

# **FEDERAL RESERVE REFORM ACT OF 1977**

---

## **HEARINGS BEFORE THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES**

**NINETY-FIFTH CONGRESS**

**FIRST SESSION**

**ON**

**H.R. 8094**

**A BILL TO PROMOTE THE ACCOUNTABILITY OF THE FEDERAL  
RESERVE SYSTEM**

---

**JULY 18 AND 26, 1977**

---

**Printed for the use of the  
Committee on Banking, Finance and Urban Affairs**



**U.S. GOVERNMENT PRINTING OFFICE**

**WASHINGTON : 1977**

## HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

HENRY S. REUSS, Wisconsin, *Chairman*

THOMAS L. ASHLEY, Ohio	J. WILLIAM STANTON, Ohio
WILLIAM S. MOORHEAD, Pennsylvania	GARRY BROWN, Michigan
FERNAND J. ST GERMAIN, Rhode Island	CHALMERS P. WYLIE, Ohio
HENRY B. GONZALEZ, Texas	JOHN H. ROUSSELOT, California
JOSEPH G. MINISH, New Jersey	STEWART B. MCKINNEY, Connecticut
FRANK ANNUNZIO, Illinois	GEORGE HANSEN, Idaho
JAMES M. HANLEY, New York	HENRY J. HYDE, Illinois
PARREN J. MITCHELL, Maryland	RICHARD KELLY, Florida
WALTER E. FAUNTROY, District of Columbia	CHARLES E. GRASSLEY, Iowa
STEPHEN L. NEAL, North Carolina	MILLICENT FENWICK, New Jersey
JERRY M. PATTERSON, California	JIM LEACH, Iowa
JAMES J. BLANCHARD, Michigan	NEWTON I. STEERS, Jr., Maryland
CARROLL HUBBARD, Jr., Kentucky	THOMAS B. EVANS, Jr., Delaware
JOHN L. LaFALCE, New York	BRUCE F. CAPUTO, New York
GLADYS NOON SPELLMAN, Maryland	HAROLD C. HOLLENBECK, New Jersey
LES AUCCOIN, Oregon	
PAUL E. TSONGAS, Massachusetts	
BUTLER DERRICK, South Carolina	
MARK W. HANNAFORD, California	
DAVID W. EVANS, Indiana	
CLIFFORD ALLEN, Tennessee	
NORMAN E. D'AMOURS, New Hampshire	
STANLEY N. LUNDINE, New York	
HERMAN BADILLO, New York	
EDWARD W. PATTISON, New York	
JOHN J. CAVANAUGH, Nebraska	
MARY ROSE OAKAR, Ohio	
JIM MATTOX, Texas	
BRUCE F. VENTO, Minnesota	
DOUG BARNARD, Georgia	
WES WATKINS, Oklahoma	

PAUL NELSON, *Clerk and Staff Director*

WILLIAM P. DIXON, *General Counsel*

MICHAEL P. FLAHERTY, *Counsel*

GRASTY CREWS II, *Counsel*

MERCER L. JACKSON, *Minority Staff Director*

GRAHAM T. NORTUP, *Deputy Minority Staff Director*

# CONTENTS

Hearings held on—	Page
July 18, 1977-----	1
July 26, 1977-----	57
Text of H.R. 8094-----	7

## STATEMENTS

Biemiller, Andrew J., director, Department of Legislation, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) ; accompanied by Dr. Rudolph Oswald, director, Department of Research—	42
Brown, Jon, Public Interest Research Group-----	161
Burns, Hon. Arthur F., Chairman, Board of Governors of the Federal Reserve System-----	57
Cohen, David, Common Cause-----	119
Wright, Hon. Jim, majority leader, a Representative in Congress from the State of Texas-----	10

## ADDITIONAL INFORMATION SUBMITTED FOR THE RECORD

Biemiller, Andrew J., statement of the executive council of the AFL-CIO on the Federal Reserve and the Nation's monetary policy, presented Bal Harbour, Fla., February 21, 1975-----	46
Brown, Congressman Garry, table submitted from a budget issue paper of the Congressional Budget Office-----	40
Burns, Hon. Arthur F. :	
Correspondence between Senator William Proxmire and members of the Federal Open Market Committee concerning the subject of monetary velocity-----	76
Response to questions of Congressman Chalmers P. Wylie-----	114
Cohen, David :	
Legal memorandum submitted re whether "Section 4 of H.R. 8094 Is in Violation of the First Amendment"-----	138
List of class C directors of Federal Reserve banks-----	135
Prepared statement-----	123
O'Reilly, Kathleen F., statement-----	54
Samuelson, Dr. Paul, statement-----	38
Stanton, Hon. J. William, article submitted from the Wall Street Journal of July 26, 1977, entitled "Off Target"-----	66
Wright, Hon. Jim, prepared statement-----	15

# FEDERAL RESERVE REFORM ACT OF 1977

MONDAY, JULY 18, 1977

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10 a.m. in room 2128 of the Rayburn House Office Building; Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss, Gonzalez, Annunzio, Hanley, Mitchell, Neal, Blanchard, Spellman, Hannaford, Lundine, Pattison, Cavanaugh, Oaker, Mattox, Vento, Barnard, Stanton, Brown, Rousset, Hansen, Kelly, Grassley, Fenwick, Leach, and Caputo.

The CHAIRMAN. Good morning.

The House Committee on Banking, Finance, and Urban Affairs will be in order for the commencement of hearings on H.R. 8094, a bill to promote the accountability of the Federal Reserve System.

Congress, under article I, section 8 of the Constitution, has the power "to coin money, regulate the value thereof."

After much experience with panic and depression, Congress under the Federal Reserve Act of 1913 delegated to the Federal Reserve System the day-to-day operations of its monetary power, with particular reference to the need for a "flexible currency."

When we speak of the independence of the Federal Reserve, we speak of its independence from the executive branch and not from the Congress. Congress could have delegated its monetary power to the Executive. It chose instead to delegate it to the Federal Reserve, whose Board members' 14-year terms effectively insulate them from Executive manipulation. Though the Executive gained the ascendancy over the Federal Reserve during World War II and for half a decade thereafter, the 1951 accord between the Treasury and the Fed, negotiated by the Congress, reaffirmed and reinforced the independence of the Federal Reserve from the Executive.

For the first half century or so of its existence, the Federal Reserve can hardly be said to have been successful in its monetary policy. Until the late 1920's, there was no monetary policy worthy of the name. Thereafter, it was mostly wrong-headed. Excessively restrictive monetary policy helped bring on the depression of 1929 and snuff out the beginnings of recovery in 1937.

During the war years, and right up until the accord of 1951, Federal Reserve monetary policy was excessively dominated by the Executive, and excessively loose. During most of the 1950's, monetary policy was too restrictive, and contributed to the slow growth of the decade.

In the last 15 years, monetary policy has been too frequently characterized by stops and starts. Too much new money was created in

the Vietnam years of 1967 and 1968, helping to cause inflation. Then policy reversed and became too restrictive. Overease revived again in 1972 and 1973, to be followed by the excessive restrictiveness of late 1974 and early 1975.

Then, in March 1975, Congress enacted House Concurrent Resolution 133. This resolution set up quarterly dialogues between the Federal Reserve and the House and Senate Banking Committees, and resulted in the Federal Reserve's stating its targets for the following 12 months for the money supply, principally  $M_1$  (the public's holdings of cash and checking accounts). By and large, this policy has worked well in the ensuing 2 years.

There have been at least two exceptions, due to unfortunate relapses into stop-start policies. In June 1975, unnecessarily upset by the increase in the money supply caused by the Federal income tax rebate, the Fed put on the monetary brakes, and contributed to the slowdown in recovery in the summer of 1975. Again, in April 1977, the Fed created an exorbitant amount of new money, at an annual rate of almost 20 percent. Then, on some two-wrongs-can-make-a-right basis, it lowered the creation of new money to zero in May 1977, causing a wholly unnecessary increase in the bank prime rate.

But I hope these were monetary aberrations from a sensible new trend. I hope the Federal Reserve will be able to resist the temptation to join what Business Week calls the new Metternichs—the European central bankers—some of whom want to go back to the discredited operation of fighting inflation by so squeezing the money supply as to cause increased unemployment.

So far I have been discussing the major activity of the Federal Reserve System—monetary policy. But the Fed has two other very important functions—as principal regulatory agency for State member banks of the Federal Reserve System, and as servicer of the banking system through check clearing operations and coin and currency transfers.

As I have suggested, the Federal Reserve is a more serviceable agency today than at any time in its history. Its Chairman, Dr. Arthur Burns, is an able and respected leader.

All the more reason, then, that the accountability to the public of the Fed needs to be sharpened. The five major provisions of H.R. 8094, now before us, would attempt to sharpen that accountability.

There follow the five provisions of H.R. 8094, and the reasons for them:

(1) **MAKE PERMANENT THE CONGRESSIONAL-FEDERAL RESERVE DIALOG ON MONETARY POLICY**

House Concurrent Resolution 133, which authorizes the quarterly dialog, expired by its own terms at the end of 1976. Chairman Burns continues to appear quarterly before the House and Senate Banking Committees. But these appearances should be regularized and made businesslike by statute. A successor Chairman, for example, could refuse to engage in the dialog, and Congress could point to no law which was being flouted.

In the course of making the dialog an ongoing procedure, two improvements are needed. That Federal Reserve monetary policy is

meant to serve the Nation's goals contained in the Employment Act of 1946—for maximum employment, production, and price stability—needs to be explicitly stated.

Second, the Federal Reserve should be required to testify not only concerning its proposed monetary aggregates for the ensuing year, as House Concurrent Resolution 133 requires, but on three related matters—anticipated velocity, estimated interest rates, and portfolio composition.

First, the velocity with which money changes hands has a profound effect on the amount of new money that will be needed. The bill, therefore, includes “anticipated monetary velocity,” as a subject on which the Fed should testify.

Second, as part of the overall annual economic program of both the administration and the Federal Reserve, it is necessary at least to make an estimate of the levels of interest rates—particularly on business loans and on long-term mortgages. It is not suggested that a target for interest rates be stated, but merely an estimate of expected rates.

Coordination of fiscal and monetary policy would be greatly enhanced if Government economists outside the Fed understood what the Fed's interest rate anticipations were. As the people's representatives, the Congress is also entitled to know the Fed's view of the course of interest rates for the ensuing year.

What about the fear that public revelation of anticipated interest rates would cause disruption in financial markets? This is hard to see. Making such information available to all simply removes the advantage that insiders in financial markets now enjoy, and reduces speculation based on rumors and misinformation that do cause instability in the markets. It is worth noting that the Fed's often-stated view that prompt disclosure of Federal Open Market Committee directives would cause disruption in the market has not proved true. The reduction from 90 to 30 days in the time FOMC decisions are kept secret has had no destabilizing effect, and in fact appears to have been beneficial.

Finally, the Federal Reserve can affect the structure of interest rates by the composition of its portfolio of securities, currently valued at close to \$100 billion, equal to one-fourth of the privately held national debt. For example, by increasing its holdings of longer term securities, the Fed can modestly bring down long term interest rates relative to short term interest rates. Proposed portfolio policy is, therefore, an important part of the Federal Reserve's quarterly presentation.

These broadened guidelines would avoid the present total concentration on the monetary aggregates alone.

#### (2) BROADEN THE ECONOMIC INTEREST OF FEDERAL RESERVE BANK DIRECTORS

Under present law, the nine Directors of each of the 12 Federal Reserve banks have unduly narrow backgrounds. Commercial banks elect six of the nine—three class A Directors, always bankers, as their direct “representatives,” and three class B Directors from “commerce, agriculture, or some other industrial pursuit.” The three class C Di-

rectors are chosen by the Federal Reserve Board of Governors, with nothing said as to who they may be.

As the Banking Committee staff study "Federal Reserve Directors: A Study of Corporate and Banking Influence," August 1976—disclosed, this has produced a representation grossly banker-oriented at the expense of other groups. Furthermore, it has resulted in the virtual exclusion of women, blacks, and representatives of labor unions and consumer interest organizations.

H.R. 8094 would remedy the situation with respect to discrimination by requiring that all directors—A, B, and C—be chosen "without discrimination on the basis of race, creed, color, sex, or national origin."

As to economic representation, the three class A Directors would be left as they are now—bankers.

Class B directors would be specifically designated "public" and broadened from the present "commerce, agriculture, or some other industrial pursuit" to "with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers." While class B directors are elected by the member banks, they should be chosen from a broader category than the ambiguous existing "commerce, agriculture, or some other industrial pursuit." It is archaic to concentrate, for example, on "industrial pursuit," when service industries are steadily becoming more prominent than the purely industrial pursuits which were in everyone's minds in 1913 when the Federal Reserve Act was written. "Services, labor, and consumers" are groups of our citizenry whose economic interests entitle them to consideration for seats on the Federal Reserve bank boards.

Class C directors would be chosen, as now, by the Federal Reserve Board of Governors. But instead of no language as to qualification, they would have the same qualifications as class B directors: They must represent the public, and "with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers."

These first two provisions of H.R. 8094—the permanent Congressional Federal Reserve dialog, and the broadening of the Federal Reserve bank directors—are substantially similar to H.R. 12934, which passed the House by a vote of 279 to 85 on May 10, 1976. Because of the adjournment of the Senate in September 1976, the bill did not reach action there.

### (3) REQUIRE SENATE CONFIRMATION OF THE CHAIRMAN OF THE BOARD OF GOVERNORS

Under existing law, members of the Federal Reserve Board of Governors, who serve 14-year terms, are subject to Senate confirmation at the time of their appointment; one of the Board Members is designated by the President to serve as Chairman for a 4-year term, but without Senate confirmation. Thus, the President can designate as Chairman someone who was confirmed by the Senate some 13 years previously, yet the Senate be powerless to confirm the appointee to what was recently called the Nation's "No. 2 position." The bill would make the President's choice of Chairman subject to the advice and consent of the Senate. The Federal Reserve recently told this subcommittee that it has no objection to this provision.

## (4) PREVENT THE FED'S USING BANKS AS ITS LOBBYISTS

The Federal Reserve System has been using bankers—who are deeply beholden to the Fed because of the Fed's ability to give or withhold a discount window loan, or to give or withhold such privileges as approval for a merger, holding company acquisition, or an Edge Act office—to lobby on the Fed's behalf with legislators and other Government officials.

For example, as revealed by the minutes of the Board of Directors of the Federal Reserve Bank of Chicago for May 23, 1974, Vice Chairman George W. Mitchell of the Federal Reserve Board of Governors commented on the lobbying efforts of the Fed to kill the bill requiring a GAO audit:

Governor Mitchell also noted that the GAO audit bill should come up for vote next week on the floor of the House. Reserve bank directors have been helpful in contacting Congressmen and hopefully the bill can be at least amended to restrict the type of audit if chances for outright elimination lessen.

Chicago Federal Reserve Bank President Robert P. Mayo at the same meeting called for continuing lobbying efforts:

Mr. Mayo commented further on the GAO audit bill, noting that it is House Bill numbered 10265 and should be up for consideration on May 29. He then requested each director to make whatever calls seem natural to him in order to encourage support for the Federal Reserve position.

The Philadelphia Federal Reserve Bank, in its minutes for May 4 and May 18, 1972, described its use of private commercial banks and the New Jersey Bankers Association against a New Jersey bill which might have attracted independent banks away from the Fed:

President Eastburn said there was a bill in the New Jersey Assembly to permit nonmembers to keep up to 50 percent of their reserves in Government securities. He indicated that this Bank had been in touch with New Jersey bankers, the New Jersey Bankers Association and key legislators to express the feeling that the bill would be divisive, inequitable, and disruptive, and would have an adverse effect on membership. He reported that the bill had recently been sent back to committee.

Again, the Richmond Federal Reserve Bank has also been adept at using bankers as official unregistered lobbyists for the Fed. In October 1975, Richmond Federal Reserve Bank Chairman Robert W. Lawson, in a speech to the American Bankers Association at Hot Springs, Va., congratulated the bankers for their great lobbying assist to the Fed. Chairman Lawson's remarks were the subject of a colloquy between myself and Chairman Arthur Burns of the Federal Reserve Board of Governors at a hearing before the subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Currency and Housing on January 21, 1976:

Chairman REUSS. Let me now get into the area of politics, which you brought up several times this morning in connection with the audit bill for the Fed. On October 1, 1975, the American Banker carried an interesting story on your Reserve Bank chairman in Richmond, Robert L. Lawson.

The headline was, "Federal Reserve Board Official Hails Bank Role in Killing GAO Audit of the Fed." And then it went on to describe his speech to a bankers group, in which he said:

"Banks played a key role in blocking a congressional audit of the Federal Reserve Board. The bankers in our district and elsewhere did a tremendous job in helping to defeat the GAO bill. It shows what can be done when the bankers of the country get together."



My question is: If you get the support of the banks on an issue which is of great concern to you, whether Congress has the right to audit your books or not, are they not likely to expect in return kind treatment from you as a regulator? They would not get it, of course, but are they not likely to expect it?

Dr. BURNS. As for Mr. Lawson's statement, let me merely remind you that, as I indicated in my testimony, we have in the System 269 directors, and neither I nor the Board can be responsible for what individual directors may or may not say.

Chairman REUSS. Did not the Federal Reserve people, to your knowledge, communicate with the banks about bank lobbying against the audit bill?

Dr. BURNS. I played no part in this activity at all, not because I would consider it wrong, but because I did not have the time.

Chairman REUSS. My question was, with respect to people at the Fed, was there not a little communication there?

Dr. BURNS. Yes. That is to say, there was some communication between our various directors, not with bankers as such, but with bankers, journalists, business people. I do not know whom they contacted. And that, I think, is an entirely legitimate activity. After all, do not Members of Congress want to hear from their constituents?

It is just as improper for the Federal Reserve System to use a regulated industry as its lobbyist as it would be for, say, the Federal Power Commission to enlist executives of the oil and gas companies it regulates to lobby Congress on matters of concern to the FPC. Such activities by the Federal Power Commission, would, of course, be clearly illegal under the overall act forbidding lobbying by administrative agencies with money appropriated by the Congress (18 U.S. Code, 1913). The Fed is technically exempt from this statute because its funds are not appropriated by Congress.

Such use of the banks for lobbying purposes should cease. Accordingly, section 4 of H.R. 8094 forbids directors or officers of the Federal Reserve from getting banks or other institutions regulated by the Fed to lobby for legislation at the Fed's behest.

**(5) PROHIBIT FEDERAL RESERVE OFFICERS, EMPLOYEES, AND DIRECTORS FROM ACTING WHERE THEY HAVE A CONFLICT OF INTEREST**

Under existing law, employees and officers of the U.S. Government may not participate in any matter before the Government in which they or a member of their family or business have an interest, unless there is first a full disclosure of this interest and an official written determination by an official that this interest is not substantial. The Fed is not covered. H.R. 8094 extends this prohibition to Federal Reserve Bank officers, employees, and directors. The minutes of Federal Reserve Bank meetings previously referred to contain instances of Federal Reserve officials proceeding to exercise their authority despite a clear conflict of interest.

The proposal for an audit of the Federal Reserve System contained in an earlier version of the Federal Reserve Reform Act of 1977 has been dropped because the House Government Operations Committee on June 28 reported a bill providing for such an audit, H.R. 2176. That bill provides for an audit not only of the Fed but of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

Taken altogether, this legislation will make the Federal Reserve System more accountable. As Dean Jonathan Swift said: "Providence never intended to make the management of public affairs a mystery, to be comprehended only by a few persons of sublime genius."

[A copy of H.R. 8094 follows:]

95TH CONGRESS  
1ST SESSION

# H. R. 8094

---

## IN THE HOUSE OF REPRESENTATIVES

JUNE 29, 1977

Mr. REUSS introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

---

## A BILL

To promote the accountability of the Federal Reserve System.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3 CONGRESSIONAL-FEDERAL RESERVE DIALOG ON MONETARY  
4 POLICY

5 SECTION 1. Insert a new section 2A immediately after  
6 section 2 of the Federal Reserve Act to read as follows:

7 "SECTION 2A. GENERAL POLICY: CONGRESSIONAL REVIEW

8       “(a) The formulation and implementation of monetary  
9 policy under this Act shall be governed by the national  
10 policy to promote maximum employment, production, and  
11 price stability.

12       “(b) At quarterly hearings conducted alternately by the

1 Committee on Banking, Housing, and Urban Affairs of the  
2 Senate and the Committee on Banking, Finance and Urban  
3 Affairs of the House, representatives of the Federal Reserve  
4 System shall testify concerning the Board of Governors' and  
5 the Federal Open Market Committee's proposed monetary  
6 policy for the next twelve months, including proposed mone-  
7 tary aggregates, anticipated monetary velocity, estimated  
8 levels of interest rates (particularly on business loans and on  
9 long-term housing mortgages), and the proposed composi-  
10 tion of the Federal Reserve's portfolio."

