administration of national credit policies:" (Underscoring supplied.)

Despite all of these clear indications that the Board is a Government agency and a part of the United States Government, the Board's status as such has been challenged on two occasions.

The first challenge arose when the United States Employees' Compensation Commission, later known as the Bureau of Employees' Compensation in the Department of Labor, ruled in May 1938 that employees of the Board were not "civil employees of the United States" and therefore were not covered by the Federal Employees' Compensation Act. Apparently, the ruling was based primarily on the ground that the Banking Act of 1933 had provided that the Board's funds should not be construed to be "Government funds or appropriated moneys." Arguing that this

14/ H.R. Rept. No. 1383, 73d Cong., 2d Sess., p. 7.

15/ Executive Order No. 8843, Aug. 9, 1941.

provision did not change the Board's status as a Government agency, the Board in 1953 and again in 1960 requested reconsideration of the Bureau's ruling. Finally, in February 1962, the Director of the Bureau conceded that "the members, officers, and employees of the Board are considered employees within the purview of the Federal Employees' Compensation Act."

The second challenge occurred in May 1939 when, during a House Banking and Currency Committee hearing, Representatives Steagall and Patman suggested that, because it was not owned by the United States, the Federal Reserve Board's new building on Constitution Avenue was taxable by the D. C. Government. As a result, the D. C. Corporation Counsel in July 1940 ruled that the Board's building was not only subject to real estate taxes but also to charges for water service.[16/] The Board's General Counsel submitted a memorandum arguing, on the basis of the Attorney General's 1914 opinion, that the Board was an establishment of the Federal Government. Nevertheless, in December 1941 (four days before Pearl Harbor), the D. C. Government published a notice that the Board's building would be sold on January 6, 1942, for nonpayment of taxes. Time Magazine noted that the Federal Reserve had "often proclaimed its independence from the United States Government, but in this case it claimed to be an arm of the Government - hence tax-free." The sale did not take place; but in December 1942 the D. C. Government again published notice of a scheduled sale of the Board's building for

16/ Corporation Counsel Elwood Seal reversed his earlier opinion that the Board was a "strictly governmental" entity and therefore exempt from the water service charge.

nonpayment of taxes. Again the sale was forestalled, but the controversy dragged on. It was not until October 1944, after "quitclaim deeds" to the Board's building had been executed by each of the 12 Reserve Banks, that the D. C. Government conceded that the building was not subject to D. C. taxes.17/

These two episodes demonstrate that, because of its special treatment under Federal law, even the status of the Board as a Government agency has been brought into question. It seems unlikely that that status will be challenged again. There remains, however, the question whether the Board, as a Government agency, is a part of the "legislative branch" or of the "executive branch" of the Federal Government.

III. THE "BRANCH OF THE GOVERNMENT" QUESTION

A. BACKGROUND

The United States Constitution provides in Article I that all "legislative powers" shall be vested in the Congress of the United States, in Article II that the "executive power" shall be vested in a president of the United States, and in Article III that the "judicial

17/ It should be noted that the D. C. Government had some logical basis for its position that the Board's building was not owned by the U. S. Government. In January 1935, both the Secretary of the Treasury, in consideration of receipt of over $750,000 from the Board, and the Director of the National Park Service, in consideration of the sum of $10, had given the Board "quitclaim deeds" transferring to the Board "all the right, title and interest of the United States of America" to the property involved.

power" shall be vested in one supreme court and in such inferior courts as the Congress may ordain and establish. From these provisions it has become traditional to refer to the legislative, executive, and judicial "branches" of the Federal Government. Traditionally also, one thinks of the legislative branch as <u>making</u> the laws, of the executive branch as <u>executing</u> the laws, and of the judicial branch as <u>interpreting</u> the laws.

A simple but superficial answer to the question as to which of these branches of Government embraces the Federal Reserve System can be found in the table of contents of the annually published Government Manual prepared by the Office of the Federal Register of the National Archives. That table lists the Board of Governors of the Federal Reserve System, along with Executive Departments and other "independent establishments", under the "Executive Branch". Unfortunately, the table of contents to the Government Manual has no legal significance.

Another simple answer to the question can be based on the argument that the Board does not legislate and is not a court and that, therefore, it <u>must</u> be in the "executive" branch of the Government. Such an answer, however, again is unsatisfactory. In issuing regulations, the Board exercises at least quasi-legislative functions; and, in carrying out its responsibilities under Federal laws, it must frequently interpret those laws and thus exercise quasi-judicial functions. Moreover, it should be noted that the General Accounting Office, which "executes" laws of Congress, is nevertheless regarded as being within the "legislative" branch of the Government.

In 1952, Chairman Martin of the Federal Reserve responded, with other Government officials, to a questionnaire prepared by Representative Patman, then chairman of the Subcommittee on General Credit Control and Debt Management of the Joint Economic Committee. One of the questions was whether the Federal Reserve Board and the FOMC were parts of the executive branch of the United States Government. Mr. Martin replied that the courts had "not had occasion to determine in which of the three branches of the United States Government the Board of Governors and the Federal Open Market Committee should be classified." Evading a reply to the specific question, he cited the legislative history of the Federal Reserve Act and other reasons for which the Federal Reserve should perform its statutory functions free from direction by the President.[18/]

As stated by Mr. Martin in 1952, there has been no judicial determination as to the "branch" of the Government in which the Federal Reserve belongs. As far as the writer knows, there has never been any serious suggestion that the Board of Governors falls within the "judicial" branch. Former Senator Robert Owen, chairman of the Senate Banking and Currency Committee in 1913, once referred to the Board as the "supreme court of finance";[19/] but obviously this was not intended to mean that the Board would be a court in the Constitutional sense of the term.

18/ Replies to Questions Submitted by Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, 82d Cong., 2d Sess. (Feb. 1952), pp. 242-248. [Hereafter cited as 1952 Patman Compendium.]

19/ 50 CONG. REC. 5998.

Whether seriously or not, it has sometimes been suggested that the Federal Reserve is in a <u>fourth</u> branch of the Government. When the Reorganization Act of 1949 was under consideration, Representative McCormack observed that "independent agencies have developed for all practical purposes into a fourth department of the Government" and that they had crossed "the lines of the legislative, executive and judicial branches of government."[20/] With specific reference to the Federal Reserve, Professor Harry G. Johnson, in 1964, suggested that the Federal Reserve, a monetary authority, was "a fourth branch of the Constitution".[21/] Although firmly denied by Reserve Board Chairman Martin, the charge has been made by Mr. Patman that the Federal Reserve Board is "kind of off from the Government" and that the Board is "dissociated from the executive branch of the Government, and from the legislative branch."[22/]

If the Federal Reserve is not in the judicial branch and if it does not constitute a "fourth" branch of the Government, it must be in either the legislative or the executive branch.

20/ 95 CONG. REC. 396.

21/ <u>Hearings before Subcommittee on Domestic Finance of the House Banking and Currency Committee on "The Federal Reserve System After Fifty Years"</u>, 88th Cong., 2d Sess., p. 970. [Hereafter cited as <u>Hearings on Federal Reserve After Fifty Years</u>.]

22/ <u>Id</u>., at 19.

B. AN "ARM OF CONGRESS"?

The General Accounting Office, the Library of Congress, the Government Printing Office, and the Botanical Gardens are generally described as being in the "legislative branch" and are so classified in the U. S. Government Manual. The Comptroller General is referred to in the law "as an agent of the Congress."[23/] The Reorganization Act of 1945 specifically exempted the Comptroller General and the General Accounting Office and expressly declared them to be parts of the legislative branch of the Government. As far as the writer knows, the Federal Reserve Board has never been explicitly described, by statute, court decision, or otherwise, as being in the legislative branch. It has, however, often been referred to (although not in statutes or court decisions) as an agent or "arm" of Congress and as not being subject to control by the President, thereby suggesting that it falls in the legislative branch.

Although Representative Patman has sometimes argued that the Federal Reserve should be subjected to Presidential control, he has frequently contended that it is an agent of Congress. In 1938, he recommended legislation that would have expressly declared the Federal Reserve Board "to be the agency of the Congress to create money and regulate the value thereof."[24/] When asked whether he considered the

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23/ 31 U.S.C. § 65(d).

24/ Hearings before House Banking and Currency Committee on H.R. 7230, 75th Cong., 3d Sess. (Mar.-Apr. 1938), p. 166. [Hereafter cited as 1938 House Hearings.]

Board as being in the "legislative or executive branch of the Government", he replied: 25/

"Well, now, I guess it is quasi-legislative. It is intended, I presume, to carry out the constitutional mandate on Congress to regulate the value of money. Yet Congress, because of the laws and the amendments to the laws that it has passed, has very little power over that Board. Congress has given up most of its power, and, as you suggest, it has placed more in the power of the Executive than in Congress. If that is true, it should be taken away from the Executive and brought back to Congress. There is no constitutional grant of power to the President to control that Board."

In Reserve Board Chairman Martin's 1952 response to the Patman questionnaire, it was stated that the Board and the FOMC "prescribe rules and determine policies as agents and on behalf of the Legislative branch." 26/ While recognizing that their functions are different, Mr. Martin compared the Board with the Federal Trade Commission and cited the following statement by the U. S. Supreme Court in Humphrey's Executor v. United States: 27/

"The Federal Trade Commission is an administrative body created by Congress to carry into effect legislative policies embodied in the statute in accordance with the legislative standard therein prescribed, and to perform other specified duties as a legislative or as a judicial aid. Such a body cannot in any proper sense be characterized as an arm or an eye of the executive. Its duties are performed without executive leave and, in the contemplation of the statute, must be free from executive control. . . ." (Underscoring supplied.)

With respect to the independence of the Federal Trade Commission, the

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25/ Id., at 170.

26/ 1952 Patman Compendium, p. 246.

27/ 295 U.S. 602, 628 (1935).

Court said:[28]

"Thus, the language of the act, the legislative reports, and the general purposes of the legislation as reflected by the debates, all combine to demonstrate the Congressional intent to create a body of experts who shall gain experience by length of service - a body which shall be independent of executive authority, except in its selection, and free to exercise its judgment, without the hindrance of any other official or any department of the Government. . . ."

Granting that these statements clearly indicated that the Trade Commission was designed to implement legislative policies and was free from Presidential control, they also indicated that the Commission was an "administrative body". In an earlier case, the Supreme Court had stated that the Commission "exercises only the administrative functions delegated to it by the Act, not judicial powers."[29]

That the Federal Reserve is a creature of Congress designed to implement legislative policies is undeniable. But so are all agencies established by Congress, including the Executive Departments. In 1961, the Report of the Commission on Money and Credit stated:[30]

". . . Others assert, instead, that the accountability of the System is achieved through its responsibility to Congress, and call the Federal Reserve an 'agent of Congress,' invoking then the doctrine of the separation of powers to argue that this requires independence for the Federal Reserve from the executive. It has been argued, however, that the FRB is less accountable to Congress than the line departments in the presidential hierarchy. It does not depend on appropriations for its funds and so is freed from the most potent of congressional

28/ Id., at 625.

29/ Federal Trade Commission v. Eastman Kodak Company, 274 U.S. 619, 623 (1927).

30/ Money and Credit: Their Influence on Jobs, Prices, and Growth, Report of the Commission on Money and Credit (1961), p. 86. [Hereafter cited as CMC Report.]

> controls over administrative agencies. And Congress has been notably circumspect in even suggesting its policy views to the Board, let alone incurring responsibility for its decisions. All agencies, line departments like the Treasury no less than the FRB, are 'creatures of Congress' in the sense of owing their existence and powers to legislation. And agencies with single heads are more easily held accountable by Congress or by anyone else than those with boards at the top."

It is sometimes argued that the Board is accountable or responsible to Congress because it is required by law to make annual reports to Congress. The House Committee's Report on the original Federal Reserve Act stated that it was [31/]

> ". . . deemed best that the board shall annually report to the House of Representatives, thereby establishing a direct relationship between the board and the Congress."

The fact that the Board reports to Congress, however, does not prove that it is in the legislative branch. Other agencies of the Government are similarly required to make annual reports to Congress. Such agencies include the Interstate Commerce Commission, [32/] the Federal Power Commission, [33/] the Federal Trade Commission, [34/] and the Federal Communications Commission. [35/] Even the Federal Home Loan Bank Board, which is expressly declared by statute to be an independent agency "in the executive branch of the Government" [36/] is required to report

31/ House Report on Original Act, p. 44.

32/ 49 U.S.C. § 21.

33/ 16 U.S.C. § 797(d).

34/ 15 U.S.C. § 46(f).

35/ 47 U.S.C. § 154(k).

36/ 12 U.S.C. § 1437(b).

to Congress.[37/] And the Secretary of Defense, the head of a major Executive Department, is required to report to Congress "on the expenditures, work, and accomplishments" of that Department.[38/]

As indicated in the CMC Report cited above, the Board actually is less accountable to Congress than the old line Executive Departments since it does not depend upon appropriations and thus is "freed from the most potent of congressional controls over administrative agencies." In addition, because it has sole control with respect to the compensation and leave of its employees, the Board is not subject to laws of Congress relating to the compensation and leave of Government employees generally.

As indicated in Chairman Martin's reply to the 1952 Patman questionnaire, some of the Board's functions, its rule-making functions, are of a "quasi-legislative" nature. This does not mean, however, that the Board is therefore in the "legislative branch". Other Government agencies, including Executive Departments like the Treasury and Commerce Departments, promulgate regulations. Certain of the Board's functions, e.g., passing upon bank holding company applications, are "quasi-judicial" in nature; but this does not require classification of the Board in the "judicial branch" of the Government.

On the basis of all the evidence, it must be concluded that, while the Board - like all other Government agencies - is an agent or arm of the Congress in carrying out laws enacted by Congress, it is <u>not</u> in the "legislative branch" of the Government.

37/ *Ibid.*

38/ 10 U.S.C. § 133(c).

C. IN THE EXECUTIVE BRANCH?

If the Board is not in the "legislative branch" and since clearly it is not in the "judicial branch", the logical conclusion must be that it is in the "executive branch". Before reaching this conclusion, however, we must consider the significance of statements to the effect that the Board, once appointed by the President, is not subject to control by the President, as well as the generally prevailing impression, as reflected by the White House "leak" in the summer of 1971, that the Board is not in the "executive branch".

Referring to the Board's freedom from Presidential control, Representative Barkley, during debates on the original Act, made the following statement:[39/]

> "There is no board until the President appoints one, and the act of appointment and the manner of appointment are not similar nor coextensive with the acts of the board after they are appointed. The President does not control the action of the Federal Reserve Board after they are appointed any more than he controls the action of the Interstate Commerce Commission after he appoints its members."

Many years later, as already noted, the U. S. Supreme Court stated that the Federal Trade Commission was "free from executive control" and that it was "independent of executive authority, except in its selection." Exactly the same may be said of the Federal Reserve Board. Such statements, however, do not require the conclusion that the Board is not in the "executive branch" of the Government. This is because, as a Constitutional principle, officials of the Government,

39/ 50 CONG. REC. 4789.

including those in the executive branch, are not subject to control or direction by the President in the performance of functions vested in them by Congress.

This principle was expressed by Attorney General Wirt in 1823, when he said: 40/

"But the requisition of the constitution is, that he [the President] shall <u>take care</u> that the <u>laws</u> be executed. If the laws, then, require a particular officer by name to perform a duty, not only is that officer bound to perform it, but no other officer can perform it without a violation of the law; and were the President to perform it, he would not only be not taking care that the laws were faithfully executed, but he would be violating them himself."

The principle was reaffirmed by the U. S. Supreme Court in 1838. Recognizing that the Constitution requires the President to "take care that the laws be faithfully executed", the Court said: 41/

". . . it by no means follows [from the President's duty to "take care", etc.] that every officer in every branch of that [executive] department is under the exclusive direction of the President. . . .

* * * * *

". . . it would be an alarming doctrine that Congress cannot impose upon any executive officer any duty they may think proper, which is not repugnant to any right secured and protected by the Constitution; and in such cases the duty and responsibility grow out of and are subject to the control of the law, and not to the direction of the President."

In brief, the fact that an agency's activities are not subject to direction by the President does not of itself exclude that agency from the executive branch of the Government.

40/ 1 <u>Op</u>. <u>Atty</u>. <u>Gen</u>. 624, 625.

41/ Kendall v. United States, 12 Peters 610.

With respect to the Board, there is at least one clear evidence of Congressional intent that the Board should be regarded as a part of the executive branch.

The so-called Reorganization Act [42/] authorizes the President to submit plans for the reorganization of Government agencies. It defines an "agency" as meaning any "Executive agency" and any office or officer in the "executive branch". When the Act was originally enacted in 1939, it specifically excluded 21 agencies, including the Federal Reserve Board, an exclusion that would not have been necessary if the Board were not regarded as within the executive branch. As revised in 1945 and again in 1949, the Act did not exempt the Board. When the 1945 revision was under consideration, the House bill provided for a "single-package" treatment of certain agencies, including the Board, i.e., a requirement that any reorganization of such agencies should not be combined with reorganization of other agencies; but this requirement was dropped in the Senate. Quite clearly, the Board was regarded as an agency in the executive branch of the Government that would be subject to a Presidential reorganization plan.

In the writer's opinion, the Board obviously is an agency in the executive branch of the Government. As has been noted, this does not mean that the Board is subject to direction by the President; nor does it mean that the Board's status is the same as that of other agencies in the executive branch. Congress itself, by specific provisions of the Federal Reserve Act, has given the Board more freedom from control by the President and by the Congress than it has given most other Government agencies.

42/ Chapter 9 of Title 5 of the U. S. Code.

D. WHAT DIFFERENCE DOES IT MAKE?

In the last analysis, the question whether the Federal Reserve is in the legislative or executive branch is partly academic. Confusion has arisen because of failure to distinguish that question from the question as to the extent to which the Federal Reserve is exempted by law from restraint by both the Congress and the President. As stated by Reserve Board Chairman Martin in 1952,[43/]

> "In any event, irrespective of the branch of Government in which judicial determination might place the Board and the Open Market Committee, such determination would not affect their authority to exercise the discretion vested in them by Congress."

The one respect in which the question of the Board's place in the three branches of the Government may sometimes make a difference is the applicability of particular statutes of Congress to the activities of the Federal Reserve.

Some statutes are so broad in their scope as to leave no doubt as to their applicability to the Board. For example, the so-called Administrative Procedure Act is clearly applicable to the Board regardless of the branch of the Government in which it falls, because that Act defines an "agency" as meaning "each authority of the Government of the United States" except Congress, the U. S. courts, and the governments of the District of Columbia and the territories and possessions.[44/]

43/ 1952 Patman Compendium, p. 247.

44/ 5 U.S.C. § 551.

In some instances, the question whether the Board is in the executive branch can be avoided. Thus, some statutes that apply to agencies in the executive branch can be regarded as not applicable to the Board because they are clearly meant to apply only to agencies that, unlike the Board, derive their funds from appropriations.[45/] Similarly, statutes relating to the employment, compensation, or leave of Government employees do not apply to the Board's employees because of the provisions of section 10 of the Federal Reserve Act that give the Board sole authority with respect to such matters. On this ground, for example, the Board has not followed the Government Employees' Incentive Awards Act.[46/]

There are, however, some statutes that by their terms apply to agencies in the executive branch and that are of a kind that do not clearly justify exemption of the Board by reason of its exemption from appropriation acts or from laws relating to the employment, compensation, and leave of Government employees. For example, Title 5 of the U. S. Code, relating generally to the organization of the Federal Government, defines an "Executive agency" as meaning any "Executive department, a Government corporation, and an independent establishment."[47/] Clearly, the Board is not an Executive Department or a Government corporation; but, as the Attorney General held in 1914, the Board is an "independent establishment". However, the Code defines an "independent establishment"

45/ See, e.g., Act of Oct. 26, 1970, P.L. 91-510.

46/ 5 U.S.C. § 4501.

47/ 5 U.S.C. § 105.

as an establishment "in the executive branch". 48/ Consequently, provisions of Title 5 that apply to "Executive agencies" apply to the Board only if it is in the "executive branch". As previously noted, the Reorganization Act, which is a part of Title 5 and applies only to Executive agencies, has been regarded, partly because of its legislative history, as applicable to the Board. On the other hand, the Board has not regarded itself as subject to some statutes that apply generally to "Executive agencies", such as the Hatch Act. 49/

It is interesting to note that the Board has chosen to comply with statutes where they confer benefits upon employees or where they are of a sort that reflect a general policy with which noncompliance by the Board would seem to be inappropriate or even embarrassing. In the first category are the Federal Employees' Group Life Insurance Act of 1954 and the Federal Employees' Health Benefit Act of 1959. In the second category are the Equal Employment Opportunity Act and the President's executive order regarding conduct of Federal employees. 50/

48/ 5 U.S.C. § 104.

49/ 5 U.S.C. §§ 7321-7327.

50/ While the President's Executive Order No. 11222 of May 8, 1965, regarding conduct of Government employees, applies broadly to any "independent agency", section 7301 of Title 5 of the U. S. Code authorizes the President to prescribe regulations only "for the conduct of employees in the executive branch."

IV. THE FEDERAL OPEN MARKET COMMITTEE

Like the Board of Governors, the Federal Open Market Committee is a creature of Congress. Like the Board also, the FOMC has important public regulatory functions, i.e., regulation of open market operations by the Federal Reserve Banks with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. Unlike the Board, however, not all of the Committee's members are appointed by the President of the United States with the advice and consent of the Senate. The seven members of the Board are ex officio members of the Committee, but the remaining five members of the Committee are presidents of the Reserve Banks elected annually by the boards of directors of designated Reserve Banks as prescribed by statute. The Reserve Bank presidents in turn are appointed by their respective boards of directors subject to approval by the Board of Governors.

Unquestionably, the FOMC is an agency separate and distinct from the Board of Governors. Moreover, it seems clear that the Committee is an agency of the United States Government despite the fact that five of its members are not appointed by the President. Although the members of most Government boards and commissions are appointed by the President, a body may nevertheless constitute an agency of the Government even though none of its members is appointed by the President. For example, the old Railway Adjustment Board consisted of 36 members, all private citizens, 18 of whom were selected by the railroads and 18 selected by labor unions of railroad employees; but that Board was declared by the Supreme Court of the United States to be a "public agency".[51/]

51/ Washington Terminal Company v. Boswell, 124 F. 2d 235 (1941), affirmed by the Supreme Court in 319 U.S. 732 (1943).

Regulations and policy directives of the FOMC are published in the Federal Register in accordance with the requirements of the Administrative Procedure Act and the records of the Committee are made available for public inspection pursuant to the requirements of that Act. Thus, it is apparently assumed that the Committee constitutes an "authority of the Government of the United States" for purposes of that Act.

The Reserve Bank presidents while serving as voting members of the FOMC cannot be regarded as "officers of the United States" in a strict Constitutional sense because, under Article II, section 2, of the Constitution, officers of the United States include only persons appointed by the President, by the courts, or by heads of Executive Departments. Nevertheless, it is clear that the Reserve Bank presidents while serving as members of the Committee are officers of the United States in the general and usual meaning of the term and are regarded as such for purposes of particular statutes. Thus, section 3331 of Title 5 of the U. S. Code requires every individual (except the President) "elected or appointed to an office of honor or profit in the civil service or uniformed services" to take a prescribed oath of office upon assuming his public duties; and each Reserve Bank president upon his election as a member of the Committee takes such an oath of office.

Whether the FOMC is in the legislative or executive branch of the Government depends upon considerations like those heretofore discussed with respect to the Board of Governors. Chairman Martin's response to the 1951 Patman questionnaire regarding the status of the Board as part of the executive branch of the United States Government applied also to the status of the FOMC. It expressed the view that, in the absence of an authoritative court decision, no definite answer can be given to the question but that, regardless of what the answer might be, it would not affect the authority and duty of the Committee, as well as the Board, to exercise its own best judgment and discretion in performing its responsibilities under the law. For reasons similar to those discussed with respect to the status of the Board, it is believed that, if an answer must be given, it should be that the FOMC, like the Board, falls within the executive branch of the Government. It is nevertheless clear, as indicated by Chairman Martin, that the FOMC is free from Presidential direction or control in the performance of its statutory responsibilities in the area of Federal Reserve open market operations.

Although the Committee has an official staff consisting of officials of the Board of Governors and the Reserve Banks, it has no funds or employees of its own. Consequently, there can be no occasion for question to arise as to whether statutes of Congress relating to the use of appropriated funds or to the employment, compensation, and leave of Government employees are applicable to the Committee.

V. THE FEDERAL RESERVE BANKS

A. RELATION TO THE GOVERNMENT

The status of the Federal Reserve Banks in relation to the Federal Government is not easy to define. This is because the Reserve Banks have some attributes that are private in nature and some that are governmental.

In form, each Reserve Bank is organized like any private corporation. All of its stock is owned by its member banks. It is authorized to adopt and use a corporate seal. The stockholding member banks elect six of its nine directors. Its board of directors is required by the Federal Reserve Act to "perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law." 52/

On the other hand, a Reserve Bank differs in very important respects from a private corporation. The amount of stock of a Reserve Bank to which a member bank may prescribe is fixed by law at 6 per cent of the member bank's capital stock and surplus. 53/ Such stock may not be transferred or hypothecated. 54/ Dividends on the stock are limited to 6 per cent per annum on the amount actually paid in, regardless of the profits of the Reserve Bank. 55/ The stockholding member banks have

52/ Federal Reserve Act, § 4, ¶ 7; 12 U.S.C. § 301.

53/ *Id.*, § 5; 12 U.S.C. § 287.

54/ *Ibid.*

55/ *Id.*, § 7; 12 U.S.C. § 289.

no voice in the management of the affairs of the Reserve Bank other than the right to participate in the election of six of the nine directors.[56/] In the event of liquidation of a Reserve Bank, any remaining surplus would be paid to the United States rather than to the Reserve Bank's stockholders.[57/]

Moreover, the authority of the directors of a Reserve Bank in the management of the Bank's affairs is limited by the law. While the directors are authorized, like directors of private corporations, to appoint officers and employees, the selection of the president and first vice president of each Reserve Bank is subject to the approval of the Board of Governors, and the compensation of the directors, officers, and employees is subject to approval by the Board of Governors.[58/] Finally, in addition to regulatory authority with respect to specific matters, the Board of Governors is given the power of "general supervision" of the Reserve Banks.[59/]

It seems clear from the legislative history of the original Federal Reserve Act that the Reserve Banks were not regarded as being parts of the Government itself like the Federal Reserve Board. For example, the Report of the House Banking and Currency Committee on the original Act stated that the only factor of centralization was to be found in the Federal Reserve Board, which was to be "a strictly

56/ Id., § 4; 12 U.S.C. § 304.

57/ Id., § 7; 12 U.S.C. § 290.

58/ Id., § 4; 12 U.S.C. §§ 341, 307.

59/ Id., § 11(j); 12 U.S.C. § 248(j).

Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself." 60/ During the debates, Carter Glass described the Federal Reserve Board as "a part of the Government itself", whereas there was no such characterization of the Reserve Banks. 61/

Although it was not contemplated that the Reserve Banks would be a part of the "Government itself", Carter Glass stated that they would have "an essentially public character"; 62/ and it has always been recognized that the Reserve Banks are operated for public purposes and not for private profit.

In 1952, in reply to the specific question whether the Reserve Banks were parts of the executive branch of the United States Government, Reserve Board Chairman Martin, without directly answering the question, stated that the Reserve Banks are "corporate instrumentalities of the Federal Government created by Congress for the performance of governmental functions" and that they had been described by the courts as "important agencies of the Federal Government in its control of banking and currency". 63/ He referred to the fact that the stock of the Reserve Banks was owned by the member banks but pointed out the differences between the effects of such stock ownership and of ownership of stock

60/ House Report on Original Act, p. 18.

61/ 50 CONG. REC. 4644.

62/ House Report on Original Act, p. 16.

63/ 1952 Patman Compendium, p. 261.

in ordinary private corporations. In summary, he said: 64/

"Ownership of Federal Reserve Bank stock by member banks is an obligation incident to membership in the System - in effect, a compulsory contribution to the capital of the Reserve Banks. It was not intended to, nor does it, vest in member banks the control of the Reserve Banks or the determination of System policies. Such control would obviously be inappropriate in view of the functions exercised by the Reserve Banks."

In reply to a similar question, the presidents of the Reserve Banks, in a joint answer, described the Reserve Banks in the following language: 65/

"As distinguished from the Board of Governors of the Federal Reserve System, Federal Reserve banks are not independent establishments of the Government. Federal Reserve banks are 'instrumentalities' of the Federal Government. As such, they act as agents of the Government in performing Government functions.

"There are many kinds of Government instrumentalities. Distinctions may be drawn between such instrumentalities of the Government as (a) private independent contractors working on Government contracts; (b) national banks, which are wholly privately owned and controlled, and are operated for private profit; (c) Federal Reserve banks, all the stock of which is privately owned, a majority of the directors of which are elected by such stockholders, and which are operated (under the general supervision of the Board of Governors of the Federal Reserve System, an independent establishment of the Government) primarily for public and governmental purposes and not at all for private profit; and (d) the numerous corporations wholly owned and controlled by the Federal Government and operated entirely for Federal governmental purposes, such as the Reconstruction Finance Corporation.

"In our opinion Federal Reserve banks are partially part of the private economy and are part of the functioning of the Government (although not technically a part of the Government). Because they are a part of the functioning of Government the public interest is dominant in their policies. They thus

64/ Id., at 262.

65/ Id., at 648, 649.

carry out the original intent for which they were formed which was to function somewhere between private enterprise and the Government itself (much closer to the Government than are national banks, but not so close as are 'Government agencies'). We believe that it was an essential part of the intent of Congress, in enacting the Federal Reserve Act, that Federal Reserve banks should thus be allied to the Government but not be a part of the Government itself."

In a separate reply to the question, President Allan Sproul of the New York Reserve Bank stated:[66/]

"In my opinion Federal Reserve banks are not part of the United States Government nor are they wholly a part of the private economy. Disregarding the pitfalls of semantics, I would say that in discharging their most important responsibilities - participation in the formulation and execution of monetary and credit policy - the Federal Reserve banks are part of the functioning of Government. In performing their duties as fiscal agent, they are instrumentalities of Government. In the provision of such services as the clearing of checks, they are part of the private economy. In the field of monetary and credit policy, the Government or public interest is dominant and controlling as it should be. In the field of fiscal agency operations, the Federal Reserve banks act as agents of a Government principal. In the field of check clearings, and similar operations, the private economy is served in the public interest.

"I share the belief that it was the original intent of those who created the Federal Reserve System, that the Federal Reserve banks should function somewhere between private enterprise and the Government. I believe that it has been the continuing intent of each succeeding Congress that the Federal Reserve banks should be allied to Government but not part of Government. . . ."

If the Reserve Banks are not, strictly speaking, parts of the Federal Government and yet "somewhere between private enterprise and the Government", a troublesome question arises as to whether they are "agencies" of the Government and therefore subject to various Federal statutes that apply to Federal agencies.

66/ *Id.*, at 649.

As noted in Mr. Martin's 1952 reply to Representative Patman, one court described the Reserve Banks as "important agencies of the Federal Government in its control of banking and currency". 67/ Other courts have said that the Reserve Banks are governmental agencies operating under the direction of the Federal Reserve Board; 68/ that a Reserve Bank is "a Federal agency exercising powers conferred by Federal statute"; 69/ and that a Reserve Bank is "an operating agency of the Federal government." 70/

Despite the language used in these court decisions, it may be argued that the courts in these cases described the Reserve Banks as Federal "agencies" only in the sense of being "instrumentalities" of the Federal Government and not in the sense in which the Board of Governors is a Government agency. Thus, in 1928, the Supreme Court of the United States noted that, while the Reserve Banks are instrumentalities of the United States, they are not departments of the Government. 71/

Clearly, the employees of the Reserve Banks are not regarded as employees of the United States. 72/ They are not regarded as subject

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67/ Federal Reserve Bank of Richmond v. Kalin, 77 F. 2d 50, 51 (CCA 4th, 1935).

68/ Raichle v. Federal Reserve Bank of New York, 34 F. 2d 910, 916 (CCA 2d, 1929).

69/ Armand Schmoll, Inc. v. Federal Reserve Bank, 286 N.Y. 503, 506, 37 N.E. 2d 225 (1941).

70/ Federal Reserve Bank v. Register of Deeds, 288 Mich. 120, 284 N.W. 667, 668 (1939).

71/ Emergency Fleet Corporation v. Western Union Telegraph Co., 275 U.S. 415, 425.

72/ See Opinion of Comptroller General, B-5836, Sept. 15, 1939.

to the Federal civil service laws, Federal leave regulations, the Federal Employees' Group Life Insurance Act, the Federal Employees' Health Benefit Act, and other statutes generally applicable to Government employees. The provisions of the Administrative Procedure Act have not been construed as applicable to the Reserve Banks even though that Act covers "any authority of the Government of the United States".[73/]

The President's Executive Order 11491 of October 29, 1969, relating to labor-management relations in the Federal service, is applicable by its terms to any "agency" or "nonappropriated funds instrumentality of the United States". The System, nevertheless, has taken the position that this Executive Order does not apply to the Reserve Banks despite the fact that the Order covers instrumentalities as well as agencies of the United States.

The National Labor Relations Act defines the term "employer" as not including the United States or any wholly-owned Government corporation "or any Federal Reserve Bank".[74/] It may be argued that, if the Reserve Banks were regarded as a part of the United States Government, it would have been unnecessary for Congress to provide specifically for their exclusion from that Act. Conversely, the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970,[75/] in defining the term "Federal agency" for purposes of that Act, includes

73/ 5 U.S.C. § 551.

74/ 29 U.S.C. § 152.

75/ P.L. 91-646.

not only any department, agency, or instrumentality in the executive branch of the Government but also, in specific language, the Federal Reserve Banks and their branches. Again, it may be argued that, since Congress felt it necessary to bring the Reserve Banks specifically under the coverage of this Act, it must have regarded the Reserve Banks as not constituting "Federal agencies" for other purposes. Such arguments, however, are not conclusive. In reply, it may be contended that Congress was simply attempting to make it clear that it was excluding the Reserve Banks from the coverage of one act but specifically bringing them within the scope of the other.

In 1967, a Federal District Court held that the San Francisco Reserve Bank, in making advances to a member bank, was an "agency or instrumentality" of the United States for purposes of the Federal Tort Claims Act,[76] thus leaving up in the air the question whether a Reserve Bank is an "agency" or an "instrumentality" of the United States.

To summarize, it seems clear that, while the Reserve Banks are not parts of the Federal Government in the same sense as the Board of Governors, they are "instrumentalities" of the Federal Government and operate for public purposes. It is also clear that, in acting as fiscal agents for the Treasury Department and other Government agencies, the Reserve Banks act as "agents" of the United States. It remains debatable, however, whether the Reserve Banks may properly be regarded as "Federal agencies" for purposes of Federal laws in general. It may

76/ A.M.R., Inc., et al v. Federal Reserve Bank of San Francisco, United States District Court of the Northern District of California, Southern Division, Civil Action No. 44367, Apr. 26, 1966.

be that the question has to depend upon the language and intent of a particular statute; or it may be, as suggested by Reserve Bank President Sproul in 1952, that in the exercise of certain functions the Reserve Banks are Federal agencies but that in the exercise of other functions they are not Federal agencies.

Whatever may be the legal status of the Federal Reserve Banks, it appears that even Representative Patman's Subcommittee of the Joint Economic Committee in 1952 was satisfied with that status. In its Report, that Subcommittee stated:[77/]

> ". . . On the whole, the Subcommittee sees no objection to this hard-to-define position of the Federal Reserve banks. The Federal Reserve System has been a helpful institutional development. Its roots are sunk deeply in the American economy and it has borne good fruit. This is more important than that each portion of it be subject to classification by species and genus according to the rules of a textbook on public administration.
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> "But, one fact with respect to the legal status of the Federal Reserve banks stands out, and it is the only fact of importance. Congress created the Federal Reserve banks and Congress can dissolve them or can change their constitution at will. On dissolution the entire surplus of the banks would become by law the property of the United States. Ultimately they are creatures of Congress."

B. RELATION TO THE BOARD OF GOVERNORS

The framers of the original Federal Reserve Act apparently contemplated that the regional Reserve Banks would be considerably more autonomous than they are regarded today and that the Board of Governors would rarely exercise any controlling power over the Reserve Banks, despite the Board's authority with respect to "general supervision".

77/ Joint Committee Print, Report of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, 82d Cong., 2d Sess. (1952), p. 51. [Hereafter cited as 1952 Patman Subcommittee Report.]

Thus, Senator Shafroth said: 78/

". . . These Federal reserve banks are the ones that deal with the individual banks, pass upon the securities presented, direct what paper shall be discounted, and attend to all matters involving the care and investment of the enormous sums of money which will be held by them. It is upon the boards of directors of these Federal reserve banks that bankers should be placed, as is provided in the bill."

Similarly, Senator Nelson stated: 79/

". . . While we place at the head of this system a general reserve board here in Washington, we establish in the system a number of reserve or regional banks. We equip them with a board of directors and give the board of directors practically plenary banking powers. It is only in a few special cases and in remote contingencies that the Federal reserve board can exercise any controlling power. . . ."

During the first few years of the System, the governors of the Reserve Banks, and particularly Governor Benjamin Strong of the New York Reserve Bank, took the position that the Federal Reserve Board in Washington had only limited authority to direct or control the affairs of the Reserve Banks. Under the leadership of Governor Strong, the Reserve Bank governors organized themselves in a Conference of Governors and that Conference "came to assume the duty of recommending changes not only in policy but also in legislation." 80/ Inevitably, the Reserve Bank governors came into conflict with the Federal Reserve Board. Early in 1915, the governor of the Richmond Reserve Bank complained that the Board was exceeding its authority in promulgating rules regarding

78/ 50 CONG. REC. 6023.

79/ 51 CONG. REC. 516.

80/ H. Parker Willis, The Federal Reserve System: Legislation, Organization and Operation (Ronald Press Company, New York, 1923), p. 705.

purchases of acceptances that were more restrictive than the Federal Reserve Act itself.81/ Some of the other governors charged that the Board's practice of suggesting discount rate changes to the Reserve Banks likewise went beyond the Board's authority.82/

Finally, in 1916, the Board in effect told the Reserve Bank governors that they should no longer have conferences except when called by the Board and with participation by the members of the Board.83/ The Board's policy was reflected in the following statement in its Annual Report to Congress for 1917:84/

> ". . . Moreover, the activities of the year have been so great as to require the constant presence of the executive officers at their banks. There have in consequence been no meetings of the Federal Reserve agents during the year, and but two meetings of the Board with the governors of the banks. The events of the past year have done much to bring into their proper relationship as parts of a working whole the several component elements of the Federal Reserve system. Experience has demonstrated that in all vital matters of general policy calling for prompt and decisive action concentration of responsibility without division of authority is indispensable. The position of the Federal Reserve Board, as the coordinating agency for all of the 12 banks and as the governing body of the Federal Reserve system, is now well defined and the line of distinction between the local management of each one of the 12 banks as a district bank, and the operation of all of the 12 banks as a system, has become more marked."

The Board's hands were somewhat strengthened by a 1919 opinion of the Attorney General of the United States that held, partly because

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81/ Lester V. Chandler, Benjamin Strong, Central Banker (The Brookings Institution, Wash., D. C., 1958), p. 7.

82/ Id., at 71.

83/ See supra note 80, p. 706; Karl R. Bopp, The Agencies of Federal Reserve Policy, University of Missouri Studies, Oct. 1, 1935, p. 75; and supra note 81, pp. 72-74.

84/ 1917 Annual Report 29.

of the Board's power of "general supervision", that the Board has ultimate authority over the determination of Reserve Bank discount rates.[85]

Despite the Attorney General's opinion, the relative influence of the Reserve Banks continued to be strong for a number of years. Since 1936, however, the autonomy of the Reserve Banks has diminished and their powers in relation to those of the Board of Governors have declined. In large part, this has been due to changes in the Federal Reserve Act made by the Banking Act of 1935. Among other things, that Act for the first time expressly provided that each Reserve Bank should have a president and vice presidents and that the president should be the chief executive officer of the Bank, and it provided further that the president and the first vice president should be appointed by the board of directors of the Reserve Bank but only with the approval of the Board of Governors and for a limited term of five years.

In 1938, Reserve Board Chairman Eccles said:[86]

> "Since its establishment in 1914, the Federal Reserve System has undergone many changes in the direction of increased control by the Board of Governors. With the passage of the Banking Act of 1935 this control has been greatly strengthened insofar as national policies are concerned. . . ."

In 1952, Reserve Board Chairman Martin noted that changes in the law had "modified the role of the boards of directors of the Federal Reserve Banks in the formulation of System credit policies."[87] And the 1952

85/ 32 Op. Atty. Gen. 81.

86/ 1938 House Hearings, p. 448.

87/ 1952 Patman Compendium, p. 250.

Patman Subcommittee Report stated: 88/

". . . At one time this independence [of the Reserve Banks] was much greater. The original Federal Reserve Act appears to have conceived the individual Federal Reserve banks as important policy-making agencies and the Board of Governors (then the Federal Reserve Board) as principally a regulatory agency, like the Interstate Commerce Commission. The subsequent trend has been toward a somewhat greater degree of independence of the central board from the President but a much diminished autonomy for the individual banks. The most important changes in this direction were made by the Banking Act of 1935, but it has been the trend for the whole period since the adoption of the original Act and is, for the most part, merely a reflection of the growth in the importance of monetary policy and the recognition of the fact that this policy cannot be determined by regions but must apply over an entire currency area."

If the Reserve Banks do not have the degree of autonomy that apparently was contemplated by Benjamin Strong and other Reserve Bank officials during the early years of the System, the Reserve Banks nevertheless continue to play an important part in the affairs of the System. They are by no means mere regional branches of the Board of Governors. Under the direction of their boards of directors, they are responsible for carrying out important functions vested in them by the law, including the initiation of discount rates, administration of the discount window, examination of State member banks, and the collection of checks for their member banks. As members of the Federal Open Market Committee, the Reserve Bank presidents participate in the formulation of open market policy. On the other hand, the Reserve Banks are parts of a "system" of which the Board of Governors is the governmental "capstone"; and the Board has statutory powers through the exercise of which it can supervise the activities of the Reserve Banks. The _extent_ of the Board's supervisory authority, as in the early days of the System, can still be a subject of dispute between the Reserve Banks and the Board.

88/ _1952 Patman Subcommittee Report_, p. 53.

VI. THE FEDERAL ADVISORY COUNCIL

Any treatment of the legal status of the Federal Reserve System and of its component parts would be incomplete without at least a brief discussion of the status of the Federal Advisory Council.

The Advisory Council was a 1913 compromise designed to appease those who felt that the Federal Reserve Board should be composed of bankers or at least that its members should be selected by bankers. It was President Wilson who suggested that, as a means of gaining banker support for the Federal Reserve bill, provision should be made for an advisory body consisting of bankers.[89] The result was that section 12 of the original Federal Reserve Act established the Federal Advisory Council of 12 members, one to be chosen annually by the board of directors of each of the Reserve Banks, with power to confer with the Federal Reserve Board on general business conditions, to make representations concerning matters within the jurisdiction of the Board, and to call for information and make recommendations regarding discount rates, reserve conditions, note issues, Reserve Bank open market operations, and "the general affairs of the reserve banking system."[90] Although the statute does not expressly require that the Council shall be composed of bankers, its members, with only two or three exceptions, have always been bankers.

Legally, the Council is a separate and independent statutory body. This was recognized at the outset when the Federal Reserve Board

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89/ See Carter Glass, An Adventure in Constructive Finance (Doubleday, Page & Co., 1927), pp. 113-116.

90/ Federal Reserve Act, § 12; 12 U.S.C. § 262.

invited the Council to meet with it on December 15, 1914, "recognizing that the Federal Advisory Council is a separate and independent body."[91/] Although its members are selected by the boards of directors of the Reserve Banks instead of being appointed by the President, this fact does not preclude the Council from being an agency of the Federal Government. If it is such an agency, one may question whether its only employees, a secretary and assistant secretary, should not be regarded as employees of the United States. That question, however, has never been raised. With the approval of the Board, the relatively nominal expenses of the secretariat of the Council and its other expenses have been paid by the Reserve Banks.

The status of the Council as an agency of the Federal Government has never been of particular importance because its functions are purely advisory; it has no substantive powers. Nevertheless, the status of the Council <u>within</u> the Federal Reserve System has been the subject of debate on several occasions.

In 1935, a member of the Council from the Boston District, Mr. Thomas W. Steele, upheld the "independence" of the Council. In a speech at a meeting of the stockholding member banks of the Boston Reserve Bank, Mr. Steele said:

> "A quite unjustified difference of opinion has arisen at times upon the status of the Council as an independent body. Only ignorance could lead to uncertainty on this point. No one can read the statute intelligently, particularly if he does so in the light of its historical setting, without the conviction that it was intended to be fully independent of the Federal Reserve Board and of any other body. . . ."

91/ 1914 Annual Report 185.

In December 1946, the Council, while conceding that its powers were only advisory, vigorously maintained that it was "not subject to control or direction by the Board of Governors":

> "Unless and until the Congress changes the law, the Council will continue to exercise the powers given it to the best of its ability in the interest of the national welfare as it sees it. While the Council realizes its function is advisory, it will insist on its statutory right to confer with the Board of Governors, to make oral or written representations, to make recommendations, and to ask for information which the law entitles it to have. It reserves the right to make its recommendations public if it so desires. Within these limitations it desires to cooperate with the Board of Governors to the end that whenever possible the Council can support the Board's position publicly and in banking circles. . . ."

Confrontations between the Council and the Board involved disputes as to the kinds of questions with respect to which the Council may make recommendations to the Board (in 1934), the right of the Council to make its views known to the public (also in 1934), and the right of the Council to have access to information in the possession of the Board (in 1944). All of these disputes occurred during the tenure of Mr. Marriner Eccles as chairman of the Board. It is not necessary for the purposes of the present paper to give a detailed account of these disputes. They are mentioned only to indicate that questions have arisen as to the status of the Council within the Federal Reserve System.

Whether the Council, a compromise in 1913, is necessary today has been questioned on various occasions. In 1938, Representative Patman introduced a bill that would have abolished the Council, and Reserve Board Chairman Eccles agreed that the Council was not "able to contribute very much." [92/] In 1949, the secretary of the Independent Bankers

92/ 1938 House Hearings, p. 449.

Association felt that there was no reason for the existence of the Council.[93]

In any event, the Federal Advisory Council remains as an integral, but not a dominating, part of the Federal Reserve System. It is a governmental agency, but, because its functions are only advisory, its status as such is relatively unimportant.

VII. THE ROOTS OF FEDERAL RESERVE INDEPENDENCE

A. IN GENERAL

The independence of the Federal Reserve System has been the subject of extensive and frequent discussion and debate. It was dealt with in detail in Dr. Clifford's book on the subject.[94] The 1971 report that the President was about to take measures to terminate the independence of the System stimulated considerable newspaper comments and evoked apprehension that "the Fed's independence was being threatened".[95] What is the nature of this "independence" of the Federal Reserve System? Upon what grounds is it based? Can it be justified? It is with these questions that most of the remainder of this paper is concerned.

93/ Monetary, Credit, and Fiscal Policies, Collection of Statements Submitted to Subcommittee of Joint Committee on the Economic Report, 81st Cong., 1st Sess. (1949), p. 312. [Hereafter cited as 1949 Douglas Compendium.]

94/ See *supra* note 4.

95/ Bratter, "The Independence of the Federal Reserve", Baltimore Sun, Aug. 11, 1971, p. A-10.

[redacted]

In one sense the Federal Reserve is no more and no less "independent" than any other agency in the executive branch of the Federal Government. As has been mentioned, no agency or officer of the Government is subject to control or direction of the President in the performance of its or his statutory functions. Despite the President's constitutional duty to "take care that the laws be faithfully executed", the duties and responsibilities of every officer of the Government "grow out of and are subject to the control of the law, and not to the direction of the President."[96/] Thus, even the head of one of the Executive Departments cannot be directed by the President in the exercise of discretion conferred upon him by a statute of Congress.

The Federal Reserve's independence, however, goes beyond this "constitutional" independence that it shares with other Government agencies. Its greater degree of independence derives from various provisions of the Federal Reserve Act that give the Federal Reserve System special protection not only from influence by the President but from influence by the Congress as well.

As has been noted, the original Federal Reserve Act was a compromise between those who wanted the System to be controlled by the banks and those who wanted complete Government control. The first group lost when President Wilson insisted that bankers should not select the members of the Federal Reserve Board; but it won to the extent that six of the nine directors of each Reserve Bank were to be chosen by the member banks and that a Federal Advisory Council of 12 bankers was

96/ Kendall v. U. S., 12 Peters 610 (1838).

established to advise the Board. Part of the System's "independence" results from its regional nature and its mixture of public and private interests. Although the Reserve Banks are subject to general supervision by the Board, their semi-autonomous status continues to reflect a concept that was uppermost in the minds of the framers of the original Act, i.e., a central banking system that was not too "central".

One of the main ideas in the minds of the framers of the Act was that the System should be insulated from all political pressures. In the House Committee's Report, Chairman Carter Glass stated: 97/

> "It cannot be too emphatically stated that the Committee regards the federal reserve board as a distinctly nonpartisan organization whose functions are to be wholly divorced from politics."

In order that this objective might be accomplished, the Act included specific provisions designed to protect the Board from pressure by the President. The Banking Acts of 1933 and 1935 added provisions that gave the System a certain degree of independence from the Congress itself, as well as a guarantee of independence from the Treasury Department. It is because of these provisions of law that the Board, although a part of the "executive branch", is "independent" within the Federal Government to a greater extent than most other Federal agencies.

97/ House Report on Original Act, p. 43.

B. INDEPENDENCE FROM THE PRESIDENT

Terms of Board members

As a means of insulating the Federal Reserve Board from Presidential influence, the original Federal Reserve Act provided that the members of the Board should serve for long and staggered terms. As reported in the House, the bill provided for three *ex officio* members and four appointive members to serve for eight-year terms. The bill met with opposition because it would have permitted a new President immediately to select a majority of the Board - the three *ex officio* members and one of the appointive members; but the reported bill passed the House. In the Senate, both sections of the Senate Committee sought to prevent the President from appointing a majority of the Board during his first two years in office. Senator Hitchcock argued for a nine-man Board with only one *ex officio* member (the Secretary of the Treasury) and eight members appointed for eight-year terms, in order to remove the Board from political control.[98/]

The Senate passed a bill providing for a seven-man Board consisting of the Secretary of the Treasury and six appointive members to serve for six-year terms. In the end, the Act provided for a Board of seven members, but with two *ex officio* members - the Secretary of the Treasury and the Comptroller of the Currency - and five members to be appointed by the President for staggered terms of 10 years. This meant

98/ He urged "that the welfare of the country, the welfare of the system, and the permanency of the banking system required that the board should not only be larger, but that it should be further removed from immediate political control." 51 CONG. REC. 964.

that the President could select only three of the seven members during his first two years in office. As stated by Representative Temple, this "change in the bill practically takes the Federal reserve system out of politics."99/

In 1933, the terms of appointed members of the Board were lengthened to 12 years; and since February 1, 1936, the term of a Board member has been fixed at 14 years. Except for the Comptroller General of the United States, who serves for a 15-year term, a member of the Board has the longest statutory term of any official of the Federal Government. And the purpose of such a long term clearly is to assure "independence" from Presidential influence.

The House Committee's Report on the original Federal Reserve Act "thought it wise that they [the appointive members of the Board] should be assigned a tolerably long tenure."100/ In 1952, former Reserve Board Chairman Martin observed that the 10-year terms provided by the original Act "obviously contemplated a high degree of independence for members of the Board."101/ Mr. Martin felt that "long terms tend to keep Government positions nonpolitical in nature."102/ In 1964, the then president of the American Bankers Association argued that a reduction in the term of Board members would have the effect of defeating "the original intent of Congress . . . to assure the Board members a high degree of independence from the executive branch."103/

99/ *Id.*, at 1459.

100/ House Report on Original Act, p. 43.

101/ 1952 Patman Compendium, p. 245.

102/ *Id.*, at 301.

103/ Hearings on Federal Reserve After Fifty Years, p. 1877.

Freedom from removal

The head of an Executive Department - a member of the President's cabinet - has no statutorily fixed term of office and is subject to dismissal at the President's pleasure. As has been noted, the President cannot direct or control any officer of the Government, even the head of an Executive Department, in the performance of his statutory functions. But, if the President dislikes the manner in which a Department head performs his duties, the President can fire that officer. In contrast, if the President does not approve of the way in which a member of the Federal Reserve Board discharges his duties, he cannot fire the Board member for that reason alone. Once appointed by the President, a Board member may serve his full 14-year term with the knowledge that he cannot be removed by the President merely because he acts contrary to the wishes of the President.

The original Federal Reserve Act provided that a member of the Board could be removed by the President only "for cause", 104/ and this provision has never been modified. While not specifically defined, the term "for cause" appears to mean for incompetence, malfeasance, or flagrant neglect of duty. Presumably, a Board member, like a member of the Interstate Commerce Commission, cannot be removed by the President except for "inefficiency, neglect of duty, or malfeasance in office." 105/ Since the enactment of the original Act - a period of nearly 60 years - no President has attempted to remove a member of the Board.

104/ Federal Reserve Act, § 10, ¶ 2; 12 U.S.C. § 242.

105/ 49 U.S.C. § 11.

Relations to President under the Employment Act

That the determination of economic policy by the Federal Reserve is not subject to Presidential control is significantly illustrated by the relationship of the Board to the President under the Employment Act of 1946.[106/] That Act sets forth a Congressional statement of economic policy[107/] that unquestionably applies to the Federal Reserve.[108/] Nevertheless, it seems clear that the Board is not obliged to agree with or adhere to the specific economic goals set forth by the President in his economic report to Congress pursuant to the Employment Act but may exercise its own judgment as to the manner in which the policy stated in that Act may best be achieved.

In 1958, hearings were held on a bill introduced by Representative Reuss to amend the Employment Act to require the President to include in his annual economic report to Congress recommendations as to "monetary and credit policies."[109/] Reuss made it clear, however,

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106/ Act of Feb. 20, 1946, 60 Stat. 23, 15 U.S.C. §§ 1021-1025.

107/ 15 U.S.C. § 1021.

108/ In 1949, Board Chairman McCabe observed that the Act applied "to the Federal Reserve as well as to other Federal agencies." 1949 Douglas Compendium, p. 26. Chairman Martin made a statement to the same effect in 1952. 1952 Patman Compendium, p. 209. In 1966, Dr. Arthur F. Burns, who later became chairman of the Board, made the following statement:

> ". . . The President, his Council of Economic Advisers, the Congress, in some degree the entire executive and administrative establishment, including the Federal Reserve Board, now function under this 'constitution' when major economic policies are developed." Twentieth Anniversary of the Employment Act of 1946: An Economic Symposium, Hearing before Joint Economic Committee, 89th Cong., 2d Sess. (Feb. 23, 1966), p. 27. [Hereafter cited as 1966 Symposium.]

109/ H.R. 12785, 85th Cong., 2d Sess.

that his amendment would not oblige the Federal Reserve to abide by the President's recommendations. He noted that President Eisenhower had repeatedly regarded "the independence of the Federal Reserve as a reason for refraining from even making administration recommendations in the field of monetary and credit policy." 110/

In 1959, Mr. Reuss introduced another bill 111/ that similarly would have required the President to include in his economic report to Congress recommendations as to monetary and credit policies and that, in addition, would have provided that, if the Federal Reserve Board disagreed, it should submit a statement of its views and reasons for disagreement. Again Reuss emphasized that his bill would not require the Board to agree with the President's recommendations or "to do what he says." 112/ In connection with consideration of an identical bill in 1960, 113/ Reuss once again stated that the bill would not mean that "the Federal Reserve Board has to do what the President thinks it ought to do." 114/

110/ Hearings before Subcommittee of House Committee on Government Operations on H.R. 12785, 85th Cong., 2d Sess. (July 1958), p. 5. [Hereafter cited as 1958 Hearings on Employment Act.]

111/ H.R. 4870, 86th Cong., 1st Sess.

112/ Hearings before Subcommittee of House Committee on Government Operations, 86th Cong., 1st Sess. (Mar., Apr. 1959), p. 37. [Hereafter cited as 1959 Hearings on Employment Act.]

113/ S. 2382, 86th Cong., 1st Sess.

114/ Hearings before Subcommittee of Senate Committee on Banking and Currency, 86th Cong., 2d Sess. (Feb. 1960), p. 17. [Hereafter cited as 1960 Hearings on Employment Act.]

Clearly, if amendments of the kind proposed by Representative Reuss were not intended to make the Board subject to economic policies proposed by the President, the existing Employment Act must likewise have been regarded as not subjecting the Board to the President's direction in the monetary area.

In December 1965, the Board asserted its freedom from the President's views as to monetary policy when it increased the discount rate. Shortly thereafter, in February 1966, the Joint Economic Committee, under the chairmanship of Representative Patman, held a unique hearing in the form of a "symposium" at the Washington Hilton Hotel in celebration of the twentieth anniversary of the Employment Act. Only one or two statements by the participants had any relation to the question whether the Federal Reserve is bound by the policy goals stated by the President in his economic report under that Act. It is worth noting, however, that Dr. Walter W. Heller referred to the Board's discount rate action in December 1965 as an illustration of the fact that the Federal Reserve had not always gone along with the President as to monetary policy. Dr. Heller said: 115/

> ". . . In December, as domestic demands began to change, the Federal Reserve slipped out of the harness of monetary-fiscal coordination and touched off a wave of interest rate increases, for both buyers and sellers of money, that must be surprising even to those who initiated the move."

A "supplement" to the 1966 symposium printed by the JEC contained statements by economists that clearly recognized that the President could not legally control or influence the monetary policies of the

115/ 1966 Symposium, p. 43.

Board. For example, Professor Angell of Columbia University said:[116/]

> "The most serious gap in the [Employment] act, I believe, is its failure to make any explicit provision for orderly incorporation of the policies and actions of the Board of Governors of the Federal Reserve System into its own framework. Legally, in its operations the Board is independent of the Federal Government as such. . . ."

In recent years, Representative Patman has introduced bills, to be discussed later in this paper, that would amend the Employment Act in a more drastic manner than that proposed by Representative Reuss. The Patman bills would have expressly required the System to conduct its operations in accordance with programs and policies proclaimed by the President pursuant to the Employment Act. None of these bills has been enacted and again the clear inference is that the President has no authority under existing law to require the Board to follow or to implement economic policies proposed by him.

C. INDEPENDENCE FROM THE CONGRESS

Exemption of Board employees from the classified civil service

Section 11(l) of the Federal Reserve Act, which has never been amended, reads as follows:[117/]

> "Sec. 11. The Board of Governors of the Federal Reserve System shall be authorized and empowered:
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> * * * * *
>
> "(l) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as

116/ 1966 Symposium, Supplement, p. 24.

117/ 12 U.S.C. § 248(l).

> the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January sixteenth, eighteen hundred and eighty-three (volume twenty-two, United States Statutes at Large, page four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof: Provided, That nothing herein shall prevent the President from placing said employees in the classified service."

The provision of this subsection exempting employees of the Board from the classified civil service has been responsible in a large degree for the Board's "independence" from Congress since it means that the Board's employees are not subject to statutes of Congress and regulations of the Civil Service Commission relating to Government employees in the classified civil service. Nevertheless, it appears that the framers of the original Act did not look upon the provision as a means of protecting the Board from Congressional influence. In fact, the legislative history of the provision is of considerable interest.

No such provision was contained in the bill that passed the House of Representatives nor in the bills reported by the Senate Banking and Currency Committee. The paragraph that now constitutes section 11(l) of the Act was introduced on the floor of the Senate on December 18, 1913, by Chairman Owen of the Senate Committee, although in the form in which introduced it did not include the last clause of the present subsection authorizing the President to place the Board's employees in the classified civil service. Senator Owen gave no reasons as to the need for his amendment, but the amendment promptly met with vigorous opposition on the part of Republican senators, particularly Senators Burton, Bristow, Root, Townsend, Norris, and Cummins. They argued strongly that exemption of the Board's employees from the Civil Service Classification Act would put the Board directly into politics and give rise to a "spoils system". They urged that there was no more reason for exempting Board employees from the classified civil service than for exempting employees of any other Government agency.[118/] To cite one example, Senator Norris said:[119/]

> "The amendment now before the Senate, it seems to me, goes toward the proposition that I was seeking in that article to avoid - placing this board, which has the control over all the banks, in politics. No argument has been offered, and none can be presented, in favor of taking these appointees out from under the civil service that will not apply to every appointment that has ever been made in the history of the civil-service system.
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> "Mr. President, if we injure this legislation now by making it partisan, by making it possible for official political influence to become instrumental in placing favorites in office under this law, we will, in my judgment, eliminate the good that would otherwise come from it. I can not understand, I can not appreciate, how any man, realizing the importance of the measure that we are now to place upon the statute books - and it will probably remain upon the statute books longer than any of us will live - I can not see how anyone can for a single moment concede the proposition that the appointees of this board should be politicians, rather than be appointed on account of their fitness for the places they are to occupy."

Senator Owen confessed that he was "amazed" by the severe criticism of his amendment. He stated that he believed completely in the civil service system; but his only defense of the amendment was that the Federal Reserve Board would need to have expert employees and that it would be better able to select them than the Civil Service Commission. He added that, in any event, the number of the Board's

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118/ See 51 CONG. REC. 1134-1144.

119/ *Id.*, at 1137, 1138.

employees would be small.[120/] Agreeing with the last statement, Senator Williams felt that "there will probably be six or eight clerks and three or four messengers at the reserve board's headquarters."[121/] Only Senator Smoot, who opposed the amendment, felt that it was "ridiculous" to assume that the Board would have no more than a dozen employees. He predicted that within a year the Board would have 100 or more employees.[122/]

Perhaps the best defense of the amendment was made by Senator Reed. Arguing that the Board would require "special talent" and that its hands should not be tied in selecting its employees, he said:[123/]

> "This board has a great task before it. It requires special talent to enable it to put this system into effect, and it would be as ridiculous to tie its hands and compel it to take incompetent people who have passed some kind of an examination prescribed by a civil-service board, who know nothing about banking, as it would be to compel the Supreme Court of the United States to select its clerk from a list of clerks that might have been furnished to it by a civil-service board."

When the amendment came to a vote, it was approved by a close margin of 34 to 29.[124/] Even then, the objectors did not give up. On the next day, December 19, Senator Burton moved to strike out the whole subsection. His proposal was defeated by a vote of 43 to 40. Immediately, Senator Brandegee moved to strike only the sentence specifically exempting the Board's employees from the Classification Act and this

120/ *Id.*, at 1138.

121/ *Id.*, at 1140.