11 **BOARDS OF DIRECTORS OF FEDERAL RESERVE BANKS**

12 **SEC. 2.** The following paragraphs of section 4 of the  
13 Federal Reserve Act are amended:

14 (a) the tenth paragraph by inserting after the  
15 comma the following: "without discrimination on the  
16 basis of race, creed, color, sex, or national origin,".

17 (b) the eleventh paragraph by striking all after  
18 "members," and substituting "who shall represent the  
19 public and shall be elected without discrimination on the  
20 basis of race, creed, color, sex, or national origin, and  
21 with due but not exclusive consideration to the inter-  
22 ests of agriculture, commerce, industry, services, labor,  
23 and consumers.".

24 (c) the twelfth paragraph by inserting immediately  
25 after the first sentence thereof the following sentence:

6 SENATE CONFIRMATION OF CHAIRMAN OF BOARD OF  
7 GOVERNORS

16 LOBBYING COMMUNICATIONS WITH REGULATED  
17 INSTITUTIONS

18 SEC. 4. Section 10 of the Federal Reserve Act is  
19 amended by inserting immediately after the last sentence  
20 thereof the following sentence: "No member of the Board  
21 of Governors, director, officer, or employee of the Federal  
22 Reserve system may communicate with any director, officer,  
23 or employee of any institution subject to the regulatory au-  
24 thority of the Federal Reserve System to influence legisla-  
25 tive actions affecting the Federal Reserve System."

1 CONFLICTS OF INTEREST

2 SEC. 5. Subsection 208 (a) of title 18, United States  
3 Code, is amended by adding "a Federal Reserve bank direc-  
4 tor, officer, or employee," immediately before "or of the  
5 District of Columbia".

6 REFERENCES TO FEDERAL RESERVE ACT PARAGRAPHS

7 SEC. 6. References in this Act to paragraphs of the Fed-  
8 eral Reserve Act refer to the paragraphs as designated in the  
9 compilation of the Federal Reserve Act as amended through  
10 1974, compiled under the direction of the Board of Governors  
11 of the Federal Reserve System in its legal division.

12 SHORT TITLE

13 SEC. 7. The short title of this Act shall be the "Federal  
14 Reserve Reform Act of 1977".

The CHAIRMAN. We are fortunate to have with us this morning the majority leader of the House of Representatives, Hon. Jim Wright, of Texas. Mr. Wright has a prepared statement which, under the rule and without objection, will be received in full into the record.

Before calling on Mr. Wright, I turn to our friend, the ranking minority member, Mr. Stanton, to inquire whether he has any opening remarks.

Mr. STANTON. Mr. Chairman, I have no opening remarks. I would just take this opportunity to say I am glad the majority leader is with us, and I would be glad to have him proceed.

The CHAIRMAN. Thank you very much.

Mr. Wright?

**STATEMENT OF HON. JIM WRIGHT, MAJORITY LEADER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS**

Mr. WRIGHT. Mr. Chairman and members of the committee, for many years, under the leadership of the late Wright Patman, of Texas, and now under that of Chairman Reuss of Wisconsin, the House Banking Committee has taken the lead in stimulating public discussion on the importance of monetary policy in the Nation's economy.

Today the public is more aware than ever of the impact of monetary policy and interest rates on jobs, inflation, production, and economic growth. The heightened awareness is due partly to the persistent efforts of this committee, partly, also, to the wrenching experience of 1974 when interest rates climbed to levels we could not have imagined previously and wreaked havoc with the Nation's economy. The public and Congress now recognize better than ever the importance of the Federal Reserve's conduct of monetary policy and its regulation of the banking system, the need for regular oversight by Congress, and greater accountability to the public on the part of the Fed—in short for the provisions embodied in this bill, H.R. 8094, the Federal Reserve Reform Act of 1977.

This committee has done a thorough job of laying the groundwork for this legislation. The FINE study, "Financial Institutions and the Nation's Economy," in the 94th Congress, heard from scores of witnesses about the need for financial reform, many of them directing their testimony to the need for changes in the Federal Reserve System. The landmark committee study, "The Federal Reserve Directors—A Study of Corporate and Banking Influence" of August 1976, spelled out in great detail the way in which the Federal Reserve System has become dominated by a fairly narrow range of interests.

No more studies or hearings are needed. Every aspect of the issues dealt with in this legislation has been well explored. What is needed now is legislation addressing the problems that have been identified in the Federal Reserve System, and enhancing the role of Congress in oversight of monetary policy in the coming years.

This legislation goes directly to the chief concerns that have been raised.

You have done an excellent job, of course, Mr. Chairman, explaining the five fundamental provisions of the bill. Let me just touch on each of them very briefly.

The first thing the bill would do would be to require a quarterly dialog on monetary policy. It seems to me that the experience with House Concurrent Resolution 133 in the last Congress would give us every reason to make this practice of mandatory quarterly appearances before the Banking Committees of the House and Senate a permanent part of the statute.

The Federal Reserve is expected, after all, to be responsive to the Congress. It was never intended to be entirely independent of Congress, as has been well recognized for some time.

For instance, in hearings on the President's economic report before the JEC in 1960, Mr. Patman asked former Fed Chairman William McCresney Martin: "Would you agree, Mr. Martin, that the only authority for issuing money and regulating the value of money is the constitutional authority of Congress?"

And Mr. Martin replied, "I have never questioned the authority of Congress."

It is extremely important that the views of Congress be made explicit to the Fed. The Fed is, after all, not infallible, and in fact has had a rather spotty record over the years in management of the money supply.

House Concurrent Resolution 133 required the Fed to testify only on targets for monetary growth for the ensuing year. The requirement in this bill that the Fed testify also on anticipated velocity, estimated levels of interest rates, and the composition of the Fed's portfolio is a worthy addition to House Concurrent Resolution 133. It will contribute greatly to the public's understanding of monetary issues, and will help make the Fed more accountable to Congress in a completely appropriate way.

A second basic provision of the bill would broaden the public representation on the boards of directors of the Federal Reserve banks.

The summary conclusion of your committee's staff study of Federal Reserve Directors was very well put, namely, that "the Federal Reserve Directors are apparently representatives of a small elite group which dominates much of the economic life of this Nation." It has been true, as the study noted, that the list of the Federal Reserve Directors reads like a page out of "Who's Who in American Corporations."

Mr. Chairman, the boards of directors have been too narrowly dominated by bankers and big businessmen. There are many others who have just as much expertise and certainly as great an interest in the health of the Nation's economy as directly influenced by the policies of the Federal Reserve.

The third requirement of the bill would be that the Chairman of the Board of Governors would have to be confirmed by the Senate. Now, the Chairman of the Federal Reserve Board certainly occupies one of the most powerful positions in the United States. It is almost inconceivable to me that the person can be appointed to that position for a period of 4 years without undergoing the same process of Senate confirmation that governs far less important positions in the Federal Establishment.

Now, for the position of Chairman, the Senate should have the opportunity to explore the nominee's qualifications and views above and beyond the examination customarily undertaken for a person who would serve as only one of seven members of the Board of Governors, and this bill would remedy that omission.

The fourth provision of the bill would restrict lobbying by the Federal Reserve.

Mr. Chairman, one need not have been around Congress as long as I have to be painfully aware of the intense lobbying activities that seems to arise whenever a bill opposed by the Federal Reserve is before the Congress. Members are swamped with calls and visits from bankers and businessmen. It has been evident that this intense lobbying activity is no spontaneous grassroots affair. Not until the minutes of the boards of directors of the Federal Reserve banks became available to your committee, however, had it been documented how extensively this lobbying has been orchestrated by the Federal Reserve Board itself.

Now, if the Federal Reserve wishes to kill or modify a particular piece of legislation, it has a powerful network of friends from the biggest corporation board rooms to the smallest banks that it can call upon. It seems highly improper to me for the Federal Reserve, an

agency of the U.S. Government, to urge bankers who it regulates to lobby the Congress in support of specific legislation and get their friends and associates in the banking communities to do the same.

As you have observed, Mr. Chairman, the Federal Reserve has a powerful hold on those bankers. It makes critical decisions affecting their businesses, and the bankers, naturally, are anxious to respond to its plea for help.

Officials of other agencies of the Government, I might point out, have been specifically forbidden by law from the kinds of lobbying activities which have been disclosed by the Fed's own minutes. The Federal Reserve is exempted only because of the technicality that its funds are not appropriated by Congress. Well, that is a loophole that I think should be closed. It is no more acceptable for the Federal Reserve to use its officials or directors to lobby on behalf of its interests than it would be for members of any other regulatory commission to elicit industries they regulate in lobbying efforts. Nobody wants to limit the rights of any citizen to petition his Congress, but the limits to the propriety of such activity in the case of officials of the Government are well recognized in law.

Finally, this bill would prevent conflicts of interest.

Public trust in Government is one of the fundamentals of success of the democratic government. Unfortunately, public opinion polls in recent years have shown a strong element of distrust in Government. One factor that feeds such distrust is the revelation from time to time of conflict of interest situations on the part of Government officials. Therefore, it seems quite essential to me that every effort be made to prevent conflicts of interest.

While I have great confidence in the basic integrity of the Federal Reserve and its officials, the minutes of the Federal Reserve Board of Directors do reveal that conflict of interest situations may not always have been satisfactorily resolved, so it is important, it seems to me, that potential conflict of interest situations be explicitly dealt with in the statute.

The Federal Reserve has not been covered by the same conflict of interest statutes that govern employees of other official departments and agencies, and this bill, H.R. 8094, would extend to Federal Reserve bank officials, employees, and directors the same restrictions against conflicts of interest that apply elsewhere in government.

Mr. Chairman, it seems to me that the changes proposed in this legislation are hardly revolutionary, but I believe they are very important. They would hold the Federal Reserve more accountable to the Congress and to the public in the conduct of monetary policy without compromising the essential degree of independence of the Fed originally intended by Congress. These changes would increase the participation of a broader segment of the public in the operation of this vital institution, and they would apply to the Fed the same strictures against lobbying and conflicts of interest that have applied for a long time to other agencies of the Government.

And so, Mr. Chairman, I would like to commend you and this committee for undertaking the important reforms that are embodied in this legislation.



The CHAIRMAN. I want to commend you, Mr. Wright, for a very able statement and in saying, as you do on page 3 of your statement—and I quote: “The Fed is, after all, not infallible, and in fact has had a rather spotty record over the years in management of the money supply.”

You are carrying on in the tradition of Dean Swift, who I mentioned in my introductory remarks said that “Providence never intended to make the management of public affairs a mystery to be comprehended only by a few persons of sublime genius.”

I think it is a credit to your leadership and to the new look in Congress generally that the legislature has recently been better fulfilling its constitutional mandate under article I, section 8, to supervise the coinage of money and the value thereof. And I think the Federal Reserve has come a long way, too; and thus it is my hope and belief that this rather modest bill will be taken in good spirit by all concerned and that it can be speedily enacted.

And I want to thank you so much for coming here.

[The prepared statement of Congressman Wright follows:]

STATEMENT BY REPRESENTATIVE JIM WRIGHT OF TEXAS  
BEFORE THE HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,  
ON THE FEDERAL RESERVE REFORM ACT OF 1977

For many years under the leadership of the late Wright Patman of Texas and now Chairman Reuss of Wisconsin, the House Banking Committee has taken the lead in stimulating public discussion on the importance of monetary policy in the nation's economy.

Today the public is more aware than ever of the impact of monetary policy and interest rates on jobs, inflation, production and economic growth. The heightened awareness is due partly to the persistent efforts of this Committee, partly also to the wrenching experience of 1974 when interest rates climbed to levels we could not have imagined previously. The public and Congress now recognize better than ever the importance of the Federal Reserve's conduct of monetary policy and regulation of the banking system, the need for regular oversight by Congress, and greater accountability to the public on the part of the Fed -- in short, the provisions embodied in H. R. 8094, the Federal Reserve Reform Act of 1977.

This Committee has done a thorough job of laying the groundwork for this legislation. The FINE Study (Financial Institutions and the Nation's Economy) in the 94th Congress heard from scores of witnesses about the need for financial reform, many of them directing their testimony to the need for changes in the Federal Reserve System. The landmark Committee study, "The Federal Reserve Directors -- A Study of Corporate and Banking Influence" of August, 1976, spelled out in great detail the way in which the Federal Reserve System has become dominated by a fairly narrow range of interests.

No more studies or hearings are needed. Every aspect of the issues dealt with in this legislation has been well explored. What is needed now is legislation addressing the problems that have been identified in the Federal Reserve System, and enhancing the role of Congress in oversight of monetary policy in the coming years.

This legislation goes directly to the chief concerns that have been raised.

A. Requiring a quarterly dialogue on monetary policy.

The experience with H. Con. Res. 133 in the 94th Congress gives us every reason to make the practice of mandatory quarterly appearances before the Banking Committees of the House and Senate a permanent part of the statute. The dialogue is a most constructive two-way affair. It gives the Fed a forum for explaining its policies to Congress, and gives Congress an institutionalized forum for raising questions and expressing its own concerns.

The Fed is expected, after all, to be responsive to Congress. It was never intended to be entirely independent of Congress, as has been well recognized for some time. For instance, in hearings on the President's economic report before the JEC in 1960, Mr. Patman asked former Fed Chairman William McChesney Martin: "Would you agree, Mr. Martin, that the only authority for issuing money and regulating the value of money is the Constitutional authority of Congress?" And Mr. Martin replied, "I have never questioned the authority of Congress."

It is extremely important that the views of Congress be made explicit to the Fed. The Fed is, after all, not infallible, and in fact has had a rather spotty record over the years in management of the money supply. During 1972 and 1973, for instance, the Federal Reserve expanded the money supply by up to 9 percent annually. The Fed was warned repeatedly by Members of Congress, including Members of this Committee, that too rapid an expansion of the money supply would be inflationary. And we saw inflation grow from 3.3 percent in 1972 to 6.2 percent in 1973 and up to 11 percent in 1974. Beginning in 1973, apparently recognizing that its money supply policies were causing inflation, the Fed began to slow down the money supply. Then in mid-1974 the Fed abruptly put on the brakes, dropping the money supply to an annual growth rate of just 1.5 percent between June, 1974 and January, 1975. Together with the on-going inflation, the result was a prime rate at 12 percent and Treasury bills at 9.6 percent, with disastrous effects on the economy. Perhaps had H. Con. Res. 133 been in effect during that period, the worst excesses of that experience could have been avoided.

H. Con. Res. 133 required the Fed to testify only on targets for monetary growth for the ensuing year. The requirement in this bill that the Fed testify also on anticipated velocity, estimated levels of interest rates, and the composition of the Fed's portfolio is a worthy addition to H. Con. Res. 133. It will contribute greatly to the public's understanding of monetary issues, and will help make the Fed more accountable to Congress in a completely appropriate way.

B. Broadening public representation on the boards of directors of the Federal Reserve Banks.

The summary conclusion of this Committee's staff study of Federal Reserve Directors was very well put -- namely, that "the Federal Reserve Directors are apparently representatives of a small elite group which dominates much of the economic life of this nation." It has been true, as the study noted, that the list of the Federal Reserve Directors reads like a page out of "Who's Who in American Corporations."

Mr. Chairman, the boards of directors have been too narrowly dominated by bankers and businessmen. There are many others who have just as much expertise and certainly as great an interest in the policies of the Federal Reserve. The requirement that Class B directors be considered "public" representatives, as well as Class C directors, and that both groups represent consumers, labor, and services as well as agriculture, commerce, and industry is well conceived.

And while it should not have to be stated that directors be chosen "without discrimination on the basis of race, creed, color, sex, or national origin," the record of the Fed indicates that such a statutory requirement is indeed advisable. It is interesting that until this Committee and its Chairman launched a campaign during the 94th Congress to end discrimination in the Fed, not a single woman and only five minority representatives had ever been counted among the 1,042 persons who had served on the boards of directors during

the history of the Federal Reserve. The Fed should be commended for its recent steps to end discrimination. I believe reinforcement of the Fed's effort with explicit statutory requirements would be highly desirable.

C. Requiring Senate Confirmation of the Chairman of the Board of Governors.

The Chairman of the Federal Reserve Board is one of the most powerful positions in the United States. It is almost inconceivable to me that a person can be appointed to that position for a period of four years without undergoing the same process of Senate confirmation that governs far less important positions in the federal establishment. For the position of Chairman, the Senate should have an opportunity to explore the nominee's qualifications and views above and beyond the examination it would customarily undertake for a person who would serve as only one of seven members of the Board of Governors. It is time to remedy this omission.

D. Restricting Lobbying by the Fed.

Mr. Chairman, one need not have been around Congress as long as I have to be painfully aware of the intense lobbying activity that seems to arise whenever a bill opposed by the Federal Reserve is before the Congress. Members are swamped with calls and visits from bankers and businessmen. It has been evident that this intense lobbying activity is no spontaneous grass roots affair.

Not until the minutes of the boards of directors of the Federal Reserve Banks became available to this Committee recently, however, has it been documented how extensively this lobbying has been orchestrated by the Fed itself.

If the Fed wishes to kill or modify a particular piece of legislation, it has a powerful network of friends from the biggest corporate board rooms to the smallest banks that it can call upon. When Members of the Board of Governors attend meetings of the regional Reserve Bank boards of directors to urge them to lobby against a GAO audit of the Fed, and to encourage their friends and associates to join the campaign, a powerful network of influence is unleashed. The problem is especially serious in the case of directors who are bankers subject to the regulation of the Fed, and who are asked to join in the lobbying effort. The Fed has a powerful hold on these bankers. It can approve or disapprove a bank merger or holding company acquisition. It can approve or disapprove a loan to a bank from the Federal Reserve discount window. The bankers are naturally anxious to respond to the Fed's plea for help.

Officials of other agencies of the government have been specifically forbidden by law (18 U. S. Code, 1913) from the kinds of lobbying activities disclosed by the Fed's own minutes. The Fed is exempt only because of the technicality that its funds are not appropriated by Congress. This is a loophole which should be closed. It is no more acceptable for the Federal Reserve to use

its officials or directors to lobby on behalf of the Fed's interest than it would be for members of any other regulatory commission to enlist the industries they regulate in lobbying efforts.

No one wishes to limit the rights of any citizen to petition his Congressman. But the limits to the propriety of such activity in the case of officials of the government are well recognized in law.

I strongly endorse the provisions of H. R. 8094 which apply to the Fed restrictions against lobbying similar to those that apply to other agencies of the government.

#### E. Preventing Conflicts of Interest.

Public trust in government is one of the fundamentals for the success of democratic government. Unfortunately, public opinion polls in recent years have shown a strong element of distrust in government. One factor that feeds such distrust is the revelation from time to time of conflict of interest on the part of government officials. Therefore, it is essential that every effort be made to prevent conflicts of interest.

While I have great confidence in the integrity of the Federal Reserve and its officials, the minutes of the Federal Reserve board of directors do reveal that conflict of interest situations may not always be satisfactorily resolved. So it is important that potential conflict of interest situations be explicitly dealt with in the statutes.



The Federal Reserve has not been covered by the same conflict of interest statutes that govern employees and officials of other departments and agencies. H. R. 8094 would extend to Federal Reserve Bank officials, employees, and directors the same prohibition against participation in possible conflict of interest situations that apply elsewhere. It should become a part of our body of law.

\*\*\*\*\*

The changes proposed in this legislation are hardly revolutionary, but they are important. They hold the Fed more accountable to Congress and to the public in the conduct of monetary policy and regulation of banks, without compromising the essential independence of the Fed originally intended by Congress. They increase the participation of a broader segment of the public in the operations of the Fed. And they apply to the Fed the same strictures against lobbying and conflicts of interest that apply to other agencies of the government.

Mr. Chairman, I would like to commend you and this Committee for undertaking the important reforms embodied in this legislation.

The CHAIRMAN. Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Mr. Chairman, I join you in commending our distinguished majority leader for his very excellent statement on H.R. 8094.

I have been on this committee for 13 years; and in all of the years that I have been on the committee, we have been attempting to bring a closer relationship between the Congress of the United States and the Federal Reserve Board.

I have many times made the statement that I don't like the word "independent" to begin with. You know, this business of "independence"—it is dependent upon the Congress. We are a Nation that has been built upon a party system; and I think, in order to get wet, you must jump into the pool.

And the fact that, on this committee we have had legislation to audit the Federal Reserve Board, and then we had an amendment to that legislation, and then the minutes of the Open Market Committee, where we said they would be made available a year later and then that legislation was defeated—we have been toying with the idea of a coterminous term for the Chairman of the Federal Reserve, with the President of the United States. I have never really seen anything wrong with that. I thought that was an excellent idea.

Now, to broaden the membership to include different segments of our community seems a logical step; and I applaud you for taking the time out this morning to give us your views on the legislation.