122/ *Id.*, at 1142.

123/ *Id.*, at 1141.

124/ *Id.*, at 1144.

time the vote was a 43-43 tie, broken only by the "nay" vote of the Vice President. Thus, by a margin of one vote, the exemptive provision became a part of the law. It was at that point that Senator Jones brought forth an amendment to add the clause authorizing the President to place the Board's employees in the classified service; and this amendment was agreed to, with the concurrence of Senator Owen, by a vote of 63 to 19.[125/]

It should be noted that the third sentence of section 11(1) - that exempting Board employees from the classified service - is no longer carried in the U. S. Code. It was omitted in the 1964 edition of the Code and again in the 1970 edition. The codifier's explanation for the omission, as set forth in a note following § 248 of Title 12 in the 1970 edition, is as follows:

> "Provisions of subsec. (1), which authorized appointment of attorneys, experts, assistants, clerks and other employees without regard to the provisions of the act of January sixteenth, eighteen hundred and eighty-three, and amendments thereto, or any rule or regulation made in pursuance thereof, were omitted since the employees referred to are now in the classified civil service and subject to the applicable compensation schedules.
>
> "The authority for covering excepted positions into the classified civil service is given the President by section 3301 et seq. of Title 5, Government Organization and Employees. By Executive Order 8743, Apr. 25, 1941, set out as a note under section 3301 of Title 5, the President exercised this authority with respect to many previously excepted positions.
>
> "For positions now covered by the Classification Act of 1949, see section 5101 et seq. of Title 5. For the power of the Civil Service Commission to determine the applicability of those sections to specific positions, see section 5103 of Title 5."

125/ *Id.*, at 1217.

Obviously, the codifier is in error. The Board's employees clearly are not in the classified service and no one (except the codifier), not even the Civil Service Commission, regards them as being so.

The codifier's note states that the authority to cover excepted positions into the classified service is given to the President by section 3301 et seq. of Title 5 of the U. S. Code. Those sections, which relate to the examination, selection, and placement of persons in the classified civil service, contain no specific provision authorizing the President to bring excepted positions under the civil service. In his corresponding explanation in the 1964 edition of the Code, the codifier had referred to the so-called Ramspeck Act of 1940,[126] which expressly authorized the President to cover into the classified service any offices or positions in the Government. This authority was broad enough to cover employees of the Board; but on December 27, 1940, the President wrote the Civil Service Commission to the effect that it was not his intention to place the Board's employees under the classified civil service or the Classification Act; and on January 3, 1941, the chairman of the Commission, in replying to the President, stated that the Commission would be guided accordingly.

Pursuant to the Ramspeck Act, the President on April 23, 1941, issued Executive Order 8743, referred to in the codifier's 1964 note, placing under the classified service all positions in the "executive civil service of the United States" with certain specific exceptions but without any exception for employees of the Board. That Order,

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126/ 54 Stat. 1211.

however, was never regarded as applicable to the Board's employees. In December 1941, the Civil Service Commission issued its Schedule A showing that all positions under the Board were excepted from the classified service; and on February 23, 1953, the Commission sent to the Senate a document listing "positions not under the civil service" and indicating that employees of the Board of Governors were among such positions.

In 1966, Title 5 of the U. S. Code was recodified as positive law[127/] and this codification omitted the authority of the President to place positions in the classified service. Section 5102(c) of the recodified Title 5 expressly exempts from the chapter relating to the classification of Government positions -

> "(14) Employees whose pay is not wholly from appropriated funds of the United States, ..."

Since Board employees are not paid from appropriated funds, it seems clear on the face of it that they are not covered by provisions of present law relating to the classified service.

Section 2102 of Title 5 of the Code defines the "competitive service" as consisting of all civil service positions in the executive branch except positions that "are specifically excepted from the competitive service by or under statute". Even if it is conceded that the Board is in the executive branch, this provision would appear to exempt Board employees from the competitive service, since they are specifically exempted from the classified civil service by section 11(l) of the Federal Reserve Act despite the U. S. Code codifier's contention to the contrary.

127/ P.L. 89-554.

The provision just quoted and the provision exempting employees who are not paid from appropriated funds might be construed as meaning that the Board's employees are exempted by law from the classified service and that the President no longer has any authority under section 11(l) of the Federal Reserve Act to place such employees in the classified service.

In any event, it is clear that the Board's employees are not now in the classified service. Members of Congress apparently have proceeded upon that assumption. For example, a bill introduced in the 92d Congress by Representative Rarick[128/] would amend the definition of "competitive service" in section 2102 of Title 5 of the U. S. Code to provide expressly that all positions and employees under the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks shall be under the competitive service and shall not be removed or excepted therefrom.

Freedom from reliance upon appropriations

The Federal Reserve System has never been obliged to depend upon Congressional appropriations in order to finance its operations. Section 10 of the original Federal Reserve Act contained the following language, which has never been changed:[129/]

> "The Board of Governors of the Federal Reserve System shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and

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128/ H.R. 3999, 92d Cong., 1st Sess., Feb. 9, 1971.

129/ 12 U.S.C. § 243.

the salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year, ..."

All of the Board's expenses have always been met from such assessments.

Freedom from the appropriations process means that the Board is also free from the usual budgetary processes of the Federal Government. Consequently, the System's operations can be carried on without uncertainty as to whether Congress will provide sufficient funds to finance them.

Moreover, the fact that the Board does not operate with appropriated funds means that various statutes that clearly apply only to agencies using appropriated funds do not apply to the Board. For example, the Act of October 26, 1970,[130/] which authorizes the Secretary of the Treasury and the Director of the Office of Management and Budget, in cooperation with the Comptroller General, to develop a standard information and data processing system for budgetary and fiscal data for use by "all Federal agencies", clearly is not applicable to an agency like the Board that is not included in the Federal budget and does not operate with appropriated moneys. Again, the so-called "dual compensation" statutes[131/] do not apply to the holding of two positions by a Government employee if one of the positions is not paid from appropriated funds.[132/]

130/ P.L. 91-510; 31 U.S.C. § 1151.

131/ 5 U.S.C. § 5533.

132/ Opinion of the Comptroller General, Oct. 4, 1940.

Freedom from audit by the General Accounting Office

In November 1914, shortly after the Federal Reserve Board began to function, the Attorney General of the United States held that moneys derived from the semiannual assessments levied on the Reserve Banks by the Federal Reserve Board were "public moneys" within the meaning of the auditing statutes and that such moneys were therefore subject to audit by one of the auditors of the Treasury Department. 133/ This conclusion was based on the ground, among others, that such assessments were levied by a board whose members met all the requirements of the definitions of "public officers" and "officers of the United States"; that they were levied by such officers under provisions of Federal law and were devoted to the payment of official salaries and the expenses of an official board; and that, after collection, the moneys derived from the assessments were no longer the property of the paying banks and had to be viewed as "moneys belonging to the United States, and therefore public moneys as defined by the Supreme Court of the United States".

As a result of that opinion, the funds of the Board were audited by the Treasury Department until 1921, when the General Accounting Office was established by the Budget and Accounting Act of that year. From that time until 1933, the Board's funds were audited by the General Accounting Office.

The Banking Act of 1933 amended section 10 of the Federal Reserve Act by adding the following provisions: 134/

133/ 30 Op. Atty. Gen. 308.

134/ 12 U.S.C. § 244.

". . . The Board shall determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid, and may leave on deposit in the Federal Reserve banks the proceeds of assessments levied upon them to defray its estimated expenses and the salaries of its members and employees, whose employment, compensation, leave, and expenses shall be governed solely by the provisions of this Act, specific amendments thereof, and rules and regulations of the Board not inconsistent therewith; and funds derived from such assessments shall not be construed to be Government funds or appropriated moneys. . . ."

These provisions, by declaring that the Board's funds were not "Government funds", freed the Board from GAO audit and thereby established one of the principal bases for the independence of the Board. As indicated in the Report of the Senate Banking and Currency Committee on the Glass-Steagall Act in 1932[135/] and in the Report of the same Committee in 1933,[136/] the Banking Act of 1933 had as one of its purposes an increase in the "independence" of the Federal Reserve Board. The 1933 Report of that Committee stated that the provisions above quoted would leave "to the Board the determination of its own internal management policies."[137/]

The General Accounting Office recognized that the Board's funds were no longer subject to audit by that Office. In a letter to Chairman Patman of the Subcommittee on General Credit Control and Debt Management, dated April 29, 1952, the Acting Comptroller General listed governmental agencies not subject to audit by the General Accounting Office and the first of the agencies listed was the Federal Reserve

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135/ Senate Rept. No. 584, 72d Cong., 1st Sess., Apr. 22, 1932, p. 13.

136/ Senate Rept. No. 77, 73d Cong., 1st Sess., May 15, 1933, p. 12.

137/ *Id.*, at 14.

System. In explanation, the Acting Comptroller General stated:

> "The Board of Governors of the Federal Reserve System is authorized by law (12 U.S.C. 243) to levy assessments against Federal Reserve banks to pay the expenses of the Board. The Board is authorized to determine and prescribe the manner in which its obligations shall be incurred and its expenses allowed and paid. Further, it specifically is provided (12 U.S.C. 244) that funds derived from the assessments against Federal Reserve banks to defray the expenses of the Board 'shall not be construed to be Government funds or appropriated moneys.'
>
> "In view of the broad authority conferred upon the Board to determine and prescribe the manner of incurring obligations and to pay its expenses and the fact that funds used to defray the expenses of the Board are not Government funds or appropriated moneys, together with the rule, as set out in 12 U.S.C. 484 that no bank is subject to any visitorial powers other than authorized by law, or vested in the courts, or as shall be exercised or directed by the Congress or by either House thereof or by any committee of Congress or of either House duly authorized, it is my opinion that the General Accounting Office would be unable to undertake an audit of the activities of the Board and the Federal Reserve banks without specific authority of the Congress."

In April 1955, Chairman Dawson of the House Committee on Government Operations requested the Comptroller General to make an audit of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks for the year 1954. In a letter to the Comptroller General dated June 22, 1955, the Board outlined the reasons for which it believed that it was not subject to audit by the General Accounting Office and stated that it could not lawfully acquiesce in an audit by that Office. The Board's letter noted that Chairman Dawson's request was predicated upon provisions of the U. S. Code[138/] authorizing the Comptroller General to make such investigations as shall be ordered by either House of Congress or by any committee

138/ 31 U.S.C. § 53.

having jurisdiction over revenue, appropriations, or expenditures, and that clearly those provisions related only to public funds appropriated by and expended in accordance with the directions of Congress. The Board then pointed out that under section 10 of the Federal Reserve Act, as amended by the Banking Act of 1933, the Board's funds were expressly declared not to be Government funds or appropriated moneys.

Ten years later, Chairman Patman of the House Banking and Currency Committee wrote the Board a letter in which it was stated that he was asking the Comptroller General to conduct a complete physical inventory of the investment portfolio of the Federal Open Market Committee located at the New York Reserve Bank and requested to be informed when the Comptroller's staff could undertake this investigation. In a reply dated March 31, 1965, Reserve Board Chairman Martin stated that the Board "would not be justified in making the arrangements" proposed by Mr. Patman. Chairman Martin's letter reviewed the history of the question of GAO audit of the Federal Reserve System and particularly reminded Mr. Patman that in April 1952 the Comptroller General's Office had addressed a letter to Mr. Patman in which the position was taken that the General Accounting Office would be unable to make an audit of the activities of the Board and the Federal Reserve Banks without specific authority of Congress.

It should be noted that in one instance Congress has expressly provided for audit by the GAO of operations of the Reserve Banks, although the Reserve Banks were not mentioned by name. By an Act of May 20, 1966,[139/] section 16 of the Federal Reserve Act was amended

139/ 80 Stat. 161.

to provide that Federal Reserve notes unfit for circulation shall be cancelled, destroyed, and accounted for under procedures prescribed and at locations designated by the Secretary of the Treasury.140/ The regulations issued pursuant to this provision provided for destruction of certain Federal Reserve notes on the premises of the Reserve Banks.141/ Section 5 of the 1966 statute reads as follows:142/

> "SEC. 5. The Comptroller General of the United States shall audit the cancellation and destruction, and the accounting with respect to such cancellation and destruction, of any currency of the United States unfit for circulation, regardless of who is responsible for, and regardless of who performs, such cancellation, destruction, or accounting. The Comptroller General shall have access to any books, documents, papers, and records which he deems necessary to facilitate an effective audit pursuant to this section."

In effect, therefore, Congress felt it necessary to provide expressly for GAO auditing of these operations of the Reserve Banks even though the Reserve Banks, in destroying unfit currency, act as agents for the Treasury Department.

Control of expenses and of compensation and leave of employees

The provisions added to section 10 of the Federal Reserve Act by the Banking Act of 1933, as heretofore quoted, expressly gave the Board authority to determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid. They also provided that the employment, compensation, leave,

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140/ 12 U.S.C. § 413.

141/ See Hearings before House Banking and Currency Committee on H.R. 12754, 90th Cong., 1st Sess. (Sept. 1967), p. 59. [Hereafter cited as 1967 House Hearings on Temporary Interest Rate Controls.]

142/ 31 U.S.C. § 49a.

and expenses of the members and employees of the Board shall be governed solely by the provisions of the Federal Reserve Act, specific amendments thereof, and rules and regulations of the Board not inconsistent therewith. These provisions, in addition to the provision that the Board's funds shall not be construed as public moneys, were in implementation of the intent of Congress to leave to the Board full discretion in the management of its internal affairs. It is because of these provisions that employees of the Board are not subject to Federal laws relating to the compensation and leave of Government employees generally.

<u>Control of the Board's building</u>

In 1934, Congress amended section 10 of the Federal Reserve Act by adding to the provision regarding assessments upon the Reserve Banks the following language:[143/]

> ". . . such assessments may include amounts sufficient to provide for the acquisition by the Board in its own name of such site or building in the District of Columbia as in its judgment alone shall be necessary for the purpose of providing suitable and adequate quarters for the performance of its functions. After approving such plans, estimates, and specifications as it shall have caused to be prepared, the Board may, notwithstanding any other provision of law, cause to be constructed on the site so acquired by it a building suitable and adequate in its judgment for its purposes and proceed to take all such steps as it may deem necessary or appropriate in connection with the construction, equipment, and furnishing of such building. The Board may maintain, enlarge, or remodel any building so acquired or constructed and shall have sole control of such building and space therein."

By virtue of these provisions, the Board has sole control in determining matters relating to the construction, enlargement, remodeling, and maintenance of its building in Washington, including control

143/ 12 U.S.C. § 243.

of the space in such building. Consequently, the Board and its building are not subject to Federal laws generally applicable to Government buildings.

D. INDEPENDENCE FROM THE TREASURY DEPARTMENT

When the Attorney General ruled in 1914 that the funds of the Federal Reserve Board were public moneys subject to audit by one of the auditors of the Treasury Department, it was then necessary for him to determine which auditor of the Treasury should do the auditing, since apparently there was one "auditor for the Treasury Department" authorized to audit bureaus and offices under the direction of the Secretary of the Treasury and another auditor authorized to audit all boards, commissions, and establishments of the Government not within the jurisdiction of any of the Executive Departments. He concluded that the Federal Reserve Board was an "independent board or Government establishment" and not a bureau of the Treasury Department.[144/]

A provision of the original Federal Reserve Act, which has never been changed, presently contained in paragraph 6 of section 10 of the Act, could be regarded upon hasty reading as suggesting that the Federal Reserve Board is subordinate to the Treasury. That provision reads:[145/]

> "Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested

144/ 30 Op. Atty. Gen. 308.

145/ 12 U.S.C. § 246.

> by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary."

Literally and out of context, this provision might be read as meaning that, if <u>any</u> power of the Board conflicts with <u>any</u> power of the Secretary, the Board's power shall be exercised subject to the supervision and control of the Secretary of the Treasury. Obviously, however, this was not the intent. The paragraph refers only to the powers of the Secretary that relate to his supervision, management, and control of the Treasury Department and its bureaus. It was these powers that Congress clearly intended should not be affected by any powers vested in the Board by the Federal Reserve Act. This interpretation was supported by the Attorney General in his 1914 opinion. Indeed, he cited this paragraph of the Federal Reserve Act as evidencing the intent of Congress that the Board should be independent of the Secretary of the Treasury where there was no conflict with the powers of the Secretary. He stated:

> "It is evident that while the purpose of this clause was, amongst other things, to insure the preservation and supremacy of all existing powers of the Secretary of the Treasury in all cases where it might be claimed that such powers overlapped or conflicted with those of the Federal Reserve Board, nevertheless by this very provision the act clearly recognized the existence of powers of the Board independent of the Secretary in cases where no such conflict existed."

Although it is clear that the original Act intended that the Board should be an agency independent from the Treasury, Congress nevertheless concluded that the Secretary of the Treasury, as well as the Comptroller of the Currency, should be an <u>ex officio</u> member of the new board. Apparently, it was felt that the Secretary of the Treasury should be a member because the Treasury Department, as stated in the House Committee's Report, was a "fundamentally important factor in the financial organization of the country" [146/] and because the Secretary was "the head of our financial system". [147/]

Even at that time, however, there were many in Congress who opposed the ex officio membership of the Secretary of the Treasury on the Federal Reserve Board on the ground that it would place the Board under the domination of the Treasury and subject it to control by the President. Thus, Representative Mondell argued that, if the Comptroller of the Currency, an officer of the Treasury subordinate to the Secretary, was also an ex officio member, this would mean that the Secretary would be "the Poo-bah of the Glass system" and would come "very near being the whole show." [148/] Senator Burton argued that an "undue degree of importance" would be attached to the Secretary's suggestions as a member of the Board. [149/]

For more than 20 years, the Secretary of the Treasury and the Comptroller of the Currency served as ex officio members of the Board. Senator Glass had favored the membership of the Secretary in 1913, but by 1932 he had changed his mind and in that year he urged that the Secretary of the Treasury be removed as an ex officio member. During the debates on the Glass-Steagall Act in 1932, Glass confessed that he

146/ House Report on Original Act, p. 43.

147/ Statement by Representative Hayes, 50 CONG. REC. 4658.

148/ 50 CONG. REC. 4690.

149/ 51 CONG. REC. 853.

himself, as Secretary of the Treasury, "had an undue influence in the activities of the board" and went on to say: 150/

> ". . . But my very experience convinced me that the Secretary of the Treasury should not, in ordinary peace times, be a member of the board. To start with, he has practically two votes, his own and that of the Comptroller of the Currency. I do not recall any man ever having been a member of that board without the recommendation of the Secretary of the Treasury. So, he is the dominant figure, and, as I have before stated, the Federal reserve banking system has been made a doormat of the United States Treasury."

The proposal to remove the Secretary of the Treasury from the Board was not included in the bill that became the Banking Act of 1933, apparently only because the then Secretary of the Treasury, Andrew Mellon, was in poor health and greatly wished to continue as a member of the Board. 151/ Two years later, however, both the Secretary of the Treasury and the Comptroller of the Currency were eliminated from the Federal Reserve Board by the Banking Act of 1935. In supporting the change, Senator Glass said: 152/

> "Since the establishment of the system, and now, the Secretary of the Treasury and the Comptroller of the Currency have been members of the Federal Reserve Board. Periodically, it has been urged upon the Banking and Currency Committees of the two Houses of Congress that these two officials should be eliminated, for various reasons. With respect to the Secretary of the Treasury, it was urged - and I know it to be a fact, because I was once Secretary of the Treasury - that he exercised undue influence over the Board; that he treats it rather as a bureau of the Treasury instead of as a board independent of the Government, designed to respond primarily and altogether to the

150/ 76 CONG. REC. 1938.

151/ See statement by Senator Glass during debates on the Banking Act of 1935, 79 CONG. REC. 11776, 11777.

152/ 79 CONG. REC. 11776.

requirements of business and industry and agriculture, and not to be used to finance the Federal Government, which was assumed always to be able to finance itself."

Clearly the action of Congress in removing the Secretary and the Comptroller from ex officio membership on the Board was intended to make sure that the Board would be insulated from undue domination or influence by the Treasury Department.

One small evidence of the understanding and intent of Congress that the Board is not subject to control by the Secretary of the Treasury is to be found in provisions of the so-called Thomas Amendment of May 12, 1933.[153] At that time, regulation of open market operations was vested in the Board. The provisions of the Thomas Amendment authorized the President to enter into agreements with the Board and the Federal Reserve Banks as to open market operations in Government obligations, but it was expressly provided that, if the Secretary, when "directed" by the President, was "unable" to secure the assent of the Board and the Reserve Banks, the President was authorized to direct the Secretary to take certain other measures.

E. LIMITATIONS ON INDEPENDENCE

The fact that the Federal Reserve System enjoys a certain degree of independence because of the provisions of law heretofore discussed should not be regarded as meaning that the System is completely independent as a practical matter either from the Congress or from the President. As has frequently been observed, the Board and the Open Market Committee are parts of the Federal Government

153/ 31 U.S.C. § 821.

[redacted]

and are not intended to function without regard to other agencies of the Government.[154/]

It was Congress itself that freed the System from reliance upon appropriations and from audit by the General Accounting Office, and the System is always subject to change if Congress considers it desirable. As stated by Professor Viksnins in 1966, "in the last analysis the System is a creature of Congress and a destructive credit policy would surely not be tolerated for a long period."[155/] Moreover, few agencies of the Government, thanks largely to Representative Patman, are subject to more scrutiny and inquiry in Congressional hearings than the Federal Reserve Board and the System in general.

While the President cannot dictate the policies followed by the Federal Reserve, this does not mean that the System is able to escape entirely from the influence of the President and the Treasury Department. The 1952 Report of Mr. Patman's Subcommittee of the Joint Committee on the Economic Report noted that "the formal independence of the Board of Governors from the President is inevitably limited by the hard fact that fiscal and monetary policy must be coordinated with each other and with the other policies and objectives of the Government if the Government is to be of the greatest service to the Nation", and

154/ See, e.g., reply by Reserve Board Chairman Martin in 1952 Patman Compendium, p. 248. President Kelly of the American Bankers Association in 1964 stated that the view that the Federal Reserve System has severed ties with the Government that created it and is governed by no authority but its own should be dispelled. Hearings on Federal Reserve After Fifty Years, p. 1911.

155/ 1966 Symposium, Supplement, p. 173.

the Report went on to say:[156/]

> ". . . This means that the Board of Governors must inevitably discuss and endeavor to reconcile its differences with the Executive agencies. What is needed is not the best monetary policy or the best fiscal policy, each as ends in themselves, but the best over-all economic policy. This is naturally most likely to be attained, from the point of view of the Federal Reserve System, when its influence in Government policy formation is at a maximum. A good case was made at the hearings that the over-all influence of the Federal Reserve System would be increased if it were less independent and more highly integrated with the Executive branch. . . ."

Historically, there have been periods during which the Federal Reserve was compelled to follow policies of the Administration. In fact, for the first two or three years of the existence of the System, following the outbreak of World War I, the System was practically helpless to determine monetary or credit policies. As stated by Professor Chandler in his biography of Benjamin Strong:[157/]

> "In short, it was the fate of the Federal Reserve that during its first two and a half years it was powerless to control the general monetary and credit situation and had little opportunity to develop either objectives or instruments of general monetary policy. Not until well after the war, when the System was already more than five years old, would it be in a position to exercise positive control and begin to develop broad peacetime policies."

Again, during the period of the Korean War, when the Federal Reserve supported the prices of Government securities, the independence of the Federal Reserve was overshadowed by the fiscal needs of the period. Professor Brownlee remarked in 1964:[158/]

156/ 1952 Patman Subcommittee Report, p. 52.

157/ Supra note 81, p. 64.

158/ Hearings on Federal Reserve After Fifty Years, pp. 1076, 1077.

"We talk about the independence of the Federal Reserve, but the administration has exerted a good deal of control over the Federal Reserve; that is, there are periods in which the monetary policy of the Federal Reserve was completely subordinated to the Treasury, and 1945 to 1951 is an example where the monetary policy was to stabilize interest rates. When you have stable interest rates, you cannot choose any money supply that you want."

In sum, the "independence" of the System is a qualified independence; it is limited by the basic policies of the Government as a whole and, in its own interest, the System must adapt itself to a large degree to those policies. Otherwise, the System could find itself with so much "independence" that it might actually have less power in the formulation of monetary policies. This point has been made by Dr. Bach: 159/

"No one seriously believes that the Federal Reserve should be expected, or permitted, to negate the basic economic goals of the Congress and the executive branch. The real question, thus, is the terms on which the Federal Reserve participates in governmental policymaking and execution. Extreme independence is more likely to mean splendid isolation than effective power in the decisions that matter. The times when the Federal Reserve has been least effective have been the times when it has been most isolated from the President and from effective working relationships with the Secretary to the Treasury and other high level governmental officials - for example, during the 1940's. The stronger role exerted by the Federal Reserve over the last decade reflects in significant part closer and easier working relationships with the executive branch of the Government. . . ."

Recognizing that the Federal Reserve cannot go its own way without consideration of the fiscal policies of the Administration in power, the Federal Reserve, the Treasury, and the President have agreed that there must be constant coordination between the Federal Reserve and the Treasury in the formulation of their respective policies. In

159/ Id., at 1389.

1952, the Secretary of the Treasury described the ways in which the Treasury worked with the Federal Reserve in connection with their day-to-day problems. 160/ Similarly, Reserve Board Chairman Martin described the procedures by which the Board sought to cooperate with the Treasury and other Government agencies. He said: 161/

> "The Board of Governors of the Federal Reserve System endeavors to keep informed about the policies and operations of other Government officials and agencies that may in any way affect or be affected by the operations of the Federal Reserve System, to take them into consideration in formulating its policies, and to notify or confer with the agencies regarding related policies. The Federal Open Market Committee and the Federal Reserve Banks, generally through the Board of Governors, follow similar practices.
>
> "The Chairman, other members of the Board or the Open Market Committee, or members of the Federal Reserve staff have frequent conferences with other Government officials about matters of common interest. These include particularly officials of the Treasury, the Budget Bureau, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Council of Economic Advisers, the Securities and Exchange Commission, the Housing and Home Finance Agency, the Farm Credit Administration, and the various departments and agencies concerned with international financial problems. Whenever appropriate, the Chairman of the Board also confers with the President, who is regularly kept informed of all important policy actions by the Federal Reserve System. Members of the Board's staff also serve on numerous inter-departmental committees which work together on problems of common interest to groups of agencies."

When President Kennedy announced his reappointment of Mr. Martin as chairman of the Federal Reserve Board, he said: 162/

> "As you know, the Federal Reserve System is a fully independent agency of the U. S. Government but it is essential

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160/ 1952 Patman Compendium, p. 80.

161/ Id., at 263, 264.

162/ As quoted by Governor Daane in Hearings on Federal Reserve After Fifty Years, p. 1193.

that there exist a relationship of mutual confidence and cooperation between the Federal Reserve, the economic agencies of the administration, including especially the Secretary of the Treasury, and the President."

Similarly, in a message to Congress in April 1962, President Kennedy referred to the interrelated functions of the Federal Reserve and other Federal agencies and noted that coordination of monetary and fiscal policies was essential for effective representation of the System's own views in the formulation of executive policies:[163/]

"Federal Reserve monetary policies affect, and are affected by, the economic and financial measures of other Federal agencies. Federal Reserve actions are an important part, but not the whole, of Government policies for economic stabilization and growth at home and for the defense of the dollar abroad. Therefore, as has been recognized throughout the history of the Federal Reserve, the principal officer of the System must have the confidence of the President. This is essential for the effective coordination of the monetary, fiscal, and financial policies of the Government. It is essential for the effective representation of the Federal Reserve System itself in the formulation of Executive policies affecting the System's responsibilities."

Reserve Board Chairman Martin again agreed in 1968 that it is "important that monetary policy and fiscal policy be coordinated in the promotion of our national economic goals."[164/]

To summarize, even though the Federal Reserve System is legally "independent" from the Treasury and the President in the exercise of its monetary functions under the law, it must and does take measures to coordinate its policies with those of the Treasury. The close day-to-day

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163/ As quoted by Chairman Martin in Compendium on Monetary Policy Guidelines and Federal Reserve Structure, Subcommittee Print of Subcommittee on Domestic Finance of House Committee on Banking and Currency, 90th Cong., 2d Sess. (Dec. 1968), p. 47. [Hereafter cited as 1968 Compendium.]

164/ Id., at 29.

relationship between the Board and the Treasury described by Chairman Martin in 1952 continues to exist, largely through weekly meetings between the chairman of the Board and the Secretary of the Treasury and daily contacts between the staffs of the two agencies.

VIII. PROPOSALS FOR CHANGES IN THE SYSTEM

From time to time over the years, many suggestions have been made for changes in the structure or operations of the System that might have varying effects on the independent status of the System. Some of the proposals, like subjecting the System to budgetary and appropriation processes or to audit by the General Accounting Office, obviously would impair the freedom from Congressional control that is now enjoyed by the System. Other proposals just as obviously would give the President greater influence over the Board's operations, e.g., power to remove a Board member whether or not for "cause". Still other proposals, however, might or might not seriously endanger the degree of independence possessed by the System.

Each of the various proposals that might affect the independence of the System will now be considered.

A. NUMBER AND TERMS OF BOARD MEMBERS

At the outset of this paper, reference was made to a report from the White House in July 1971 to the effect that the President was planning to double the size of the Board in order to bring it "under the Executive Branch". The report was subsequently denied; but it suggested one means by which the Board's freedom from executive control might be diminished or destroyed.

Proposals to change the number of Board members and the length of their terms have been numerous. As to the number of members, suggestions have ranged from a "board" of only one member to a board of 16 members. As to terms, it has never been proposed that the present 14-year term be increased, but various suggestions have been advanced for shortening the term, ranging from 10 years down to 4 years.

In 1952, the extreme proposal that the Board be replaced by a single governor was opposed by then Chairman Martin of the Board for various reasons. Principally, however, he was concerned "that a single governor, even if counseled by the Reserve Bank presidents and other advisers, would distrust his own judgment if he thought it opposed by the Executive."[165/]

Representative Patman's many bills designed to lessen the independence of the Federal Reserve System have included various proposals for changes in both the number and terms of Board members. For example, in 1938 he introduced a bill[166/] that would have established a Board of 15 members, including three *ex officio* members. In 1952, his Subcommittee on General Credit Control and Debt Management recommended that the number of Board members be reduced to five; but in 1954, 1955, and 1959, Patman bills provided for a Board of 12 appointive members with six-year terms. In 1968, he favored a Board of five

165/ *1952 Patman Compendium*, p. 304.

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

members with five-year terms.[167] His latest bill, introduced in January 1971,[168] would provide for a Board of seven members with five-year terms.

A Federal Reserve Board of more than seven members has been opposed, not so much because the independence of the System would be affected, but because such a Board would be "unwieldy".[169] On the other hand, System officials have indicated that they would not be opposed to a reduction in the number of Board members to as few as five.[170] A smaller Board, it has been argued, would give the individual Board members greater prestige.

As to terms, Federal Reserve officials on occasion have conceded that a 14-year term may be too long.[171] Nevertheless, they have argued that the term should not be so short as to preclude a Board member from developing specialized knowledge of the Board's functions and obtaining sufficient experience. It has also been argued that, if the term is too short, and particularly if there is a prohibition against reappointment, it would be difficult to obtain well-qualified individuals to serve as members of the Board.[172] Finally, it has frequently been

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

168/ H.R. 11, 92d Cong., 1st Sess.

169/ See statements by Eccles, 1938 House Hearings, p. 447; Martin, Hearings on Federal Reserve After Fifty Years, p. 14; and Governor Mitchell, *id.*, at 1180.

170/ See statements by Sproul of the New York Reserve Bank, 1949 Douglas Compendium, p. 164; Martin, 1952 Patman Compendium, p. 302.

171/ See, for example, statement by Chairman Martin, 1952 Patman Compendium, p. 301.

172/ See statements by Governor Mitchell, Hearings on Federal Reserve After Fifty Years, p. 1180; Martin, 1968 Compendium, p. 46.

argued that, if the term is too short, a member would be more susceptible to political and other pressures and that the independence of the Board would be weakened. Thus, in 1952, Chairman Martin observed that "long terms tend to keep Government positions nonpolitical in nature."173/ In 1964, the president of the American Bankers Association argued that a legislative proposal to reduce Board members' terms to four years would defeat the original intent of Congress that the Board members should possess "a high degree of independence from the executive branch."174/ In 1968, Secretary of the Treasury Fowler felt that a reduction in the length of terms to five years might "carry greater risks of subjecting Board member to [political] pressures."175/

Judgments may differ as to whether some proposals for changes in the number of Board members or the length of their terms would seriously affect the independence of the System. It seems clear, however, that a combination of fewer Board members and shorter terms could have an adverse effect upon that independence. For example, if the Board were to be reconstituted with five members serving for five-year terms, a new President would be in a position to appoint a majority of the Board during his first three years in office and four of the five members during his first term of office.

173/ 1952 Patman Compendium, p. 301.

174/ Hearings on Federal Reserve After Fifty Years, p. 1877.

175/ 1968 Compendium, p. 65.

B. TERM OF CHAIRMAN OF THE BOARD AS CHAIRMAN

Under the original Federal Reserve Act, the Secretary of the Treasury was *ex officio* chairman of the Federal Reserve Board; but the Act provided that one of the appointive members should be designated by the President as "governor" of the Board and another as "vice governor" and that the governor should be the Board's "active executive officer". The Act did not fix the period for which they should serve as governor and vice governor. Until 1927, it appears to have been customary for the President to designate the governor for one year at a time; and from that time until February 1, 1936, when the Board was reconstituted, one member of the Board was designated by the President to serve as governor "until otherwise directed".[176/]

Early in 1935, bills were introduced in Congress that would have confirmed the then-existing practice by providing that the governor and vice governor should "serve as such until the further order of the President".[177/] They provided also that, if the governor was not re-designated as such, his term of office as a member of the Board would automatically cease. Reserve Board Governor Eccles, while agreeing that the governor should serve at the pleasure of the President, pointed out that under these bills the President theoretically could successively designate each member of the Board as governor and successively terminate

176/ See message from President Kennedy to Congress, Apr. 17, 1962.

177/ See, e.g., H.R. 5357, 74th Cong., 1st Sess.

such designations so that, in effect, the President could "finally create a new Board completely". 178/

Taking the Ecclés point into account, the House Banking and Currency Committee, in reporting the bill that became the Banking Act of 1935, recommended provisions under which the governor, while still serving as such at the pleasure of the President, could continue to serve out his term as a member of the Board even though not redesignated as governor. In this connection, the Committee's Report stated: 179/

> "The amendment makes no substantive change so far as the designation by the President of the Board's Governor is concerned. The present law states that 'of the six persons thus appointed, one shall be designated by the President as Governor.' This has been consistently interpreted to mean that the Governor serves as Governor at the pleasure of the President. The bill follows this interpretation without changing it, by including the additional words 'to serve as such until the further order of the President.'"

As finally enacted as the Banking Act of 1935, the Federal Reserve Act was amended to reorganize the Board (effective February 1, 1936) by eliminating the two _ex officio_ members and providing for seven appointive members with 14-year terms. The amended Act changed the name of the Board to the Board of Governors of the Federal Reserve System and provided that the governor and vice governor henceforth should be known as the chairman and the vice chairman. It also provided that they should be designated by the President "to serve as such for terms of four years". Presumably, it was expected that their

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178/ _Hearings before House Banking and Currency Committee on H.R. 5357_, 74th Cong., 1st Sess. (Feb.-Apr. 1935), p. 203. [Hereafter cited as _House Hearings on Banking Act of 1935_.]

179/ _Report of House Banking and Currency Committee on H.R. 7617_, Rept. No. 742, 74th Cong., 1st Sess. (Apr. 19, 1935), p. 8.

terms would generally coincide with the term of the President; but the amendments did not specify when their terms should commence and a situation developed under which their terms, as a result of resignations, did not conform to the term of office of the current President.

In 1949, Reserve Board Chairman McCabe pointed out that the purpose of the 1935 Act was to afford a new President an opportunity to designate the chairman and vice chairman but that in practice this had not been the case. He recommended that the law be changed to provide specifically that the terms of the chairman and vice chairman should expire on March 31, 1953 (a year in which a new President would be inaugurated), and March 31 of every fourth year thereafter.[180/] Three years later, in almost identical language, Reserve Board Chairman Martin made a similar proposal.[181/]

In 1961, the Commission on Money and Credit proposed that the law be changed to make the terms of the chairman and vice chairman approximately coterminous with the term of the President. That recommendation led President Kennedy in January 1962 to include such a proposal in his economic report to the Congress; and on April 17, 1962, he sent to Congress a specific recommendation to that effect. His message to Congress stated that Chairman Martin of the Board of Governors concurred in this proposal. The proposal was endorsed by a number of witnesses during 1964 hearings before the House Banking and Currency Committee,

180/ 1949 Douglas Compendium, p. 68.

181/ 1952 Patman Compendium, p. 302.

including Secretary of the Treasury Dillon.[182/] It was supported by the Board of Governors in a letter to Congress in October 1966. And in 1968 it was strongly favored by a number of respondents, including Reserve Board Chairman Martin, Secretary of the Treasury Fowler, and the President's Council of Economic Advisers, in replies to a questionnaire distributed by Chairman Patman of the Subcommittee on Domestic Finance of the House Banking and Currency Committee.[183/]

A few have argued that, if the term of the chairman of the Board should be made approximately coterminous with that of the President, the effect would be to put the Board into politics and to impair the System's independence. For example, Professor Henry A. Latane felt that it might lead some central banks to regard the chairman as a "political appointee";[184/] and Professor Meyer L. Burstein has said:[185/]

> ". . . This would put the Federal Reserve into the heart of politics, leading up to a worse system than at present: there would be no real independence of the Federal Reserve but there would be considerable administrative and other confusion."

Those who have favored the proposal, however, including Federal Reserve officials, argue that adoption of such a proposal would not affect the independence of the System but would actually give the System a more effective representation in the formulation

182/ Hearings on Federal Reserve After Fifty Years, pp. 444, 1101, 1232, 1388, 1480.

183/ 1968 Compendium, pp. 46, 66, 82, 149, 153, 471.

184/ Id., at 420.

185/ Id., at 105.

of Presidential policies that might affect monetary and credit conditions. Thus, when President Kennedy submitted this proposal to Congress in April 1962, he noted that the 14-year terms of Board members "assured the System both continuity and independence from political influence", but he went on to point out that "the principal officer of the System must have the confidence of the President", not only to assure effective coordination of monetary and fiscal policies of the Government but to give the System itself effective representation in the formulation of executive policies that affect the System's responsibilities. 186/

Similar arguments in support of the proposal were advanced by Reserve Board Chairman Martin in 1968: 187/

> "A change in the law enabling the President to appoint a Chairman of his own choice shortly after his inauguration would provide a practical basis for effective coordination of Federal Reserve monetary policies with the fiscal and financial policies of the executive branch of the Government without affecting the exercise of independent judgment by the Board in the discharge of the responsibilities imposed upon it by Congress. Such an arrangement would in fact afford a means by which the Federal Reserve, through the Chairman of the Board, would be better able to participate, at the highest level of the executive branch, in continuing efforts to promote the sound conduct of the Government's financial affairs."

186/ See message from President Kennedy to Congress, Apr. 17, 1962.

187/ 1968 Compendium, p. 47. Professor G. L. Bach has expressed the view that the proposal "makes practical administrative sense" and that it would not "jeopardize" the System's independence. Hearings on Federal Reserve After Fifty Years, p. 1389.

C. REMOVAL OF BOARD MEMBERS

One of the principal protections against Presidential control of the Board is the fact that the law not only gives a Board member a statutory term of 14 years but prohibits his removal by the President except "for cause". Obviously, if the President were able to remove a Board member at pleasure at any time, as he may remove the head of an Executive Department, the Board would be directly subject to the President's control.

On a few occasions, those who strongly believe that the Board should not be "independent" but should be subject to Presidential direction have urged that the law be amended to authorize the President at his pleasure at any time to remove not only the chairman of the Board but any member of the Board. One of the bills introduced by Mr. Patman that was the subject of hearings in 1964[188] would have provided that the President "may remove any appointive member from office." Professor Robert H. Strotz of Northwestern University, a witness at those hearings, objected strongly to the independence of the Federal Reserve System, arguing that the central bank should not be removed from direct control by the executive, and endorsed this provision of the bill in the following language:[189]

> "House bill 9631 meets these objections by bringing the Board of Governors directly under the control of the President and authorizing the President to remove any appointed member from office at his pleasure. Federal Reserve bank policy would

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

189/ Hearings on Federal Reserve After Fifty Years, p. 1454.

therefore be more responsive to the will of our elected officials and could thereby be better coordinated with fiscal and other instruments of policy for achieving diverse national economic objectives."

In commenting on another Patman bill in 1968, Professor Raymond P. Kent of Notre Dame University similarly contended that only by giving the President authority to remove Board members at his pleasure would there be assurance that Federal Reserve policy would be in accord with the President's economic program.190/

It is interesting to note that, although Representative Patman frequently refers to the Board as an agent of the Congress, he has consistently urged in recent years that the Board should be made subject to greater control by the President. Nevertheless, while some of his bills would have made Board members subject to removal by the President at his pleasure, he made the unique proposal in 1938 that Board members should be subject to removal by the Congress. During hearings before the House Banking and Currency Committee on a bill introduced by him to reorganize the System,191/ he proposed an amendment to the bill that would have declared the Board to be an agency of Congress and would have made the service of a Board member directly subject to the will of Congress. That amendment would have read as follows:192/

"The Board of Governors of the Federal Reserve System is hereby declared to be the agency of the Congress to create money and regulate the value thereof as authorized by the Constitution

190/ 1968 Compendium, p. 363.

191/ H.R. 7230, 75th Cong., 1st Sess.

192/ 1938 House Hearings, p. 168.

of the United States and the individual members of such Board shall hold office subject to the will of the Congress of the United States; and either the Senate or the House by resolution may authorize and request the President of the United States to nominate a successor to a member of the Board from any Federal Reserve district regardless of the term for which he was appointed, whereupon, the office of such member upon the passage of such resolution shall be vacated."

D. SECRETARY OF TREASURY AS MEMBER OF BOARD

As has been noted, the Secretary of the Treasury and the Comptroller of the Currency were *ex officio* members of the original Federal Reserve Board but both were dropped from the Board by the Banking Act of 1935, principally on the ground that their memberships, particularly that of the Secretary, might enable the Treasury to influence the policies of the Board. Since 1935, restoration of the Secretary of the Treasury's *ex officio* membership has been proposed from time to time, generally by Representative Patman.[193/]

The argument for *ex officio* membership of the Secretary is that it would facilitate coordination of debt-management policies with the monetary policies of the Federal Reserve. Thus, in 1949, the Reserve Bank presidents, while opposing the idea, stated the argument as follows:[194/]

"The principal advantage of providing that the Secretary of the Treasury should be a member of the Board presumably would be that it might facilitate coordination of debt-management

193/ In 1938, he introduced a bill (H.R. 7230, 75th Cong., 1st Sess.) that would have made the Secretary a member of the Board, and he introduced a bill with similar effect in 1964 (H.R. 9631, 88th Cong., 2d Sess.).

194/ *1949 Douglas Compendium*, p. 113.

> policy with monetary or credit policy. It would provide an opportunity for the Secretary of the Treasury to hear and participate in discussions of credit policies by the Board of Governors of the Federal Reserve System, and the Federal Open Market Committee and to discuss with other members of the Board and the Committee the Treasury financing and debt-management policies that would be most appropriate in the light of Federal Reserve credit policies."

In opposition to restoration of the Secretary as a member of the Board, it has been argued that he has enough to do to manage his own Department. 195/ The principal argument against this proposal, however, is that the membership of the Secretary would subject the Board to domination by the Treasury. Carter Glass in 1935 stated that the Secretary, when he was a member of the Board, "exercised undue influence over the Board" and treated it "as a bureau of the Treasury." 196/ In 1949, the Reserve Bank presidents, in commenting on a proposal to make the Secretary a member of the Board, said: 197/

> "The principal disadvantage would be that it would tend to strengthen the suspicion that Federal Reserve policies were being influenced unduly by consideration of facilitating Treasury financing and the management of the public debt. It would probably be suspected, rightly or wrongly, that the influence of the Secretary of the Treasury would be exerted in the direction of low interest rates to hold down the interest cost on the debt, even at times when the appropriate credit policy would be one of restraining credit expansion with the probable accompanying result of raising interest rates."

A number of witnesses during 1964 hearings held before the House Banking and Currency Committee opposed provisions of a Patman

195/ See, e.g., statement by Secretary Dillon in 1964, Hearings on Federal Reserve After Fifty Years, p. 1407.

196/ 79 CONG. REC. 11776.

197/ 1949 Douglas Compendium, p. 113.

bill that would have restored the Secretary as a member of the Board on the ground that such a change would endanger the System's independence. President Hayes of the New York Reserve Bank stated: 198/

> ". . . The Secretary of the Treasury is under constant pressure to borrow money at the lowest possible interest rate. It seems to me to be obvious that H.R. 9631 would permit that pressure to become the dominant factor in carrying out monetary policy."

Reserve Board Governor Robertson opposed the suggestion for similar reasons: 199/

> "I think this bill would effectively destroy the independence of the system and would make it - and I think it is perhaps so designed - an appendage of the Treasury. I think this would not be wise. I think that there is a real need to separate monetary policies from fiscal policies, because of the possibility of utilizing the money creating facilities of the Federal Reserve System for purposes of financing unsound operations on the part of the Government."

And the conflict-of-interest argument was stated by President Bopp of the Philadelphia Reserve Bank as follows: 200/

> "The bill would change the structure and composition of the Board. It would make the Secretary of the Treasury Chairman. This would place on the Secretary a new responsibility that is inconsistent with an existing responsibility. As Secretary, he is the largest borrower in the world by a wide margin. As borrower he appropriately desires the lowest borrowing cost possible. As Chairman of the new Board, he would head the agency with the largest single portfolio of Government securities, an agency whose primary concern is to promote credit conditions appropriate to the entire economy, including but not limited to the Government. The sad experience of many countries, including our own, with putting these conflicting responsibilities in the hands of a single individual leads me to conclude that it should not be done."

198/ Hearings on Federal Reserve After Fifty Years, p. 527.

199/ Id., at 107.

200/ Id., at 422.

Similar arguments against restoration of the Secretary of the Treasury's membership on the Board have been advanced by persons outside of the Federal Reserve System, including the Secretary of the Treasury himself. In 1964, Secretary Dillon, in referring to such a proposal, stated:[201]

> "This proposal seems to me to raise most important questions of public policy, for inevitably the implication is that the stature of the Federal Reserve - independent not of the Government, but of the Treasury - would be, to some degree, diminished.
>
> * * * * *
>
> "Proposals of this kind also raise the possibility that decisions on monetary policy, directed toward the overall health of the economy, will at times, consciously or unconsciously, be biased by the constant pressures on the Secretary of the Treasury to assure the economical financing of the dominant borrower in our economy - the Federal Government itself. . . ."

201/ *Id.*, at 1231.

E. AUDIT BY GENERAL ACCOUNTING OFFICE

Chronological history of proposals

Since 1933, when Congress in effect terminated the authority of the General Accounting Office to audit the Federal Reserve Board, numerous proposals to bring the Federal Reserve System again under GAO audit have been advanced in Congress.

The GAO itself has not shown any great interest in auditing the Federal Reserve. During hearings on the Government Corporation Control Act of December 6, 1945, members of Congress raised questions as to whether the Federal Reserve should be subject to that Act. One of the witnesses was Mr. Frank Weitzel, an attorney in the General Accounting Office who was introduced by the Comptroller General as an expert on Government corporations. In response to a statement by Senator Murdock that the Federal Government's only interest in the Federal Reserve Banks was in the surplus of the Banks in the event of their liquidation, Mr. Weitzel agreed and went on to express the view that they should be excluded from the Act because they were "examined frequently and thoroughly" by examiners under the direction of the Board of Governors.[202/] Again in 1952, the Comptroller General's Office took the position that the Federal Reserve should not be subject to audit by that Office. In a letter of April 29, 1952, to Chairman Patman of the Subcommittee on General Credit Control and Debt Management of the Joint Economic Committee, Mr. Frank L. Yates, Acting Comptroller General, stated:

202/ Hearings before Subcommittee of Senate Banking and Currency Committee on S. 469, 79th Cong., 1st Sess. (Apr., May 1945), p. 32.

"The question as to whether the Board of Governors of the Federal Reserve System and the Federal Reserve banks should be made subject to audit by the General Accounting Office was discussed at the time of enactment of the Government Corporation Control Act of 1945, (31 U. S. C. 841) but it was determined that they should be excluded from the audit provisions of that act since a strong control was exercised over the banks through the Board and all of the stock of the banks was owned by member banks. There has occurred nothing since that time which would require any different view. . . ."

Despite such indications of the contrary position of the GAO itself, Representative Patman for more than 20 years has repeatedly and strongly urged that the GAO should audit not only the Board but also the Federal Open Market Committee and the Federal Reserve Banks.

In 1951, a Subcommittee of which Mr. Patman was chairman distributed a questionnaire that, among other things, asked whether the accounts of the Board and the Reserve Banks were subject to budgetary or audit control by any other agency of the Government and, if not, whether they should be. In replying to this question, Chairman Martin of the Board gave a comprehensive description of the budgetary and audit control procedures followed by the System at that time and stated that, if the finances of the System were subject to review or control by another agency of the Government, the result would be a "growing loss of effectiveness" on the part of the Federal Reserve System. 203/

In the course of 1952 hearings, Mr. Patman, with the support of Senator Douglas, questioned Chairman Martin as to why the System should not be audited by GAO, and Mr. Martin's reply was simply that it would lead to "nationalization" of the Federal Reserve System. 204/

203/ 1952 Patman Compendium, p. 307.

204/ Hearings before Joint Economic Committee, 82d Cong., 2d Sess. (Mar. 1952), pp. 97-99, 121, 122. [Hereafter cited as 1952 Patman Subcommittee Hearings.]

Nevertheless, the Report of Mr. Patman's Subcommittee in June 1952 recommended that the accounts of the Board should be audited annually by the General Accounting Office, although the audit should be in the nature of a post-audit only, and further that each of the 12 Reserve Banks should be audited annually by an outside auditor appointed by its board of directors and approved by the Board of Governors.205/

Apparently prompted by the 1952 hearings and the Patman Subcommittee's Report, the Board in 1952 engaged the accounting firm of Arthur Andersen & Company to audit the accounts of the Board; and in the following year the Board engaged the same firm to review and observe the procedures used by the Board's examinations staff in the course of examination of one of the Reserve Banks. These were significant changes in the practice that had been followed since 1933 under which the Board's accounts had been audited annually by auditors of one of the Reserve Banks and the accounts of the Reserve Banks themselves had been subject only to review by the auditors of those Banks.

Such changes in the System's practice, however, were not satisfactory to Representative Patman. On January 28, 1954, he introduced a bill 206/ that would have required an audit by GAO for the year 1953 of the accounts of the Board, the Federal Open Market Committee, and the Federal Reserve Banks. The bill was strongly opposed by Chairman Martin of the Board in a letter dated March 30, 1954, to the chairman of the House Committee on Government Operations. On the following day, March 31,

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205/ 1952 Patman Subcommittee Report, p. 7. Senator Flanders, a member of the Subcommittee, dissented from the recommendation that the Board be made subject to GAO audit, although he indicated that he would agree with the requirement for annual audit of the Board by an outside auditor selected by the Board.

206/ H.R. 7602, 83d Cong., 2d Sess.

1954, the Bureau of the Budget also opposed the bill on the ground that it was unnecessary and undesirable. Hearings on the bill were held in June 1954 at which both Representative Patman and Chairman Martin appeared as witnesses, Patman supporting the bill and Martin opposing it.

In 1955, Mr. Patman again introduced a bill 207/ providing for GAO audit of the Federal Reserve System; and again the proposal was strongly opposed by Chairman Martin in a letter dated March 18, 1955.

During Senate hearings on the proposed "Financial Institutions Act" in November 1956, question was raised as to the desirability of GAO audit of the Federal Reserve. At that time Governor Robertson of the Board suggested a compromise, i.e., that Congress by statute should require audit of the Federal Reserve Board by an outside certified public accountant and that copies of the annual reports of examinations of the Reserve Banks be transmitted to the Senate and House Banking and Currency Committees. 208/ Provisions that would have implemented Governor Robertson's recommendations were included in the Financial Institutions Act as it passed the Senate. 209/ The bill was not passed by the House, but, during hearings before the House Banking and Currency Committee, Mr. Patman engaged in a long colloquy with Governor Robertson, a witness at the hearings, regarding the need for GAO audit of the Federal Reserve System. 210/

207/ H.R. 2643, 84th Cong., 1st Sess.

208/ Hearings before Senate Banking and Currency Committee on "Study of Banking Laws", 84th Cong., 2d Sess. (Nov. 1956), p. 229. [Hereafter cited as Senate Hearings on Financial Institutions Act.]

209/ For explanation of these provisions, see Report of Senate Banking and Currency Committee, Senate Rept. No. 121, 85th Cong., 1st Sess., pp. 43, 44.

210/ Hearings before House Banking and Currency Committee on S. 1451 and H.R. 7026, 85th Cong., 1st Sess. (1957), pp. 47-51. [Hereafter cited as House Hearings on Financial Institutions Act.]

Mr. Patman's next opportunity came during 1958 hearings before the House Committee on Government Operations on proposed amendments to the Government Corporation Control Act, the statute providing for budget review and GAO audit of certain Government corporations. Appearing as a witness, Mr. Patman urged that the Act be made applicable to the Federal Reserve. 211/ His recommendation was not adopted.

In July 1959, Mr. Patman introduced another bill 212/ that, like his 1955 bill, would have required audits of the System from 1913 until the year prior to the introduction of the bill. In the course of 1959 hearings before the Joint Economic Committee, Mr. Patman engaged in a long exchange with Chairman Martin of the Board regarding the need for GAO audit of the Federal Reserve System. 213/ In 1960, Mr. Patman raised the issue again in hearings on the Economic Report of the President, charging that the Reserve Banks had been wasting and illegally spending public funds. 214/

In April 1963, Chairman Patman appointed a Special Subcommittee to investigate the disappearance of United States Government securities from the vaults of the San Francisco Reserve Bank. That Subcommittee, under the chairmanship of Representative Reuss, held hearings in San Francisco and subsequently submitted a Report to the House Banking and Currency Committee which, among other things, charged that the System

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211/ Hearings before Subcommittee of House Committee on Government Operations on Amending the Government Corporation Control Act, 85th Cong., 2d Sess. (Feb. 1958), pp. 146-149.

212/ H.R. 8302, 86th Cong., 1st Sess.

213/ Hearings before Joint Economic Committee on Employment, Growth, and Price Levels, 86th Cong., 1st Sess. (July 1959), Part 6A, pp. 1471-1474. [Hereafter cited as 1959 Hearings before J.E.C.]

214/ Hearings before Joint Economic Committee on January 1960 Economic Report of the President, 86th Cong., 2d Sess., pp. 209, 210. [Hereafter cited as 1960 J.E.C. Hearings.]

"audits itself" and expressed dissatisfaction with existing arrangements for internal audit of the Reserve Banks.215/ One member of the Subcommittee, Representative Talcott, dissented from the conclusions of the Subcommittee and expressed the hope that that investigation would not be "a prelude to an attempt to impose General Accounting Office auditing upon the historical independence of the Federal Reserve System."216/

Meanwhile, on April 3, 1963, Representative Multer introduced a bill217/ that, unlike earlier Patman bills, provided for annual audits in the future by the GAO of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks.

Several bills relating to the structure of the Federal Reserve System were used as a basis for hearings held by Mr. Patman in 1964. One of them218/ contained provisions requiring the Comptroller General to make annual audits of the Federal Reserve Board and the Federal Reserve Banks and their branches, and provided that, in making such audits, representatives of the General Accounting Office should have access to all books, financial records, reports, files, and other papers belonging to the entities being audited. Following the 1964 hearings, Mr. Patman's Subcommittee released a document that included the recommendations of the eight Democratic members of the Subcommittee and also a lengthy memorandum by the Subcommittee's staff summarizing the hearings.

215/ Report of Special Subcommittee of House Banking and Currency Committee, H.R. Rept. No. 354, 88th Cong., 1st Sess. (1963), p. 26. [Hereafter cited as 1963 Special Subcommittee Report.]

216/ Id., at 29, 30.

217/ H.R. 5443, 88th Cong., 1st Sess.

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

Not surprisingly, one of the Subcommittee's recommendations was for a public audit by the Comptroller General of all expenditures by the Federal Reserve Board and the Reserve Banks; and the staff summary quoted extensively from the hearings in support of this recommendation. 219/

In September 1967, the House Banking and Currency Committee held hearings on a bill introduced by Mr. Patman to extend the termination date of a 1966 statute giving the Federal Reserve Board, the FDIC, and the Federal Home Loan Bank Board temporary powers with respect to regulation of rates of interest and dividends payable by banks and savings and loan associations. One section of this bill reflected Mr. Patman's 1964 proposal for GAO audit of the Federal Reserve System. 220/ Needless to say, that section of the bill was eventually dropped.

In the following year, 1968, Mr. Patman submitted a series of questions to members of the Board, the Secretary of the Treasury, the chairman of the Council of Economic Advisers, and a large number of bankers and economists, asking their views with respect to proposals to reorganize the Federal Reserve System reflected in a bill introduced by Mr. Patman. 221/ One section of that bill provided for audit of the Federal Reserve by the Comptroller General and access by representatives of his office to all records and papers in their possession, including

219/ Proposals for Improvement of the Federal Reserve and Staff Report on Hearings before the Subcommittee on Domestic Finance of the Committee on Banking and Currency, 88th Cong., 2d Sess., Aug. 25, 1964, pp. v and 85-90. [Hereafter cited as 1964 Patman Subcommittee Staff Report.]

220/ H.R. 12754, 90th Cong., 1st Sess.

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

reports of examinations of member banks. This proposal, like earlier such proposals, was opposed by the chairman of the Federal Reserve Board and the Secretary of the Treasury, as well as by the chairman of the Council of Economic Advisers and many of the private witnesses. A staff summary of the responses indicated that 31 witnesses favored the proposal while 25 opposed it.[222/] The staff's count of those who favored and those who opposed the proposal may not have been entirely accurate. For example, it listed Paul W. McCracken as favoring GAO audit; but Mr. McCracken's response made no reference to this proposal. Actually, he strongly opposed such measures as requiring the System to operate on appropriated funds and "generally to make the monetary authority simply another Governmental agency."[223/]

To bring the chronology down to the present, it should be mentioned that in January 1971 Mr. Patman again introduced his bill "to make the Federal Reserve System responsive to the best interests of the people of the United States", a bill that in several Congresses has been labeled H.R. 11. Section 16 of this latest bill reads as follows:

> "SEC. 16. (a) The Comptroller General shall make, under such rules and regulations as he shall prescribe, an audit for each fiscal year of the Federal Reserve Board and the Federal Reserve banks and their branches.
>
> "(b) In making the audit required by subsection (a), representatives of the General Accounting Office shall have access to all books, accounts, financial records, reports, files, and

222/ 1968 Compendium, p. 27.

223/ Id., at 473.

all other papers, things, or property belonging to or in use by the entities being audited, including reports of examinations of member banks, and they shall be afforded full facilities for verifying transactions with balances or securities held by depositaries, fiscal agents, and custodians of such entities.

"(c) The Comptroller General shall, at the end of six months after the end of the year, or as soon thereafter as may be practicable, make a report to the Congress on the results of the audit required by subsection (a), and he shall make any special or preliminary reports he deems desirable for the information of the Congress. A copy of each report made under this subsection shall be sent to the President of the United States, the Federal Reserve Board, and the Federal Reserve banks. In addition to other matters, the report shall include such comments and recommendations as the Comptroller General may deem advisable, including recommendations for attaining a more economical and efficient administration of the entities audited, and the report shall specifically show any program, financial transaction, or undertaking observed in the course of the audit which in the opinion of the Comptroller General has been carried on without authority of law.

"(d) The Comptroller General is authorized to employ such personnel and to obtain such temporary and intermittent services as may be necessary to carry out the audit required by subsection (a), at such rates as he may determine, without regard to the civil service and classification laws, and without regard to section 15 of the Act of August 2, 1946, as amended (5 U.S.C. 55a)."

No hearings have been held on this bill.

Arguments for GAO audit

The basic arguments in support of GAO audit of the Federal Reserve run somewhat as follows: The Federal Reserve System is an agency of the Federal Government to which Congress has delegated its Constitutional powers over money and credit; the System handles and expends public funds in substantial amounts; it should therefore be brought more closely under the control and supervision of Congress through the General Accounting Office, an agency of the Congress, so that Congress may be more fully informed as to the operations of the

System; and there is no sound reason for which the System should not be subject to such control by Congress like other governmental agencies.

These arguments have been supported by arguments to the effect that present internal auditing procedures followed by the System are not adequate or effective; that they amount only to a "self-audit"; and that, as a result, expenditures by the System, particularly by the Reserve Banks, are frequently of a kind that would be considered improper or even illegal on the part of other Federal agencies.

The "basic" arguments for GAO audit of the Federal Reserve System were advanced by Mr. Patman when he appeared as a witness during hearings by the House Committee on Government Operations in 1954 in support of his bill [224/] to require GAO audit for the year 1953. At those hearings, Mr. Patman said: [225/]

> "It is my belief that a very bad precedent has been set by permitting the Federal Reserve System to operate independently within the Government and from the Government to the extent that Congress has not had an opportunity to become acquainted with its activities and the way its funds, which are public funds, are expended. To my mind, this matter involves a fundamental principle of Government.
>
> "If the Federal Reserve System should be permitted to continue as it has continued in the past, many other agencies are entitled to the same privileges; and if and when they are granted to the other agencies equally entitled to them, the Congress will lose effective control of the Government and particularly its pursestrings.

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224/ H.R. 7602, 83d Cong., 2d Sess.

225/ Hearings before House Committee on Government Operations on H.R. 7602, June 2, 1954 (stenographic transcript), pp. 2, 3, 4, 9. [Hereafter cited as 1954 House Government Operations Committee Hearings.]

"The Federal Reserve Banking System is set up as an agency or instrumentality of the Government, and it operates solely on the Government's credit through its power to create money, which includes the power to determine the volume of money, its value, interest rates and is charged with the duty of performing a public service, not organized for profit.

* * * * *

"The fact that the System does not need appropriations deprives the Congress of the privilege of being informed annually about its operations. Not only has the Congress been kept in the dark during these forty years about what the System has been doing because it did not have to get any appropriation from Congress, the System has not during this time made adequate reports to the United States Congress - its master - as to what it was doing or the extent of its operations. . . .