But, Mr. Wright, do you see anything in H.R. 8094 that in any way would impede the Federal Reserve Board in doing its job of regulating the monetary policy of our Government?

Mr. WRIGHT. Mr. Annunzio, I don't see anything that would impede it in doing its job. It would make it responsive to the Congress and responsible to the people's elected representatives. I think that is what was intended in the very beginning.

I don't think Congress intended, as you have suggested, to create a completely autonomous group of people to make decisions of such total magnitude and such great consequence to the whole economy of the entire United States and to be unreportable to anybody.

Surely Congress did not intend to create a group of people not answerable to Congress, not answerable to the President, not removable by the people nor by the Congress, not even identifiable by most of the people, not answerable in the sense of the appointment of the Chairman of that group being subject to confirmation by the U.S. Senate.

I don't think that was really intended.

Of course, the decisions made by the Federal Reserve group, unelected people, have a profound effect. They can vitiate and set at naught the clear, purposeful intent of the U.S. Congress. We have to go back only a couple of years to have a perfect and shocking example.

Congress, in the early part of the last Congress, in 1975, intentionally and purposefully voted a tax reduction act. The reason Congress did it was to make more money flow and lubricate the machinery of prosperity so we could pull ourselves out of the recession.

The Federal Reserve, unelected, unanswerable, on its own, unilaterally decided that Congress was wrong, apparently, and set at naught, vitiated the effects that we had intentionally set in motion.

In late spring or early summer, the Federal Reserve practically doubled the interest rates of short-term securities and halted the recovery in its tracks, stalling the revival of the economy and utterly doing away with the congressional initiative.

Now, I just don't think that ought to be tolerated.

Mr. ANNUNZIO. Mr. Wright, as you know, virtually every other agency in our Government is controlled by provisions such as have been outlined in H.R. 8094. Do you have any evidence to show that these other agencies have been hampered in performing their job because of these controls?

Mr. WRIGHT. Well, Mr. Annunzio, quite frankly, I don't think anybody could make a showing that the modest controls that are proposed in this bill have hampered any other agency of Government in performing its functions.

I suppose we could find restrictive language that has at times been placed around other agencies and departments and encumbered them to some degree, but certainly nothing of the type that is encompassed in this bill.

Every other agency that I know anything about is required by law to comply with these fundamental guidelines; and I can't see any reason on Earth why the Federal Reserve Board should be sacrosanct and exempt.

Mr. ANNUNZIO. I thank you for your very constructive contribution. My time has expired. Thanks for being with us.

The CHAIRMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Mr. Wright, we are always pleased to see you; and I don't know—you could quickly correct me: either you used to be, or somehow a long time ago, a bank director yourself. Is that true?

Mr. WRIGHT. No. I never have been a bank director. In the past I was a bank depositor. [Laughter.] More recently, I have been a borrower. I have owned some stock which I inherited from my parents' estate in a small bank. But that is the extent of my expertise in the question of directing banks. I could not claim that I know much about directing a bank.

Mr. STANTON. I am glad you corrected me on that. I wasn't sure. But I was getting at the point.

As I said earlier, we are very pleased to see you; and I wonder, are you appearing in your role as truly one of the most respected Members of Congress, most knowledgeable, and a man I follow more times than I don't; or are you really in a capacity to lend this legislation in your leadership role, the approval of the basic idea from the leadership?

Mr. WRIGHT. Well, nobody ever can divorce himself completely from his own convictions; and he should not try to. I believe in this kind of reform. I believe in it as a Member of Congress.

I just happen to feel that the decisions of the Federal Reserve are very fateful. They profoundly affect the lives of every American; and I think those Americans are entitled, through their elected repre-

sentatives, to have some greater degree of influence and control over the policies that are made.

I don't impugn any false motives or bad motives to anybody who ever has served on the Federal Reserve Board. That is not my purpose. I think they are sincere people. I do think sometimes they are out of touch with the average people in the country and out of touch with what is necessary to make the economy grow.

And for that reason, it seems to me that, as I said, as a citizen and as a Member of Congress and as a spokesman for the majority, in all of those roles, I favor this basic legislation.

Mr. STANTON. Last week I had an opportunity to speak to some of the government people of France and some French bankers. In listening to them talk, I could not draw the conclusion whether or not the majority of the big industrial businesses owned more banks or the banks owned more industrial businesses, it is so interrelated.

I don't know how you could ever separate the two in a country like France.

And one of them made an interesting remark to me. He said:

You know, you people in the United States of America are most fortunate in probably having the best fiscal system ever devised in modern times.

Would you agree with that?

Mr. WRIGHT. I must confess to you, Mr. Stanton, I am not an authority on fiscal systems in vogue in other countries.

Mr. STANTON. But he was speaking about, you know, we have 14,000 banks and the separation of the banks and the investment business and the security business and so forth.

Mr. WRIGHT. The conclusion does seem plausible to me. Yes; I would have to say, on balance, that our banking system in the United States is a good one. I don't disparage it at all. I just think it ought to be strengthened. And I think that the Congress of the United States has a rightful role to play in a dialog over far-reaching policies.

Mr. STANTON. In colloquy there with Mr. Annunzio, in pointing out one example that you felt was bad and the rising of the price of money and so forth in 1972 and 1973 and you felt Congress should do something about that, and so forth and so on. Do you think Congress should have full authority over both the monetary and fiscal policies of our country?

Mr. WRIGHT. When you ask the question, I think it is necessary for us to understand what we mean when we say "full authority." Obviously, it would not be well for us to require all 435 Members of the House or all 535 Members of Congress every time interest rates go up or down to have a vote on the House floor. That would be unwieldy. I don't believe that it would produce a professional result.

Obviously, it is necessary for people with understanding and expertise to have enough flexibility to manage and control the Nation's money supply, its growth and the velocity of its growth and the effect that it has on interest rates, because interest rates just deeply affect the lives of all Americans.

Now, to the end that Congress should set broad policy, yes; I think Congress should set broad policy.

Mr. STANTON. In both the fiscal and monetary areas?

Mr. WRIGHT. Yes; I think so. I don't think Congress can administer the specific day-to-day decisions any more than it could make the day-to-day decisions about operating the Army or the Navy or any other agency of the Federal Government.

But broad policy, yes; I think Congress should, indeed. At least, it ought to have views and a regular forum in which its views are capable of being communicated to those people whose responsibility it is to carry out policy.

Mr. STANTON. Well, I would be glad to discuss my own thoughts with you at a later time on that. We sure don't agree on that. But my time has expired.

The CHAIRMAN. Mr. Hanley?

Mr. HANLEY. Thank you very much, Mr. Chairman.

I, like all of us, am delighted that our esteemed majority leader took the time and the initiative to be the first witness this morning.

I am further delighted with the content of your testimony and, in particular, one sentence part, about the regulating the value of money is the constitutional authority of the Congress. And I have been a long, long-time critic of the virtual autonomy of the Fed.

I am delighted that we are dealing with the legislation that is in front of us, and am delighted with your support in its behalf.

And, as you have essentially said, under the concept that has prevailed, in my judgment, for far too long, the Fed has virtually unlimited authority to make decisions, establish programs and policy that have such a dramatic effect on the economy of this country. And they are not—do not have to be responsive to the will of the majority of the American people.

If their judgment happens to be poor—and I am also delighted to note the fact recognized that those who are associated with the Board are representative of really only corporate America—but if their judgment falters, with a negative effect upon the economy of the United States, the Congress has to respond and react—and defend, for that matter—without really having had any input into a judgment that resulted in that subsequent economic defect.

And I, on a number of instances in this committee, would say to Dr. Burns:

At what point in time are you going to change that policy, where you are turning the tap off from the standpoint of money supply, in an effort—supposedly in an effort to get at inflation—when you are not accomplishing your goal, and in America that policy has produced a phenomena whereas we have intolerable inflation along with recession?

But the plea that some of us made—the reaction was like the proverbial “water off the duck's back.” So you can express yourself, but that is as far as you go.

So, in any event, I am delighted that I am in good company with you, Mr. Wright, and that apparently we are on the same frequency.

I want to commend, in particular, our chairman for the initiative that he has taken and the determination and the persistence that he has evidenced in an effort to get at the root of his problem.

I might ask you a question. I understand that next up we are going to hear from representatives of the consumer groups and a recom-

mendation, as I understand it, is that three people, representative of consumers, would be sitting on the Board. What would your opinion of that be?

Mr. WRIGHT. Well, I think it is highly appropriate. Mr. Hanley, the decisions that are made by the Federal Reserve Board affect consumers all over the land. There has persisted a somewhat outmoded concept, in my judgment, among some of those serving on the Federal Reserve Board, to the effect that the only way successfully to fight inflation is to raise interest rates.

Now, I just don't happen to believe that's true. At one time, it might have been true; but it certainly is not true today; and the evidence of the last few years brings sharply into focus the fallacy of any such doctrine as that—when a few people can sit down and unilaterally make decisions which raise interest rates to the levels they reached in 1974.

They affect the lives and futures of consumers all over the United States. It isn't just bankers who are involved in interest rates; and it isn't only direct borrowers from banks who are involved in interest rates.

The rise in interest rates is more inflationary and more depressive to the economy simultaneously than almost any other action one can imagine.

Dr. Leon Keyserling, who was the Chairman of the Council of Economic Advisers under President Truman, put it rather well, I think, once when he made this comparison. He said :

When you raise the price of steel, that is more inflationary than when you raise, for example, the price of artichokes, because steel is used in the production of more end commodities than artichokes.

Then, he asked the question, "What commodity is used in the production of more end commodities than anything else?"

And the answer, of course, is borrowed money. When you raise interest rates, you raise prices at every level of the economic structure; and when you do that, you layer in an extra weight upon the back of the final consumer, who, in his final purchase price, is paying those increased interest rates that have been assumed by the manufacturer, that have been assumed by the wholesaler, that have been assumed by the retailer. And he gets a triple dose.

So, it seems only logical to me that decisions which so profoundly and vitally affect his well-being as a consumer are decisions which ought not to be made in a vacuum, absent his input or his opportunity through some spokesman to have some say about what is happening.

Mr. HANLEY. I appreciate that response; and I think, again, evidence of the necessity for this legislation is vested in the fact that this Congress this year has had to appropriate something like \$15 billion in "antirecession programs." And I believe that the reason for the necessity for that lies in defects in Fed policies.

Again, I appreciate your appearance.

And I thank you, Mr. Chairman.

The CHAIRMAN. Mr. Mitchell?

Mr. MITCHELL. Mr. Chairman, because I was late getting in, I will defer my questions.

I apologize to our distinguished majority leader. I have your testimony in front of me; and I assure you, sir, that I shall read it, or I shall scan it—and “scan” really means read word for word. But I will defer the questions.

The CHAIRMAN. Mr. Rousselot?

Mr. ROUSSELOT. Thank you, Mr. Chairman.

It is always a pleasure to have our distinguished majority leader here.

Mr. Wright, many of us have supported the Senate-passed version of House Concurrent Resolution 133, which had the following statement in it—and as a matter of policy of this committee in our relation with the Federal Reserve Board—and I notice it is absent in this resolution—and that was as follows:

The policy of maintaining the longrun growth of monetary and credit aggregates commensurate with the economy's longrun potential to increase production so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

The thing that made that attractive to me, aside from the fact that part of the language came from the Full Employment Act of 1946, was the requirement that we were suggesting in policy to maintain a long-run growth of monetary and credit aggregates commensurate with the economy's longrun potential to increase production.

In other words, we tried to relate it to potential output increases.

Would you object to our including that kind of policy statement in this language?

Mr. WRIGHT. Mr. Rousselot, I would not presume to suggest to the committee what it should or should not include by way of specific language. Everything I have said has been fundamentally conceptual.

Certainly the goals you have expressed and the language you have just read are goals that most of us embrace, I should think. I think most of us want to achieve the kind of steady and consistent and orderly growth in the economy which will support maximum employment, minimum inflation, and moderate long-term rates.

I don't suppose there is a person here who would not endorse those fundamental concepts. But as for the writing of specific language or a statement of basic principles. I think I should leave that to the members of the committee.

Mr. ROUSSELOT. Well, do you think there should be, in our policy statements, some relation to potential output increases?

Mr. WRIGHT. I don't think anything can be considered apart from its rightful relation to productivity. I think that is one of the problems that has been encountered by those who truly believed in the old laissez-faire manner that one way to curb inflation was to have high unemployment. Well, you know, it just hasn't worked that way. It doesn't work that way anymore; and one of the reasons it doesn't is because when you have a plant operating and the Nation's economic plant operating at 60- or 70-percent capacity, you incur inordinately high relative overhead costs which reduce individual worker productivity.

If that plant is operating at 95-percent capacity, individual worker productivity and unit costs are affected. Productivity goes up; unit cost goes down.

And so, it seems to me that the question of worker productivity and economic growth and full utilization or somewhere near full utilization of the Nation's economic plant capacity are quite compatible goals.

Mr. ROUSSELOT. So, I assume your answer is "yes"?

Mr. WRIGHT. I have forgotten what your question was.

Mr. ROUSSELOT. If we might include in our statement of policy here that there should be some relation to potential output increases.

Mr. WRIGHT. I have no objection to it, Mr. Rousselot.

As I say, I am not trying to dictate the precise terms of the legislation.

Mr. ROUSSELOT. Well, I just hope, in some of the mandates that we have in this bill, that we do better with this than we did with the Post Office. That is all I have to say.

Mr. WRIGHT. To that, I would add, "amen."

The CHAIRMAN. Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

And Mr. Wright, thank you for being here to express your opinions.

I personally think this is generally a good bill. It certainly addresses some problems that have gone unaddressed for some time.

I, though, have a problem with the emphasis on interest rates that you addressed, Mr. Wright, and others have commented on, because there seems to be an understanding that the Fed could reduce interest rates at will and that that reduction would not have any impact on some other aspects of the economy. That seems to be what I am hearing anyway; and I would like to explore that with you for a minute, if I can.

If we had absolute control over the Federal Reserve, which I know is not suggested by this bill, it would seem to me—and knowing, as you pointed out, the impact of interest rates on our economy and how they affect everyone—that if we had the ability here, if we had the control over the Fed, I would think that it would be our goal to bring down interest rates, and I imagine you would share in that goal; would you not?

Mr. WRIGHT. I would ardently hope for it.

Mr. NEAL. It is my further understanding that the only way that the Fed can bring down interest rates is to increase the supply of money; is that not correct? Or is there some other way?

Mr. WRIGHT. I am going to leave the answer to that question to some of the rest of you on the committee. I am not at all sure that that is a total and complete answer.

Certainly the supply of money has a profound effect upon the proper interest rate. There is no question about that.

It seems to me, though, that the idea of controlling inflation by manipulative raising of interest rates and restriction of the amount of money flowing is fallacious. I don't think it works anymore.

I think any objective review of the last 20 years would reveal that it does not work. High interest rates surely have provided the primary reason for the decline in housing and for the inordinate escalation of the price of housing. A young family today seeking to buy a very modest home for, let us say, \$40,000, which certainly is not a



mansion, must pay in the normal amortization at prevailing interest rates, more than twice that amount, almost three times that amount, before he gets the home paid for.

It is paying much more for the mere privilege of borrowing the money than it is for the land, the labor, the materials, the construction, the house itself.

The major part of the cost of that house to that young couple is interest. They can't afford it. We know they can't afford it; they know they can't afford it.

And so, surely, it seems to me, that anything which produces more acceptable interest rate ranges must be good for the whole economy.

I just think, if you look over the last two or three decades or more, you can draw two parallel lines: one line being the economic level, the health of the economy; the other line being the level of interest rates. And I believe you will usually conclude that increases in interest rates have preceded a reduction in economic activity and have preceded an increase in unemployment. And I think those are things we can't afford in this economy.

Mr. NEAL. Let me say I couldn't agree with you more. You described the problem quite correctly; and I think we are all trying to get at the problem of high-interest rates. I think the question, the fundamental question, is how best to do that. And I think that is really what we have to come to some mutual understanding of.

It is my understanding that if we print a lot of money to bring down interest rates in the short term, that, in fact, we can do that. But the inevitable effect of that, in the long term, will be even higher interest rates, because we will, by that action, increase inevitably the rate of inflation. And it seems to me that that can be seen as a consistent trend whenever it has happened. And the question then becomes, "How do you deal with not only the short-term problem, but the long-term problem?"

I guess the Fed could bring interest rates down tomorrow to a considerable degree, just by beginning to print a lot of money. Money would be more available and thus cheaper. But the inevitable result of that, it seems to me, is inflation down the road, and it is because of that time lag that we don't always see that relationship.

And even though the bill doesn't call for it, it does seem to me that if we only focus on interest rates, that—and only focus on the short term—that we are going to pay a very high price for it.

Mr. WRIGHT. Well, I think surely one would have to agree with that; and I don't believe that the bill contemplates a focus only on interest rates or focus only on the short term.

We have to look at these things on a long-term basis and understand where we are going and where we intend to go and have some control over it.

Mr. NEAL. I thank you. My time has expired.

Mr. HANLEY [presiding]. Thank you, Mr. Neal.

Mr. BROWN?

Mr. BROWN. I was late; so I believe the other members should have an opportunity to go first.

Mr. HANLEY. Mr. Kelly?

Mr. KELLY. Thank you, Mr. Chairman.

Mr. Wright, in your testimony, you said the supply of money has an impact on interest rates. And also in your testimony it seemed as though we in this country have just one problem, really, and that is the Federal Reserve Board; and if we can get a little more democracy into the Federal Reserve Board, that is, have labor have a little stronger voice in the operation of the Federal Reserve Board—and I think you equate that with direct input by the people—that then we won't have any more problems because interest rates are the predicate for all fiscal difficulty and all monetary difficulty, and the action by the Fed in reducing the money supply has really caused all of our difficulty.

Now, isn't this overlooking the proposition that when the Federal Government moves into the money markets with huge deficits that this Congress has piled up over recent years, doesn't that have an adverse effect on the money supply, the same as activity by the Fed?

Mr. WRIGHT. Mr. Kelly, there is no question that it does. And I think what you have said might be a rather gross oversimplification of what I have been suggesting.

I don't suggest to you, by any manner of means, that a sole cause of the problems of the country is the Federal Reserve Board, nor would I presume to suggest that enactment of this bill will solve all the problems of the country. There are other problems as well.

What I am saying, I think, is that it just makes sense to have a broader view and a more general public view available in the discussion of something as profoundly fateful to the American public as the determination of the monetary supply and interest rates.

The Federal Reserve Board regulates banks; and yet, its system is so constructed that it is made up of bankers.

Now, let me just ask you: Do you think it would make sense if we were to say that the Federal Power Commission should be made up only of power producers? Do you think if would make sense if we were to say that the Interstate Commerce Commission should be made up only of those who are regulated—the truckers and the railroad owners and so forth—and that nobody else would have any right to have a say?

I don't believe you would embrace any such doctrine as that; and therefore, I don't know any reason why you should embrace such a doctrine with respect to the Federal Reserve Board.

Now, yes, with respect to your question about the effect of Federal deficits upon money supply and the effect of Federal deficits upon inflation, there can be no question—debt itself is inflationary, to the end that it uses money—not only that which is in our pockets but that which we don't yet have to bid up the price of goods.

Mr. KELLY. Let me ask you this: Aren't we really moving toward, this legislation, a situation where the same forces that caused this Nation to have a \$700 billion debt to have all of these deficits each year, and that being a minor part of it, that we have in excess of \$3 trillion of obligations that the people of this country have to pay, and this has all been done by Congress, and that now we are going to let the Congress get into the monetary system as well as the fiscal system, and that when the forces can work on the monetary system the same way they have worked on the fiscal system, we can follow New York right down the

tube at an accelerated rate? Because there is nothing to indicate that the Congress is going to exercise any reponsibility.

The \$700-billion debt is really the good news. The \$3 trillion that we are in debt is probably the bigger lump. And what has Congress done that would recommend to you that we ought to increase the control of Congress over the Fed?

Mr. WRIGHT. Mr. Kelly, an extension of your argument might conclude that Congress hasn't got sense enough to control fiscal policy and, therefore, we ought to create some autonomous board out here and let them set taxes and surrender and abrogate the responsibilities of the Congress for doing that.

I don't happen to have that lack of faith in this system. I think the people's elected representatives, by and large, are going to make right decisions. I suppose if I did not believe that, I would not believe in this thing we call democracy. I believe in the representative system, and I think it is incumbent upon us, as elected representatives of the people, to behave in a responsible fashion in the decisions that we make.

Mr. KELLY. Just let me ask you this one question about the interest rates and housing.

You seem to indicate that interest rates are what are responsible for housing slowdowns.

Mr. WRIGHT. You don't think they are?

Mr. KELLY. No; I don't think they are. I think the fact that houses now—the price of a house is up over 100 percent in recent years has something to do with it. If you are suggesting that we don't care what the price is, the American public—they just want to know what the interest rate is—then I think that your suggestion is sound. But I think the American public still wants to know how much something is going to cost, and the price of everything in a house has gone up, and that has to do with the amount of interest that has to be paid, and I just ask you, isn't this suggestion that interest rates really are what caused the slowdown may be an oversimplification?

Mr. WRIGHT. I think it is one of the major contributing causes to the economic slowdown. I really do. I think increased interest rates always, or almost always, cause economic slowdown. I believe that is a supportable conclusion.

And with respect to the price of a house, I believe you will conclude that the major part of what a young family would have to pay if it amortizes and pays off its house is interest rates. And I do believe that the American public is intelligent enough that it wants to know what it is going to be paying in interest.

If we have concluded that debt is inflationary, I don't think it does us any good just to make it easier to get into debt and harder ever to get out of debt, and yet that is what happens when the interest rates go to an inordinate level. It doesn't stop people from going into debt, necessarily at least not until it gets to the point where nobody can afford it. It does make it harder for people to get out of debt. It seems to me that a better policy would be making it a little harder for people to get into debt, maybe, rather than making it harder for them to get out of debt.

Now, we are talking about broad, philosophical terms here, but I certainly would not agree to what appears to be your fundamental conclusion, that the people's elected representatives in Congress lack the intelligence to address themselves to monetary policy. I don't believe that's true.

Mr. KELLY. You don't have any examples to indicate that that is not true, do you?

Mr. WRIGHT. Well, I think we, in general, with all of our faults and all of our flaws and our mortal imperfections in the Congress of the United States have done a fairly creditable job of running the country. Perhaps democracy is not the most efficient form of government, but I believe it is the safest and, in the long run, the best for people. And if I didn't believe that, as I said a moment ago, I don't know that I would want to be in the Congress of the United States. I don't suppose I would believe in democracy and this representative system that we have.

No, we are not all wise, those of us in the Congress. We are probably, as the late Hale Boggs once described us, a collection of ordinary men and women grappling with extraordinary problems. But I don't think we solve those problems by abrogating our responsibilities and just turning them over to somebody else and saying, you fellows take care of that and we are going to look the other way; we don't think we are smart enough.

If we don't have that much confidence in our collective wisdom and in our collective responsibility, then I don't think we have any business being in Congress.

The CHAIRMAN [presiding]. The time of the gentleman has expired. Mr. Blanchard?

Mr. BLANCHARD. Thank you, Mr. Chairman.

We seem to have strayed a little bit away from the bill.

I would like to ask you two quick questions—and I know you probably have other scheduling commitments this morning.

It is not in the bill, but it has been suggested that the Chairman of the Board of Governors of the Fed should have a term that runs co-terminus with that of the President.

Do you have any feelings on that either way? That is something that could be an amendment offered to this bill.

Mr. WRIGHT. Well, there might be some justification for it, yes.

A President of the United States finds himself to some degree hamstrung, I should think, if he can appoint the Cabinet officials but must necessarily be saddled with a holdover from a previous administration who directs anything so essential and so vital as monetary policy.

Now, if the President is entitled to have those people in policy-making positions and Cabinet secretaryships, if he is to carry out the purposes of his administration it seems equally important to me that a new President should have the opportunity to have someone harmonious with his economic aspirations and his economic goals serving as Chairman of the Federal Reserve Board.

Mr. BLANCHARD. Thank you.

One other question: Have you discussed this legislation at all with the President?

MR. WRIGHT. No, I haven't had that opportunity, Mr. Blanchard.

MR. BLANCHARD. Thank you for your time.

MR. MITCHELL. Would the gentleman yield?

MR. BLANCHARD. I would be happy to yield to my colleague from Maryland.

MR. MITCHELL. Mr. Wright, I just want to make sure I understood your responses properly.

As you know, I have introduced a bill calling for Senate confirmation of the appointment of the Federal Reserve Board Chairman and the Vice Chairman—that is, H.R. 6273—and also regularizing the appointment to come 1 year and 12 days after the inauguration of the President. You responded in terms of the regularizing of it and responded in the affirmative.

Would you briefly respond to the matter of Senate confirmation of the appointment of the Chairman of the Federal Reserve?

MR. WRIGHT. I would be happy to, Mr. Mitchell. In fact, in my initial testimony, I did so. I definitely believe that the Senate should have the opportunity to confirm any appointee who would serve in a position of this importance. I think I said that the Senate does have the responsibility and the right to act in confirmation of officials of much lesser and less-grave responsibilities, and that it seems only proper that the Senate should have the opportunity to examine the credentials and the views and the background and the qualifications of a nominee for the position of Chairman of the Federal Reserve Board.

MR. MITCHELL. Thank you very much.

And I thank the gentleman for yielding to me.

MR. WRIGHT. And I commend you, Mr. Mitchell, very strongly for the foresight which encouraged you to introduce that legislation. I think you are on the right track. I am here in support of your initiative.

THE CHAIRMAN. Mrs. Spellman.

MRS. SPELLMAN. I want to thank the gentleman, the distinguished majority leader, for his excellent statement delivered with his usual eloquence. I always enjoy hearing you talk.

MR. ANNUNZIO said earlier that he had been here for 13 years and that he felt that there ought to be a change, and I must say that I have been here for less than 3 years and I found it was absolutely shocking that the Fed is insulated from and impervious to the directions in which the Congress attempts to move and the fiscal policies which it attempts to set. It just makes perfectly good sense to me that monetary policy should complement and not thwart the fiscal directions set by the Congress.

I was interested that you used housing as an example, and it is very timely that you do so, because it was just this weekend that I was talking with a group of builders who were lamenting the fact that houses have gone so high, and someone who is not in the building industry pointed a finger at labor and said, oh, yes, labor has really sent the cost of housing up, and the builders turned to him and said, oh, no, it is interest rates that have sent housing costs so high, because as they start on a development or on the building of a few homes, they start with borrowed money, and all the way through the cost of money is so high, every time they turn—and they need to borrow money constantly—that by the time that house is ready, the interest costs have

driven the cost up to the point where young people cannot afford to buy those homes.

And so I don't intend to take a great deal of time because your statement is so explicit in itself, but I do want to compliment you for that statement, and for the comments that you have made since.

Mr. WRIGHT. Well, thank you very much, Mrs. Spellman. I fully share the conclusions which you have expressed.

Mrs. Spellman. I yield back the balance of my time, Mr. Chairman. The CHAIRMAN. Mrs. Fenwick.

Mrs. FENWICK. Thank you, Mr. Chairman.

Mr. Wright, like my colleagues, I am always amazed and impressed by the fact that every one of your sentences has a verb. [Laughter.]

Mrs. FENWICK. I wish I could say the same of my own testimony, when I see it in the transcripts.

And I, too, am here only 3 years, but my reactions, I am afraid, are quite different in this regard from my colleagues.

I wish that Mr. Stephens was still here to describe for us Mr. Carter Glass' reasons for establishing the Federal Reserve as an independent body and the difficulties that the enabling legislation was designed to correct, by setting up an independent Federal Reserve. But I remember one occasion when he was still with us in which this was very cogently and eloquently described.

As I understand it, as a member of the public, the purpose of the Federal Reserve Board is to see that we have sound banks in this country, and that we have a stable monetary situation. That is why Congress delegated to them, according to the description that was given us, the power to act in this field. It is absolutely essential to the economy of the country and far more essential than quick responses to political exigencies. We have to have a sound banking system which people can have confidence in, and it seems to me that to guarantee this, it is essential to keep politics out of our monetary policy.

But speaking of housing, it is also interesting that I, too, have just received a great deal of information concerning housing. This is contained in a study conducted for the Smith-Richardson Foundation by Rutgers University, and most specifically, by Dr. George Sternlieb, who, as you know, is a great authority in housing.

Well, as a result of this study—and I have here a chart—what affects the cost of housing in most cases is Government regulation itself—specifically, 9 Federal Government regulations, 5 State government regulations, 14 local government regulations—and the cost of financing only one.

Now, this is an in-depth study not just of one or two builders' opinions but a very careful and scholarly research effort. It is going to be published and it is going to be an enormous volume. It was reported in a preliminary fashion in the Wall Street Journal. The study goes into the government regulations that affect housing costs: environmental controls, zoning requirements, all kinds of building codes, current building costs and subdivision costs and energy conservation requirements. Then the study goes on to say that a Federal Real Estate Settlement Procedures Act is, as much as interest rates, a problem in the cost of buying a house.

And then, of course, he mentions, also, interest rates.

"It would be a welcome change if more Congressmen would take a look once in a while at information like this," writes the Journal concerning the Sternlieb report. "One would think that a new consumer agency might take as its job to put this kind of consideration before the rest of government. The spectacle might be worth the price of admission."

Now, we have excellent suggestions concerning the consumer interest, but I think that the primary concern—it seems to me, as a member of the public we must look to the Federal Reserve for something that is indeed independent. Certainly, they must report to Congress. Certainly, I think that the House Concurrent Resolution 133 was in every way a wise measure. Certainly, I see no reason why the Federal Reserve chairman shouldn't be confirmed by the Senate. All of these seem to me to be without any danger to an independent body.

But the first duty of the Fed is sound banking. I would be uneasy if I thought that the Federal Reserve Board was indeed not concerned with guaranteeing sound banks and not concerned with a stable economy and was bending to the whims of public members, such as myself, who might or might not understand the whole theory of banking.

So perhaps you and I arrive at the same conclusion from slightly different points of view.

Mr. WRIGHT. Mr. Chairman, before responding to the comments so aptly made by Mrs. Fenwick, may I express a personal problem?

On Friday when we adjourned, Speaker O'Neill expressed to me a question as to whether he would be here for the opening of business on Monday. I promised that I would check in at his office at 11:30 on Monday, and if he is here, would be present at his daily press conference, and if he is not here, would tend to those matters necessary preparatory to the convening of the House. And I am wondering, under those circumstances, if it would be possible for me to receive any other questions that might be available and respond to them in writing.

I am loath to do it, because I enjoy the colloquy with my colleagues and regret very deeply that some of them have not had the opportunity yet to express their thoughts to me.

I would say to Mrs. Fenwick that I have listened very carefully to the comments that she has made. Not only do all of her sentences have verbs, her logic contains verve.

Mrs. FENWICK. You are charming, as always.

The CHAIRMAN. May I ask those—I think starting with Mr. Hannaford—who have not had an opportunity to interrogate our distinguished witness would be willing to submit their questions, any questions they have. I know the majority leaders would promptly answer them for the record, thus enabling him to be dismissed.

Mr. BROWN. Well, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. BROWN. I certainly will not make it impossible for the majority leader to take care of his obligations to the Speaker. However, I would much prefer to have an opportunity to get into some of the things in his statement with him present so we could have the kind of open discussion and colloquy that we should.

For instance, his statements regarding the cost of housing and so on are just wrong. The facts prove otherwise. The cost of the median price of a home has gone up 100 percent while interest rates have gone up 30 percent. The cost of land has even exceeded the cost of a house at a rate greatly in excess—two or three times the increase in interest rates.

I think that maybe it might be edifying for him to have the opportunity maybe to participate personally in such a discussion.

The CHAIRMAN. If the gentleman from Michigan had been here during the hour and a half that Mr. Wright has been here, we could have had the benefit of such a discussion. However, I would hope if there are specific questions, they would be asked of the majority leader in writing.

Mr. WRIGHT. Mr. Chairman, I am apologetic. I just got another message asking that I come over there to the Speaker's office, and if it is not satisfactory to the members that I would respond in writing, I would be more than happy to come back at some other time, if that is what is desired.

I have been too long winded, and it is probably my fault, that I have taken too much time in answering various questions.

The CHAIRMAN. You have been most cooperative, and I think that members will take in good heart these constraints on your situation. I want to express on behalf of all of us our gratitude to you for coming here this morning, and we appreciate it.

Mr. WRIGHT. Thank you for your tolerance and your patience, for letting me be with you.

The CHAIRMAN. A statement by Dr. Paul Samuelson, institute professor, department of economics, Massachusetts Institute of Technology, has been submitted for the record, and that statement is in everyone's portfolio. Under the rule and without objection, that will be received into the record.

Is there objection?

[No response.]

The CHAIRMAN. Hearing none, that page will be printed in the record at this point.

[The statement referred to of Dr. Samuelson follows:]



Statement By  
Dr. Paul Samuelson  
Institute Professor, Department of Economics  
Massachusetts Institute of Technology  
Nobel Laureate in Economic Science

Since monetary policy affects incomes of different citizens, employment opportunities, and must compromise between different macro-economic aggregates, no independent body of appointed persons can be allowed responsibility for monetary policy. The Constitution gives to Congress ultimate responsibility in this area. The Board of Governors of the Federal Reserve System must, therefore, in the last analysis be responsible to Congress.

Along with most American economists, I approve of explicit legislation requiring the Federal Reserve authorities to report regularly and in detail to Congress, outlining the major goals to be achieved in the year ahead with respect to the overall level of income, production, employment, interest rates, and price levels. To insure responsible coordination of monetary and fiscal policies, the Chairman of the Board of Governors should be subject to approval by the Senate and should have a term of office that runs contemporaneously with the election of the new President. As a responsible government agency, the Board of Governors of the Federal Reserve System should be subject to conflict-of-interest rules and procedures and should be precluded from lobbying for Congressional legislation or from bringing influence upon the banks and holding companies that it regulates to engage in such lobbying.

The CHAIRMAN. We had expected at this moment to hear from Ms. Kathleen O'Reilly of the Consumer Federation of America who had to absent herself to testify before another committee.

Let us stay in session here for a few minutes. I will ask staff to inform us precisely when she will get here. I want to apologize to those members who did not have a chance to interrogate the witness.

Mr. BARNARD. Mr. Chairman, would it be possible to coordinate with the majority leader so that he can return for questioning during our hearings?

I personally feel it would be very helpful for us to have dialog with him, because he brought out some very interesting aspects of this legislation.

The CHAIRMAN. I hear what you and Mr. Brown have said, and I will see the majority leader and see if we can't ask for his return. I would say that we might be able to ask supplementary questions.

Mr. BROWN. Mr. Chairman, I would ask unanimous consent that page 28 of the budget issue paper put out by the Congressional Budget Office in January of this year be included in the record, since that page shows that median-priced homes in the period 1970-75 went up 67.9 percent whereas interest rates went up 6.6 percent.

[The information referred to by Congressman Brown, page 28 of the budget issue paper put out by the Congressional Budget Office follows:]

TABLE 11a. CHANGES IN COMPONENTS OF OVERALL HOMEOWNERSHIP COSTS, MEDIAN-PRICE NEW HOMES, 1970-1975

	Total Monthly Cost	Monthly Mortgage Payment	Mortgage Payment as a Per- cent of Total Hous- ing Cost	Sales Price	Inter- est Rate	Insur- ance	Prop- erty Taxes	Main- tenance and Repairs	Heat and Util- ities
1970	\$217	\$141	65%	\$23,400	8.45%	\$5.65	\$31.76	\$12.15	\$26.74
1971	230	143	62	25,200	7.74	10.09	37.89	13.20	26.27
1972	256	154	60	27,600	7.60	6.50	47.45	15.88	31.67
1973	305	187	61	32,500	7.95	7.84	50.63	20.82	38.54
1974	370	224	61	35,900	8.92	13.12	62.80	24.00	43.35
1975	396	248	63	39,300	9.01	10.68	64.98	26.45	46.21
Change 1970- 1975	82.4%	75.9%		67.9%	6.6%	89.0%	104.6%	117.7%	72.6%

SOURCE: See Table 4.

TABLE 11b. CHANGES IN COMPONENTS OF OVERALL HOMEOWNERSHIP COSTS, FIXED-QUALITY NEW HOMES, 1970-1975

	Total Monthly Cost	Monthly Mortgage Payment	Mortgage Payment as a Per- cent of Total Hous- ing Cost	Sales Price	Inter- est Rate	Insur- ance	Prop- erty Taxes	Main- tenance and Repairs	Heat and Util- ities
1970	\$268	\$173	64.6%	\$28,900	8.45%	\$6.93	\$43.25	\$14.89	\$30.05
1971	282	172	61.0	30,300	7.74	13.06	50.25	15.86	31.41
1972	299	180	60.2	32,200	7.60	7.79	56.42	16.64	36.28
1973	335	205	61.2	35,600	7.95	12.03	52.62	21.86	43.72
1974	388	243	62.6	38,900	8.92	13.12	62.80	24.00	45.35
1975	428	268	62.6	42,900	9.01	11.43	73.59	29.47	45.23
Change 1970- 1975	59.8%	54.9%		48.4%	6.6%	64.2%	70.2%	97.9%	50.5%

SOURCE: CBO computation based on data as in Tables 5a and 5b.

The CHAIRMAN. While we are waiting, the Chair will point out that we are going to hear this afternoon at 2 from Mr. Biemiller of the AFL-CIO, and we will know in a moment whether Ms. O'Reilly will be with us now or sometime this afternoon.

Mr. VENTO. Mr. Chairman.

The CHAIRMAN. Mr. Vento.

Mr. VENTO. Would the gentleman from Michigan yield?

Does that also indicate the increase in the price of housing and the increase in the price of loan costs in terms of housing in that article that you quoted from the Congressional Budget Office in January?

Mr. BROWN. If the gentleman will yield—all I am submitting are the tables from the CBO.

Mr. VENTO. That makes a significant difference, and I would like it entered in the record at this time.

Mr. BROWN. What is your point?

Mr. VENTO. Well, I haven't seen the article, and the gentleman from Michigan left the impression that income had gone up 68 percent.

Mr. BROWN. If the gentleman would yield, to the contrary, I have made no mention of income, rather the tables merely reflect the increases from 1970-75 in all aspects of cost and maintenance of homes, mortgage, utilities, et cetera, and the average figure for a median-cost home.

For instance, as I indicated, it shows the median cost of homes during the period 1970-75, went from \$23,400 up to \$39,300, which is a 67.9-percent increase, whereas interest rates during the same period went from 8.5 percent up to a 9.01 percent, which is a 6.6-percent increase. These figures are from your Congressional Budget Office. I don't think that office would put out figures that are tilted to the side or toward the argument that many of us are making on this side of the aisle.

Mr. VENTO. Mr. Chairman, my point is that the price of a home has gone up, and that compounds the effect of the interest rate.

In any case, I will examine the article.

The CHAIRMAN. I am told, members of the committee, that Ms. O'Reilly will be detained before the Interstate and Foreign Commerce Committee for another 20 minutes, and, accordingly, we will make an effort to schedule her this afternoon. In the light of that, we will recess the committee until 2 o'clock this afternoon, at which time we will hear from witness Biemiller and very likely also from Ms. O'Reilly and, if we can get him back, from the majority leader.

[Whereupon, the committee recessed for lunch.]

#### AFTERNOON SESSION

The CHAIRMAN. Good afternoon. The House Committee on Banking, Finance and Urban Affairs will be in order for continuation of its hearings on H.R. 8094.

Our first witness this afternoon will be a distinguished representative of the labor movement who is well and favorably known to this committee for his frequent and very valuable testimony, Andrew J. Biemiller.

Mr. Biemiller has a prepared statement on behalf of the AFL-CIO; and, without objection and under the rule, that will be admitted in full.

We would then like to ask you to proceed.

Ms. Kathleen O'Reilly, of the Consumer Federation of America, will be available later on this afternoon; and Congressman Jim Wright, the majority leader, will also be available for those who did not have an opportunity to examine him this morning.

All right, Mr. Biemiller, would you proceed, sir.

**STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL-CIO); ACCOMPANIED BY DR. RUDOLPH OSWALD, DIRECTOR, DEPARTMENT OF RESEARCH**

Mr. BIEMILLER. Mr. Chairman, my name is Andrew J. Biemiller. I am director of the department of legislation for the AFL-CIO.

I am accompanied by Dr. Rudolph Oswald, director of the department of research of the AFL-CIO.

We appreciate this opportunity to present the views of the AFL-CIO on H.R. 8094, the Federal Reserve Reform Act of 1977, introduced by the chairman of this committee.

H.R. 8094 was originally introduced as H.R. 7646, a version which included provision for regular audits of the Federal Reserve System by the Comptroller General of the United States.

We are pleased to note that audit legislation has been reported by the House Committee on Government Operations. Audit provisions do not, therefore, appear in H.R. 8094.

H.R. 8094 is a very modest bill in its remaining provisions. Of course we support it and gladly. But we believe additional reforms are needed to do the job in view of the magnitude of the problem being addressed, namely that of rendering the Federal Reserve System more accountable to the Congress and to the public.

It is a problem which the Congress, and particularly this committee, has struggled for years.

The Federal Reserve System is perhaps the most powerful of the Government's economic agencies. Its policies and decisionmaking have fateful consequences for the economy at large and for the lives of every citizen of this country.