* * * * *

"I respectfully submit that the Federal Reserve System, an agency of Congress, should be brought within the supervision and control of Congress - the master - to the extent that Congress will be made acquainted with its activities at all times and also to the extent that waste and extravagance will be discouraged.

"The Federal Reserve System, as presently operated, is free from all restraints, limitations and supervisions in the handling and expenditure of public funds required of other major agencies in the three branches of Government. It is operating more like a fourth branch of Government, which is repulsive to our form of Government that recognizes the will of the people expressed through Congress.

"It is my sincere belief that this audit should be authorized in the public interest and in accordance with our form of Government in the careful handling and spending of public funds, which virtually affect all the people and particularly the taxpayers."

In the course of 1957 hearings by the House Banking and Currency Committee on the proposed Financial Institutions Act, Mr. Patman stated: 226/

"Since its organization in 1913, there has never been an outside audit of the System or any part of it. Now this is shocking, Mr. Chairman. It is bound to be shocking to

226/ House Hearings on Financial Institutions Act, p. 1549.

all American citizens that we would let the Federal Reserve System handle hundreds of billions of dollars of the Government's money - and two-thirds of every board of directors of each Federal Reserve bank is composed of private bankers or people selected by the private bankers - and never have any audit."

Mr. Patman reiterated his arguments in the course of hearings held by the Joint Economic Committee in 1959.[227/] At that time, in a colloquy with Chairman Martin of the Federal Reserve Board, Mr. Patman said:[228/]

". . . If it [the Federal Reserve] is as you think clean as a hound's tooth, you have nothing to fear, and I don't see why you should not agree to it. It is public funds. It is a public institution owned by the Government, and there is no reason why you should not do it."

In the following year, 1960, the Report issued by the Joint Economic Committee included "supplemental views" of Mr. Patman, in the course of which he stated:[229/]

"The Federal Reserve System should be required to submit to annual audits and to the normal audit control of the Comptroller General of the United States. The System receives its income - or substantially all of its income - in the form of interest payments from the U.S. Treasury on the huge amounts of U.S. bonds and other obligations which the System is holding. This provides an income vastly in excess of what the System needs for all purposes. The System pays its expenses out of this income - most of which are incurred in providing free services to the private banks - and then it returns what remains to the Treasury. At least the System returns 90 percent of what remains; it puts the other 10 percent in 'surplus' funds."

227/ 1959 Hearings before J.E.C.

228/ *Id.*, at 1473.

229/ Report of Joint Economic Committee on the January 1960 Economic Report of the President, Senate Rept. No. 1152, 86th Cong., 2d Sess., p. 33. [Hereafter cited as 1960 Report of J.E.C.]

In 1967, during hearings on a bill to extend temporary interest rate controls, Mr. Patman again argued that there was no reason why the Federal Reserve should be free from GAO audit:[230/]

"No one on this committee would claim that the U. S. Treasury should be exempt from the GAO audit. Yet, the U. S. Treasury handled only $272,297 million worth of transactions in the last fiscal year. These transactions were all subjected to GAO audit. Yet, the Federal Reserve System, which went completely unaudited was involved in transactions totaling more than $3 trillion in the same fiscal year - over 10 times the amount handled by the Treasury."

In support of the general arguments for GAO audit as described above, Mr. Patman and others have contended that existing internal arrangements for audit of the Board and the Reserve Banks do not involve truly independent audits but are in effect "self-audits". Thus, in 1952, Mr. Patman's Subcommittee stated that it was "inclined to question the adequacy of what is essentially a self-audit". It recommended that the accounts of the Board be audited by the General Accounting Office and that each Reserve Bank be audited annually by an outside auditor nominated by its directors and approved by the Board of Governors.[231/]

During hearings in 1952, Senator Douglas noted that other Government agencies were audited by the General Accounting Office and that the Federal Reserve was the only agency, so far as he knew, that "audits itself". He questioned whether it was "safe to have any group audit its own accounts".[232/]

230/ 1967 House Hearings on Temporary Interest Rate Controls, p. 4.

231/ 1952 Patman Subcommittee Report, p. 63.

232/ 1952 Patman Subcommittee Hearings, p. 97.

As has been mentioned, since 1952 the Board has engaged a reputable commercial auditing firm to make annual audits of the Board and reports of such audits have been sent to the Banking and Currency Committees of both Houses of Congress. In addition, an outside commercial auditing firm has been engaged each year to accompany the Board's examiners in connection with an examination of one of the Reserve Banks in order to review the procedures followed and to submit recommendations.

Despite these changes in practice, the System has continued to be criticized for auditing itself. Thus, during 1957 hearings on the proposed Financial Institutions Act, Mr. Patman said: 233/

> "The only audit Federal Reserve banks have ever had is an internal audit, where they select the auditors, give the auditors their instructions, and report back to themselves. It is bordering on a disgrace for Congress to permit that situation to continue. It just doesn't make sense, either common, book or horse. There is just no sense to it."

Again, in 1959, after Chairman Martin had remarked that the Federal Reserve was "one of the best audited organizations" that he knew of, Mr. Patman said: "Add 'self-audited', and I will agree." 234/

In 1963, a Special Subcommittee of the House Banking and Currency Committee that investigated the "mysterious disappearance" of Government securities at the San Francisco Reserve Bank stated in its Report (with one member dissenting): 235/

> "It is disturbing to be reminded as we were during the investigation that neither the Federal Reserve Board nor the district banks are subject to an outside audit; that this

233/ House Hearings on Financial Institutions Act, p. 1549.

234/ 1959 Hearings before J.E.C., p. 1471.

235/ 1963 Special Subcommittee Report, p. 26.

vast central banking system to which the Congress had delegated vital money powers, <u>audits itself</u>. While the Board audits the Federal Reserve banks annually, we do not regard the practice as similar to the kind of external audit by the General Accounting Office required for other independent agencies, as well as agencies of the executive branch. The experience of this subcommittee gives no ground for satisfaction with present arrangements."

Quite apart from the charge that audits of the Board and the Reserve Banks are "self-audits", Mr. Patman has argued that reports of such audits are inadequate and incomplete. During hearings in 1954 on his first bill to require a GAO audit of the Board, he referred to the fact that, for the first time in history, an audit of the Board had been filed on May 1, 1954, with the Banking and Currency Committees of the House and Senate but that that audit failed "to make adequate or satisfactory disclosures as to the operation of even the Board of Governors for the year 1953."[236/] Moreover, he apparently felt that the audits of the Reserve Banks did not go far enough. In this connection, he stated:[237/]

"A proper audit of the operations of the regional banks would not be limited to counting the petty cash or verifying the Government bonds. It should also look into the adequacy of the internal checks in the accounting systems and into the efficiency of procedures employed in handling the tremendous volume of transactions, which go through the regional banks. A report on the audit ought to state whether operations of the banks are efficient and state wherein improvements in organization, procedures or management might be possible."

Similarly, in 1958, Mr. Patman referred to the limitations of the existing audits of the Reserve Banks:[238/]

236/ <u>1954 House Government Operations Committee Hearings</u>, p. 4.

237/ <u>Id</u>., at 6.

238/ <u>House Hearings on Financial Institutions Act</u>, p. 1589.

"These internal audits of the Federal Reserve banks have many limitations with respect to verification of currency, checks, gold, and securities. Frequently the banks' audits do not conform to the recommended procedures of the Conference of Auditors and the audit committees of the boards of directors of the banks themselves. The audit committees override the recommended procedures of the Conference of Auditors. Sometimes audit committees of the board of directors fail to meet even once a year."

Following hearings in 1964 before Mr. Patman's Subcommittee on Domestic Finance of the House Banking and Currency Committee, a Subcommittee staff summary of those hearings charged that the System's own audits had failed to disclose improper expenditures because the standards were "often vague". 239/

"Improper" expenditures by the System have been referred to on many occasions by Mr. Patman. In 1959 hearings, when Chairman Martin of the Board was a witness and had maintained that the activities of the Reserve Banks had been conducted "extremely efficiently", Mr. Patman disagreed: 240/

"Mr. Martin, I think you are clearly wrong. I know you are sincere in believing that you are conducting the affairs properly and that the banks are. I think it has been conducted in such a loose fashion that the presidents of these banks feel that they can spend public money for any purpose for which any private corporation could spend money. In fact, they actually argue that. When I gave out a statement recently showing the loose way in which these public funds were handled, and wasteful and extravagant waste, some of the presidents of the banks were brazen enough to say, Why, sure, they spent money that way, because private concerns spend money that way, and as long as they did what other private concerns were doing, it was all right. They honestly believed it. They failed to put themselves in the position of a postmaster in the town in which they were located but they really are in that public

239/ 1964 Patman Subcommittee Staff Report, p. 87.

240/ 1959 Hearings before J.E.C., p. 1472.

position. They have no more right to spend that money than the postmaster has a right to spend the money that he collects in the sale of stamps. It is all public money. They should not be allowed to believe that they can spend it in an extravagant manner. To that extent, I am disappointed in the Board of Governors for not doing a little brainwashing, educating the regional banks about what the law is on handling public funds."

In the following year, during hearings on the President's economic report, Mr. Patman said: 241/

"I submit, Mr. Martin, that you gentlemen, in view of these charges and your admissions of the loose handling of the public funds - and I think you admit to things that indicate illegal and unlawful handling of public funds - should ask the Congress to investigate you and find out whether or not these charges are true."

In the Report of the Joint Economic Committee following those hearings, Mr. Patman, in "supplemental views", again referred to the "freehanded spending of public funds" by the Reserve Banks. 242/

During House hearings in 1964, Mr. Patman listed a variety of expenses by the Reserve Banks that in his opinion demonstrated the need for GAO audit. For example, when President Hickman of the Cleveland Reserve Bank was a witness, Representative Patman referred to expenses by that Bank for such matters as dues in banking associations, luncheons for high school students, and golf and dinner parties. 243/ His Subcommittee's staff summary of the 1964 hearings included the following statements regarding expenditures of such kinds: 244/

241/ 1960 J.E.C. Hearings, p. 209.

242/ 1960 Report of J.E.C., p. 33.

243/ Hearings on Federal Reserve After Fifty Years, p. 204.

244/ 1964 Patman Subcommittee Staff Report, p. 86.

"In addition, testimony given before the subcommittee indicated that despite the System's internal audits and reviews of same, its remarkable freedom from any external public audit has led to many questionable expenditures. A random sample by the committee staff of the System's expenditure vouchers reveals such items as $4,697.61 for an employees' dinner, including $125 for a comedian and $435 for an orchestra; $462.59 for an employees' bowling banquet; a contribution of over $5,000 to a local chapter of the American Institute of Banking; and $5,350.35 for a luncheon given by the New York Federal Reserve Bank for the New York Bankers Association at the Waldorf-Astoria. No expenditures of these kinds without congressional approval would be allowed in the case of other Government activities subject to the Budget and Accounting Act."

Three years later, in 1967, Mr. Patman again questioned the propriety of payments by the Reserve Banks to the American Bankers Association and State banking associations, as well as the propriety of expenses for "many other shocking things."[245/]

More recently, in September 1971, when Reserve Board Chairman Burns testified during hearings before the Subcommittee on Domestic Finance of the House Banking and Currency Committee, Mr. Patman raised questions as tothe propriety of various expenditures of the Federal Reserve Banks and as to the legality of the Thrift Plan established by the System for employees of the Reserve Banks and the Board of Governors. At that hearing, Mr. Patman distributed a memorandum, presumably prepared by his staff, itemizing various "questionable" expenditures of the Reserve Banks during the year 1969.[246/]

245/ 1967 House Hearings on Temporary Interest Rate Controls, p. 21.

246/ Oversight Hearings of the Federal Reserve System, Hearings before Subcommittee on Domestic Finance of the House Banking and Currency Committee, Sept. 27, 1971, p. 42.

Although Mr. Patman has stated that the principal reason for which the Federal Reserve should be audited by GAO is to bring the Federal Reserve "within the supervision and control of Congress", he has argued nevertheless that GAO audit would not impair or destroy the "independence" of the Federal Reserve. For example, during hearings on one of his bills in 1954, he said: 247/

"It has been stated in the reply by the Chairman of the Federal Reserve Board that it is likely that the independence of the System would be jeopardized by any kind of an audit. In answer to that, the White House, the President of the United States, must always get an appropriation from the Congress. The Congress looks over every item that is appropriated for the benefit of the Executive Department and it is certainly an independent branch of our Government.

"The Judicial branch of our Government, from the Supreme Court on down, including the salaries of the Justices of the Supreme Court, is provided for by appropriations from the United States Congress, and it has certainly not destroyed the independence of the Supreme Court; neither has it destroyed the independence of the Executive branch.

"Therefore, I think the argument that it is likely to interfere with the independence of the Federal Reserve is a weak one, particularly for the reasons I have cited."

Ten years later, Mr. Patman insisted that GAO audit would not involve determination by GAO of the policies of the Federal Reserve, although Representative Bolton disagreed. During hearings before Mr. Patman's Subcommittee on Domestic Finance, the following discussion took place: 248/

"The Chairman. You think I would want a subcommittee, an appropriation committee, to determine policy for the Federal Reserve?

247/ 1954 House Government Operations Committee Hearings, p. 8.

248/ Hearings on Federal Reserve After Fifty Years, p. 384.

"Of course not.

"Mr. Vanik. The GAO never determines any policy. This arm of Congress has an exemplary record of developing accountability without policy interference. I think it would be terrible to make that sort of charge against the GAO. This is the audit we seek and want here.

"Mr. Bolton. If the gentleman will apologize - I mean I will - allow me to apologize for taking the time -

"The Chairman. No, I wanted the Fed to make policy.

"Mr. Bolton. The recommendations of the GAO with regard to Erieview certainly had to do with policymaking matters. They were not purely accounting matters. They were doggone well policy, decision matters. And this is not said in criticism of the GAO at all. This is purely said in the framework of the discussion with the Fed."

Following those hearings, the Subcommittee's staff summary emphatically stated that GAO audit would not mean that pressure would be brought to bear on the Federal Reserve with respect to monetary policies: 249/

"The question of the System's independence is, to the Federal Reserve officials, apparently the most worrisome aspect of a GAO audit. They fear that such an audit would somehow allow pressure to be brought to bear on the Federal Reserve, that it would confer on the GAO power to dictate Federal Reserve policy and to cut off Federal Reserve funds, and that it would undermine the authority of the Board of Governors and the bank directors. Testimony by Mr. Smith, however, demonstrated that these fears are based on a misconception of GAO's powers and functions. In the first place, it is important to distinguish between the Federal Reserve's monetary policy and its internal management policies. The GAO would not be concerned with monetary policy. . . ."

In support of those views, the staff summary quoted a statement made during the hearings by a Mr. Smith, representing the General Accounting Office, in which Mr. Smith said that his office had "no authority to direct the operation of an agency as such." 250/

249/ 1964 Patman Subcommittee Staff Report, p. 89.

250/ Hearings on Federal Reserve After Fifty Years, p. 909.

Arguments against GAO audit

Essentially, the arguments advanced by those who oppose audit of the Federal Reserve by GAO are two: (1) such an audit is unnecessary, and (2) it would tend to impair the independence of the Federal Reserve System.

When the issue of GAO audit was first raised by the Patman questionnaire in 1951, Chairman Martin, on behalf of the Board, described in detail the budgetary and audit control procedures of the Federal Reserve System. With respect to the Board itself, he pointed out that since 1933, when the Board's accounts became no longer subject to GAO audit, a policy had been followed of having the Board's accounts audited twice each year by auditors from a selected Federal Reserve Bank: 251/

> "It has been the policy of the Board through 1951 to have its accounts audited twice each year by auditors from a Federal Reserve Bank selected by the Board for the purpose. This selection has been changed every 3 years, and since the present arrangement was put into effect in 1933 the accounts of the Board have been audited by the auditing staffs of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Altanta, and Chicago. One of the audits each year has been a surprise audit and the other has been made as of December 31. As stated above, arrangements are being made, beginning in 1952, to have the Board's accounts audited twice each year by qualified outside auditors."

As to the Federal Reserve Banks, Mr. Martin noted that each Reserve Bank was audited by a resident auditor who was responsible only to the board of directors of the Bank, that copies of the auditor's report were furnished to the Board of Governors by which they were carefully

251/ 1952 Patman Compendium, p. 311.

reviewed, and that each Reserve Bank and branch was examined at least once a year by the Board's own examiners.[252/]

Two years later, when the Board reported on a bill introduced by Mr. Patman to provide for audit of the Board, the Open Market Committee, and the Reserve Banks for the year 1953, Mr. Martin was able to report that an outside public accounting firm had been engaged to audit the Board's own accounts and also to review and observe the procedures followed by the Board's examining staff during the examination of one of the Reserve Banks. After stating that Congress had provided "a sound, prudent, and adequate means of achieving efficiency and economy in Federal Reserve operations" and that legislation to superimpose a further audit would make only for "needless duplication and additional expense", Mr. Martin said:[253/]

> "As part of the process of double-checking and improving methods, the Board in 1953 engaged the public accounting firm of Arthur Andersen & Co., to review and observe the procedures used by the Board's examination staff during the examination of one of the Reserve Banks. That firm's report commented favorably upon the competence and effectiveness of these procedures. The Board has arranged to have similar reviews made of its examinations of other Federal Reserve Banks from time to time in order to be doubly sure that the examinations are as good as the combined efforts of responsible men in and out of Government can make them.
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> "For many years the Board of Governors had its own accounts audited by the independent audit department of one or another of the Federal Reserve Banks, and that arrangement

252/ Id., at 314.

253/ Letter from Board to chairman of House Committee on Government Operations on H.R. 7602, Mar. 30, 1954.

provided a thorough and trustworthy audit. However, in order that there may be no question as to the independence of these audits, the public accounting firm mentioned above was engaged to audit the accounts of the Board of Governors in 1952, and the firm is just completing an audit of the Board's accounts for the year 1953."

On the following day, March 31, 1954, the Bureau of the Budget opposed enactment of Mr. Patman's bill on the ground that there was no need for audit by the Comptroller General. The Bureau's letter stated in part: 254/

"The Bureau believes that the proposed legislation is unnecessary and undesirable. . . . The Board of Governors of the Federal Reserve System supervises and audits the expenditures of the Federal Reserve banks, and is itself audited annually by an independent firm of accountants. This has been fully adequate in the past, and there appears no need for an audit by the Comptroller General. We, therefore, recommend against enactment of H.R. 7602."

In the course of 1954 hearings on the Patman bill, Chairman Martin reiterated the position that the accounts of the Board and the Federal Reserve Banks were already subject to careful audit and that there was no need for further audit by another Government agency. In this connection, he said: 255/

"The Board of Governors recognizes the importance of budgetary and accounting procedures that will make for effective and efficient operations throughout the Federal Reserve System and is entirely in sympathy with the objectives sought in various proposals on the subject that have been advanced in the Congress. Fully effective procedures are already provided, however, and to superimpose a further budgetary and auditing review upon the existing procedures is neither necessary nor advisable."

254/ Letter from Bureau of the Budget to chairman of House Committee on Government Operations, Mar. 31, 1954.

255/ 1954 House Government Operations Committee Hearings, p. 43.

During Senate hearings on the proposed Financial Institutions Act in 1956, Reserve Board Governor Robertson reviewed again the reasons for which Federal Reserve audit by the General Accounting Office was not necessary: 256/

"We have a crew of men who devote their entire time to this job, and the head of that group is a CPA himself. We have gone over the procedures they use and the operations they engage in very carefully. But we haven't been satisfied with that. In order to make it as good as possible, we have employed an outside firm of certified public accountants to go with those examiners into one Federal Reserve bank each year, not for the purpose of making the audit, but for the purpose of overlooking that crew to see whether or not they are doing their job as they should, whether the procedures they use are appropriate, whether anything can be devised to make it a better examination. And at the end of that particular examination - they vary it each year, a different Federal Reserve bank each year - they send to us their views as to improvements which they think could be made.

"And we consider those carefully, and we make those improvements, so that we think we do a pretty good job in that field.

"With respect to the Board itself, in 1952 we engaged in the practice which we think should be mandatory of having outside firms of qualified public accountants go over the books and records of the Board with no strings whatsoever attached. They have complete freedom to make whatever audit they think is appropriate. And they do. And we've benefited highly from that."

In 1960, the House Committee on Government Operations requested the Board's views regarding a bill that would have directed the Comptroller General to audit the accounts of the Board, the Open Market Committee, and the Reserve Banks from the beginning of the System until the end of 1958. In response, Chairman Martin said: 257/

256/ Senate Hearings on Financial Institutions Act, p. 229.

257/ Letter from Martin to chairman of House Committee on Government Operations, Apr. 13, 1960.

"The proposed legislation, except for the period covered, is similar to H.R. 2643, introduced in the 84th Congress, upon which the Board has previously expressed its views in a letter to your Committee dated March 18, 1955. The Board also had previously reported to your Committee by letter dated March 30, 1954, on H.R. 7602, a similar bill introduced in the 83rd Congress and concerning which I testified in a hearing before your Committee on June 2, 1954.

"As stated in the above-mentioned reports and as emphasized in my statement to your Committee, the Board of Governors recognizes the importance of budgetary, accounting, and auditing procedures that will make for effective, efficient, and proper operations throughout the Federal Reserve System. The Board, however, believes that fully effective procedures are being followed.

"As an agent of Congress and as directed in the Federal Reserve Act, the Board of Governors conducts annual examinations of the Federal Reserve Banks and branches, and of the System Open Market Account. A staff of examiners versed in the operations of the Federal Reserve Banks is maintained exclusively for this work, and the Board is confident that its examination procedures meet the highest standards of the accounting profession. In order to be assured that such standards are maintained, the Board has for a number of years retained public accounting firms of recognized reputation to accompany the examiners on one Federal Reserve Bank examination each year for the purpose of reviewing and observing the adequacy of the procedures and practices.

"Nationally known public accountants also are retained to audit the Board's books. The auditor's certificate is published each year in the Board's Annual Report, and copies of the audit report are sent to the Senate and House Banking and Currency Committees."

During the 1964 "anniversary" hearings, there were a number of statements not only by Federal Reserve officials but by others to the effect that existing procedures for audit of the Board and the Federal Reserve Banks were adequate and effective and that any additional audit by GAO would be superfluous. Thus, Chairman Martin, after restating the existing audit procedures, said:[258/]

258/ Hearings on Federal Reserve After Fifty Years, p. 16.

". . . This combination of internal and external scrutiny provides an audit coverage of the Reserve banks that is unexcelled in any other organization, and is as objective and independent in approach as human ingenuity can devise. It is difficult to perceive how the GAO or any other audit group could achieve a more effective result."

President Hayes of the New York Reserve Bank similarly argued that the existing audit procedures were "fully effective"; 259/ and President Swan of the San Francisco Reserve Bank felt that audit by any other agency would simply "add another layer of supervision and cost." 260/ Treasury Secretary Dillon questioned whether GAO audit would be "a useful and necessary expense" and expressed the view that existing System auditing procedures were "adequate". 261/ Finally, the president of the American Bankers Association felt that it was "highly doubtful whether GAO audits of the Federal Reserve banks would provide Congress with more information than now is being provided by the excellent audits conducted by the Board of Governors." 262/

Again, in 1968, Chairman Martin expressed the view that GAO audit would be "unnecessary"; 263/ and Professor James S. Earley of the University of California felt that no important purpose would be served by an annual audit of the Federal Reserve by GAO. 264/

259/ Id., at 529.

260/ Id., at 665.

261/ Id., at 1254, 1255.

262/ Id., at 1878.

263/ 1968 Compendium, p. 48.

264/ Id., at 150.

The most complete restatement of the reasons for which present auditing procedures within the Federal Reserve System are effective and need not be supplemented by GAO audit was made by Vice Chairman Robertson of the Board during Congressional hearings in 1967. His statement with respect to this matter was as follows:[265/]

> "Manifestly, Federal Reserve operations should be conducted with maximum efficiency and economy. To that end Congress has placed upon the Board of Governors, an arm of the Congress, direct responsibility for general supervision and periodic examination of the Reserve Banks. The Federal Reserve Act also provides that each Reserve Bank shall have a board of nine directors chosen from its district. They are outstanding in their communities; many have had broad experience in business and professional life, and are therefore able to apply to the Reserve Banks the high standards of efficiency prevalent in private enterprise. Thus the Federal Reserve combines advantages of Governmental control with advantages of private business management.
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> "Since 1952, the Board has been audited annually by independent public accounting firms, and their audit reports have been submitted to the Banking and Currency Committees of both Houses of Congress. We have endeavored to select top-flight auditing firms for this work. The firms selected have been Arthur Andersen & Co., Price Waterhouse & Co., Haskins & Sells, and, most recently, Lybrand, Ross Bros. and Montgomery.
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> "The Federal Reserve Act provides that the Board 'shall, at least once a year, order an examination of each Federal Reserve bank.' The Board maintains a staff of examiners who devote themselves exclusively to this work. The Board's instructions to its examiners require, briefly, that the examination shall look to (a) each bank's financial condition through appraisal of its assets and verification of its assets and liabilities; (b) its proper discharge of all its responsibilities; and (c) its compliance with all applicable provisions of law and regulations. Each year, an outside commercial auditing firm (Haskins & Sells for 1967) is engaged to accompany the Board's examiners on their examination of one of the Reserve Banks, to review, observe, and submit recommendations for improving, the examination procedures. Also, each Reserve Bank has a resident auditor, responsible directly to the Bank's

265/ 1967 House Hearings on Temporary Interest Rate Controls, pp. 10, 11.

board of directors and not dependent on any of the Bank's officers for security of position. Throughout the year, he and his staff make comprehensive audits of all phases of the Bank's operations, reporting directly to the board of directors of the Bank. Copies of these reports are reviewed by the Board of Governors of the Federal Reserve System.

"In sum, then, we have in each Reserve Bank an internal audit program conducted the year round by the Bank's resident auditor and his staff, who, by a deliberately established plan of organization, are directly responsible to the board of directors and independent of the Bank's operating management. In addition, a staff of examiners directly employed by the Board of Governors in Washington examines each Bank every year and reports directly to the Board of Governors. We have the statements of certified public accountants of national repute that the examination procedures employed by the Board's staff conform to generally accepted auditing standards. This combination of internal and external scrutiny provides an objective audit coverage of the Reserve Banks that is unexcelled in any other organization."

With particular reference to the need for GAO audit of the accounts of the Open Market Committee, Chairman Martin pointed out in 1954 that the Committee has no funds of its own and that the Open Market Account at the New York Reserve Bank is subject to careful audit and review.[266/] In 1965, when Mr. Patman requested arrangements for audit by GAO of the investment portfolio of the Open Market Committee at the New York Reserve Bank, Chairman Martin replied that the Board would not be justified in making such arrangements since they were not authorized by Congress. In his letter to Mr. Patman, however, Chairman Martin gave the following explanation as to why, quite apart from legal authority, any additional audit of the Open Market Account would be unnecessary:[267/]

266/ 1954 House Government Operations Committee Hearings, p. 45.

267/ Letter from Martin to Patman dated Mar. 31, 1965.

"Apart from the broad question, the Board believes there is no sound reason for any additional inventory or other audit activities such as suggested in your letter. A physical inventory of the securities would serve no purpose in view of the physical and operating controls that now govern their custody, and the frequent audits and examinations of the System Open Market Account. The securities are lodged in steel chests, within a compartment enclosed by steel partitions, within a maximum security vault. The door to the vault is controlled by electrical time devices; it bears two separate combination locks; each combination is known only to designated members of a control group, and a member from each of the two separate control groups each must turn his combination before the door may be opened. During the day an armed guard is stationed at the door of the vault, and access is controlled by a day gate which is kept locked at all times, the key being in the custody of a member of the vault division. No one is admitted beyond the day gate until it is established that he has business that necessitates his entry into the vault, and in each instance the entrant must sign his name on a register. Similarly, the doors to each compartment are kept locked, being controlled by the custodians assigned to the compartment. The chests in which the securities comprising the System's investment portfolio are stored are locked except when a deposit or withdrawal is being made; they may be opened only when two custodians, each representing a separate control group, release their respective locks. All securities received or delivered are separately verified by each of the two custodians, acting on properly authorized instructions.

"The program of the internal auditing department of the Reserve Bank requires at least two verifications annually of the securities held for the System Open Market Account by detailed count and verification of each bill, certificate, note, and bond in the portfolio, and agreement of the holdings so verified with the accounting controls. The internal auditing department's procedures also provide for an appropriate check of each purchase and sale transaction executed for the account, a verification of the accounting of interest, discount and premium, and other procedures necessary to assure that the operations of the account are conducted in accordance with the instructions of the Federal Open Market Committee."

While System officials and others have repeatedly opposed GAO audit on the ground that it is <u>unnecessary</u>, the principal ground for their opposition has been the fear that such audit would impair or tend to <u>impair the independence of the System</u> and hamper the effective performance of its functions.

In replying to a question posed by Representative Patman as to why the Board and the Reserve Banks should not be subject to audit control by another agency of the Government, Reserve Board Chairman Martin in 1952 stated:[268/]

"As indicated in answers to other questions, the functions and responsibilities of the Board of Governors are such that Congress has provided that they be carried out with a maximum exercise of independent discretion and judgment. Accordingly, the expenses and other accounts of the Board and the Federal Reserve Banks are not subject to any budgetary or audit control of any other agency of the Government. If through some measure of control over its finances another agency of Government were empowered to restrict operations which the reserve banking system deemed essential for the discharge of its statutory duties, there obviously would result a substitution of judgment of such other agency of Government for that of the reserve banking system, with a consequent and growing loss of effectiveness on the part of that instrumentality.[47]

"47. It is relevant to note here that despite the fact that England and France have nationalized their central banks, neither has placed the expenses of these organizations under direct government control nor the officers or employees thereof under civil service."

In the course of 1952 hearings on the replies to the Patman questionnaire, Chairman Martin told Mr. Patman that audit of the Federal Reserve by the General Accounting Office would not be a "good thing" because he thought it "would be a step toward nationalization of the System."[269/] Following those hearings, Mr. Patman's Subcommittee issued a Report which, among other things, suggested that the Board should submit to the two Banking and Currency Committees of Congress each year its own budget and the budgets of each of the Reserve Banks for the information

268/ 1952 Patman Compendium, p. 307.

269/ Hearings on 1952 Patman Compendium, p. 122.

of such Committees and consideration as they might consider suitable. Even this proposal was objected to by Senator Flanders, a member of the Subcommittee, who felt that it might prove an entering wedge "for a subsequent impairment of the System's independence."270/

In reporting on a Patman bill for audit of the Federal Reserve, Chairman Martin in 1954 again argued that it "would not only make for needless duplication and additional expense but would be regarded as an entering wedge in encroaching upon the independence of judgment which Congress in the Federal Reserve Act has sought to safeguard and which is indispensable in the execution of impartial credit and monetary policy."271/

The Bureau of the Budget in 1954 likewise opposed Mr. Patman's bill in a letter stating that the independence of the Federal Reserve System was "an important cornerstone of the Administration's fiscal and monetary policies, and H.R. 7602 might impair the System's independence."272/

During the 1964 hearings on "The Federal Reserve System After Fifty Years", a number of witnesses opposed GAO audit of the Federal Reserve on the ground that it would impinge upon the System's independence and bring it under political pressures.273/

270/ 1952 Patman Subcommittee Report, p. 62.

271/ Letter from Martin to chairman of House Committee on Government Operations dated Mar. 30, 1954.

272/ Letter from Bureau of the Budget to chairman of House Committee on Government Operations dated Mar. 31, 1954.