As regulator of the money supply, it can produce recessions almost overnight by choking off funds to vulnerable segments of the economy, such as housing, small business, and State and local governments. By inducing rises in interest rates, it can raise the cost of doing business throughout the economy and generate price increases in everything we buy. Its responsibilities and the impacts of its decisions are truly awesome.

The System is a legal instrumentality of the Federal Government, but essentially it now represents the interests of the banking community and its large corporate customers.

This bias is built into the basic structure of the System. Created as an "independent" agency, it has become virtually immune to the requirements of national policy and the broader public welfare except as they may accidentally coincide with the public interest as perceived by bankers.

Endowed with its own independent income from loans and investments, it is beyond the power of the purse exercised by the Congress over its other more humble creations. Backed by its influential banking and business constituency, it can readily muster formidable clout to frustrate any legislative threat to its policies and its preferred methods of operation, including secrecy.

Quite logically, the bill leads off with a directive setting the broad framework of national economic policy within which the Federal Reserve Board should pursue its monetary policies. No such statement now appears in the Federal Reserve Act, leaving the Board totally at liberty to pursue its own version of national economic policy, with near disastrous consequences over the past many years.

Essentially, the directive is an adaptation of the goals set forth in the Full Employment Act of 1946, to promote "maximum employment, production, and purchasing power."

However, the bill substitutes the words "price stability" for "purchasing power". We believe the broader concept should not be eliminated, and suggest that the bill be changed to include "purchasing power" as well as "price stability."

The Federal Reserve System has in the past rather doggedly pursued "price stability" through economywide reductions in purchasing power, output, and production, regardless of the real causes of inflation. We would prefer that its mandate be clear that this singleminded course is not acceptable.

Second, the bill writes into permanent law the previous requirement under House Concurrent Resolution 133 for quarterly reporting on proposed monetary policy to the Banking Committees of the House and the Senate.

This is potentially an important vehicle for Federal Reserve accountability, particularly since it specifies additional information beyond mere monetary aggregates. Under the now-expired resolution, the Chairman of the Board, Dr. Burns, was successfully able to frustrate questions seeking to probe the underlying assumptions used in arriving at the overall monetary policy.

As noted by the late Nathaniel Goldfinger in testimony 2 years ago before this committee: "Questioning Dr. Burns about monetary policy and its related economic and social implications has been like pushing on a string."

We fully support the effort to obtain more meaningful information on the goals and assumptions underlying the goals on monetary aggregates.

Section 2 of the bill concerns the composition of the boards of directors of the regional banks. The amendments implement national antidiscrimination policy on race, creed, color, sex, or national origin. And they expand the economic interest groups from which class B directors may be selected to include "services, labor, and consumers."

These directors are to be designated as representing the public. This is a long overdue recognition of changes that have taken place in the economy of our Nation since the year 1913, when the present language was adopted.

Our question is why this logical updating does not extend to the remaining structures of the System, including the Board of Governors itself, the Open Market Committee, and the Federal Advisory Council.

Our position is that all of the governing and advisory committees of the Federal Reserve System should be operated under the same expanded representation format. Monetary policy should not remain a preserve of the banking community.

Because of the extraordinary power of the Open Market Committee, we have further recommended that it be abolished and its functions be undertaken by the Board itself, whose members are appointed by the President and confirmed by the Senate.

Section 3 of the bill provides for Senate confirmation of the President's nomination for Chairman of the Board. This has been included in view of the fact the President can choose a nominee for Chairman whose original Senate confirmation is of some antiquity, owing to the 14-year terms which Board members serve.

We believe a more fundamental solution is to shorten the terms of Board members to 7 years.

The CHAIRMAN. Mr. Biemiller, if you will excuse my interruption, we unfortunately, as I indicated before, are now in the process of a series of votes on suspensions of the rules, which will take us some 50 minutes. Accordingly—and I having discussed this with you, and we greatly appreciate your cooperation—we will declare ourselves in recess until 3 p.m. and ask that you return at that time to finish your testimony and to respond to such questions as there may be.

The Chair will also state that, without objection, the testimony of Ms. Kathleen O'Reilly will be admitted into the record following the testimony and any colloquies that may ensue with Mr. Biemiller.

We now stand in recess until 3.

[Brief recess is taken.]

Mr. CAVANAUGH [presiding]. Mr. Biemiller, Chairman Reuss has asked me to convey his apologies to you, but he was called to a House-Senate conference and is unable to return. But we will resume the hearings with your testimony; and I would like to express my personal gratitude and the gratitude of the committee for your patience in waiting for us during the course of this long vote.

So, you may continue; and thank you very much.

Mr. BIEMILLER. Thank you very much, Mr. Cavanaugh.

I will pick up where we were interrupted.

Section 3 of the bill provides for Senate confirmation of the President's nomination for Chairman of the Board. This has been included in view of the fact that the President can choose a nominee for Chairman whose original Senate confirmation is of some antiquity, owing to the 14-year terms which Board Members serve.

We believe a more fundamental solution is to shorten the terms of Board Members to 7 years.

We support Senate confirmation of the designated Chairman and urge that the term of the Chairman coincide with that of the President.

These changes should help make the Board more responsive to overall national economic policy without impairing a necessary degree of independence.

Section 4 of the bill deals with the problem of lobbying activities generated by the Federal Reserve System on behalf of its positions with respect to pending legislation.

Almost all Government agencies generate a certain amount of support from among their various constituencies, but the crucial point is one of the extent and the propriety of such activities.

The extensive report on "What the Secret Minutes of Federal Reserve Banks Meetings Disclose" recently presented by Chairman Reuss not only documents extensive solicitation of powerful support from the Fed's constituency but also the near identity of interest between the regulators and the regulated.

We would anticipate that such enactment of section 4 would muffle the Fed's direct leadership in such campaigns, but that the lobby would continue nonetheless. Section 4 should really occasion no opposition.

Finally, section 5 extends provisions on conflict of interest presently applicable to Federal Government officers and employees to Federal Reserve bank directors, officers, and employees. We can see no possible basis for objection to such requirements.

In short, Mr. Chairman, you have a good and useful bill. It makes limited, but necessary, amendments in the Federal Reserve System. We urge your serious consideration of the additional changes we have suggested.

The AFL-CIO has long been a supporter of basic changes in the structure of the Federal Reserve System, to make it more responsive to the needs of the public. I am attaching a copy of the Executive Council statement of February 21, 1975, which is the most recent statement directly pertinent to the content of this legislation.

[The statement of the AFL-CIO executive council follows:]



Statement by the AFL CIO Executive Council

on

The Federal Reserve  
And the Nation's Monetary Policy

Bal Harbour, Florida  
February 21, 1975

For the second time since 1969, the Federal Reserve System under the chairmanship of Dr. Arthur Burns has brought recession to the American economy and unemployment to millions of workers.

The Federal Reserve's arrogant brinkmanship with the American economy in 1973 and 1974 has resulted in the worst downward spiral since the Great Depression, with no end in sight.

In the name of combatting inflation, the Federal Reserve's money-crunch and ever-higher interest rates added to inflationary pressures, brought a depression to the housing industry and mass unemployment.

The Federal Reserve System created by the Congress to be the nation's central bank:

- \*Has utterly failed to serve the needs of the American people for full employment, economic expansion and adequate public facilities and services, while contributing to cycles of boom and bust.

- \*Has been an engine of inflation, with soaring interest costs imposed, directly and indirectly, on consumers, home-buyers, small business, public utilities and government itself.

- \*Has been a major cause of the recession of 1969-1970 and today's disastrous conditions -- resulting in the highest unemployment rate in 34 years and huge deficits in the federal budget.

- \*Has discriminated against the extension of needed credit for home-building, small business, state and local governments and public utilities. At the same time its discriminatory policies provided substantial amounts of credit for commodity market and land speculation, inventory hoarding and foreign lending.

- \*Has brought the economy to the brink of depression, with spreading bankruptcies of businesses and banks.

This key government agency, whose decisions are a major factor in determining the economic welfare of the American people, continues to operate in relative secrecy and with little accountability to the Congress, which created it.

The time is long overdue to overhaul the structure of the Federal Reserve and its policies -- to make them responsive to the needs of the American people. Therefore, we call on the Congress to:

1. Direct the Federal Reserve to reduce short and long-term interest rates and to allocate available credit for high-priority economic activities. America needs a sufficient expansion of money and credit, at reasonable interest rates, to encourage balanced economic expansion. A substantial portion of available credit should be allocated for such purposes as housing, community facilities and essential capital investment, while the flow of credit should be curbed for such activities as speculation, business takeovers and foreign lending.

2. Establish comprehensive oversight review of the entire Federal Reserve System to bring America's central bank fully into the government structure.

3. Require that the operations of the Federal Reserve System be subject to a yearly audit by the General Accounting Office.

4. Fix the term of the chairman of the Federal Reserve at four years, coincident with that of the President who appoints him. The term of members of the Board of Governors should be cut from 14 years to seven.

5. Abolish the Open Market Committee, the policy arm of the Federal Reserve System -- with five of its 12 members not government appointees. Its functions should be absorbed by the Board of Governors whose members are appointed by the President and confirmed by the Senate.

6. Extend membership on the Board of Governors of the Federal Reserve and on the governing and advisory committees of the entire Federal Reserve System, including its 12 district banks, to representation from major groups in the economy, including consumers and organized labor.

7. Require all commercial banks to be participants in the Federal Reserve System.

The Board of Governors should keep the Congress and the public informed with reasonable promptness and with reasonable detail on its major policy decisions and the reasons for arriving at them.

Mr. CAVANAUGH. Thank you, Mr. Biemiller.

And I'm sure I express the chairman's sentiments for presenting your outstanding testimony here this afternoon and following upon the distinguished majority leader's testimony this morning in support of this legislation. It adds considerable impetus, I am sure, to its eventual success, I would hope.

Mr. BIEMILLER. We would, too.

Mr. CAVANAUGH. I would have a couple of questions for you.

Mr. Biemiller, if the Chairman's term coincided with the President's, unless there is a resignation from the Fed's Board of Governors, the Chairman will have to be designated from among the seven sitting Governors, so wouldn't it be better to put the appointment 1 year after the inauguration of the President rather than to coincide directly?

Mr. BIEMILLER. I would refer that directly to Dr. Oswald.

Dr. OSWALD. The intent is to allow the new President to have some ability to influence the Director, or the Chairman. A 1-year lag might be too much of a time, maybe. An appropriate timelag might be 3 or 6 months after the time that the new President takes office.

Mr. CAVANAUGH. The problem in that case is there might not be a vacancy on the Board 3 or 6 months after.

Dr. OSWALD. If at some point, and assuming that we start with the ability of the Chairman in 1981 to serve a 4-year term, thereafter he would always have the ability to have a term that would be coincidental with that of the President.

The problem is that the term of the present Chairman expires next January 31. The legislation—his term as Chairman expires January 31. His term as a member continues until 1982. I would think that the legislation should provide maybe a short interim period so that starting in 1981 there would be the possibility of a 4-year term that would be similar to that of the new President.

Mr. BIEMILLER. I could just add to that, Mr. Chairman, that, obviously, what we are talking about is the intent of legislation. The details, as Dr. Oswald has suggested, can very easily be worked out, but it is also tied in part to our recommendation that the committee give serious consideration to taking the 14-year term and reducing it to 7 years. This has always been one of the things that has bothered us very much, that 14-year term. It is a long, long time to put somebody into that kind of a powerful position.

I am talking now just about members, not only chairmen.

You could always appoint somebody from the Board if you did not like the present chairman.

Mr. CAVANAUGH. Well, I would agree with you that 14 years is a long time, and we are not, apparently, prepared to confront that situation in this legislation.

I would not have any further questions.

I see Mr. Vento has joined us, and he may have questions.

Mr. Vento?

Mr. VENTO. Mr. Chairman, it is a pleasure to welcome to the committee Mr. Biemiller and his presentation on this issue.

I haven't read your statement, but I know that it addresses itself to something about which we are all concerned, the Federal Reserve Board and its impact upon the economy.

This morning someone pointed out that the Federal Reserve Board's actions are limited to monetary policy and to the stability of banks, which I found rather interesting, and I am interested in your reaction to that, Mr. Biemiller. I know your statement addresses specifically that, but perhaps for the record we could establish some further dialog on that point.

Mr. BIEMILLER. I will let Dr. Oswald take that one.

Dr. OSWALD. Mr. Vento, the actions, while they are monetary actions, affect all Americans, not just the banks. It affects the interest rates that people pay for the homes that they buy. It affects the interest rates that they pay on the consumer goods that they buy, whether it is from department stores or from the gasoline stations with their charge accounts. It affects the small businessman when he goes to borrow money, and it affects all businesses in their own lending.

It affects the levels of employment and unemployment in terms of how tight or expansionary a monetary policy is followed by the Federal Reserve Board, and is part and parcel of the whole economic policy activities which the Government in the broad sense is able to follow in terms of influencing the economy.

Mr. VENTO. Well, I am pleased to hear your observations are similar to others toward what we think the impact of the Federal Reserve System is. It was created by Congress to carry out something at arm's length but not at such length that it differs from the policies established by this Congress nor in coordination with the policies that are established or worked out between the Executive and this Congress, which is in fact what has occurred in some instances in the past.

Stability, I suppose, is one thing, but to countermand the effects of established policy and political policy, I think, is a grave error in terms of what their general charge is.

We discussed to some extent the impact of interest rates again this morning. The majority leader, as you know, testified before this committee. Consumer advocates have done so. And I must so that I am very pleased that labor has sought to come forth and make a statement on this concern.

There is an element with interest rates that, obviously, affects the various aspects of the workability of the entire free enterprise system and that addresses itself to what I would call, for lack of a better word, creative entrepreneurship and a very marked effect on venture capital, the willingness to take risks that occurs when you do have high-interest rates. One of the reasons that I sponsored amendments to the Council on Wage and Price Stability, was to have them focus on that particular aspect so we could better understand the interrelationship of interest rates, foreign investment, extra capital in this country, so we could determine what that impact is.

When I asked the current chairman of the Federal Reserve to testify or to respond to questions, he of course agreed that high interest rates did limit the ability of risktaking for an entrepreneur, but nonetheless he has commented that the need to fight inflationary forces apparently countermands any decision by business to invest.

The problem with this is it gets back to what we have seen in the last couple of years. We have capital available to fund the national debt. We have in this country a tremendous amount of investment by

foreign nations and so forth, which goes pretty much unnoticed but nonetheless is very important. So we have these dollars available but, nevertheless they are accruing 9 or 10 percent interest while small business is trying to fund things through various Government-oriented type of programs on the local community level with investor revenue bonds or at some other level where we are providing some sort of tax incentive or a limit to risks. So just as you limit risks in the past with a certain type of security or an interest-bearing bond, you limit risks in these ventures.

And this, I believe, is one of the direct outgrowths of a type of situation where we have an artificially controlled interest rate, and inappropriately controlled interest rate level.

And I feel that if we could move toward one that is more flexible or toward one that would reflect what congressional policies are so we would have them coordinated, we would be a long way toward obtaining the type of economic stimulation that we need without the necessity of Government programs to accomplish that end. And I know that to some extent you share that goal.

This bill in and of itself addresses some points of this. By itself, however, it does not accomplish, for instance, that mandate of cooperation. It, in my judgment, specifies that a policy that is established by a chief executive might be reflected in the Federal Reserve System and the Federal Reserve Board by virtue of appointments of the Director. It assures a wider participation by various groups or various members of the public, but it does reframe some of the general responsibilities, but nevertheless, I think, in rather general terms.

In my judgment, there is not the guarantee to obtain the types of goals that I may see or you may see. I hope that this committee, other than the two freshmen who are sitting here right now, will eventually come to grips with that and provide the proper assurance that is necessary, whether it is somewhat of a different political persuasion than I, but I think coordination should be the goal.

I think that what we have created with the Federal Reserve System is something that is imperfect, and I think it does need to get back on the track to provide more dynamic an instrument in terms of fiscal regulation than currently exists in the present system. It is good. It has provided some stability. But it also lends itself to some other manifestations that I don't think are intended nor desirable, and I think they are contradictory, to say the least.

So I guess that is kind of a long statement, but I do want to enlist your responses, if you have any. I will certainly consider your statement, and I hope that we can hammer our something here.

The audit aspects, of course, have been addressed by the Government Operations Committee. We have a long way to go in order to accomplish the type of improvement in personnel within the Federal Reserve System so that they can obtain the limitations on rates and other types of limitations that our chairman has been advocating. One of the things that did come up is the necessity for controlling lobbying. I have read over the notes that our chairman presented on this, and what is the essence of this bill—lobbying registration and so forth and prohibiting an official from recruiting the support for legislation or monitoring legislation which is supposed to regulate him.

It is a tough provision to enforce. We are going to find that there is going to be some anguish over that particular language as we go through this. I would anticipate that we would have that difficulty.

Any words of wisdom that you can offer for that?

In my judgment, banks have the right to be represented here, but it is improper for the Fed to encourage lobbying as it has.

Maybe you would like to comment about some of my earlier remarks and specifically the one about limiting the lobbying by the Fed.

Mr. BIEMILLER. Let me make a couple of general observations, and then Dr. Oswald will probably want to add something.

First, on the question of lobbying, we comment on that in our statement. We think it is a very, very bad situation when the Fed does, in effect, stimulate lobbying on the part of banks and gets them going.

Now, like you, we are not denying that banks have a perfect right to lobby, but we don't know why the Federal Reserve does their lobbying for them, which is one of the things you are up against.

We particularly don't like this because, as President Meany has observed repeatedly, we regard Dr. Burns as a national disaster. We think he has done more than anybody else to prolong unemployment in this country in recent years, and he and Alan Greenspan combined have been a real problem for the economy.

But, certainly, in terms of lobbying, we don't think that the Federal Reserve Board should be allowed to stimulate and to lobby for banks. They are pretty well able to take care of themselves, and they do a pretty efficient job of lobbying. They don't need the Federal Reserve Board to lobby for them.

What irks us is that here the Fed is supposed to be a creature of the Congress, but you have to dig pretty deep to find that out because the Fed has been off acting so independent for years and years that you sometimes wonder if they know that Congress exists, and—for example, we have repeatedly said, if we are ever to get the Humphrey-Hawkins bill or any reasonable facsimile thereof, the Fed has got to be pulled into the fight for full employment. The influence that the Fed would have on any policy affecting full employment is tremendous, and this is the kind of thing that is concerning us as it is concerning you.

I think we are in basic agreement with the statements you make.

Dr. Oswald can add to this.

Dr. OSWALD. I just wanted to add that each of the steps that are in the chairman's bill are very minimal steps. They are all steps in the right direction.

For example, on the recommendation that the Federal Reserve, pursuing its monetary policies, adopt the goals set forth in the Full Employment Act of 1946, it seems we need to call this to the attention of the Federal Reserve Board 31 years after enactment of the Employment Act of 1946. But it is clear that has not been a central concern of the Federal Reserve Board in terms of its policies. And as Mr. Biemiller indicated, the provisions in the Humphrey-Hawkins bill would go a step further in terms of requiring the Fed to indicate how its actions would be consonant with such maximum employment, production, purchasing power, and price stability, which would be a step further than is in the chairman's current bill.

We think it is also only a small step the chairman has in his bill that provides for consumers and others to be represented on the boards of the local Fed banks. We believe that that should be expanded to include all of the operations of the Board, including the Board of Governors itself, the Open Market Committee, if that committee remains as a committee, and the Federal Advisory Council itself.

The actions of the Board, as you indicate, though, are such that they affect people substantially more than bankers, and I think that needs to be reflected in a substantial change in the makeup of the Board itself as well as the member banks and the various advisory committees.

Mr. VENTO. Mr. Chairman, I know my time has expired, but one of the provisions in the current act excludes anyone from being an officer of a bank to be a class B or C director. I don't know what the provision is for class A. Maybe I could call on staff and they could tell me. I assume it would be identical, that they would be excluded.

I would yield to the Representative from Georgia.

Mr. CAVANAUGH. Mr. Barnard.

Mr. BARNARD. I believe class A directors come from banking classifications.

Mr. VENTO. Is there any provision in current law, do you know, for divestiture of interests, financial interests, at all?

Mr. BARNARD. Not for the class A directors.

Mr. VENTO. Well, that would be semantically impossible, I suspect. The others are divested of various financial holdings, is that right?

Mr. BARNARD. I am not sure, but do not think so.

In other words, the Fed would not be lending any money itself to those entities, so there would be no conflict of interest there.

Mr. VENTO. Well, thank you for your response to my questions. I appreciate it.

Mr. CAVANAUGH. Mr. Barnard.

Mr. BARNARD. Thank you.

Mr. Biemiller, it is good to have you and Dr. Oswald here today to comment on this legislation.

Let me ask you a question. How do you feel about the Federal Reserve bank and Federal Reserve System being a check-and-balance program in our monetary makeup?

Do you think it should be a check-and-balance process?