273/ See, e.g., statement by President Kelly of the American Bankers Association that such audit could "impinge upon this independence which the Congress has been so intent on preserving", Hearings on Federal Reserve After Fifty Years, p. 1919; and a statement by Professor Henry H. Villard of the College of the City of New York that he was opposed to more Congressional pressure on the System through GAO audit. Id., at 1023.

In 1967, Vice Chairman Robertson of the Board made the following statement in opposition to GAO audit: 274/

"Over the years, spokesmen for the Board and the Reserve Banks have tried in varying ways to express the reasons why we believe audit of the System by the General Accounting Office would be unwise. A former Chairman of the Board, Marriner Eccles, in a letter to your Chairman in 1952 referred to GAO audit as 'the kind of encroachment which, if carried on its logical conclusion, would ultimately hamstring and destroy the independence of judgment and action by the Reserve System.' In the course of hearings presided over by Mr. Patman in that same year, the late Malcolm Bryan, then President of the Reserve Bank of Atlanta, put it this way:

"'Now, the Federal Reserve System in its management of the Nation's money supply is the repository of what is probably the greatest trusteeship in the world's history. It has certainly the greatest fiduciary responsibility ever granted by the Congress. If this System, established and articulated with scrupulous care, which itself possesses the highest sense of money accountability, with auditors and independent counter auditors checking each other, cannot now be trusted in the management of its privy purse, so that it must be set upon by still further auditing, then we have, in a sickening plunge, descended from the sublime to the ridiculous.'"

In the following year, in reply to a questionnaire submitted by Representative Patman, Reserve Board Chairman Martin made the following comment with respect to a proposal to provide for audit of the Reserve Board and the Reserve Banks by the Comptroller General: 275/

"Adoption of this proposal would represent a radical alteration of the basic concept of the Federal Reserve System and prevent the System from discharging its statutory functions in the most effective manner, which requires the exercise of independent judgment and freedom from political and partisan pressures or the possibility of such pressures."

Whether or not GAO audit would directly and immediately impair the System's independence, Federal Reserve officials and others have

274/ 1967 Hearings on Temporary Interest Rate Controls, p. 10.

275/ 1968 Compendium, p. 49.

frequently expressed the view that it would be a "foot in the door" or "entering wedge". Thus, in testifying on the proposed Financial Institutions Act in 1956, Vice Chairman Robertson of the Board made the following statement:276/

> ". . . Just a pure audit by General Accounting Office isn't of great importance by itself as far as I see it. It's just another agency making an audit. And I have no reason to think they are not just as honest as anyone else, but from my point of view I think that it is just a wedge, a foot in the door toward destroying the independence of the Federal Reserve System. There are many people who disagree with this, but this is the way I feel about it."

During the 1964 hearings previously mentioned, President Hayes of the New York Reserve Bank stated that audit by GAO of the Federal Reserve System "could be regarded as an entering wedge that would encroach upon the independence of judgment which Congress has sought to safeguard, and which is indispensable if credit and monetary policies are to be made and executed in an impartial way."277/ Similarly, Professor G. L. Bach of Stanford University said:278/

> "In establishing the Federal Reserve in its present form the Congress has said to the Fed, we want a group of men who stand apart from the day-to-day pressures of the Congress, the President of the United States, and the Secretary of the Treasury. To establish an audit in the sense that I believe you are suggesting would, it would seem to me, be an entering wedge to remove that degree of separateness of degree of independence that I think the Congress wanted to establish in the Fed."

The words "entering wedge" were used again by Vice Chairman Robertson

276/ Senate Hearings on Financial Institutions Act, p. 230.

277/ Hearings on Federal Reserve After Fifty Years, p. 529.

278/ Id., at 1421.

of the Board in 1967 when he made the following statement during Congressional hearings: 279/

"Now, then, from my point of view the question is not simply whether you want to determine that all the expenditures that have been made are warranted or whether the figures gibe. There must be a different reason, and that is why most of the people in the Federal Reserve System feel that this is merely an entering wedge designed to reduce the independence of the Federal Reserve System within the Government so that its decisions will be more in accord with those of the administration, whatever administration is in power at any given time."

Former Reserve Board Governor Abbott L. Mills spelled out what Federal Reserve officials apparently have in mind when they refer to audit by GAO as an "entering wedge" that would impair the independence of the System: 280/

". . . over the years where there have been recurrent proposals to reduce the independence of the Federal Reserve System, it has been the sense of the officers of the Federal Reserve System that if the System were to become subject to examination by the General Accounting Office, that the next step would be to bring its operations under the coverage of the Budget Bureau and appropriated funds, and to terminate the present authority of the System to recruit for the Board in particular its personnel as its own wishes dictate, and not from the civil service list. So it is a fear that movements in those directions would set up a momentum that at its logical conclusion would change the character of the System and limit its independence."

Opponents of GAO audit have sometimes drawn a distinction between an audit that would amount simply to a verification of accounts, to which they would not object, and one that would go beyond such a verification and involve review of policy decisions. For example, during the 1964 hearings, Reserve Board Governor Robertson observed

279/ 1967 Hearings on Temporary Interest Rate Controls, p. 14.

280/ Hearings on Federal Reserve After Fifty Years, p. 114.

that no one could object to "scrutiny by an impartial outside agency of the Federal Reserve System for the purpose of determining whether or not money had been stolen or wasted" but that, if the purpose were to exert pressure on the judgment of the System, the audit would be an entirely different matter.281/ Similarly, former President Ellis of the Boston Reserve Bank stated that, if GAO audit was not "simply verification", it would amount to an effort "to replace our judgment with somebody else's judgment as to the appropriateness of a particular expenditure."282/ And President Wayne of the Richmond Reserve Bank agreed that his concern was whether the purpose of the so-called audit would be "a substitution of judgment as against simply a verification of expenditures."283/

Despite Representative Patman's assertion on one occasion (see page 112 of this paper) that GAO audit would not be intended to influence the System's policies, others have expressed disagreement. Thus, as has been noted, Representative Bolton felt that recommendations of GAO "certainly had to do with policymaking matters."284/ President Kelly of the American Bankers Association referred to the fact that an officer of GAO had previously testified before the Banking and Currency Committee of the House to the effect that "GAO examination of the Fed, would have to go beyond a pure audit, and would probably

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281/ Ibid.

282/ Id., at 395.

283/ Ibid.

284/ Id., at 384.

take into consideration policy matters."285/ Secretary of the Treasury Dillon, the head of an Executive Department who should have been in a position to know, stated that in many cases representatives of GAO had tried to affect policy.286/

During 1967 hearings, another president of the American Bankers Association observed that it was "generally understood that such audits [by GAO] involve not only review of financial operations but also the consideration of policy matters."287/ Vice Chairman Robertson of the Board likewise expressed the view that GAO audit of the Federal Reserve would have a tendency to review the System's policies.288/ The chairman of the Federal Home Loan Bank Board, which is subject to GAO audit, was asked specifically whether representatives of the Comptroller General had caused any problems for his Board. He replied that, while his Board had experienced no insurmountable difficulty, he would not be completely frank if he did not say that there had been times when there were some problems.289/

Even a representative of the General Accounting Office admitted in 1964 that his Office would look at the policies of the Federal Reserve System if it should be authorized to audit the Federal Reserve. The following colloquy took place between Representative Harvey and

285/ Id., at 1919.

286/ Id., at 1255.

287/ 1967 House Hearings on Temporary Interest Rate Controls, p. 64.

288/ Id., at 42.

289/ Id., at 32.

Mr. Fred Smith, Deputy Director, Accounting and Auditing Policy Staff, of the GAO: 290/

"Mr. Harvey. I wonder again if I could get a yes or no answer. Would you feel that your job was to pass judgment on policies of the Federal Reserve System?

"Mr. Smith. We would look at their policies, yes, sir. It would be part of our job.

"Mr. Harvey. Despite the fact that you would have said you had no persons with Federal Reserve training or any experience in that field whatsoever?

"Mr. Smith. We take the view that the best approach to any type of a job is to use commonsense."

In two particular respects, System officials and others have opposed GAO audit of the Federal Reserve on the ground that it would violate the confidentiality of certain records. Among one category of such records are those relating to the relationships of the Reserve Banks with foreign central banks; the other relates to reports of examinations of member banks.

With respect to records regarding dealings with foreign banks, Vice Chairman Robertson in 1967 observed that Mr. Patman's bill raised "serious questions about whether the System would be able to maintain relationships such as those presently in effect with foreign central banks, which depend on our ability to assure others that we can maintain confidentiality when they request it." 291/

Mr. Patman's 1967 bill for Federal Reserve audit, unlike his previous bills on the subject, specifically mentioned reports of

290/ Hearings on Federal Reserve After Fifty Years, p. 916.

291/ 1967 House Hearings on Temporary Interest Rate Controls, p. 12.

examinations of member banks as among the records of the Reserve Banks to which representatives of GAO should have access. This provision was vigorously opposed by Reserve Board Governor Robertson and others. In this connection, Governor Robertson said: 292/

> ". . . As to one particular aspect of this problem, section 2 is crystal clear: it specifically requires that we make available to GAO the reports of examination of member banks. As I have indicated before, the System stands ready to answer any question about its own expenditures. But we believe that the long-established tradition that reports of examination of commercial banks should be kept confidential is not only essential to maintain effective supervision, but also to protect the privacy of customers of the member banks in their personal and business affairs."

Chairman Randall of the FDIC similarly opposed this provision: 293/

> "Congressman, the FDIC is audited by the GAO with respect to its financial transactions. This means all activities of the Corporation except those that relate to examination of State-chartered insured nonmember banks and our access to examination reports of member banks that we obtain for insurance purposes. We strongly react to this factor. We would be most adamant in our objections to extending the audit to the Federal Reserve. We think such restriction is completely necessary to preserve the confidential nature of examination reports and the rapport necessary between the banks and the examiner in the field. Encroachment in this area would be most unfortunate."

The president of the American Bankers Association likewise voiced strong opposition to giving GAO access to reports of examinations: 294/

> "Mr. Chairman and members of the committee, I could not imagine anything more dangerous than for anyone to go into the examination of member banks of the Federal Reserve System. I think that this treads very closely on the independence of the Federal Reserve. I think it certainly threatens the confidentiality of bank examinations."

292/ Ibid.

293/ Id., at 31.

294/ Id., at 67.

F. RELIANCE UPON APPROPRIATIONS

While Representative Patman has advocated GAO audit of the Federal Reserve System since 1952, it is only since 1964 that he has coupled that proposal with a proposal that the System be made dependent upon Congressional appropriations for payment of its expenses.

Since 1913, when the System was established, the Federal Reserve Board's expenses have been paid from assessments on the Federal Reserve Banks and the expenses of the Reserve Banks have been paid from the earnings of those Banks. As Carter Glass once said, not a dollar of the expenses of the System has come from appropriations of Congress.[295/] In 1933, Congress amended the Federal Reserve Act to provide expressly that the funds available to the Board from assessments on the Reserve Banks should not be regarded as "government funds or appropriated moneys."

In 1964, however, when Mr. Patman held hearings to commemorate the fiftieth anniversary of the System, one of the bills that was a subject of the hearings would have required the Board and the Reserve Banks to rely upon appropriations by Congress for payment of their expenses. Since 1964, Mr. Patman has introduced other bills to the same effect, the latest being one presented by him in January 1971.

Defenders of the "independence" of the Federal Reserve have consistently argued that such proposals for operation of the System with appropriated funds would endanger that independence even more than proposals for audit of the System by the GAO. While a majority

295/ 79 CONG. REC. 11778.

of the respondents to Mr. Patman's 1968 questionnaire favored GAO auditing of the Federal Reserve, a much larger majority, including some who felt that the System should not be "independent", was opposed to the proposal that the System be required to operate with appropriated moneys.296/

In the course of the 1964 hearings, Reserve Board Governor Robertson said:297/

> "There is no reason at all why the Federal Reserve System could not operate effectively on the basis of appropriated funds or on the basis of the appropriation process such as other Government agencies are subjected to. However, it seems to me that the purpose of this proposal is simply to reduce and eliminate the independence of the system which I think is bad and therefore I would be in opposition to the proposal."

During the same hearings, the president of the Kansas City Reserve Bank expressed the view that Patman's proposals for GAO audit and operation of the System with appropriated funds would be "a very long step in the elimination of the independence of the Federal Reserve System."298/ Another Reserve Bank president stated:299/

> ". . . the proposal that the GAO audit the Federal Reserve System is very closely linked with the one to bring the Board and the banks under congressional appropriations procedures, because then Congress would establish the expenditures criteria the GAO would need. This, I believe, would undermine the independence of the Federal Reserve and its ability to formulate and execute monetary policy one step removed from the political arena. The prestige of the dollar and confidence in our monetary policy would suffer a dangerous blow."

296/ 1968 Compendium, p. 27.

297/ Hearings on Federal Reserve After Fifty Years, p. 108.

298/ Id., at 817.

299/ Id., at 666, statement by President Swan of the San Francisco Reserve Bank.

In 1968, Reserve Board Chairman Martin argued that subjecting the System to the appropriations process would hamper the System in the performance of its public service functions and inject political pressures: 300/

> "A requirement that the expenses of the Board and the Reserve banks be paid only from funds appropriated by Congress would create unnecessary and hampering rigidities in the performance of the public service functions of the System. More importantly, however, it would inject political pressures and considerations into the formulation of monetary and credit policies.
>
> ". . . It would be unfortunate if, after so many years, Congress should abandon the basic principle that the expenses of the Board, as well as those of the Reserve banks, should not be subjected to the limitations inherent in the appropriations process."

President Karl Bopp of the Philadelphia Reserve Bank cited specific examples of the manner in which the System's public service functions, such as its check collection services, could be curtailed if the System had to depend upon Congressional appropriations: 301/

> "The Congress could expose the country to the hazard of seriously interrupting our payments mechanism by subjecting the Reserve System to congressional appropriations. An efficient system of payments - collection of checks, provision of currency and coin - is indispensable to sustained economic growth. Interruption in the smooth flow of checks or inability to secure cash could cause panic. To assure that there would be no such interruption in these functions - which vary widely and at times unpredictably - the System would either (1) have to be given wide discretionary authority by the Congress, or (2) would have to defend a budget of sufficient size to meet maximum possible needs. Grant of wide discretionary authority would defeat the purpose of subjecting the System to congressional appropriations. Budgets designed to meet maximum needs, on the other hand, would tend inevitably to increase costs. Experience with the severe coin shortages in recent years demonstrates that deficiency appropriations are no dependable solution."

300/ 1968 Compendium, p. 50.

301/ Hearings on Federal Reserve After Fifty Years, p. 423.

He dramatized his point with the following illustration: 302/

"For the last several years we have had severe shortages of coin and have had to ration them at the Federal Reserve banks, and this is a very difficult thing to do.

"Now, the U.S. Mint, however, has been unable to secure sufficient appropriations from Congress to see that we have available an adequate supply of coin. I then move from that to currency and ask myself if this were required also with respect to currency, then the problem would be even more difficult.

"If, for example, under the appropriations of Congress we had exhausted the appropriation granted for the check collection mechanism in our bank before the year is over, because of some unforeseen event, we would then - and Mr. Bryan in the statement he prepared, indicated we would have to write to the various banks saying, 'We are sorry; we didn't make quite the amount of appropriations we needed; your checks are coming in. We are keeping them in order as we receive them, and when we get an additional appropriation, maybe next year, we will then sort these checks in the order in which they were received.'"

Two Secretaries of the Treasury have opposed Mr. Patman's proposal that the System's expenses be paid from appropriated funds. In 1964, Secretary Dillon testified: 303/

"Well, I think the Treasury has always taken the position that it would be better not to have a Federal Reserve subject to the appropriations process because it does not fit into the mold of an ordinary Government agency.

"It will be difficult to get the character or the type of professional appointees that they need there if they were subject to the regular appropriations. This is not anything unique in the Fed. None of the banking supervisory agencies of the Government are subject to appropriations. This also applies to the Comptroller of the Currency. It also applies to the FDIC. So the Fed is in that same situation.

"So that is one, I think, that is fairly clear-cut. The Congress took that decision very deliberately, and I think it was a wise decision when it was taken."

302/ Id., at 468.

303/ Id., at 1254.

In 1968, Secretary Fowler argued that the proposal would not only reduce the System's independence but would also introduce unnecessary "operational rigidities": 304/

"It would not be desirable to make the Federal Reserve subject to the regular congressional appropriations process. There is every evidence that the Federal Reserve is managed prudently and efficiently; thus there is no clear need for the proposal. Adoption of the proposal would almost certainly lead to a major reduction in the existing degree of Federal Reserve independence within the Government and in its insulation from day-to-day political pressures. It would also tend to introduce unnecessary operational rigidities that might diminish the System's ability to respond very promptly and flexibly to various domestic and international contingencies.

"While the role of the Federal Reserve within the Government is in many ways unique, it should be noted that the Congress has also exempted the other major bank supervisory authorities - that is, the FDIC and the Comptroller of the Currency - from the regular appropriations process."

Opposition to the appropriations proposal has come not only from Federal Reserve officials and Secretaries of the Treasury but also from bankers and economists. On behalf of the American Bankers Association, the Association's president in 1964 said: 305/

"We believe that the administration of sound monetary policy requires effective insulation of the monetary authorities from day-to-day political pressures. Consequently, we oppose legislation which would require the Federal Reserve System to rely on congressional appropriations for its funds. We note, in addition, that such a requirement would be inconsistent with the quasi-private status of Reserve banks - a status which adds to the System's regional strength and undergirds its independence within Government."

Professor Harold Barger of Columbia University felt that the "proposed change would risk subjecting monetary policy to congressional

304/ 1968 Compendium, p. 67.

305/ Hearings on Federal Reserve After Fifty Years, p. 1878.

direction through the withholding of appropriations."[306/] Professor Ross M. Robertson of Indiana University opposed the change in the following language:[307/]

> "This bill would subject the Federal Reserve System to congressional appropriation. I see no compelling reason for such a provision, and I think it would be intolerable to have the service functions of the central bank in even the slightest danger of interruption. The very essence of a central bank is the money-creating power. The foundation of the money-creating power lies in the fundamental fact of economic life that a central bank can write a check on itself. It seems to me inconceivable that an institution with power to write checks in the amount of billions of dollars per annum to carry on open-market operations should be required to come as a suppliant to Congress for the relatively minor expenses of its operation."

Professor James S. Earley of the University of California has expressed the view that dependence upon appropriations would subject the System to political pressures:[308/]

> "I would not favor making the expenditures of the Federal Reserve System subject to congressional appropriation. I think congressional appropriation would make transitory political pressures greater than they should be. Monetary policy and central bank operations are extremely complex, and must be carried out professionally. Although the ultimate responsibility of the Federal Reserve to Congress and the Nation should be made clear, the System should not be subjected to great political heat. . . ."

Another University of California professor, Thomas Mayer, although favoring reduction of the System's independence, opposed use of the appropriations process for this purpose because it would "give power

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306/ *Id.*, at 1355.

307/ *Id.*, at 1360, 1361.

308/ *1968 Compendium*, p. 150.

over monetary policy to the appropriations committees of the Congress rather than to those committees more directly concerned with monetary policy."309/

One of the bankers who have opposed the appropriations proposal on the ground that it would subject the System to political pressures is Dr. Tilford C. Gaines of Manufacturers Hanover Trust Company of New York. In 1968, he wrote:310/

> "Finally, the proposal that funds to operate the Federal Reserve System be appropriated by the Congress is an apparently innocent proposal but one that is potentially dangerous. The long history of money management has repeatedly emphasized the need for the central bank to be as independent as possible from the political process. There is no more certain way to get the central bank involved in the political process than to make the appropriation of funds necessary for its existence subject to action by the Congress. By comparison with other Government agencies, the total staff and total expenses of the Federal Reserve System are nominal. There certainly can be no suspicion that the Federal Reserve is spending lavishly and that such expenditures might be curtailed if subjected to congressional scrutiny. It is not possible to foresee economies from this proposal; its only apparent purpose would seem to be to bring Federal Reserve policy directly under congressional control, and the only reason for this objective would be to enable the Congress to direct the Federal Reserve as to the kind of policies that should be followed if its appropriations are to be approved. The System has worked well as now constituted and almost surely over the history of the Federal Reserve has worked better than would have been possible if Congress had been calling the tune."

And Dr. Guy E. Noyes of Morgan Guaranty Trust Company said:311/

> "The System's expenditures for other than purely routine operational functions, such as the clearing and collection of checks, are minuscule in comparison to those of almost any

309/ Hearings on Federal Reserve After Fifty Years, p. 472.

310/ 1968 Compendium, p. 235.

311/ Id., at 507.

> other Government agency. Therefore, the only function that the introduction of the appropriations procedure could serve would be to place in the hands of a relatively small number of Congressmen, in contrast to the Congress as a whole, the power to punish or reward the Federal Reserve System for actions which coincided or failed to coincide with their particular predilections. This would, in my judgment, be unfortunate."

Those who have supported the proposal to subject the Federal Reserve to appropriations are those who feel that the System's "independence" is indefensible. Thus, Professor Michael D. Reagan of Syracuse University felt that the Federal Reserve should be more accountable to Congress: 312/

> ". . . I would deny the validity of the argument, frequently made by spokesmen of the Fed, that the System is now sufficiently accountable to the Nation because it is accountable to the Congress. First it is less accountable than regular departments because appropriations are not its lifeblood.
>
> "I have read enough appropriations hearings and other substantive hearings of the Congress to feel rather firmly that the power of the purse string does remain a very important power of the Congress. The Federal Reserve is not subjected to this accountability."

Professor William G. Dewald of Ohio State University favored the appropriations proposal on the ground that it "would put some teeth in congressional controls on the Federal Reserve and reduce the independence of the Federal Reserve to introduce changes in policy and regulations without congressional sanction." 313/

Mr. Patman's latest bill to reorganize the Federal Reserve System, 314/ introduced in January 1971, like his earlier bills in 1964

312/ Hearings on Federal Reserve After Fifty Years, p. 1577.

313/ 1968 Compendium, p. 147.

314/ H.R. 11, 92d Cong., 1st Sess.

and 1968, would subject the System to the appropriations process by three amendments to the Federal Reserve Act.

First, the bill would amend section 7 of the Act to add the following new paragraph:

> "The full amount of all interest, discounts, assessments, and fees received by Federal Reserve banks shall be paid or credited by such banks to the Secretary of the Treasury and covered into the Treasury as miscellaneous receipts. The expenses of such banks may be paid only from such funds as may be specifically authorized or appropriated for that purpose."

Second, the third paragraph of section 10 of the Federal Reserve Act, which contains the original provision for payment of the Board's expenses out of assessments on the Reserve Banks and the 1934 amendment regarding the cost of construction of the Board's building, would be replaced by the following new paragraph:

> "There are hereby authorized to be appropriated such sums as may be necessary to pay the expenses of the Federal Reserve Board and the salaries of its members and employees. Subject to the availability of appropriations, the Board may maintain, enlarge, or remodel its office building in the District of Columbia and shall have sole control of such building and space therein."

It may be noted that the revised paragraph eliminates now obsolete provisions with respect to the original construction of the Board's building and would authorize the Board to maintain, enlarge, or remodel its building but subject to the availability of appropriations. Strangely enough, the amendment would continue the Board's freedom as to control of its building and of space therein.

In the third place, the fourth paragraph of section 10 of the Federal Reserve Act would be amended by striking out the third sentence of that paragraph. That sentence provides: "In the absence of the chairman and the vice chairman, the Board shall elect a member to act as chairman pro tempore." Clearly, this sentence has nothing to do with the matter. It seems certain that the bill was intended to refer to and to strike the fourth sentence of the paragraph, the sentence that provides, among other things, that the funds of the Board shall not be construed to be Government funds or appropriated moneys.

These amendments to the Federal Reserve Act, under Mr. Patman's latest bill, would become effective on the first day of the first fiscal year beginning after the enactment of the amendments. During the period between the date of enactment and the effective date of such amendments, the Reserve Banks and the Board would be required to take steps to change their accounting period from the calendar year to the fiscal year "and otherwise to bring their accounting practices and procedures into conformity with those employed by other agencies of the United States operated with appropriated funds."

G. COMPENSATION AND LEAVE OF SYSTEM EMPLOYEES

As noted earlier in this paper (see page 55), a part of the System's independence derives from the fact that employees of the Board and the Reserve Banks are not subject to Federal statutes and regulations relating to the employment, compensation, and leave of Government employees. Employees of the Reserve Banks are not regarded as Government employees and their compensation is fixed by the boards of directors of the several Reserve Banks subject to approval by the Board of Governors. Under section 10 of the Federal Reserve Act, the employment, compensation, leave, and expenses of employees of the Board are governed solely by the provisions of the Federal Reserve Act and rules and regulations of the Board not inconsistent with that Act. In addition, section 11(l) of the Act expressly exempts employees of the Board from the classified civil service.

Bills introduced by Mr. Patman in recent years would deprive the System of the flexibility it now enjoys with respect to compensation of its employees. His latest bill, for example, apparently would be intended to repeal the sentence in section 10 of the Federal Reserve Act that gives the Board sole discretion with respect to the employment, compensation, leave, and expenses of its employees. The bill also would provide that the Board shall determine the maximum salary permitted to be paid to officers of "member banks", with the provision that in no event shall the salary of any such officer be greater than that of a Cabinet member of the Federal Government. While the bill refers to "member banks", it seems obvious that the intent must have been to refer to Reserve Banks.

In general, Mr. Patman has not elaborated on the need to terminate the somewhat privileged status enjoyed by employees of the Board and the Reserve Banks. In 1964, however, he called attention to the fact that salaries of Board officials and particularly those of top officials of the Reserve Banks were far out of line with salaries of high officials of the Federal Government. He released a list of the salaries of the principal Federal officials, including the highest-paid officials of the Reserve Banks, as of January 5, 1964, that showed the president of the New York Reserve Bank as receiving a salary higher than any official of the Federal Government except the President of the United States. The list revealed also that the presidents of all but two of the Reserve Banks received salaries higher than the Chief Justice of the United States and that many of the officials of the Board of Governors and the Reserve Banks were paid at a rate higher than that paid to Cabinet members, which at that time was $25,000.[315/]

It is interesting to note that, with all of his proposals to "reform" the System, Mr. Patman has never proposed that the provision of the Federal Reserve Act exempting Board employees from the classified civil service should be repealed, although presumably he would approve of such a proposal. One Congressman, however, specifically recommended legislation in the 92d Congress[316/] that would have expressly brought all employees of the Board of Governors, the Federal Open Market Committee, and the Federal Reserve Banks under the competitive civil service.

H. CONGRESSIONAL POLICY MANDATE

Up to this point, mention has been made of proposals to curb the System's independence by indirect means, e.g., by removal of Board members by the President, by making the Secretary of the Treasury a member of the Board, by GAO audit, and by subjecting the System to the appropriations process. We come now to more direct proposals to bring the System under legislative or executive control in the making

315/ Hearings on Federal Reserve After Fifty Years, pp. 921-923.

316/ H.R. 3999, 92d Cong., 1st Sess., Feb. 9, 1971.

of economic policy determinations. The first of such proposals is that the System, as the "agent" of Congress, should be subject to more specific direction by Congress in its exercise of the authority delegated to it by Congress to "coin money and regulate the value thereof."

The Federal Reserve Act has never included very specific criteria for the exercise of its functions in the area of monetary and credit policy. For example, it provides that the Reserve Banks shall establish discount rates, subject to review and determination by the Board, "with a view of accommodating commerce and business";[317] that the Reserve Banks shall extend credit accommodations to member banks with due regard to "the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture";[318] and that the time, character, and volume of open market operations by the Reserve Banks 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".[319] In the area of selective credit control, the Board is authorized to fix margin requirements for the purchase or carrying of registered securities in order to prevent "the excessive use of credit for the purchase or carrying of securities."[320] Under an almost forgotten 1933 statute, the Board of Governors, with the approval of the Secretary of the Treasury, is authorized to require the Reserve Banks

317/ § 14(d).

318/ § 4, ¶ 8.

319/ § 12A(c).

320/ Securities Exchange Act of 1934, § 7.

"to take such action as may be necessary, in the judgment of the Board and of the Secretary of the Treasury, to prevent undue credit expansion." 321/

All of such indications of Congressional policy or of criteria for the exercise of functions delegated by Congress to the System are unquestionably vague and general. In testifying on the bill that became the Banking Act of 1935, Dr. E. A. Goldenweiser, then head of the Reserve Board's Division of Research, said: 322/

> "The accommodation of commerce and business, which is the only objective that was mentioned in the Federal Reserve Act, is a vague phrase, and has all of the attributes of a statesmanlike pronouncement. It is vague, it is a glittering generality like the Declaration of Independence, and its content can be changed as circumstances change. It has, therefore, not served any very useful purpose, but has not done any particular harm."

Nearly 30 years later, Dr. Clark Warburton, then an official of the FDIC, said: 323/

> "In my reading of the Federal Reserve Act and related legislation, I have not found any such description of the System's responsibility. Instead, I find four passages, relating, respectively, to open-market operations, discounts and advances, rates of discount, and changes in reserve requirements - the first three of which refer to the 'accommodation' of commerce and of business or industry and agriculture, with an additional clause (in two cases) referring to 'maintenance of sound credit conditions' or 'the general credit situation of the country,' and the fourth referring to prevention of 'injurious credit expansion or contraction.' These passages have always been ambiguous, and for many years have been archaic, as criteria for monetary policy. The Federal Reserve Board's conception of the role of monetary policy, and of the powers and responsibilities of the System in carrying out these directions, have varied greatly from time to time. [Footnote omitted.]"

321/ Act of May 12, 1933; 31 U.S.C. § 821.

322/ House Hearings on Banking Act of 1935, p. 434.

323/ Hearings on Federal Reserve After Fifty Years, p. 1317.

Since 1935, many proposals for more specific Congressional mandates to the Federal Reserve System have been advanced. The System itself has been willing to go along with such a mandate provided it is not too specific.

When the Banking Act of 1935 was under consideration, Reserve Board Chairman Eccles proposed, and the House Banking and Currency Committee agreed, that the Federal Reserve Act be amended to include the following guide for Federal Reserve policy:

> "It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

During hearings on the 1935 bill, Representative Cross suggested a more specific standard, such as one related to the level of prices. 324/ Representative Goldsborough likewise recommended a standard expressly geared to commodity prices. He proposed that the following language be added to the Federal Reserve Act: 325/

> "It is hereby declared to be the policy of the United States that the average purchasing power of the dollar as ascertained by the Department of Labor in the wholesale commodity markets for the period covering the years 1921 to 1929, inclusive, shall be promptly restored; and that after such restoration shall have been achieved, the purchasing power of the dollar shall be maintained substantially stable in relation to a suitable index of basic commodity prices which the Federal Reserve Board shall cause to be compiled and published in complete detail at weekly intervals.

324/ House Hearings on Banking Act of 1935, p. 250.

325/ 79 CONG. REC. 7163.

"The Federal Reserve Board, the Federal Reserve banks, and the Secretary of the Treasury are hereby charged with the duty of making effective this policy. To this end it shall be the duty of the Secretary of the Treasury to establish or cause to be established in the United States a free and open market in which gold and silver may be bought and sold for use, investment, or trade, and to determine, without limitations, and with the advice of the Federal Reserve Board, the amounts and the prices at which the Treasury shall buy and sell gold and silver."

Chairman Eccles strongly opposed legislative enactment of such a standard based upon a specific price level. He argued: 326/

"I am trying to avoid a rigid requirement in the law that may be impossible of accomplishment, and hence may cause embarrassment. I would like to see enough flexibility in the law; because I do not believe that we can deal with our money, economic and social problems, and they are all interrelated, as an exact science. You have too many emotional factors to contend with, and when you talk about the problems of business stability, stable prices, full employment, and so forth, you have to take into account factors other than purely the mathematical or mechanical factors of money."

Eccles prevailed. The Banking Act of 1935 contained no Congressional economic policy mandate.

Three years later, however, Representative Patman revived the Goldsborough proposal. During hearings in 1938 on a bill to retire stock of the Reserve Banks, he introduced an amendment that would have required the Board to raise the price level to that of 1926. His amendment provided: 327/

"It shall be the duty of the Federal Reserve Board to raise the all-commodity index, or the so-called price level, until full employment of all persons able and willing to work shall have been achieved, and until the price level shall at least reach the all-commodity index of 100 as established by

326/ House Hearings on Banking Act of 1935, p. 251.

327/ 1938 House Hearings, p. 226.

the Department of Labor for the years 1914-30, inclusive. Thenceforth such price level shall be standardized and maintained at a variation not to exceed 2 percent above or below the standard reached as aforesaid. It shall be the duty of the Federal Reserve Board in accomplishing these ends to expand demand bank deposits by the purchase of United States bonds and notes, or bonds secured by the United States, or bonds of States and subdivisions thereof, or other sound bankable assets; and to contract demand bank deposits by the sale of the securities aforesaid."

Patman's chief argument for a legislative statement of policy was that a Government agency exercising monetary policy should be an agency of Congress and should be required to carry out the instructions of Congress.[328/] He said:

"I think that the people that Congress entrusts with the greatest power in America should be an agency of Congress, as I believe the Constitution of the United States contemplated, and I believe that that agency of Congress should be instructed what to do, and I believe that agency of Congress should be required to carry out the instructions of Congress, and, further, if that agency fails or refuses, or one member of that agency or all of them fail or refuse to carry out what Congress has told them to do, Congress, either House, then has a right to remove them for failure to perform a duty."

Representative Patman's principal supporter in 1938 was former Senator Robert Owen, co-sponsor with Carter Glass of the original Federal Reserve Act. Owen argued that such a legislative mandate was necessary because "Executive policy may be changed at any time, but a policy fixed by statute law cannot be changed unless by the Congress, itself."[329/] He argued also that it would be unconstitutional for Congress to delegate powers to the Federal Reserve without instructions:[330/]

328/ Id., at 178.

329/ Id., at 87.

330/ Id., at 129.

". . . I do not think that Congress has any right, constitutionally speaking, to vest vast powers in the Federal Reserve Board without any instruction to the Federal Reserve Board how to use those powers, which is in effect leaving the legislative function in the hands of persons you do not know."

Representative Spence of the House Banking and Currency Committee agreed with Owen. 331/

The 1938 proposal was strongly opposed by Reserve Board Chairman Eccles on the ground that a stable price level was not the sole objective of economic policy. 332/ He argued:

"The position of the Board of Governors on the problem of monetary objectives was indicated in a statement issued on August 2, 1937, in response to a congressional inquiry. The Board is in full agreement with the ultimate objective of proposals to promote economic stability, which means the maintenance of a volume of business activity and of national income adequate to assure as full employment of labor and of the productive capacity of the country as can be continuously sustained. The Board is aware that commodity prices are an important element in the Nation's economic life and that violent fluctuations of prices have disastrous effects. It believes, however, that price stability does not necessarily lead to economic stability and, therefore, should not be the principal objective of public policy. In its opinion the objective of economic stability cannot be achieved by monetary means alone, but rather should be sought through coordination of monetary and other major policies of the Government which influence business activity.

"The principal difficulty with a stable price level as the objective of economic policy is that it is not in itself a satisfactory indicator of a continuously smooth working of the economic machine. There have been periods in the past when the price level was stable and nevertheless there were developing numerous maladjustments which led to an economic collapse. . . ."

The Patman proposal was also opposed by Dr. Walter E. Spahr, on behalf

331/ Id., at 278.

332/ Id., at 444.

of the Economists' National Committee on Monetary Policy;[333] and Professor Frederick A. Bradford of Lehigh University felt that it would be impossible for the Federal Reserve to carry out the proposed mandate.[334]

Six years later, section 2 of the Employment Act of 1946 contained a Congressional statement of economic policy that, as has been noted, applies to the Federal Reserve as well as to other Government agencies. That statement reads:

> "SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power."

While admitting the applicability of this statement of policy to the Federal Reserve, the System has consistently taken the position that it should not be made more specific. In 1949, when Reserve Board Chairman McCabe was asked by a subcommittee of the Joint Economic Committee whether more specific guidelines for monetary policy were desirable, he replied:[335]

333/ *Id.*, at 286.

334/ *Id.*, at 282.

335/ *1949 Douglas Compendium*, pp. 26, 27.

"This question is not taken to suggest that the Federal Reserve in pursuing the objectives of the Employment Act of 1946, should be specifically required to base policy decisions on some particular formula or some particular statistical guide (such as an index of general prices or the level of employment). Such a guide would not only traverse the principle recognized in the Employment Act of 1946 but would be likely to be so rigid as to defeat its purpose, since the making of decisions on monetary policy calls at all times for the weighing of a great many different factors and for the attaching of different weights to the same factor at different times. Such decisions must always be a matter of judgment, based on the fullest and widest information respecting all phases of the national economy."

In 1952, another Reserve Board chairman, Mr. Martin, referred to the difficulty of drafting a statutory economic policy mandate that would be adequate under all circumstances. He felt that the policy statement in the Employment Act of 1946 was sufficiently specific [336/] and stated that the System had long recognized "that no single index or simple combination of indicators can serve as a continuing infallible guide to its policy". [337/]

In recent years, one of the principal proponents of a legislative monetary policy mandate to the Federal Reserve System has been Professor Milton Friedman of the University of Chicago. In 1964, he urged: [338/]

"The surest way to achieve the aim of a stable monetary structure is, in my opinion, to legislate a rule specifying the behavior of the quantity of money. The rule that I favor is one which specifies that the quantity of money shall grow at a steady rate from week to week, month to month, and year to year."

336/ 1952 Patman Compendium, pp. 237, 238.

337/ Id., at 239.

338/ Hearings on Federal Reserve After Fifty Years, p. 1134.

Four years later, he said:339/

"In the present state of our knowledge, I believe that the best - or least bad - guideline for monetary policy is steady growth of the quantity of money at a rate that on the average will mean stable prices of final products. The precise growth rate required for this purpose depends on the specific definition of money adopted. For a definition corresponding to currency plus all commercial bank deposits adjusted - demand and time - the appropriate rate is around 5 percent per year. For a definition limited to currency plus adjusted demand deposits only, the appropriate rate is a trifle lower. In my opinion, it would be desirable for Congress to instruct the Federal Reserve to adopt this policy. That would assure that the Federal Reserve System would provide a steady and stable background for private and public economic policy, instead of being itself a source of instability as it so often has been in the past and as it is currently being at this very moment."

With great candor, Professor O. H. Brownlee of the University of Minnesota has expressed the idea that Congress should control the policies of the Federal Reserve. In 1964, he said:340/

"With respect to the relationship of the monetary authority to the Government, certainly it should not be independent. That is, if Congress wants inflation, it ought to be able to get inflation, or if it wants deflation it should be able to get it. . . ."

Like Chairman Martin in 1952, Professor David L. Fand of Wayne State University in 1968 recognized that it is "very hard to legislate guidelines that could be followed by the monetary authorities in all circumstances", but, if guidelines could be developed, he felt, like Professor Friedman, that they should be "in terms of the money stock or of changes in the money stock."341/

339/ 1968 Compendium, pp. 203, 204.

340/ Hearings on Federal Reserve After Fifty Years, p. 1076.

341/ 1968 Compendium, p. 155.

Mr. Patman's latest Federal Reserve reform bill, as will be subsequently noted, would require the Federal Reserve to follow policies determined by the President; but, at the same time, the bill contains a legislative requirement that the Board "shall establish flexible interest rates and conduct its discount operations in a manner designed to provide lower interest rates to those banking institutions which make a certain percentage (determined by the Board) of their loans in economically and socially desirable areas of the economy."[342/]

I. POLICY DIRECTION BY THE PRESIDENT

In contrast to proposals for a legislative mandate to the Federal Reserve System regarding monetary policies, proposals in recent years have been directed primarily toward subjecting the Federal Reserve to direction by the President in the determination of such policies.

In 1958, Representative Reuss introduced a bill[343/] to amend the Employment Act of 1946 so as to require the President's annual report to Congress under that Act to include specific mention of "monetary and credit policies". During hearings on the bill before the House Committee on Government Operations, Mr. Reuss complained that President Eisenhower had formally renounced any responsibility to advise the Federal Reserve Board and the Open Market Committee of the Administration's position on monetary and credit policy.[344/] He

342/ H.R. 11, 92d Cong., 1st Sess., § 10(c).

343/ H.R. 12785, 85th Cong., 2d Sess.

344/ 1958 Hearings on Employment Act, pp. 4, 5.

emphasized that his amendment would in no way affect the independence of the Federal Reserve or require the Board to follow the President's recommendations as to monetary policy. His proposal was supported by a number of witnesses, including Leon Keyserling, who argued that it "would be incongruous if he [the President] should evaluate private economic policies and not evaluate the vast nationwide banking, fiscal, and monetary policies." 345/ One witness, Professor Seymour E. Harris, supported the Reuss amendment on the ground that it was at least one "step in the direction of removing independence" of the Federal Reserve. 346/

In 1959, Mr. Reuss introduced a similar bill that, in addition to requiring the President to set forth his views as to monetary policy in his reports to Congress, would have also provided that, "if the Federal agency directly responsible for the execution of such monetary and credit policies disagrees with such program and recommendations, the President shall report such disagreement to the Congress, together with a statement from the disagreeing agency of its reasons." 347/ Mr. Reuss again made it clear that his proposal was not intended to affect the independence of the Federal Reserve. 348/ A similar bill was introduced in the Senate by Senator Joseph S. Clark and, as a witness during the House hearings, he likewise disclaimed any intention of attacking Federal

345/ Id., at 23.

346/ Id., at 82.

347/ 1959 Hearings on Employment Act, p. 3.

348/ Id., at 37.

Reserve independence:[349]

> "Let me again say there is nothing in this bill of ours which attacks the independence of the Federal Reserve Board, nothing at all. This is merely an effort to give some publicity to what may turn out to be conflicting views with respect to monetary and fiscal policies and to enable the President to state his view in public and to the Congress and to enable the Federal Reserve Board, which, let us remember, is an agent of the Congress, to state its views in rebuttal should it see fit."

Dr. Keyserling, who supported the Reuss bill, observed that, while the Reuss amendment did not specifically mention the Federal Reserve Board, it could be regarded as the only agency intended to be referred to because it was the "only agency which creates a real problem."[350] Again, he emphasized that the bill would not give the President "any control over monetary policy"[351] and asserted that all the bill was meant to do was "to find some way to say that we should start to put the Federal Reserve Board under the limited scrutiny of the President."[352]

Presumably in the light of Dr. Keyserling's observation, Mr. Reuss subsequently amended his bill to refer specifically to the Federal Reserve Board and to provide that, if the Board should disagree with the President's recommendations as to monetary and credit policies, "the President in his report to Congress shall include the Board's views and reasons."[353]

349/ Id., at 26.

350/ Id., at 76.

351/ Id., at 78.

352/ Id., at 77.

353/ Id., at 5.

In 1960, Senator Clark introduced another bill identical with the 1959 Reuss bill as amended. During hearings on this bill, Representative Reuss once more argued that it would in no way make the Federal Reserve Board subject to direction by the President; but he stated that he could not see why the Federal Reserve "should be so sacrosanct as to escape even a friendly word from the President." 354/

Despite Reuss' repeated statements that his and Senator Clark's bills would not affect the independence of the Federal Reserve System, Reserve Board Chairman Martin strongly opposed those bills on the grounds that monetary and credit policy must remain flexible and that a requirement that the President make recommendations as to such policy would conflict with the independent performance of the System's duties. 355/ In connection with the 1958 bill, Mr. Martin said:

> "It is the view of the Board that a further requirement that the President shall include in his reports specific recommendations as to the monetary and credit policies to be followed in the future would be undesirable. Some instruments of national economic policy, such as fiscal policy, housing policy, and agricultural policy, are by their nature adaptable only slowly over a period of time to changing economic conditions. They lend themselves much more readily to longer term recommendations. Monetary and credit policy, on the other hand, is the most flexible of the instruments of national economic policy, and it would lose this highly important advantage if it were tied into a program of longer term recommendations.
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> "Decisions in the area of monetary and credit policy are the responsibility of the Board of Governors of the Federal Reserve System, entrusted to it pursuant to the constitutional powers of Congress in this field. A mandate to the Executive in other legislation to make recommendations

354/ 1960 Hearings on Employment Act, p. 17.

355/ 1958 Hearings on Employment Act, p. 5.

in the field of monetary and credit policy would conflict with the statutory relationships of the Federal Reserve System to the Congress and the independent performance of the duties that are entrusted to its administration."

Mr. Reuss' 1959 bill was opposed by the Board for similar reasons in a letter addressed to the chairman of the House Committee on Government Operations dated April 1, 1959. That letter read in part as follows:[356]

"The Board believes that the second and third of the proposed amendments summarized above are undesirable. Some instruments of national economic policy - such as fiscal policy, housing policy, and agricultural policy - by their nature can be adapted to changing economic circumstances only slowly. Basic decisions, once made, are difficult to change within the course of a given fiscal year, or even longer. Monetary and credit policy, in contrast, is the most flexible of the instruments of national economic policy. Most of the Federal Reserve operations are essential to meet short-term variations of a regular or special nature, and these must be adapted continuously to broader policy considerations. Monetary policies can and should be adapted quickly to changing economic conditions. This flexibility would be greatly hampered if monetary policy were to be treated in the same way as other policy areas for which longer term planning is essential.

"Furthermore, any procedure for advance recommendations on monetary and credit policy, such as proposed in this bill, would run the risk of stimulating speculative tendencies in the use of bank credit. It would of necessity reveal the Federal Reserve's own views with respect to prospective monetary policy. It would also foster speculative tendencies in the securities markets generally and, perhaps, especially in the Government securities market. The danger of speculative and destabilizing consequences could be substantial, whether the Presidential recommendations were interpreted as inflationary or deflationary in their potential effects. In this connection, it should be noted that the Federal Reserve Act requires the System to keep the use of bank credit for speculation under close and constant surveillance.

"Congress has heretofore entrusted to the Federal Reserve System responsibility for decisions in the area of monetary

356/ 1959 Hearings on Employment Act, pp. 206, 207.

> and credit policy. A separate mandate from the Congress to the Executive, as contained in this bill, to make recommendations in this area and to report to the Congress differences between him and the Federal Reserve would jeopardize the ability of the System, as an agent of Congress, to perform its duties and responsibilities in an independent, objective, nonpartisan, and impartial manner."

A similar letter was written by Chairman Martin in opposition to Senator Reuss' bill in 1960.[357]

The Board's opposition to these bills was shared by the chairman of the Council of Economic Advisers, Dr. Raymond J. Saulnier, who wrote the chairman of the House Committee on Government Operations on March 13, 1959, as follows:[358]

> ". . . we believe it would be unwise to require the President to report publicly on disagreements between his program and recommendations and the views of Federal agencies on these matters. Insofar as this requirement would be applied to agencies directly responsible to the President, a public discussion of differences of viewpoint existing within the executive branch would be of little constructive value to the Nation and might even be harmful. And insofar as the requirement would apply to matters for which the Federal Reserve System has responsibility, it would impair the congressionally established independence of the Federal Reserve System, a result which we believe would be an obstacle to the most effective administration of national economic policy. . . ."

The Report of the Commission on Money and Credit in 1961 took note of the fact that a "presidential power to issue published directives to the Board" had been suggested "on the principle that if presidential influence is to be brought to bear, it had better be done out in the open"; but the Commission felt that the "objection to this is not its

57/ 1960 Hearings on Employment Act, pp. 9, 10.

58/ 1959 Hearings on Employment Act, p. 203.

visibility but the clumsy nature of the instrument", that no one wanted every Board action to require "presidential clearance", and that a mechanism was not desirable that would "tend to dramatize differences in views." 359/

During the 1966 "symposium" to celebrate the twentieth anniversary of the Employment Act, some participants argued that the Federal Reserve should be bound by the economic goals established by the President. Thus, Professor James W. Angell of Columbia University said: 360/

> ". . . Monetary policy and fiscal policy are in many if not all situations only two sides of the same coin. They should be directed toward the same general objectives, and should be implemented by mutually consistent measures. Yet only too frequently we have witnessed virtually head-on conflicts over current goals and methods, between the Board, on the one side, and the Treasury or other organs of the administration, on the other. Such conflicts at best produce uncertainty and a probable retardation of our growth rate, and at worst could inflict really serious damage on the economy. They should be completely prevented, presumably by new legislation."

Similarly, Professor Leo Fishman of West Virginia University stated: 361/

> "As long as the Board of Governors continues to assert and to exercise complete autonomy in matters pertaining to national economic policy, it is possible for U.S. monetary policy to be oriented toward different and incompatible sets of goals. It is impossible for the President to coordinate all 'plans, functions, and resources' of the Federal Government for the purpose of promoting 'maximum employment, production, and purchasing power.'"

And Professor Frank C. Pierson, referring to the Federal Reserve's increase in the discount rate in December 1965 in defiance of the President's

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359/ CMC Report, p. 86.

360/ 1966 Symposium, Supplement, p. 24.

361/ Id., Supplement, p. 51.

views, said:[362]

> ". . . The Federal Reserve's independent move last December in raising the rediscount rate before a broader governmental decision on stabilization policy could be reached may well have been defensible on substantive grounds but it left unanswered the procedural question whether a single agency should be permitted to exercise this degree of authority in such a vital area."

Representative Patman's persistence in seeking to reduce the independence of the Federal Reserve is now almost proverbial; but he has been ambivalent in choosing means to that end. As previously indicated, he has argued that the Federal Reserve should be more accountable to the Congress. On the other hand, in recent years, he has advocated measures to bring the System more directly under the control of the President. Thus, in 1968, he introduced a bill[363] that, among other things, would have required that Federal Reserve open market operations, "as well as all other actions 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." Going far beyond the proposals of Representative Reuss and Senator Clark in 1958, 1959, and 1960, this was the first explicit effort to make the recommendations of the President under the Employment Act legally binding upon the Federal Reserve.

In July 1968, Mr. Patman, as chairman of the Subcommittee on Domestic Finance of the House Banking and Currency Committee, utilized

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362/ Id., Supplement, p. 125.

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

his new bill as a basis for a questionnaire sent to the members of the Board, the Secretary of the Treasury, the Reserve Bank presidents, and a large number of academic and research monetary economists. The first two questions were the following: 364/

> "1. Do you believe that a program coordinating fiscal, debt management, and monetary policies should be set forth at the beginning of each year for the purpose of achieving the goals of the Employment Act, or alternatively, should we treat monetary and fiscal policies as independent, mutually exclusive stabilization policies?
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> "2. If you believe a program should be specified, do you believe that the President should be responsible for drawing up this program, or alternatively, should such responsibility be dispersed between the Federal Reserve System and agencies responsible to the President?"

The staff of the Subcommittee on Domestic Finance submitted a report to Mr. Patman summarizing responses to the questionnaire. As to these two questions, the staff summary indicated that a great majority of the respondents favored a "coordinated program" such as that contemplated by question 1 and were opposed "to the present regime wherein the Federal Reserve is neither guided by a program coordinating monetary and fiscal policies on a provisional basis, nor constrained by monetary rule." The staff summary showed that only 14 respondents (including Chairman Martin and Secretary Fowler) were "in favor of the present regime." 365/

In its summary of the Federal Reserve's position, the staff report noted that Chairman Martin had argued that monetary policy must be constantly under review and subject to gradual, flexible, and even

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364/ 1968 Compendium, p. 7.

365/ Id., at 8.

reversible adjustments, and that, whereas responsibility for fiscal policy should remain with the President, monetary policy should be determined by the Federal Reserve. Chairman Martin's letter stated that "This division of responsibilities in the field of economic policy is one of the desirable checks and balances in our system of government."[366/] The staff report argued to the contrary:[367/]

> "The Federal Reserve's argument, however, is not persuasive. To begin with it calls for operational procedures which are the antithesis of democratic procedures. For, if we accept the premise that monetary policy is 'unique' - the only flexible instrument at the Government's disposal for achieving economic stabilization, then it is just plain wrong that control of monetary policy should be vested in authorities (Federal Reserve officers) who are only remotely responsible to the people. The details of the structure of the Federal Reserve are discussed later. Here our only concern is that if the premise is accepted that the economic state of the union rests so strategically on the satisfactory use of monetary policy, then surely, under our form of government, the President must control or at least guide the monetary authorities in their use of the only flexible instrument we have for achieving economic stabilization. Furthermore, the operational procedures called for by the Federal Reserve's argument contravene the requirements of existing law. For it is impossible for the President to discharge the responsibilities assigned him by the Employment Act of 1946 if he cannot guide the use of the only effective tool at the Government's disposal for achieving 'Maximum employment, output and purchasing power.'"

The System's reply to question 2 regarding responsibility for drawing up an economic policy program was as follows:[368/]

> "The responsibility for recommending to the Congress changes in Federal expenditure and revenue programs clearly rests with the President. Suggestions and advice may be

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366/ Id., at 11.

367/ Ibid.

368/ Id., at 31.

sought from interested Federal agencies as to specific content, of course, and frequently the Federal Reserve has contributed to this process.

"In the President's report there often is reference to monetary as well as fiscal policy, and the Council's report customarily discusses monetary policy developments at some length. We believe that such references are wholly appropriate, in view of the importance of financial developments to economic conditions generally, and in recognition of the role of monetary policy in the Government's economic stabilization effort. Views as to what constitutes appropriate monetary policies must of necessity be provisional for the reasons stated in answer to question I.1, but such policies must be taken into account as an important factor conditioning, and conditioned by, the economy's prospects.

"We believe, however, that <u>any specifications as to monetary policy should continue to be regarded in the nature of suggestions of what constitutes appropriate policy under clearly stated assumptions - which may or may not prove correct - rather than as instructions to the Federal Reserve System</u>. The System was created by Congress, and is answerable for its actions to the Congress; its role is that of advising and cooperating with the executive branch of Government in the public management of economic affairs, without being formally a part of it. This division of responsibilities in the field of economic policy is one of the desirable checks and balances of our system of government, and we do not believe that the Congress should cede its ultimate authority in the monetary sphere to the executive branch." (Underscoring supplied.)

Secretary Fowler's reply was somewhat similar: 369/

"The President already has the responsibility for drawing up, at the beginning of each year, a detailed economic program that is incorporated in his budget and Economic Report messages. In this context, he usually does spell out, in a general way, his assumptions regarding the monetary policies that would be consistent with the proposed fiscal and economic program and that he would regard as appropriate. In working out these assumptions, the President usually takes account of the views of various agencies as well as those of the Federal Reserve.

"Responsibility for the presentation of such a set of economic recommendations, based on specified assumptions with respect to financial developments and policies, should in our

369/ Id., at 57.

view continue to rest with the President. For the reasons spelled out in our response to the previous question, however, statements regarding assumed or desired monetary policies must necessarily be provisional and leave ample room for the flexible use of such policies. Moreover, given the traditional arrangements under which the Federal Reserve is directly answerable to the Congress, formal responsibility for the determination and execution of monetary policy must remain with the Federal Reserve and, ultimately, the Congress."

The reply of Professor Leo Fishman of West Virginia University argued that the Employment Act assigned to the President primary responsibility for coordinating all plans and functions of the Federal Government for the purpose of promoting the objectives of that Act and that it is "impossible for the President to discharge the responsibilities assigned to him in the Employment Act of 1946 unless he exercises the power to coordinate national monetary policy with national fiscal policy." 370/ However, he recognized that the Federal Reserve continued to assert its complete autonomy and that the question of the President's power had not yet been resolved.

Representative Patman's latest bill on Federal Reserve "reform", introduced in January 1971, is even more explicit than his 1968 bill in making the Federal Reserve subject to the President's monetary policy views as contained in his report pursuant to the Employment Act of 1946. It provides, for example, that, in his economic report, the President "shall prescribe those programs and policies relating to monetary policy matters which he wishes the Board to carry out in order to assist in implementing his monetary policy." It also provides, like Mr. Patman's 1968 bill, that open market operations and "all other

370/ Id., at 161.

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." Finally, having provided that the Federal Reserve shall conduct monetary policies in accordance with the "programs" of the President, the Patman bill would specifically amend the Employment Act to provide that such programs "shall include the President's recommendations on fiscal and debt management policy and guidelines concerning monetary policy, domestic and foreign, including the growth of the money supply as defined by him."

J. ABOLITION OF FEDERAL OPEN MARKET COMMITTEE

Since 1938, Representative Patman has repeatedly sponsored legislation that, among other things, would abolish the Federal Open Market Committee and vest in the Board of Governors authority to regulate open market operations of the Reserve Banks.[371/] This proposal has been supported by former Reserve Board Chairman Marriner Eccles, Representative Reuss, and the Commission on Money and Credit in its 1961 Report.[372/]

One of the arguments advanced by Mr. Patman and others for transfer of open market authority to the Board of Governors has been

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371/ H.R. 7230, 75th Cong., 3d Sess. (1938); H.R. 9631, 88th Cong., 2d Sess. (1964); H.R. 11, 90th Cong., 1st Sess. (1968); H.R. 11, 92d Cong., 1st Sess. (1971).

372/ CMC Report, p. 90. It may be noted that Mr. Eccles had strongly opposed vesting open market authority in the FOMC during consideration of the Banking Act of 1935.

that it is illogical and potentially troublesome for the exercise of tools of monetary authority to be divided between two agencies. 373/ The principal argument in support of this proposal, however, is that the most important single instrument of credit control, i.e., authority over open market operations, should not be vested in an agency composed of some members that are not appointed by the President and may be influenced by regional or private interests rather than the national interest. For example, in 1935, Mr. Eccles argued that open market authority should be vested in the Board itself as "a body representing the national interest". 374/ Representative Patman in 1938 charged that the Reserve Bank presidents who were members of the Committee did not represent the interest of the public but represented their own banks and the stockholders of their banks. 375/ Finally, during 1964 hearings, Representative Reuss said: 376/

> "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,

373/ See statement by Mr. Eccles in House Hearings on Banking Act of 1935, pp. 182, 183.

374/ Id., at 181.

375/ 1938 House Hearings, p. 56.

376/ Hearings on Federal Reserve After Fifty Years, p. 37.

> 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."

Officials of the Federal Reserve have vehemently denied that representatives of the Reserve Banks on the FOMC are in any way influenced by "private" or "banker" interests.[377/] The uncomfortable fact remains, however, that the president of each Reserve Bank is selected by its board of directors and six of the nine Reserve Bank directors are elected by member banks. This fact can naturally lead one to suppose, even though incorrectly, that the Reserve Bank presidents are "beholden" to their boards of directors and their member banks.

In opposition to the proposal to abolish the FOMC, the principal argument advanced over the years has been that such action would downgrade the Reserve Bank presidents and tend to destroy the regional character of the System. For example, in 1949, President Sproul of the New York Reserve Bank argued that the present arrangement under which the Committee is composed partly of Reserve Bank presidents "most nearly meets the requirements of our national plus regional central banking system."[378/] Similar views have been expressed from time to time by other Reserve Bank presidents.[379/] The desirability of retaining Reserve Bank presidents on the Committee as a means of

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377/ See 1952 Patman Compendium, p. 675; Hearings on Federal Reserve After Fifty Years, pp. 119, 528, 757.

378/ 1949 Douglas Compendium, p. 163.

379/ See, e.g., 1952 Patman Compendium, p. 678; Hearings on Federal Reserve After Fifty Years, p. 422.

preserving the basic concept of a regional system was explained by Chairman Martin in 1952 as follows:380/

> "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."

Arguing that abolition of the FOMC would be an undesirable change in the System's structure, President Irons of the Dallas Reserve Bank said:381/

> "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.
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> "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."

380/ _1952 Patman Compendium_, p. 294.

381/ _Hearings on Federal Reserve After Fifty Years_, p. 846.

In summary, proposals to do away with the FOMC have been opposed by System officials not so much on the ground that the change would affect the "independence" of the System but on the ground that it would tend to impair one of the unique strengths of the System - its regional nature and its blending of public and private interests. Nevertheless, some might argue that the regional nature of the System and the participation of Reserve Bank presidents in the formulation of monetary policy are closely related to the independence of the System from political pressures and that, consequently, abolition of the Open Market Committee could be regarded as impairing the System's independence.

K. SELECTION OF RESERVE BANK DIRECTORS

As has been noted in a different connection, the Federal Reserve Act of 1913 was a compromise between those who wanted complete Government control and those who felt that the bankers should have a significant voice in the management of the Federal Reserve System. One of the features of the compromise, designed to offset rejection of the demand of bankers that they have a voice in the selection of members of the Federal Reserve Board, was provision for election of six of the nine directors of each Reserve Bank by the member banks of the district. Three of the six (Class A) were to represent the member banks and three (Class B) were to represent the business community. The remaining three (Class C) were to be appointed by the Federal Reserve Board.

Provision for the election of a majority of the directors by the member banks was considered important because at that time it was expected that the directors would have an important role in the running of the Reserve Banks. The powers of Reserve Bank directors have declined since 1913 in relation to those of the Federal Reserve Board. (See pp. 40-41 of this paper.) Nevertheless, Reserve Bank directors continue to have an important although somewhat intangible function. They constitute a "link" between public and private interests, between Government and business. This function was described in the 1952 Report of Representative Patman's Subcommittee of the House Banking and Currency Committee as follows: 382/

> ". . . They are an invaluable link between the Government and the business community. Because of them, the Government is better able to understand the point of view of business and business is better able to understand the point of view of Government. The Subcommittee believes that it is important that their responsibility, not merely in the business management of their banks but also in the formulation of monetary policy, should be kept sufficiently great to attract men of high caliber. . . ."

In recent years, it has sometimes been charged, particularly by Mr. Patman, that, because the member banks own the stock of the Reserve Banks and elect six of the directors of the Banks, the Federal Reserve System is "dominated" by bankers. In order to terminate such "domination", Mr. Patman proposed a bill in 1938 that would have required all nine directors of each Reserve Bank to be appointed by the President of the United States, with the advice and consent of the

382/ 1952 Patman Subcommittee Report, p. 53.

Senate,[383/] although during hearings on the bill he agreed to an amendment providing for the appointment of all directors by the Federal Reserve Board.[384/]

Federal Reserve officials maintain that the election of two-thirds of Reserve Bank directors by the member banks does not enable those banks to dominate the Federal Reserve System.[385/] Nevertheless, there have been others than Mr. Patman who, since 1938, have charged that the boards of directors of the Reserve Banks are dominated by bankers and big business[386/] and that the Reserve Banks are too closely tied to commercial banks.[387/]

As has been mentioned, the five Reserve Bank presidents who serve on the Open Market Committee have been accused of representing private interests rather than national interests because they are selected by the boards of directors of their Reserve Banks which, in turn, are dominated by men elected by the member banks. One Federal Reserve Bank president in 1964 suggested that such arguments could be effectively met by providing for the appointment of a majority of Reserve Bank directors by the Board of Governors.[388/] Such a change in the manner of selecting Reserve Bank directors would break the

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383/ H.R. 7230, 75th Cong., 1st Sess.