Dr. OSWALD. It should be a part and parcel of the overall policy of the country in terms of the economic policy that it pursues. It should not be one that runs contrary to the policy that is enunciated by people who are elected to their positions to run the Government, and that is how it has been acting recently. It has been running contrary to the general policies often enunciated by the Congress and the elected officials of the Government in terms of pursuing policies.

Mr. BARNARD. Has there been an agency of the Government set up to do that, to control monetary policy, other than the Fed?

Dr. OSWALD. Monetary policy—it was established by Congress in 1913 to handle basic monetary policy, and it should continue to be subject to the Congress which established it.

Mr. BARNARD. What do you think would have happened in 1973 and 1974 if there had not been some constraints put on the inflation in the Federal spending? Where do you think we would be today?

Dr. OSWALD. Mr. Barnard, I think that the inflation which caused serious problems in 1973 and 1974 came about as a result of two basic increases in prices, for fuel and for food. Fuel as a result of the actions of the OPEC countries, a fivefold increase between then and now, in terms of the price of oil. And in terms of food prices, the results of the large grain shipments to Russia and to China and some of the shortages of grain.

The inflationary influence of these two items was not the result of overall excess demand in the economy. The Federal Reserve Board tried to meet those inflationary pressures as if they were general demand-caused inflation. They restricted monetary policy very tightly, and I think this became a factor leading toward the curtailment of production that led to the 1975 recession—the 1974 and 1975 recession from which we still have not recovered.

I think one of the problems was the failure of the economic policy to be in concert in terms of trying to meet the problem of inflation from an overall policy point of view which would be pursued by the country rather than one which depended almost entirely upon the very tight monetary policies and brought about the type monetary policies which were one of the influences which led to the 1974–75 recession.

Mr. BARNARD. On this point we obviously disagree. I personally feel that at that time we needed some reining in of our resources in order to take a more academic audit of where we were in the overall economy.

Does the Fed not serve as a check and balance on monetary policy?

Dr. OSWALD. Mr. Barnard, I don't believe it operates as a check or balance. I believe it currently operates as an independent operator in terms of determining monetary policy, completely independent of any check, and I think that is precisely part of the problem.

I see this current bill by the chairman as really only a minor step that would continue the provisions of the earlier House concurrent resolution that had the chairman even come before the Congress quarterly to report on the types of activities of the Fed. Prior to that he Federal Reserve Board did not even speak to the Congress. We felt that this is a very sorry state of affairs. The inclusion by the chairman in his bill of the kind of language that was in the Employment Act of 1946 indicates, I think, part of the concern of many people that the monetary policies that have been pursued by the Federal Reserve Board have not taken into consideration the issues of full employment, full production, and purchasing power—things that also lead to an expanding, healthy economy.

Mr. BARNARD. What do you think would be the results of the Fed coming to Congress and making public statements on what it anticipates doing in the next quarter or the next fiscal year. What consequences do you think that would have on the money market and other related activities?

Dr. OSWALD. Mr. Barnard, for the last 2½ years, I believe, the chairman has been coming and has been giving some indication of what he anticipates will be the likely growth in M<sub>1</sub> money and the money supply, and it has had no deleterious effects at all in terms of the overall money markets.

What it does do is, in essence, allow the Congress an opportunity to discuss with the chairman whether these types of policies are similar



and would lead to the same general overall economic developments that the Congress is trying to achieve. They should not be going at cross purposes.

Mr. BARNARD. On another aspect under discussion, what method would you use in choosing members of the Board of Governors?

Dr. OSWALD. Well, currently, as I indicated earlier, the Board is made up of both class A directors, who are bankers, class B directors, who are representatives of industry—the industrial sector and commerce, I believe, is the current language for class B directors. We would like to see that the Board be much more representative of the community at large, so that there should be a provision, as the chairman suggests, for the inclusion of consumer representation on the Board. I think that there should be labor representation on the Board. There is provision also currently for agricultural interests already in the 1913 act, and I think that the membership should be broadened to include all segments of our society.

Mr. BARNARD. They are not separated from the law now, are they?

Dr. OSWALD. But they are not required to be in the law, as are the other classes now required to be accounted for in the membership of the Board itself. And we just think that if there are certain groups required by statute to be represented on the Board, then that representation included in the legislation should be broad enough to include all segments of our society.

Mr. BARNARD. I have no further questions, Mr. Chairman.

Thank you, sir.

Mr. CAVANAUGH. Mr. Vento, do you have any additional questions?

Mr. VENTO. No, Mr. Chairman.

Mr. CAVANAUGH. Mr. Biemiller, Dr. Oswald, we thank you on behalf of the committee and behalf of the chairman for your outstanding presentation here this afternoon. I am sure you would be willing to submit to any additional questions that may be forthcoming from members of the committee in writing.

Mr. BIEMILLER. We certainly would.

Mr. CAVANAUGH. With that, we appreciate your contribution to this hearing this afternoon.

Now, without objection, I would like to enter into the record of this hearing today the statement of Kathleen F. O'Reilly, the executive director of the Consumer Federation of America, who was scheduled to testify, but, due to scheduling conflicts, was unable to be present this afternoon.

[The statement of Ms. O'Reilly follows:]

STATEMENT OF KATHLEEN F. O'REILLY, EXECUTIVE DIRECTOR,  
CONSUMER FEDERATION OF AMERICA

Consumer Federation of America is a federation of 225 national, state and local non-profit organizations that have joined together to espouse the consumer viewpoint. CFA and its member organizations represent more than 30 million consumer throughout the United States. Among our members are: Consumers Union, publisher of Consumer Reports; 17 cooperatives and credit union leagues; 45 state and local consumer organizations; 66 rural electric cooperatives; 27 national and regional organizations ranging from the National Board of the YWCA to the National Education Association; and 16 national labor organizations.

CFA has long been on record in support of significantly increasing the accountability of the FRS to the American consuming public. H.R. 8094 takes some significant steps in the right direction. For example, we applaud the permanent dialogue which would result between Congress and the FRB as to quarterly testimony with respect to monetary policy including proposed monetary aggregates, anticipated velocity, estimated interest rates and portfolio composition. Each reporting factor increases the accountability which the Congress can wield over the Federal Reserve Board. Similarly we are most enthusiastic about the requirement that the Senate confirm the Chairman of the Board of Governors. This minimum accountability is likewise a must.

CFA, however, has several suggestions as to how the remainder of the legislation must be strengthened so as to more truly achieve its intended goal.

*(1) Broadening the economic interest of Federal Reserve Board Directors*

CFA feels it is insufficient to attach the language "without discrimination on the basis of race, creed, color, sex or national origin" to the selection criteria of Class A and B Directors. Why is not an affirmative action program being suggested? The present predominantly Caucasian male pool from which Class A and B members are selected will make the "without discrimination . . ." language meaningless.

As to Class "C" Directors, what good does it do to say they must represent the public, and "with due *but not exclusive* consideration to the interests of agriculture, commerce, industry, services, labor and consumers?" That is quite an intriguing and less than rational mix of six segments of society. Certainly the "consumer" viewpoint itself is worthy of at least 3 seats. Furthermore, as CFA has consistently testified, the "consumer" representative must be statutorily defined so as to include only those who have a demonstrated expertise with respect to the issues and who receive neither a salary (directly or indirectly) nor significant investment income from the regulated industry. Anything less presents a conflict of interest. We are most disappointed that the similar message we brought to this Committee on this point in 1976 seems to have fallen on deaf ears.

*(2) The Prevention of the Fed's from Using Banks as Lobbyists and the Prohibition of Federal Reserve officers, Employees and Directors from Acting Where They Have a Conflict of Interest are not Accompanied by Sufficient Sanctions*

CFA is sorely disappointed that the legislation doesn't include the necessary teeth which would act as a sufficient deterrent with respect to the Fed's using Banks as lobbyists and with respect to conflicts of interest. It is relatively easy to prohibit a certain practice. Yet if one sincerely desires to prevent it, there must be severe civil and criminal sanctions for a violation. Minimally there should be the withholding of a federal employee's salary similar to the provisions of the Freedom of Information Act. Similarly, it is imperative that when a federal employee has been engaged in a conflict of interest situation, the action which is relative to the conflict of interest should be deemed "not in accordance with the law" for judicial review purposes.

*(3) Disclosures*

CFA recommends that strong disclosure are provisions also be included in any Federal Reserve Board accountability package. The Federal Reserve Board should be required to make quarterly reports on such factors as terms and conditions of loans including the interest rates for each class of consumer loans. Dissemination of that information to consumer groups is also a must. It should be published in the Federal Register, and beyond that should be forwarded to consumers on a regular basis; furnished on request at financial institutions and should be conspicuously posted at these institutions.

Consumers should not have to rely on the whims of regulators such as Arthur Burns who released basic information as to interest rates on various categories of consumer loans in member banks only after Consumers Union was forced to bring suit to obtain this information—information which the Federal Reserve Board readily provides its customers. The bill should give assurances that this type of information will be readily available and furnished before it is out of date and no longer usable to the consumer.

In accordance with CFA's policy resolution on Truth-In-Savings, consumers should be assured of legislation which would :

1. Require full disclosure to consumers of all types of savings contracts, essential terms and conditions of the contract prior to and when they open an account, before any changes are made in the savings contract and when earnings are paid ;
2. Prohibit the proliferation of ambiguous words, and provide for mandatory use of simply defined words requisite for efficient communication about savings ;
3. Establish as a standard for regulations issued by regulatory agencies that of intelligibility by the average savings consumer ;
4. Be included as a central feature for financial institutions reform legislation ; and
5. Require that all financial institutions compute interest due on savings accounts on the basis of the average daily balance in the account from the date of deposit to the date of withdrawal.

Trust-in-savings could do for small savers what truth-in-lending has already done to some extent for small borrowers. Studies by Professor Richard L. D. Morse at Kansas State University have demonstrated in numerous ways the very real impact of the varieties of terms and penalty features in savings accounts and other savings instruments. 6 percent is not 6 percent when the saver loses 90 days worth of interest on funds withdrawn before the rules of the institution allow. 5 percent is not 5 percent if that rate is only paid on minimum balances during the interest payment period. Truth-in-savings will be no panacea for small savers unaware of the impacts of various clauses, rules, and penalties or accounts, but combined with the effects of competition that would likely cause institutions to standardize their interest computations, the impact could be quite beneficial.

Mr. CAVANAUGH. With that, we are adjourned, subject to the call of the Chair.

[Whereupon, at 4 p.m., the hearing was adjourned, subject to the call of the Chair.]

# FEDERAL RESERVE REFORM ACT OF 1977

TUESDAY, JULY 26, 1977

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON BANKING, FINANCE  
AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10 a.m. in room 2128 of the Rayburn House Office Building; Hon. Henry S. Reuss (chairman of the committee) presiding.

Present: Representatives Reuss, Ashley, Moorhead, St Germain, Gonzalez, Annunzio, Hanley, Mitchell, Neal, Blanchard, LaFalce, AuCoin, Derrick, Hannaford, Evans (Indiana), Lundine, Cavanaugh, Oakar, Mattox, Vento, Barnard, Watkins, Stanton, Brown, Wylie, Rousselot, Hansen, Hyde, Kelly, Grassley, Fenwick, Leach, Steers, Evans (Delaware), and Caputo.

The CHAIRMAN. Good morning, and welcome, Chairman Burns. The House Committee on Banking, Finance and Urban Affairs will be in session for further hearings on H.R. 8094, a bill to promote the accountability of the Federal Reserve System.

We are most honored, as always, to have the distinguished and respected Chairman of the Federal Reserve Board before us. He will be with us again later this week, on Friday, in another capacity—and that is, sharer of our dialog on monetary policy.

Chairman Burns has told me that he is lunching with the President today, and that, therefore, he would need to leave here at the latest by 12:30 or 12:40. I see no reason why we can't expeditiously enable the chairman to meet that commitment. I am certainly going to try to.

Chairman Burns, under the rule, and without objection, your statement is received in full into the record, and would you now proceed?

## STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Dr. BURNS. Thank you, Mr. Chairman.

I am pleased to have the opportunity to present the views of the Board of Governors on H.R. 8094, the Federal Reserve Reform Act of 1977. The stated purpose of this bill is to promote the accountability of the Federal Reserve System.

Let me say at the outset that the Board fully recognizes its accountability to Congress for its performance of the duties Congress has given it. My colleagues and I appear frequently before this committee and other committees of the House and the Senate to report to you

and to answer for our actions. We have participated earnestly in the quarterly dialog on monetary policy initiated under House Concurrent Resolution 133 of the 94th Congress. I am scheduled, as you know, to appear before this committee on Friday to continue that dialog. Last year the Board recommended that the House and Senate Banking Committees evaluate our performance as bank supervisors through periodic oversight hearings on the condition of the banking system, and the first such hearing was held by the Senate Banking Committee this March. In April we advanced the dialog further by presenting testimony on the budget of the Federal Reserve System before the same committee. I believe that through proceedings such as these we are evolving an effective means by which the Congress can fulfill its oversight responsibilities with respect to the Federal Reserve while respecting the basic principle of an independent central bank.

The most significant provision of H.R. 8094 is section 1 of the bill. The objective of monetary policy set forth in this section—namely, that it “shall be governed by the national policy to promote maximum employment, production, and price stability”—is consistent with the Board’s understanding of the intent of Congress, and it also reflects the actual practice of the Board and the Federal Open Market Committee. In the Board’s judgment this would be an appropriate addition to the Federal Reserve Act. It is a clearer statement of national policy than is contained in the Employment Act of 1946, which uses the term “purchasing power” rather than “price stability.”

On the other hand, the Board is disturbed by the bill’s language relating to hearings on monetary policy, which differs in several major respects from that of the concurrent resolution it would replace. The concurrent resolution was the carefully framed product of extended discussions between the Banking Committees and the Board. It has been thoroughly tested in the course of the nine hearings held under its provisions over the past 2 years. We know of no good reason for revising it; indeed, some of the proposed revisions, if enacted, would be inimical to the orderly functioning of financial markets.

The provision calling for projections of interest rate levels for 12 months ahead is particularly ill advised. Neither the Board nor the FOMC makes such estimates. To be sure, some, if not all, members have more or less well-defined expectations about the likely course of rates in coming months, but members of the Board and of the FOMC do not discuss such expectations in public. Federal Reserve officials are extremely careful to avoid any public comment that might suggest or imply some particular outlook for interest rates.

The reason for reticence on this subject should be obvious. While the Federal Reserve cannot determine market interest rates, it certainly can influence them—particularly in the short run. Participants in financial markets know this, and they have strong incentives to make use of any clues they can get to the System’s intentions. If, for example, bondholders conclude from a remark by a System official that rates will be rising in the future, they may deem it advantageous to sell their holdings immediately—and that may cause rates to rise prematurely. It may also cause rates to move up unnecessarily if the view of the System official was not well founded but nevertheless was taken seriously.

But if the casual comments of a Federal Reserve official can affect market interest rates, public reports each quarter on the interest rate expectations of the Board or the FOMC could rock financial markets. The expectations voiced by the Board at a quarterly hearing might change a week or a month later, and in any event might be mistaken. If we made specific pronouncements about the future of interest rates, many traders would no doubt tend to respond promptly. Inappropriate as well as violent changes of interest rates could take place and the economy suffer from the financial instability so generated. The capacity for mischief inherent in the interest rate provision is so apparent that I find its inclusion in the bill inexplicable.

The provision calling for quarterly testimony on monetary velocity 12 months ahead is questionable for other reasons. Particular considerations—often of a sort that defy quantification—weigh heavily in the thinking of most, if not all, members of the FOMC. In the nine hearings held thus far under House Concurrent Resolution 133, I have tried to set forth the reasons underlying the Federal Reserve's policy decisions. In fact, I have often commented in general terms on expectations for velocity, speaking for the FOMC or the Board when that was appropriate and for myself when it was not. But in so doing, I have consistently emphasized the sensitivity and flexibility of monetary policy, which can change by the month or even by the hour, and which should never become the prisoner of some preconceived number.

Conceivably, in response to a congressional mandate, the FOMC could vote on some numerical figure for monetary velocity. But any such exercise is not necessary for effective policy formulation; if undertaken, it would divert members of the FOMC from basic analysis in which they have some competence to a numerical guessing exercise; the end result would be artificial at best, and would be grossly misleading at worst.

Finally, I must advise this committee that the Board seriously questions the provision calling for quarterly reports on the "proposed composition of the Federal Reserve's portfolio" 12 months ahead. In the first place, such reports could influence current interest rates as market participants drew inferences about Federal Reserve purchases or sales in different sectors of the market. Second, such reports could prove highly misleading. In view of the uncertainties about future considerations in securities markets, numerical projections of likely changes in the portfolio during the coming 12 months cannot be made with much confidence.

Of course, the FOMC could always instruct the Manager of the System Account to make its guesses come true, or perhaps to reduce particularly large misses, whether or not the open market operations required were consistent with the needs of the Nation. I very much doubt that Congress will want to force the Federal Reserve into that kind of predicament.

These observations on the deficiencies of section 1 of this bill suffice, I hope, to show why the Board recommends that the language providing for quarterly hearings on the conduct of monetary policy follow much more closely the carefully framed and thoroughly tested language of House Concurrent Resolution 133.

Section 2 of the present bill would prohibit discrimination and broaden the list of interests to be considered in the selection of Reserve bank directors. We are in sympathy with the concerns underlying this provision and we support it. As I stated last year, the Federal Reserve is fully committed to the principle of equal employment opportunity, and we have made vigorous efforts over the years to employ and promote qualified women and minority group members to the staffs of the Board and the Reserve banks. Moreover, we have recently increased our emphasis on the appointment of such persons to the Boards of Directors of the Reserve banks. While we have achieved some success, we recognize that it has not been sufficient. Last year I advised you that the System had 6 women serving as members of Reserve bank branch boards. For 1977, this figure has increased to 17 women directors, 4 on head office boards and 13 on branch boards. This year our minority directors have increased from 13 to 16, including 3 who serve on the boards of head offices. We appreciate Chairman Reuss's continuing interest in this matter, and I assure the committee that we intend to continue our efforts to enlarge the representation of women and members of minority groups on the Reserve bank boards.

Another change in the provisions of section 2 relating to directors would expand the categories of individuals to be considered in the selection of class B and C directors. The Board endorses this proposed broadening in the representation of the public on Reserve bank boards. Indeed, in connection with the FINE discussion principles we recommended that consideration be given to appointment of class B directors by the Board rather than their election by member banks.

We continue to hope that the committee will consider whether its objectives in this section of the bill may not be better achieved by providing for Board appointment of class B directors. As the bill stands, both class A and class B directors would still be elected by member banks, in accordance with the nomination and balloting procedures set forth in section 4 of the Federal Reserve Act. Under these procedures it is difficult to see how the bill's antidiscrimination provisions can be enforced in elections in which literally thousands of member banks will be voting on a large number of nominees. This difficulty could be overcome by specifying that class B directors are to be selected by the Board. Such an amendment would have the added benefit of putting to rest the mischievous fiction that the member banks control the Federal Reserve by virtue of their ability to elect six of the nine directors of each Reserve bank.

Section 3 of the bill provides for Senate confirmation of the person appointed by the President as chairman of the Board. As I recently testified before the Subcommittee on Domestic Monetary Affairs, we have no objection to this provision.

The Board has serious problems with the provisions of section 4 relating to so-called lobbying communications with regulated institutions. Unlike the existing provisions of law relating to lobbying by Government officials, which make it a crime to use appropriated funds for such purposes, H.R. 8094 would enact a direct prohibition against communication by any Federal Reserve official with any institution regulated by the Federal Reserve "to influence legislative actions affecting the Federal Reserve System."

The Board seriously doubts whether such a prohibition is consistent with the first amendment to the Constitution, which commands that Congress shall make no law abridging freedom of speech. Moreover, this provision of the bill is so broadly worded that it could have a chilling effect on perfectly innocent communications that, besides being constitutionally protected, are not intended to be included within the scope of this bill. Just what legislation, for example, would be excluded from the bill's reference to "legislative actions affecting the Federal Reserve System"? How explicit must the intention be to "influence" such actions? Need the Federal Reserve official urge bankers to write their Congressman in order to violate such a prohibition?

Are we prevented from informing banks about changes that the Federal Reserve is proposing in the laws that govern banking? Would we violate the law if a banker decided on his own to write his Congressman after listening to our description or analysis of a pending bill? Indeed, may not this provision be violated whether or not the banker who received a communication from the Federal Reserve subsequently communicated with his congressional representative? With such uncertainties the inevitable effect would be to inhibit Federal Reserve officials from discussing any proposed or pending legislation in a public forum—particularly if bankers were present. I cannot believe that Congress would want to limit so severely the ability of Federal Reserve officials to discuss legislative ideas or that it would want to create such impediments to the free flow of information or opinion to the Congress itself.

Moreover, since three members of each Reserve Bank board of directors are bankers, as provided by law, the bill could even be construed to prevent any discussion of pending legislation at Reserve Bank board meetings. In fact, since Federal Reserve banks could themselves be considered institutions "subject to the regulatory authority" of the Board of Governors, the bill might be read to prohibit communication between the Board and the Federal Reserve banks about such proposed legislation. Similarly, the bill could be interpreted to prohibit the Board from discussing legislative matters with the Federal Advisory Council, a body composed of bankers that was created by the Federal Reserve Act for the express purpose of counseling with the Board on matters affecting the System. Again, I cannot believe such results could be intended.

The officers and directors of the Reserve banks, as well as members of the Federal Advisory Council, are appointed under law. The Board has a responsibility to keep them informed on legislative issues, and they naturally share our concern for legislation that may have an impact upon the System. Their interest in these matters exists quite apart from the positions that some of them hold in private business institutions. Neither Government service nor election to a Reserve bank directorate should require an individual to forfeit those rights of expression and petition that are generally guaranteed by the first amendment.

We appreciate that section 4 of the bill is intended to protect against the possibility that regulated institutions, hoping to curry favor with their regulator, may be induced to promote the regulator's interest in particular legislation. One who entertains such a fear must be assum-



ing that men and women who work in regulated businesses would let themselves be used by unscrupulous regulators to express views that may not be their own. I see little basis for any such cynicism about bankers or their regulators, or—for that matter—about the ability of Congressmen to protect themselves against misleading rhetoric of their constituents.

We live in disturbed times, and if Congress should consider section 4 a proper subject for new legislation, I still see no basis for singling out for special treatment the Federal Reserve—an institution whose integrity should not be lightly questioned. I cannot deny a theoretical possibility of misconduct in the future; and if Congress believes it appropriate to address the issue, it should do so in the broad context of all Federal regulatory agencies—not excluding Cabinet departments.

Finally, section 5 of the bill would add "Federal Reserve bank director, officer, or employee" to the list of individuals covered by the conflict-of-interest prohibitions of section 208 of the Criminal Code. This section of the code prohibits any covered employee or official from participating personally and substantially in any matter in which he, or certain persons or entities related to him, has a financial interest, unless he first makes a full disclosure to the official who appointed him and receives appropriate clearance in advance.

In principle we have no objection to this proposal. The Board of Governors has, since the inception of the Federal Reserve System, recognized the need to assure that the highest standards of personal integrity are observed, not only by Board officials and employees, but by all those associated with the System. As early as 1919, the Board stated that—

it has always entertained the view that no director or officer of a Federal Reserve bank should permit his connection with the bank to be used in furthering his private business or the interest of any corporation with which he may be associated.

The Board has requested the Reserve Banks to distribute to their directors, officers, and employees the Code of Ethics for Government Service, and it has asked each Reserve bank to adopt rules on employee responsibilities and conduct comparable to those adopted by the Board itself in furtherance of Executive Order 11222. These rules constitute a broad prohibition of conflicts of interest.

While we thus concur with the principle underlying this proposal, we are disturbed by its discriminatory nature. I believe that there are many positions comparable to those of Reserve bank directors that are not now covered by section 208 of the Criminal Code. The directorates of the Federal home loan banks is the example that comes to mind most readily. If Congress is to consider extending the criminal penalties for conflicts of interest, it seems highly inappropriate to do so by singling out one group as a special target and without benefit of some deeper study of the proposal.

If such a study were undertaken, consideration would need to be given to the unique status of Reserve bank directors in the structure of the Federal Reserve System. The Federal Reserve Act provides for a balancing of economic interests on Reserve bank boards—lenders, borrowers, and public representatives. Directors are required by the act and by their oath of office to administer the affairs of the bank "fairly

and impartially and without discrimination." The legislative history of the act indicates clearly that Congress viewed class C directors as having a responsibility, as "representatives of the United States," to insure that this requirement of impartiality was carried out. The Federal Reserve System has been untouched by conflict-of-interest scandals in its 64 years of existence, and we certainly have the power to deal effectively with misconduct—even to remove officers and directors—if any such thing should occur. In light of this, and particularly if the Board of Governors appointed three additional public representatives, it is very doubtful that section 5 of the present bill is at all necessary. Not only that, there is at least the possibility that specific reference to directors under the Criminal Code would diminish the ability of the Federal Reserve banks to attract highly qualified citizens to their directorates.

We urge the committee to move very cautiously on section 5, not only for the above reasons but also because of what appears to be a technical flaw in drafting. Subsection (b) (1) of section 208 of the Criminal Code provides that the Government official responsible for the appointment of another person covered by the code may permit that person to participate in a particular matter where the person's interest in the matter is not substantial. It so happens, however, that the Reserve Bank directors in classes A and B are elected by member banks, so that there is no appointing official in their case. The obvious, but perhaps unintended, discrimination against those directors should be noted by the committee.

In summary, the Board supports enactment of several provisions of this bill. We believe, however, that the objectives of the quarterly hearings on monetary policy can be best achieved by retaining the tested language of House Concurrent Resolution 133. We urge the committee to drop the provision of the bill relating to "lobbying" because it is unjustifiably broad and of doubtful constitutionality. And we also urge the committee to study very carefully the implications of amending the Criminal Code before taking any serious legislative move in such a direction.

The CHAIRMAN. Thank you very much, Mr. Chairman, for your support of many of the provisions of the bill and for your suggestions as to certain technical corrections which ought to be made. Incidentally, I have noted them and in at least two instances. I think you are dead right. I intend to propose perfecting language. Third, in a number of cases, you disagree with the bill. Naturally, that is what I want to talk about, particularly the bill's provision for quarterly dialog, where you say again and, by your conduct in office have demonstrated it, that you agree with the principle of House Concurrent Resolution 133, but that you think that House Concurrent Resolution 133 is about right when it requested of the Fed their quarterly prognosis on proposed monetary aggregates.

Now in the bill before us, H.R. 8094, the bill's author goes farther and also asks the Fed in its quarterly dialogs to enlighten the banking committees on, and I quote, "anticipated monetary velocity," and also on "estimated levels of interest rates."

It is those two I want to talk about. On "anticipated monetary velocity," it seems to me it really isn't very helpful to tell us what

your  $M_1$ ,  $M_2$ , and  $M$ -infinity projections are going to be, if you don't tell us what your thinking is on velocity,  $M \times V = \text{GNP}$ . So it seems to me it does not do us much good to get an "M" if the "V" is not disclosed to us.

Now I know that "V" is a matter of guesswork, but we would be greatly helped next Friday, for instance, when you are before us, by having your views on what is likely to happen to velocity.

I would think that you could give us a lot of material from the Fed's staff about the future course of NOW accounts, economizing on balances, and all of the things which make for velocity. That is all the "anticipated monetary velocity" asks for. We aren't asking for you to do a King Canute, and ask that velocity go in a particular direction. In fact, you have given us your expectations many times, to our great pleasure and profit. What is wrong with "anticipated monetary velocity"?

Dr. BURNS. I have commented generally on expectations for velocity many times. I shall do that again, on Friday, when I am here. I shall continue doing that and will respond to the committee's questions in this area, to the best of my ability. But that is not the provision in the bill before us.

The provision in the bill requires the FOMC to reach a decision on velocity.

The CHAIRMAN. Let me make it clear that that is not the intention of the bill, to require the FOMC to mandate a velocity. That would be an absurdity.

What we want to know is what is in your mind on velocity. For instance, if you come in with a low projected monetary aggregate, but say that you expect a continuation of a hyperthyroid increase in velocity, then all would be understood, or vice versa.

Dr. BURNS. Mr. Chairman, I have no objection to writing into the bill that the chairman should testify at the quarterly oversight hearings as to his views on monetary velocity—no objection whatsoever.

The CHAIRMAN. Fine, then it turns out that at least your mind and my mind are met on that. And I think, by appropriate language, we can make that clearer.

Let me then turn—I hope with equally good results—to the next one.

Mr. AuCOIN. Excuse me, Mr. Chairman, I can't hear the witness. I wonder if someone could turn up the power of the microphone?

The CHAIRMAN. By all means. Perhaps, Dr. Burns, you could speak a little closer to the mike.

We now turn to estimated levels of interest rates. There, you say, "Oh, no, we couldn't give you our informed judgment on that, because it would rock financial markets." Well, did it rock financial markets last February 2 when Treasury Secretary Blumenthal testified that, and I quote, "any rise in interest rate for 1977 will be quite modest"? Or when Director Lance testified to substantially the same effect on the same day?

Again, all we are asking is that the Fed get away from its exclusively monetary preoccupation, and think through the implications of a particular monetary policy, and particular movements for interest rates.

The administration has to do it. How else can it determine what it is going to have to pay on the national debt?

Dr. BURNS. I can assure you that we devote an enormous amount of attention to interest-rate behavior, actual and prospective. But that isn't in question. The question is the propriety of having any member of the Federal Reserve System, which has such a large role in this area, speak out publicly on the issue.

I never have; and I hope you will not put the Federal Reserve in the position of my, or anyone else, having to do so. Because if you did that, you would be asking Federal Reserve officials to do something that would at times mislead—and perhaps mislead seriously—the financial and the general public.

I consider that immoral. I don't talk publicly about the stock market. I don't talk about interest rates. And I don't think we at the Federal Reserve should.

Now, if the Secretary of the Treasury, or the Director of OMB wishes to do that, or if any Member of the Congress wishes to do that, thank the Lord we still have a free country. The Federal Reserve, which has such a large responsibility in this area, should not be put in the position of having to do that.

The CHAIRMAN. My time is up.

Mr. Ashley?

Mr. ASHLEY. No questions, at this time, Mr. Chairman.

The CHAIRMAN. Mr. Stanton?

Mr. STANTON. Mr. Chairman, I would like to make some general comments concerning the Federal Reserve Reform Act H.R. 8094.

It seems to me, Mr. Chairman, that at this moment we have come to far too fast on an accelerated track, that brings this legislation before the full committee without the advantages of subcommittee scrutiny.

It arrives at a time when the full committee is in session at 10 a.m. in the morning, and Members' attention is directed toward the farm bill, and black lung legislation, and the minimum wage, and the energy bill.

Mr. Chairman, this reform bill—your bill—needs much improvement. I personally think that some of its sections can be refined, and hopefully that most of the bill can be put into law. It is my personal suggestion, Mr. Chairman, that thought be given to postponing the markup of this legislation until perhaps next week, at the earliest, or preferably until September.

At the moment, it is my honest opinion that this bill reflects only your personal view. If you should insist upon a bill in the next 24 to 48 hours. Mr. Chairman, you would probably be forced to call a hurry-up meeting of the Democratic caucus, of the members of our committee. If you have the same luck that I do, about half the members will show up. And, Mr. Chairman, they would be asked to act without the full benefit of being able to reflect upon what the chairman has just said, to act without the benefit of hearing—which I would like to have heard from—the present Secretary of the Treasury on this legislation; and last, I think they would be asked to act, regrettably, in a partisan atmosphere without the input of members of the minority, and some of whose views I think they respect.

Mr. Chairman, during the middle of the week, the minority was asked if they wanted any witnesses for this legislation. If they so indicated, only Monday morning was available.

We appreciated this offer, Mr. Chairman, and regrettably none of our witnesses could make it, on this tight time schedule. Some of those who expressed an interest to be heard included two former Democratic Secretaries of the Treasury, renowned economists, and a former Chairman of the Federal Reserve Board.

I personally think that all of the members would have enjoyed the input from these particular witnesses. Mr. Chairman, this legislation can be bipartisan. I would like to at least attempt to make it such. I would respectfully suggest that perhaps instead of a bipartisan party caucus, that we have later on this week open discussions on differences in this legislation.

Perhaps in early September we can come up with a true bipartisan bill. We can certainly only try—and I think, Mr. Chairman, that any other approach is below the high standards which the public has a right to expect from this excellent committee.

The CHAIRMAN. Would you yield, just briefly?

Mr. STANTON. I would be happy to.

The CHAIRMAN. I respect very much the tone and the substance of what you said, Mr. Stanton. Nothing would please me more than to extend the time on this. But I must point out that this bill has been before us for more than a month; that it has been the subject of hearings; and that we have, from the beginning, invited the minority to bring in any witnesses it wants.

I also wrote the President more than a month ago inviting comment from the administration on it. No comment, one way or the other, has been forthcoming.

What sticks in my mind is the reason for our schedule, which includes an executive session tomorrow on the bill, is the simple fact that Speaker O'Neill has laid it down that bills not ready for Rules Committee consideration prior to the August recess, by being reported out of committee, can't be taken up this year. To let this whole matter go over to another year seems to me a poor tradeoff.

Therefore, I renew my willingness to promptly hear witnesses, but really I think we have to stick to our schedule. But I think the gentleman for his statement.

Mr. STANTON. Mr. Chairman, someone put here before me this morning an article in the Wall Street Journal, and I assume it was this morning, by Lindley H. Clark, Jr., which pertains to mostly title I of this bill, and I would ask unanimous consent to insert it in the record.

The CHAIRMAN. Without objection, it is so ordered to be inserted right at this point in the record.

[The article from the Wall Street Journal referred to by Congressman Stanton follows:]

[From the Wall Street Journal, July 26, 1977]

#### OFF TARGET

(By Lindley H. Clark, Jr.)

This week Henry Reuss's House Banking Committee will be continuing hearings on the Wisconsin Democrat's latest legislative inspiration. If by some mischance the Congressman's notion should make its way through Congress its capacity for mischief would be considerable.

Mr. Reuss's bill superficially resembles the congressional resolution that, for more than two years now, has induced the Federal Reserve System to announce to Congress—and the rest of us—its target rates for the expansion of the money supply. Actually, the bill and the resolution are totally different.

The Reuss bill carries a lot of extra baggage that may divert attention from its real intent. One section of the bill, for instance, provides for Senate confirmation of the Federal Reserve chairman. Many people, I suspect, will be surprised to learn that the chairman is not now confirmed by the Senate, and it's hard to imagine anyone getting very exercised over the point.

Another section provides that the directors of the various Reserve banks could be just about anybody of good repute. Now the directors are supposed to "represent certain occupational groups. Once again, it's hard to imagine anyone getting very worked up about that proposed change.

A couple of sections of the bill, however, may be what one congressional staff member calls "flak-catchers." They deal with lobbying and conflict-of-interest matters. In those areas everyone is foursquare for virtue, but he may differ from his neighbor on where virtue lies.

It's the heart of the bill that sounds so much like the 1975 concurrent resolution. To start with, it requires the Fed to conduct monetary policy to promote maximum employment, production and price stability. It also calls for the Fed to report on its progress at quarterly hearings alternated between House Banking and Senate Banking. Who could argue?

Then Mr. Reuss really gets into his can of worms. At these quarterly hearings the Fed would be expected to report on its proposed monetary aggregates. Not the rate of growth, mind you, just the actual size. This could be an improvement, since the Fed now keeps shifting the base as it sets percentage targets.

Next the Fed would be expected to report the "anticipated monetary velocity." It's hard to imagine what would be gained by writing such a requirement into law. Velocity determines the impact of a given growth rate of the money supply, and any talk of a monetary target has to deal with the subject.

Third, the Fed would, in effect, have to announce interest rate targets. A great many people in Congress mistakenly believe the Fed can set interest rates just about where it pleases. This provision would set the stage for the sort of unedifying arguments we've lately heard from Budget Director Bert Lance. High interest rates are largely a function of high inflation; the Fed has problems enough without giving it this type of help.

Finally, and most mysteriously, the Reuss bill would require the Fed to tip off the lawmakers on the proposed composition of its portfolio.

It would be easy to write off all of this as an exercise in futility, which I hope it is. But the Reuss-Lance assault on the Fed has plenty of support. The current business recovery is well into its third year, an awkward age for business recoveries.

Continuation of anything like the strong growth rates of the past 6 months would quickly push the economy into a new inflationary explosion—and a subsequent recession. Fortunately, the economy already is slowing down. A year or so of relatively modest growth rates could be a good investment in prolonging this recovery. Current congressional critics of the Fed might recall that many of them face an election next year.

Economic conditions can cause Congress to do unusual things, some wise and some otherwise. When the monetary-target resolution went through Congress, the country was just beginning to emerge from a deep recession with a still frightening inflation rate. The resolution's supporters told the lawmakers that monetary targets would help to reduce the inflation, as indeed they have.

It was an unusual parliamentary exercise. Concurrent resolutions have no legal force; they merely express the views of Congress. Some observers wondered whether the Fed would simply choose to ignore the resolution.

In the event, of course, the Fed has gone along with the resolution—quietly, if not cheerfully. Chairman Arthur Burns still harbors doubts about the significance of all the M's, but he is also sensitive to the pressure. This time some of the pressure was from inside the Reserve System and not merely from the monetarist-oriented Reserve Bank of St. Louis.

There is some uncertainty as to whether the resolution is still in force—to the extent that a nonbinding resolution ever can have any force. Since the resolution was approved we have in effect elected a new House of Representatives; is the new one bound by the views of its predecessor?

None of the questions about the resolution's status have been raised—publicly at least—by the Fed, the agency chiefly involved. Chairman Burns is sched-

uled to appear before Mr. Reuss's committee today with his views on the bill. If Congress does nothing. Mr. Burns and his successors, if any, presumably would go on reporting well into the 21st Century and even beyond.

So why do anything? Mr. Reuss, like the rest of us, knows that the economy could use lower interest rates—to encourage business investment and to stimulate homebuilding and buying. So he wants the Fed to play tooth fairy and put the lower rates under our pillows.

It isn't that easy. We are stuck with an economy that is hypersensitive to inflation. The Fed could lower short-term interest rates for a while by pouring more money into the economy. But that "while" wouldn't last very long. Soon the increasing fears of inflation would be driving up both short and long rates.

Mr Reuss and his committee are scheduled to get together tomorrow to mark up some sort of a bill. If they insist on doing something they might substitute the wording of the existing resolution for the chairman's mishmash. Monetary targets are a fine idea, but Mr. Reuss's proposal misses the mark.

The CHAIRMAN. Mr. Moorhead?

Mr. MOORHEAD. Thank you, Mr. Chairman.

Chairman Burns, at page 5 of your testimony, you say that on occasion it is appropriate that you speak for the FOMC, or for the Board, and sometimes just for yourself. Do I understand, from the first sentence in your testimony, that the testimony today is not just that of Chairman Burns' but also the testimony of the Federal Reserve Board?

Mr. BURNS. That is correct.

Mr. MOORHEAD. You, and the chairman of the committee, seem to have—and I have listened to your exchange—agreed on how the matter of velocity can be handled.

Are you speaking for the Board in this instance?

Dr. BURNS. No; I am speaking for myself.

Mr. MOORHEAD. There seems to be no form of agreement on even general discussions about interest rates. Is that correct, sir?

Dr. BURNS. We can have very extensive discussions about past interest rates, very extensive discussions about current interest rates and very extensive philosophical discussions about interest rates. But you will never get a forecast concerning interest rates out of me, under any circumstances, unless you require it by law—and that would pose a very difficult moral question for me.

Mr. MOORHEAD. You have testified—or you have said that mortgage interest rates were generally declining. That is as a factual statement as opposed to a prediction; is that correct?

Dr. BURNS. I am open to questioning—unlimited questioning—about interest rate behavior in current markets, or in the more recent past, or in the more distant past, or to philosophical questions about interest rates and their role in the economy or about the behavior of interest rates abroad. In fact, I wish you would ask me questions about interest rates abroad, particularly in Latin America, in Argentina, and Chile.

Mr. MOORHEAD. Very well, let's start with your observation about interest rates in Europe, and what effect you would think that might have on interest rates in the United States.

Dr. BURNS. Interest rates in Europe have been declining generally recently—not rapidly, but they have been declining. As to the effect upon interest rates in the United States, our interest rates also have been declining generally in the long-term market. Our interest rates in our short-term market are higher now than they were several months ago.

I wouldn't expect interest-rate movements abroad to have any material influence on interest rates here, in view of the modest interest-rate movements that have occurred internationally in recent months.

Dr. MOORHEAD. On page 3 of your testimony, you say that: "participants in financial markets \* \* \* make use of \* \* \* clues," whatever clues they can get. And it seems to me that the basic philosophical difference might be that those in the know can read the clues, but the general public can't.

Dr. BURNS. I don't know what to do about that. It's just a fact of life that some people know more than others. Some people are more intelligent than others. Some people are able to act quickly on the basis of what they know or think, and others are slow in responding. I don't know what we can do about those differences, and I am not sure one ought to try very hard—at least in this area.

Mr. STANTON. Will the gentleman yield?

Mr. MOORHEAD. I would yield.

Mr. STANTON. Yes; I just wonder if we could get unanimous consent to go over and come back. Is that OK?

Mr. MOORHEAD. The chairman, I believe, went over to vote.