384/ 1938 House Hearings, p. 175.

385/ See statement by Chairman Eccles, 1938 House Hearings, p. 446.

386/ 1968 Compendium, p. 349.

387/ Id., at 613, 614.

388/ Hearings on Federal Reserve After Fifty Years, p. 756.

chain of reasoning by which it may now be alleged that the Reserve Bank presidents on the Open Market Committee are indirectly "beholden" to private bankers.

Obviously, appointment of all Reserve Bank presidents by the President of the United States would tend to bring the Federal Reserve System under the President's control. Even a change in the law to provide for the appointment of six, instead of three, of the directors of each Reserve Bank by the Board of Governors could be regarded as weakening the traditional concept of the System as involving a desirable blend of public and private participation or perhaps even as a move toward "nationalization" of the banking system.

L. RETIREMENT OF RESERVE BANK STOCK

In addition to election of six of the nine directors of each Reserve Bank by the member banks of the district, the original Federal Reserve Act provided for ownership of the stock of the Reserve Banks by the member banks. This was another of the features of the Act designed to provide a blend of public and private interests - another aspect of the compromise between those who desired complete governmental control and those who preferred "banker" control of the Federal Reserve System.

Since 1938, Representative Patman has sponsored bills to retire Reserve Bank stock,[389/] principally on the grounds that member

389/ H.R. 7230, 75th Cong., 3d Sess. (1938); H.R. 8516, 86th Cong., 1st Sess. (1960); H.R. 3783, 88th Cong., 1st Sess. (1964); H.R. 11, 90th Cong., 1st Sess. (1960); H.R. 11, 91st Cong., 1st Sess. (1969); H.R. 11, 92d Cong., 1st Sess. (1971).

bank ownership of such stock is unnecessary[390] and that it gives the impression that the Reserve Banks are controlled by the member banks.[391] Federal Reserve officials have taken pains to explain that ownership of such stock does not give member banks control of the Reserve Banks.[392] Nevertheless, Mr. Patman in 1960 referred to a newspaper report in which an officer of one Reserve Bank had stated that his Bank was "owned lock, stock, and barrel by its member banks"[393] and cited the fact that visitors to another Reserve Bank were told that "the Federal Reserve Banks belong to the member banks."[394]

Federal Reserve officials have conceded that, as a financial matter, Reserve Bank stock is not essential.[395] They have argued, however, that it serves to symbolize the "mix" of private banking interests and ultimate governmental control that constitutes one of the basic strengths of the Federal Reserve System.[396] Their major argument has been that retirement of Reserve Bank stock would be regarded by the

390/ 1952 Patman Subcommittee Report, p. 59.

391/ 1938 House Hearings, p. 17; 1960 J.E.C. Hearings, p. 207; 1968 Compendium, p. 146.

392/ See, e.g., 1938 House Hearings, p. 446; 1952 Patman Compendium, p. 262; 1960 J.E.C. Hearings, p. 197; Hearings on Federal Reserve After Fifty Years, p. 71; 1968 Compendium, p. 44.

393/ Hearings before Subcommittee No. 3 of the House Banking and Currency Committee on Retirement of Reserve Bank Stock, 86th Cong., 1st Sess. (June 1960), p. 236. [Hereafter cited as 1960 House Hearings on Reserve Bank Stock.]

394/ Id., at 165.

395/ Hearings on Federal Reserve After Fifty Years, pp. 94, 104, 692, 753.

396/ See, e.g., 1960 J.E.C. Hearings, pp. 196, 197; Hearings on Federal Reserve After Fifty Years, pp. 104, 886.

public - and by other nations - as a step toward "nationalization" of our banking system and as a weakening of the "independence" of the Federal Reserve. Thus, President Hayes of the New York Reserve Bank said in 1960:397/

"By describing the Reserve bank stock as a symbol of the System's status within the Government, I mean to refer to what has been called the independence of the Federal Reserve System - independence, that is, from direction by the executive branch in the exercise of its monetary authority. The retirement of the Federal Reserve bank stock could give rise to questions, both at home and abroad, as to the future status of the System, and as to its continued ability to maintain its present independence in achieving its goals. Confidence in the dollar is an important goal. It is our impression that, in foreign countries as well as in the financial community in this country, such confidence can be attributed, at least in part, to the existence of an independent monetary authority able to pursue its programs unhampered by political pressures. At present there would seem to be no apprehension that the Federal Reserve System, in performing its central banking function, will be diverted to a pursuit of popular, but unsound, programs. A marked change in the organizational structure of the Federal Reserve System might be viewed as a signal of a basic change in the role or status of the Federal Reserve System and could undermine public confidence in the System and the dollar."

Reserve Board Chairman Martin expressed similar views as to the possible adverse psychological effects of retirement of Reserve Bank stock:398/

"In this matter, the proposed change threatens to bring detriment rather than to promise improvement. Without laboring the point, it is sufficient to say that elimination of Federal Reserve bank stock could, in my judgment and that of the other members of the Board of Governors, be construed, both at home and abroad, as indicating a change in the structure and character of the Federal Reserve System that presaged a weakening of the resolution of the United States to maintain a stable dollar. The change would also adversely affect the

397/ 1960 House Hearings on Reserve Bank Stock, p. 75.

398/ Id., at 223.

extent to which the commercial banking system reinforces and renders valuable service to the functioning of the Federal Reserve System.

"Some may say that these are merely psychological factors; I can only reply that psychological factors are among the most important in dealing with the monetary and credit streams that are the lifeblood of our economy."

In 1964, the president of one of the Reserve Banks, referring to the proposal for retirement of Reserve Bank stock, said: 399/

"It is also possible that its retirement might have a disturbing effect in the public mind; some observers might feel such a move is a step toward nationalization of the banking system, or a lessening of the regional strength of the System, or possibly a lessening of the independence of the System within Government."

The American Bankers Association has opposed this proposal for the same reasons: 400/

". . . We are opposed to the retirement of Federal Reserve stock on the grounds that this step, also, would alter the quasi-private, quasi-public status of Reserve banks, lower the barrier against the encroachment of political pressures into System policies, and weaken the defenses of the System against subsequent attacks on its congressionally provided independence."

Even Mr. Patman's Subcommittee on General Credit Control and Debt Management in 1952 recognized that, while private ownership of Reserve Bank stock is an "anachronism", it "continues to be practically useful" because it symbolizes the "independence" of the System. The Subcommittee's Report stated: 401/

399/ Hearings on Federal Reserve After Fifty Years, p. 847.

400/ Id., at 1878.

401/ 1952 Patman Subcommittee Report, p. 60.

> ". . . One of its functions is to serve as a memo from Congress to itself that it has chosen to leave to the System a great deal of autonomy in its day-by-day and year-by-year operations. This is so because, as long as the private ownership continues, the System will not be amenable to the ordinary techniques of detailed Congressional control."

In summary, ownership of Reserve Bank stock by member banks may be only an unimportant matter that has no real bearing upon the "independence" of the Federal Reserve System. It may give rise to an erroneous impression that the Reserve Banks are "owned" by the member banks and that the System is controlled by private interests. On the other hand, it may still be a useful "symbol" of the traditional blend of private and public interests that has been one of the unique virtues of the System and the retirement of such stock might be interpreted as a step toward nationalization of the System and as a weakening of the System's political independence. In any case, it seems clear that such a change would not have such a significant effect upon the System's independence as many of the other changes that have been proposed.

IX. THE CASE AGAINST INDEPENDENCE

Those who support Mr. Patman's various measures to curb the independence of the Federal Reserve System believe, like Professor Leo Raskind, that "the basic validity of independence for which this agency was developed has lost relevance";[402/] or, like Professor Raymond P. Kent, that Federal Reserve independence is "a ridiculous anachronism."[403/]

402/ Hearings on Federal Reserve After Fifty Years, p. 1675.

403/ 1968 Compendium, p. 363.

Their principal argument against such independence is that it is undemocratic. Referring to the argument that Federal Reserve independence is "desirable to prevent Government from being able to indulge in its natural propensity to resort to inflation", Professor Harry G. Johnson of the University of Chicago has stated that this argument is "utterly unacceptable in a democratic country" and that, in effect, it is "an argument for establishing the monetary authority as a fourth branch of the Constitution." 404/ Professor Henry H. Villard of the College of the City of New York agrees: 405/

"But I do not see, in a democracy, any alternative except to give the power to make decisions on basic economic policy to the Executive. This does not guarantee that he will make the right decisions all the time, but I do not think there is any possibility of setting up a group of experts who should have this power.

"In fact, I agree with Professor Johnson's point that you would really have to have a fourth arm of the Government composed of experts if you do not want to give the power to the President.

"In short, it seems to me that, to the extent that power can be appropriately delegated by the Congress, it must be given to the President."

Another professor, Dudley W. Johnson of the University of Washington has put the "anti-democratic" argument as follows: 406/

"In my opinion, the argument for an independent monetary authority is inconsistent with the principles underlying a democracy. To argue that the control over the money supply should be independent of the values of certain representatives of the citizenry in a democracy strikes me as ludicrous. It

404/ Hearings on Federal Reserve After Fifty Years, p. 970.

405/ Id., at 1043.

406/ Id., at 1444.

is as if Congress were to create a Department of War and Peace and the President of the United States would appoint a Board composed of seven members for terms of 14 years, with the terms arranged so that one expires every year. Now this Board would have the exclusive jurisdiction to decide whether or not the United States would or would not go to war. Its decision would be binding irrespective of the wishes of the administration. And, as in the affairs of monetary management, there exists no reason to assume that this Board is so omniscient that the views of the administration are precluded from being considered in making a policy."

Reflecting similar views, Professor Abba P. Lerner of Michigan State University supported one of Mr. Patman's bills in 1964 with the following statement:407/

"H.R. 9631 is directed at making the Federal Reserve Board more responsive to the general policy of the administration. I strongly favor this since I consider it repugnant to the principles of democratic government for the Federal Reserve System to constitute a fourth power, independent of the legislature, the executive, and the judiciary, especially if it is not subject to popular election."

In answer to the argument that the Federal Reserve should be independent because monetary policies may sometimes be "unpopular", Professor John Gurley of Stanford University has said:408/

"The independence of the Federal Reserve has been defended on the ground that anti-inflationary policies are unpopular, and so should be carried out by an independent agency removed from immediate political pressures. This seems to mean that even though the majority of the people are against these tight monetary policies, the actions should still be carried out because some independent agency knows what is best for the people. Fiscal policies have their unpopular features, too, the same as monetary policies, but there is no reason why an agency, independent of the administration, should levy and collect our taxes.

407/ Id., at 1399.

408/ Id., at 1310.

What counts is the entire package of economic policies - the overall program - and it is this program that should be designed by the administration and presented by it to the public for its approval or disapproval."

Professor Milton Friedman, an opponent of Federal Reserve independence, feels that "it is most undesirable politically to give so much power to individuals not subject to close control by the electorate." 409/ Conceding that the central bank, like any other Government agency, should have a certain degree of independence in a "trivial sense", he contests the idea that a central bank should be "an independent branch of government coordinate with the legislative, executive, and judicial branches." 410/

Along similar lines, Professor Leo Fishman made the anti-democratic argument in supporting the proposal that the Federal Reserve System should be subject to appropriations by Congress: 411/

". . . Regular appearances of its officials before congressional committees authorized to inquire into the financial and fiscal affairs of the Federal Reserve System will assure full disclosure and publicity to the details of the operations of the Federal Reserve System. This process will also help to make the Federal Reserve System more responsive to the will of democratically elected officials of the Federal Government."

Professor Jacques Melitz of Tulane University feels that the Federal Reserve should be responsive to "popular preferences": 412/

"On the basic issue, I see no place for genuine central bank independence in a democracy. The central bank should be

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409/ Id., at 1134; and id., at 1169.

410/ 1968 Compendium, p. 207.

411/ Id., at 165.

412/ Id., at 479.

responsive to popular preferences, like any other department of the executive branch. Thus the bank belongs under the continuous surveillance and regulation of the elected representatives in Congress. . . ."

In a report summarizing responses to Mr. Patman's 1968 questionnaire, the staff of the Subcommittee on Domestic Finance stated: 413/

"The Federal Reserve's argument, however, is not persuasive. To begin with it calls for operational procedures which are the antithesis of democratic procedures. For, if we accept the premise that monetary policy is 'unique' - the only flexible instrument at the Government's disposal for achieving economic stabilization, then it is just plain wrong that control of monetary policy should be vested in authorities (Federal Reserve officers) who are only remotely responsible to the people. . . ."

A second argument against Federal Reserve independence is that all national economic policies should be coordinated; that it is illogical for fiscal policies to be made by the Administration and for monetary policies to be made by the Federal Reserve; and, in brief, that the present arrangement tends to produce only conflict and confusion.

This argument has been stated by Professor Gurley by way of the analogy of a baseball team with two managers: 414/

"'Independence' is a good word, and so many people think that the independence of the Federal Reserve is a good thing. But it is not a good thing. It is like having two managers for the same baseball team, each manager independent of the other. The managers could get together for lunches once a week - that might help. Or one of them could try to offset the actions of the other - that might work a bit. Nothing of this sort, really, would correct the basic situation - the intolerable arrangement of having two managers."

413/ *Id.*, at 11.

414/ Hearings on Federal Reserve After Fifty Years, p. 1309.

Professor Harry G. Johnson believes that even the possibility of political influence is preferable to the separation of monetary management from other economic policies:415/

> "My own view is that the pursuit of monetary stability through the separation of monetary management from other economic policy, and its placement under either an independent authority or a strict rule of increase, is an illusory solution to the problem. Instead, I believe that monetary policy should be brought under the control of the Executive and legislature in the same way as other aspects of economic policy, with the administration bearing the ultimate responsibility for monetary policy as part of economic policy in general. In making this recommendation, I must admit that there is a danger of monetary mismanagement in the pursuit of political objectives; but I consider it preferable for such mismanagement to be a clear responsibility of the administration, and accountable to the electorate."

And Professor Dudley W. Johnson believes that the present independence of the Federal Reserve leads only to "a state of confusion." In 1964, he said:416/

> "What I am saying therefore is that the 'political independence' of the Board, often praised as an example of separation of powers, leads to a state of confusion. Congress and the President have in effect executed self-denying ordinances conferring vital powers on their own creatures. Stated differently, when monetary, fiscal, and debt policies are determined by the Executive and Congress with monetary policies determined by the Federal Reserve, the presence of conflict or lack of coordination can cause short-run crises and long-run inefficiencies."

A vigorous opponent of Federal Reserve independence, Professor Seymour E. Harris, has argued:417/

> "Independence for the Fed is not supportable. It is the responsibility of the executive to determine the supply

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415/ Id., at 972.

416/ Id., at 1444.

417/ 1968 Compendium, p. 243.

of money and its price. It is unwise for the Fed to operate in one direction and the President in another - as in 1966." 418/

And another opponent of independence has said:

". . . It is absurd that the very important power of monetary control should be entrusted to an 'independent' agency and thus deliberately withheld from the President who has responsibility for virtually everything else of importance in the Federal executive sphere, including the power of deciding upon the use of nuclear weapons. . . ."

A third argument against an independent central banking system is that, historically, it has not assured the maintenance of "a stable monetary environment." 419/ Thus, Professor Harry G. Johnson argues:

". . . granted that a stable monetary environment is desirable, the question arises whether an independent monetary authority as presently understood is sufficient to provide such stability. The argument that it is assumes that, if free of control by the Executive and Legislature, the monetary authority will govern monetary policy in the light of the longrun best interests of the economy, and will conduct its policy flexibility and efficiency in the short run. This assumption is not consistent with the historical evidence of the behavior of monetary authorities; the evidence is rather that central banks have done little if anything to restrain inflationary policies in wartime - and war and its aftermath have been the almost exclusive source of serious inflation in the major countries in the 20th century - while in peacetime they have displayed a pronounced tendency to allow deflationary policies on the average. . . ."

Similarly, Professor Friedman maintains that a truly independent monetary authority is unlikely to achieve a "stable monetary structure" and that - 420/

". . . Experience shows that independent monetary authorities have introduced major elements of monetary instability, and analysis suggests that they can be expected to continue to do so. . . ."

418/ Id., at 363.

419/ Hearings on Federal Reserve After Fifty Years, p. 970.

420/ Id., at 1134.

Finally, it has been argued that an independent Federal Reserve gives too much weight to the views of the banking community and allows private interests to participate in the formulation of national economic policies. Thus, Professor Friedman believes that an independent monetary authority "will almost inevitably give undue emphasis to the point of view of bankers."421/ More specifically, Professor Reagan of Syracuse University, having in mind the fact that five of the twelve members of the FOMC are Reserve Bank presidents, has urged that monetary policy "is too important to be left to a half private and three-quarters autonomous body, such as the presently constituted Board of Governors and Open Market Committee."422/

X. THE CASE FOR INDEPENDENCE

Much of the foregoing discussion has already indicated the arguments advanced in defense of the independence of the Federal Reserve System. In general, the case for independence is that a country's monetary authority should be free from all private and political pressures so that, when necessary, it can dare to take measures in the best long-run interests of the country even though they may be "unpopular". In particular, the case is based on the premise that the monetary authority - the central bank - should not be bound by the short-run political objectives of the Administration in power or by the conflicting fiscal objectives of the Treasury.

421/ Id., at 1172.

422/ Id., at 1576.

Perhaps one of the best summaries of the arguments for independence was set forth in Reserve Board Chairman Martin's reply to a question propounded by Representative Patman in 1951. The question was whether the Board and the FOMC were parts of the executive branch. Evading that question, Mr. Martin gave the following reasons why the Federal Reserve, like the judiciary, should be independent from all pressures and in a position to take actions that might be unpopular: 423/

> "Credit and monetary functions, like the functions of the judiciary, depend for their effective performance upon impartial and objective judgment.
>
> "The country cannot prosper without a sound basic economy and sound credit conditions. To maintain such conditions, it is essential that money - the 'medium of exchange' by which goods and services change hands - must adequately and flexibly serve its purpose in a complex economy. To this end, some Government agency must be given the responsibility, under appropriate Congressional authority, for influencing the volume and availability of money in the public interest; and it is this responsibility which is vested in reserve banking authorities. Through instruments of credit policy, such as the fixing of discount rates, open market operations, and the determination of bank reserve requirements, these authorities can, within limits set by law, restrict credit during inflationary periods and conversely make it more readily available during periods of depression.
>
> "Because money so vitally affects all people in all walks of life as well as the financing of the Government, the task of credit and monetary management has unique characteristics. Policy decisions of an agency performing this task are often the subject of controversy and frequently of a restrictive nature; consequently, they are often unpopular, at least temporarily, with some groups. The general public in a democracy, however, is more apt to accept or tolerate restrictive monetary and credit policies if they are decided by public officials who, like the members of the judiciary, are removed from immediate pressures."

423/ 1952 Patman Compendium, p. 242.

Similar arguments to the effect that the Federal Reserve should not be influenced by political considerations and that it should be free to adopt unpopular policies were made in 1964 by the then president of the American Bankers Association: 424/

". . . There is widespread agreement among economists that policies of credit restraint are required from time to time, yet it is observable that such policies are seldom, if ever, 'popular.' If one can judge from experience in the United States, it seems fair to say that such restraint (particularly if prolonged) may provoke considerable public criticism of the monetary authorities. Money must be managed, and the monetary history of this country demonstrates conclusively that sound monetary management and 'popular' monetary management are not always compatible. Under these circumstances, the question which immediately arises is whether any one elected official can be expected consistently to incur public disfavor in the interest of a sound monetary system."

As stated by Professor Dudley G. Luckett of Iowa State University, 425/

". . . A central bank must at times be prepared to pursue a policy which is politically unpopular; its 'independence' permits it to do this."

More specifically, supporters of Federal Reserve independence argue that the System should not be subject to politically "popular" objectives of the executive branch, i.e., the President.

One of the strongest warnings against intervention by the President in the determination of Federal Reserve policies was written by Carter Glass in an introduction to Dr. Parker Willis' book on the Federal Reserve System. Dated May 29, 1923, Glass' warning read: 426/

424/ Hearings on Federal Reserve After Fifty Years, p. 1908.

425/ 1968 Compendium, p. 436.

426/ Supra note 80, p. ix.

". . . Moreover, I commend, without qualification of any description, as worthy of emulation Mr. Wilson's wise determination to refrain from executive interference with federal reserve administration and his refusal to permit politics to become a factor in any decisions taken. Unless the example thus set by President Wilson shall be religiously adhered to, the system, which so far has proved a benediction to the nation, will be transformed into an utter curse. The political pack, regardless of party, whether barking in Congress or burrowing from high official station, shall be sedulously excluded."

As indicated in Dr. Clifford's book previously mentioned, not all Presidents since President Wilson have refrained from attempting to interfere with the determination of Federal Reserve policies. In general, however, they have recognized and supported the independence of the System. For example, President Eisenhower at a press conference in 1956, after stating that the Federal Reserve Board was "a separate agency of the Government" and was "not under the authority of the President", stated that he believed "it would be a mistake to make it definitely and directly responsible to the political head of state".427/

Reserve Board Chairman Martin in 1952 cited American banking history in support of the need for monetary policies to be free from Presidential interference. In connection with the First Bank of the United States, chartered in 1791 under private management, Mr. Martin quoted Alexander Hamilton as saying that "it would, indeed, be little less than a miracle should the credit of the Bank be at the disposal of the Government, if, in a long series of time, there was not experienced a calamitous abuse of it."428/ Mr. Martin also noted that, when

427/ New York Times, Apr. 26, 1956, p. 16.

428/ 1952 Patman Compendium, p. 243.

the Second Bank of the United States was chartered in 1816, John Randolph objected to the mild proposal that five of its twenty-five directors should be appointed by the President. He quoted Randolph's statement at the time: 429/

"The objection was vital; that it would be an agency of irresistible power in the hands of any Administration; that it would be in politics and finance what the celebrated proposition of Archimedes was in physics - a place, the fulcrum from which, at the will of the Executive, the whole nation could be hurled to destruction, or managed in any way at his will and discretion."

Not only American financial history but the history of foreign central banks has been cited as proof of the danger of political, i.e., executive, control of a central bank. Thus, in 1959 Vice Chairman Balderston of the Board, in a letter to the chairman of the Committee on Government Operations, dated April 1, 1959, made the following statement:

"There can be no doubt that the Congress at any time can limit or withdraw the trusteeship it has granted to the Federal Reserve System to carry out constitutional responsibilities of Congress in the field of money and credit. However, any action that might reduce the independence of the Federal Reserve from the Executive should be considered with great care, especially in the light of the experience in other countries which have followed a similar course. The Board sincerely believes that the reasoning which led the Congress to provide for an independent monetary authority in the original Federal Reserve Act is just as relevant and valid today as it was when the act was passed in 1913."

In 1964, former Secretary of the Treasury Douglas Dillon stated: 430/

"Finally, and perhaps most fundamental to a resolution of this issue, experience over many years and in many countries

429/ Ibid.

430/ Hearings on Federal Reserve After Fifty Years, p. 1237.

has taught the wisdom of shielding those who make decisions on monetary policy from day-to-day pressures. The day of private central banks operating without regard to Government policy is long since gone, and quite properly so. But around the world, almost all countries still find it useful to maintain independence for their central banks within the government."

During Congressional hearings in 1964, President Kelly of the American Bankers Association 431/ quoted the following statement in a book by Per Jacobsson: 432/

> "The second conclusion to which we have come is that if we really need somebody to fight for the attainment of internal balance in our respective economies, the task cannot as a rule be trusted to politicians, who have all their clients to take care of. The situation calls for some institution strong enough to do the fighting, and on the Continent of Europe <u>the institutions with this qualification have mostly been the central banks</u>. [Emphasis in original.] It is almost possible to say that, in the majority of the countries where useful measures for a restoration of internal balance have been taken, this has been done thanks to the influence of their central banks. Thus on the Continent there is again a growing feeling that influential and authoritative central banks are a necessity; I am glad to say that among the general public this is coming to be realized, so that in more and more countries it is beginning to be hard for the governments to go against the views of the central banks on monetary matters."

The principal potential conflict between the policies of the monetary authority and the political Administration in power arises, of course, from the fact that the Treasury naturally is anxious to finance the public debt at the lowest possible interest rates whatever may be the policies of the monetary authority. A former Secretary of the Treasury, Douglas Dillon, himself recognized this danger when he opposed the suggestion that the Secretary be made an <u>ex officio</u> member of the

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431/ <u>Id.</u>, at 1909.

432/ Jacobsson, <u>Some Monetary Problems</u> (London, Oxford University Press, 1958), p. 269.

Federal Reserve Board: 433/

"Proposals of this kind also raise the possibility that decisions on monetary policy, directed toward the overall health of the economy, will at times, consciously or unconsciously, be biased by the constant pressures on the Secretary of the Treasury to assure the economical financing of the dominant borrower in our economy - the Federal Government itself. . . ."

Reflecting the same thought, a former president of the American Bankers Association stated that "executive responsibility for managing the Nation's money supply can create strong temptations to use monetary policy as a temporary expedient in financing the needs of Government rather than as an instrument of longer range economic stabilization." 434/

Expressing the view that treasuries have a "predictable inflationary bias" and that an independent central bank must be counted on to maintain a stable monetary unit, Professor G. L. Bach in 1964 made the following statement: 435/

"Stated bluntly, the traditional argument for Federal Reserve independence is that, if independent, the Fed will stand against inflation and financial irresponsibility in the Government. History tells of many treasuries which have turned to money issue to pay their bills when taxes were inadequate. The modern world's major inflations have all come with large governmental deficits, covered by the issue of new money (currency or bank deposits). While legislatures vote the expenditures, treasuries must pay the bills. Thus, it is argued that treasuries have a predictable inflationary bias, however well intentioned their secretaries may be. Against this bias, central bankers are alleged to be basically conservative; they can be counted on to look out for the stability of the monetary unit.

433/ Hearings on Federal Reserve After Fifty Years, p. 1231.

434/ Id., at 1876.

435/ Id., at 1393.

"Another variant is based on the presumption that the entire political process is inherently inflationary. It is always easier for Congress to spend money than to raise taxes; 'politicians' are inherently financially irresponsible. Thus, an independent Federal Reserve is needed to call a halt to the overspending tendencies of the politicians, and to the tendency of the politicians to plump too readily for good times for the economy as a whole, even though these good times may generate some inflation."

The argument was succinctly stated by Professor Luckett in 1968:436/

"The Federal Reserve was deliberately established as an independent agency to keep monetary policy out of the political arena. The reason for this is that there is a traditional 'conflict of interest' between the executive branch of the Government and the central bank. The executive branch is, by its nature, inclined to debase the currency. The most notable example of this in modern times in the United States was the 'pegging period' from 1941 to 1951. The interest of the Treasury lies in minimizing the service charges on the public debt. In practice, this means keeping interest rates at very low levels. Thus, in all disagreements between the Treasury and the Federal Reserve of which I am aware, it has always been the Treasury that wanted easier money, and the Federal Reserve that wanted tighter money.

"The risk that would be run in doing away with the Federal Reserve's independence is thus that an inflationary bias would be introduced into the conduct of monetary policy. . . ."

Advocates of Federal Reserve independence, while recognizing that this independence may seem anti-democratic and that differences between the executive and the Federal Reserve at times may be frustrating, have nevertheless argued that such disadvantages are offset by the protection of the Federal Reserve against political pressures.

436/ 1968 Compendium, p. 436.

For example, Professor G. J. Viksnins of Georgetown University made the following statement in 1966:[437/]

> ". . . There definitely does exist a potentiality in the independent Federal Reserve for largely frustrating the policy of the executive branch. A tax cut, say, could be largely nullified by a restrictive monetary policy and under present legal arrangements there is really little that could be done to stop the Federal Reserve if it were bent on a destructive or even a definitely undesirable policy. On the other hand, it can be argued fairly persuasively that the executive branch is politically quite sensitive, which means considerably more attention to employment than prices. To support every expenditure program and deny every tax increase constitutes demagoguery, which is too often politically profitable, however. Since the Federal Reserve need not respond to moment-by-moment political pressure, it may be one of the last few checks against demagoguery. While this argument may seem antidemocratic, in the last analysis the System is a creature of Congress and a destructive credit policy would surely not be tolerated for a long period."

Similarly conceding that the Federal Reserve's independence may be "inconvenient and frustrating" to the officials concerned, Dr. Walter S. Salant expressed the view that the System's present degree of independence "enforces a more thorough discussion and thrashing out of issues within the Government than might otherwise occur" and that "much of value would be lost if the Board were placed under a tighter rein."[438/]

In answer to the contention that the independence of the Federal Reserve is contrary to democratic principles, President Hayes of the New York Reserve Bank in 1964 said:[439/]

437/ _1966 Symposium_, Supplement, p. 173.

438/ _Id._, at 130, 131.

439/ _Hearings on Federal Reserve After Fifty Years_, p. 532.

"I do not regard the present procedure, as some have done, as 'anti-democratic.' The freedom of the Federal Reserve System to carry out monetary policies free from short-term political pressures represents a conscious decision that was reached by democratic processes that the national interest is best served by the existence of such freedom. . . ."

Similarly, President Kelly of the American Bankers Association observed: 440/

"The accountability of a Federal agency to the Congress, rather than to the President, does not make it a less 'democratic' institution. Nor is it required that the Congress participate directly in the decisions and administrative affairs of such an agency in order to demonstrate its ultimate responsibility for the agency's policies and operations. The fact that it does not do so has encouraged the view that the Federal Reserve has de facto independence of Congress as well as of the executive branch. This idea - that the Federal Reserve System has severed ties with the Government which created it, that it answers to no one and is governed by no authority save its own - should be dispelled."

Summing up, in effect, the case for Federal Reserve independence, Mr. T. H. Milner, Jr., on behalf of the Independent Bankers Association, stated during 1964 hearings: 441/

"It is our belief that the Federal Reserve System has stood the test of time and trials for more than 50 years, because of the built-in principles designed to give the Board of Governors independence in the exercise of credit and monetary responsibilities.

"We recall the record of the consideration of the original act, spelling out the will and intent of the Congress to create a distinctly nonpartisan agency, free of political pressures, and completely independent in safeguarding our monetary system, and representing, and responsible to, the people."

Although Representative Patman might not today agree with the statement, his Subcommittee on General Credit Control and Debt Management stated in 1952: 442/

440/ *Id.*, at 1911.

441/ *Id.*, at 1703.

442/ *1952 Patman Subcommittee Report*, p. 4.

"The independence of the Federal Reserve System is based, not on legal right, but on expediency. Congress, desiring that the claims of restrictive monetary policy should be strongly stated on appropriate occasions, has chosen to endow the System with a considerable degree of independence, both from itself and from the Chief Executive. This independence is in no way related to the unsettled question of whether the Board of Governors is or is not a part of the Executive Branch of the Government. It is naturally limited by the overriding requirement that all of the economic policies of the Government - monetary policy and fiscal policy among them - be coordinated with each other in such a way as to make a meaningful whole. The independence of the Federal Reserve System is desirable, not as an end in itself, but as a means of contributing to the formulation of the best over-all economic policy. In our judgment, the present degree of independence of the System is about that best suited for this purpose under present conditions."

other words, so the argument goes, the independence of the Federal erve from both the Congress and the President is desirable so that e claims of restrictive monetary policy" may be stated strongly "on ropriate occasions".

XI. SUMMARY AND CONCLUSIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Perhaps the best expression of the writer's opinion was contained in the 1952 Report of a Subcommittee of which Representative Patman served as chairman. That Report said:443/

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

443/ 1952 Patman Subcommittee Report, pp. 52, 53.