Mr. STANTON. Well, let us all go, so we can get back to hear the testimony.

Mr. MOORHEAD. All right, the committee will stand in recess, as briefly as possible.

[Brief recess.]

The CHAIRMAN. The committee will be in session, and the Chair recognizes the gentleman from Texas.

Mr. GONZALEZ. Thank you, Mr. Chairman, and also, thank you, Chairman Burns, for once again taking time and sharing with us the benefit of your vast experience and great wisdom which I have always felt personally very grateful for and wish to compliment you on.

I did not know what the time schedule would be on this bill until this morning, so it looks as though it will be accelerated; and therefore, I would like to ask a question.

On page 3 of the bill, section 4, the lobbying communications with regulated institutions, as I understand it—and I did not know this when we had preliminary discussions—but as I understand it, the internal regulations of the Board provide for employee responsibilities and conduct and I think the specific matter is covered by your regulations and contains a prohibition against lobbying with appropriated funds.

Now, how are these regulations enforced, and do you feel that we should extend this particular section statutorily in order to cover what it seems to me you may have already provided for in your regulations?

Dr. BURNS. I must say I think we have strict regulations. These regulations do not address the question of what our Directors say to Congressmen. There is nothing that I know of in the guidelines we have laid down that directs our directors not to talk to their Congressmen about banking legislation in which we have an interest.

We have taken the view all along that our directors are part of the System, that our directors are also citizens, that Congressmen are interested in learning the thinking of their constituents, and that it is up to our directors to communicate their views or not, depending upon



what they want to do. We see no reason for limiting them in this area, as section 4 would do.

Mr. GONZALEZ. I had misgivings. In fact, the original phraseology was a little different, because I agree with you; I think there is no way we can, by legislative fiat, suspend the constitutional privilege of a citizen to petition for a redress of grievances and make his views known.

But I was thinking in terms of what, in the discussion it seemed as though the thrust of the intent was to try and limit any longtime activity of an employee, not necessarily a director, even though the language of section 4 does include directors. And I was interested to discover that you have a regulation in your own Federal Reserve regulatory system.

Dr. BURNS. Yes; we do have such regulations, and, to the best of my knowledge, they are observed scrupulously. And I think it is an impressive fact that the Federal Reserve System has been in existence since 1913, yet there has never been any scandal involving the Federal Reserve, any of our directors, any of our bank presidents, any member of the Board, or any of our officers.

I see no need for singling out the Federal Reserve for special treatment. There seems to be an implication in this bill that we have been wrongdoers.

Mr. GONZALEZ. Well, I, of course, am not familiar with all of the record, but I don't recall any instance where you have it.

Another matter in all of this, though, it looks as if we are acting in determining fiscal and monetary policy—a country individually is its own master; whereas, from what has happened and the other discussions that you had, it seems as if we are, in a way, subject to forces outside of our territorial limits in other countries. And I don't see that we are taking into consideration here.

I think that when we kind of talk about how we can determine velocity, interest rates, and all, we forget about the interrelation that we have now in the world, where the impact of what is happening in Europe will impinge upon us.

At this moment, the dollar has been recorded as being under very severe pressure; and I can't see how, if conditions go a certain way, we wouldn't be confronting a repetition of what we were troubled with about 7 years ago.

And I notice that there was a policy pronouncement by Secretary Blumenthal to the effect that, regardless of those pressures, the Government was not thinking of intervening in the foreign exchange markets to bolster up the dollar.

Now, isn't that an integral part of what would impact our discussion here; and do you have any comments about the wisdom or lack of wisdom about this expressed intent?

Dr. BURNS. I can only speak for myself and, I think, for the Board. We are deeply concerned about the dollar. If the dollar depreciates in foreign exchange markets, that releases forces that tend to raise our price level. There are also serious international implications of a depreciation of the dollar.

When the dollar depreciates in foreign exchange markets, millions of individuals around the world and banks around the world—includ-

ing central banks which treat the dollar as a basic store value—all of these people around the world either are embarrassed or have difficulties. And we have, as a nation, a great responsibility to protect the integrity of our money, not only domestically, but also internationally.

We carry a burden; we may not like it, but we must discharge our responsibility to the best of our ability.

Let me say this: To the best of my knowledge, Secretary Blumenthal's thinking on this subject has been misinterpreted by the press, but he will have to speak for himself.

Mr. GONZALEZ. My time is up. But thank you very much, Mr. Chairman.

The CHAIRMAN. The gentleman from Michigan.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Chairman, standing out, because of its absence, with respect to this legislation is the testimony of the present administration. Neither Secretary Blumenthal, Mr. Lance, Director of OMB, nor Dr. Schultze, Chairman of the Council of Economic Advisers has apparently seen fit to appear and testify or to come out strongly in support of this legislation.

In fact, do you know of anyone of prominence, who is versed in the theory and purpose of the Federal Reserve System, who has come out four-square for this legislation?

Dr. BURNS. I find it difficult to answer the question. I have been concentrating on problems of our economy and our financial system and on certain legislation, and I have not followed the thinking of other people at all systematically. Therefore, my testimony with regard to your question would not be of much value to you.

Mr. BROWN. Well, one of the reasons I ask is, the chairman of this committee, earlier in his remarks, talked about Secretary Blumenthal and Mr. Lance and others who have made statements, and expressed opinions with respect to interest rates and other things; but still have not commented upon the value or the desirability, and so forth, of this legislation.

I was interested in his suggestion that, because these people—Secretary Blumenthal and Mr. Lance and Mr. Schultze and others have testified about GNP, economic growth, interest rates, and so forth—that because they have issued such statements and rendered such opinions that therefore, almost axiomatically, it is perfectly all right for the Chairman of the Federal Reserve Board and members of the Board of Governors to make such statements and express such opinions.

Apparently, he makes no distinction between the substantial difference, in fact, absolute distinction between the direct impact that the statements of those gentlemen or any one of them can have on interest rates vis-a-vis statements by members of the Board.

Not one of those gentlemen can affect interest rates; nor does anyone expect them to be able to affect interest rates in the direct way that the Board of Governors can.

So, to suggest that, because they have spoken out in these areas, that therefore it is entirely appropriate for you to speak out in these areas, I think just oversimplifies, if not suggests ignorance of, the differences between the two.

Mr. Chairman, you have not, in commenting upon the first section of this bill, you have not really addressed a point that I think is significant. It may be a matter of semantics, but a difference, I believe. House Congressional Resolution 133 talked about the Chairman, the Board, the System "consulting" with the Congress. This legislation says that you shall "testify" with respect to these different areas.

It seems to me that the obvious import of the change in that language is to require you to be much more specific, direct, and so forth in these areas than House Concurrent Resolution 133 contemplated. And so it is not only that the area of, and the things that you would express opinion about, are expanded, but really, the nature, it seems to me, of what you are expected to do has been tightened.

Maybe you might care to comment. I don't mean to ask questions that primarily make a statement, but I would appreciate your comments with respect to that.

Dr. Burns, I think your observation is a fair one. Also, House Concurrent Resolution 133 contained a very important sentence reading:

Nothing in this resolution shall be interpreted to require that such ranges of growth or diminution be achieved if the Board of Governors and Open Market Committee determine that they cannot or should not be achieved because of changing conditions.

I think that is a critically important part of that resolution and that it helped to define the nature of the dialog between the Federal Reserve and the two banking committees. The present bill does not contain any such sentence or safeguard.

Mr. BROWN. Mr. Chairman, I would like to pursue this with you, but time has expired. I would just like to say I appreciate your appearing before us this morning.

The CHAIRMAN. Mr. Hanley.

Mr. HANLEY. Thank you, Mr. Chairman.

Dr. Burns, as always, it is a pleasure to have you with us. I am deeply appreciative.

To go back for a moment to the colloquy between you and my friend Congressman Gonzalez, as it related to section 4, and your apprehension about the provisions of that section, certainly you do make a number of points that are salient and certainly deserving of consideration by this committee. And in an effort to sharpen the section, perhaps it might be useful for you to explain to the committee exactly what types of communications have existed between the Federal Reserve Board, the Federal Reserve banks, the commercial banks, and business interest regarding the legislation.

For example, would you provide us with the specific information on the communications, both oral and in writing, which occurred on the efforts in 1974 and 1975 to provide for an audit of the Federal Reserve System? Would you provide us with the same information on the "Sunshine" bill which passed in 1976, and exactly what steps did you and other personnel in the Federal Reserve System take to influence these two pieces of legislation; and as you can surmise, the concern of the committee relates to whether or not the Fed is really acting in conformance with the overall act which forbids lobbying by the administrative agencies with money appropriated by the Congress.

If I could go just one bit further, prior to your response, of particular interest are the minutes of the Chicago Fed which show that President Mays requested each director to make whatever calls seemed natural in order to increase support for the Federal Reserve position. When the "Sunshine" bill was up, the bank's executive secretary was told to follow up with each director the following day to see what contacts had been made.

Well, as I see it, certainly all of us would abhor, for instance, any action taken by the Federal Power Commission, were it to enlist the assistance of utilities or the oil industry to influence a piece of legislation under consideration by the Congress.

Dr. Burns?

Dr. BURNS. Let me be as factual as I can. I know that you function under a 5-minute rule, but I would love nothing better than to have you ask me questions in this area for an hour, or 2, or 3, or for a full day, because by that time, I think you would have a thorough and dependable answer to your questions?

Now you want to know about the contacts that we have with those whom we regulate. We have no contacts with bankers, as bankers, to the best of my knowledge. We do have some contact with our own directors, some of whom happen to be bankers, as specified by law, and who naturally have an interest in the institutions which they serve. That is point 1.

Point 2 is that meetings of directors are held by the New York and San Francisco Banks about every 2 weeks and by the other banks once a month. Now that would mean 26 meetings a year for each of 2 banks—that's 52—plus 120 meetings of the other banks makes a total of 172 meetings a year for the 12 Reserve banks.

Next, another factual point. Mr. Reuss was given the minutes of Reserve bank Board meetings for 3 years, so that he had the materials before him covering 172 meetings times—that is 516 occasions for reports in our Boards of Directors minutes. Now, what did he locate?

He located one item in the minutes of the Boston Reserve Bank. He located three items—you referred to one of them, Mr. Hanley—no, four items in the Chicago Bank, and one item in the Philadelphia Bank.

So out of the 516 possibilities, 5 items turned up. There was no item whatever for 9 of our 12 banks.

On the basis of this evidence one would have great difficulty in sustaining the charge that our banks boards involved themselves "intensively" in communicating with Members of the Congress.

Actually, let me say this: I wish they would involve themselves more. What is wrong with people who are knowledgeable, who have an interest, talking to their Congressmen? Doesn't every one of you talk to bankers, to industrialists, to labor leaders?

Mr. HANLEY. Dr. Burns. If I may, that really isn't the point, and certainly we don't want to deny any individual his or her constitutional right.

I think what we are trying to determine here is whether or not there has been a deliberate and orchestrated effort to influence legislation.

Now going back to the several instances that you mentioned, I think you will agree that the minutes were indeed very sketchy and incomplete.

Dr. BURNS. Now just a minute. You say they were "incomplete;" you don't know that.

Mr. HANLEY. Well, I beg to differ with you.

Dr. BURNS. What is the basis for that judgment concerning the minutes?

Mr. HANLEY. You have made references to but three or four instances—

Dr. BURNS. No; these are Mr. Reuss's references, not mine.

Mr. HANLEY. Would you not agree—as I rekindle my observation of this report, they weren't detailed at all. They were very sketchy. But the fact that there are three or four very conclusive parts here in this testimony that there was really an orchestration on the part of authorities of the Fed leads us to believe that possibly this has been a procedure. And of course if it has, then the intent of this legislation is to get at that, and certainly to make it clear that the law has been violated in the past.

Dr. BURNS. You ought to know, Mr. Hanley, that no such law has been violated, for two obvious reasons. First, the law refers to the use of appropriated funds; the Federal Reserve does not rely on "appropriated funds."

The second point is that Federal Reserve funds, unappropriated funds, were not used—not even 1 penny. What are we talking about here?

Mr. HANLEY. Well, then, that being the case, that perhaps opens up another area that the committee should get involved in: That if the intent of Congress is circumvented by the use of the Fed's own funds—

Dr. BURNS. But I have just indicated that we have not used any of our funds in such communications.

The CHAIRMAN. The gentleman's time has expired.

Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

Dr. BURNS. May I have one word? Mr. Hanley, you and I have to sit down for an extra hour, or 2, or 3, because I would like to pursue your questions. I appreciate your interest, but you are up the wrong alley.

Mr. HANLEY. Dr. Burns, I appreciate your invitation, and I look forward to getting together with you, and we will take that hour or 2.

Dr. BURNS. Thank you very much.

Mr. HANLEY. Thank you, and thank you, Mr. Chairman.

The CHAIRMAN. Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Chairman, I think you have provided us with an important opportunity for exploring a number of very important questions.

I am personally a little troubled by the concern in section 1 for interest rates and velocity. And my concern is that we would, through this legislation, focus the Federal Reserve's attention on interest rates instead of the monetary aggregates.

I would think that if the Federal Reserve were forced to predict interest rates, then they—the members of the Board, like probably all of us—would be inclined to make whatever prophesy were indicated self-fulfilling. It just seems to me that that focus would not serve our economy very well. But I guess we will have an opportunity to discuss that in greater detail during markup.

There is one other question I have, and that is: I would like to ask Dr. Burns that if, in fact, the Board deals with velocity, considers velocity during its decisionmaking process on monetary policy?

Dr. BURNS. The answer is that we do talk about and give our views on velocity. As a matter of fact, you might be interested in correspondence between members of the System and Senator Proxmire. He addressed a series of questions on monetary velocity to each member of the Board, and to each of the Reserve bank presidents who serve on the Federal Open Market Committee.

I answered for the Board, and the bank presidents answered for themselves, individually. The range of views expressed is, I think, very instructive. I think it fully supports the testimony that I have given on that subject.

I would like to send your copies of that correspondence. I think it would be instructive. If the chairman would agree, it might be helpful to put those statements into the record of these hearings.

The CHAIRMAN. What were they?

Dr. BURNS. This is correspondence between Senator Proxmire and members of the Federal Open Market Committee concerning the subject of monetary velocity.

The CHAIRMAN. Without objection, those letters will be included at this point in the record.

[The correspondence referred to and submitted for the record by Chairman Burns follows:]



CHAIRMAN OF THE BOARD OF GOVERNORS  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

June 6, 1977

The Honorable William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D. C. 20510

Dear Bill:

All members of the Board have given careful thought to the questions regarding monetary velocity raised in the letter that you addressed on May 25 to each of them and to the Reserve Bank Presidents currently serving on the Federal Open Market Committee. The Board members have recently considered this subject not only during the deliberations of the FOMC but also in developing the testimony that I presented on the Board's behalf at hearings before the Senate Banking Committee and other Congressional Committees. Accordingly, the Board has decided to make this joint response, supplemented by comments of two individual members. We understand that the five Reserve Bank Presidents on the FOMC are responding individually.

The Board's views on velocity have been set forth at a number of recent Congressional hearings, including the May 3 hearing before the Senate Banking Committee on the Conduct of Monetary Policy. In the statement presented at that hearing, we noted that, in considering growth ranges for the monetary aggregates for the year ahead, the FOMC had taken account--among other things--of "the usual uncertainties about the relationship between money and economic activity." I also made the following observation on behalf of the Board:

"During the past two years, the increases that have occurred in the stock of money have proved adequate to finance substantial gains in the physical volume of output and employment. This experience has demonstrated once again that consideration of the stock of money alone is not sufficient for assessment of the adequacy of the economy's liquidity. Money has a second dimension,

namely, velocity, or--in common parlance--the intensity with which it is being used. Over short periods of time the truly dynamic factor is not so much the stock of money as the willingness of the public to use their money balances. Upswings in business and consumer confidence are commonly reflected in substantial increases of monetary velocity. Moreover, in the case of the narrowly defined money supply, intensity of use has been increasing with special rapidity since 1975, reflecting numerous innovations in financial technology that serve to reduce reliance on demand deposits for handling monetary transactions."

The Board generally expects that over the coming year the increase in the velocity of M-1 will be quite high by historical standards, partly because we believe confidence will continue to improve as the expansion progresses and partly because we anticipate a continuation of the process of financial innovation that has so markedly reduced over-all needs for transactions balances in the past few years. Specifically, we expect that the rise in velocity--coupled with growth in M-1 at rates within the ranges projected by the FOMC in April--will be associated with satisfactory expansion in real GNP.

We also expect the velocity of M-2 to increase, although not so fast as that of M-1. While the velocity of M-2 has been relatively stable over the last ten or fifteen years, it has shown some cyclical fluctuation--perhaps mainly because of changing relationships between market and institutional interest rates. It might be noted in this connection that Governor Partee dissented from the April decision of the FOMC to reduce the upper limit of the range for M-2 (and M-3) by 1/2 of a percentage point, primarily because he believed that financial conditions might permit these broader aggregates to expand strongly for some time to come.

There are, of course, significant uncertainties surrounding the Board's expectations for velocity, as there are with all forecasts of the future, economic or otherwise. The magnitude of the velocity increases associated with continuation of the recovery at a satisfactory pace will depend on the state of confidence, on the rate of increase in prices, on the speed of financial innovations, and on other factors.

Since such uncertainties are inevitable, the Board considers it essential that the FOMC, in its continuing close surveillance of the behavior of the economy and its financial parameters, retain flexibility to adapt monetary policy to evolving circumstances. One source of



flexibility is the wise provision of House Concurrent Resolution 133 that the Committee project longer-run ranges of growth rates for the aggregates, rather than specific rates; such ranges allow for a reasonable degree of adaptation of actual growth rates within the framework of a general policy stance. More importantly, the Board is fully prepared to reconsider the longer-run ranges if developments--with respect to velocity or other relevant factors--differ from expectations or if other events appear to require such reconsideration.

We must, of course, take account of prices as well as real activity--since inflation not only works great hardships but, by its very nature, poses a fundamental threat to sustained economic growth. As the current expansion gathers momentum, it may be that interest rates will rise as part of the process of limiting credit demands--and hence real market demands--to manageable dimensions. Interest rates have, of course, usually risen--although with varying timing and force--during economic expansions. We, like you, earnestly hope that significant increases in interest rates will be avoided in this expansion, but no one can be certain of that.

The members of the Board--and, we are sure, also our Bank President colleagues on the FOMC--will continue to seek policies consistent with maintenance of a satisfactory and sustainable economic expansion that will provide increasing employment opportunities for our rapidly growing labor force.

Additional comments by Governors Coldwell and Wallich are given below.

Sincerely yours,

Arthur F. Burns

Supplement by Governor Coldwell

While I subscribe to the Board's letter, I would like to make the following additional observations.

First, I do not accept monetary aggregates and their velocities as the sole guides to, or measures of, monetary policy. In my opinion the trend and level of bank reserves, bank credit demand, and interest rates as well as the state of market, business, and consumer confidence and expectations are of significant importance to the formulation of monetary policy.

Second, I have a relatively low level of confidence in the predictability of the aggregates and velocity because of our experience with their high volatility and shifting character. The change in transactions balances is creating even greater uncertainty in the definition and measurement of aggregates thus reducing further their reliability as policy targets.

Finally, in pragmatic terms monetary policy, in my opinion, has its primary impact within a 6-month period and should be principally concerned with the demand elements of instability. This position makes me unwilling to assign greater importance to long-range mechanical targets and leads me toward increased emphasis upon bank credit, reserves, and interest rates.

#### Supplement by Governor Wallich

I support the views put forward in the foregoing letter. Nevertheless, I would like to add some views of my own. In doing so, I would like to note that the velocity approach is only one of several ways of looking at monetary theory and policy. While currently I pay close attention to it and in fact examine very carefully the points raised in your letter, I would by no means rely entirely on this type of analysis.

The need to look at velocity arises principally from the fact that today we are using the money supply as a major guide to monetary policy. Under ordinary, i.e., noninflationary conditions, interest rates would be a better guide. Interest rates in the broadest sense, including equity yields, are the channel through which monetary policy and money supply variations transmit their effect to the real sector of the economy. Under noninflationary conditions, I would normally favor as low a level of rates as possible consistent with continued price stability.

Under conditions of inflation, however, market interest rates cease to have a clear meaning. The real interest rate is the rate after deducting the rate of inflation. In recent years, the real short-term rate has been negative much of the time. The real long-term rate, depending as it does on subjective expectations of inflation over the life of the asset, is hard to discern. But taking into account that the inflation premium contained in an 8-9 per cent rate, of perhaps 5-6 per cent, is taxable to the creditor and tax deductible to the debtor, long-term rates probably have been negative for many taxable lenders and borrowers. I believe that this condition in the long run is incompatible with the survival of a market economy.

Under inflationary conditions, interest rates become a poor guide to monetary policy because (1) their economic meaning is distorted, and (2) the central bank no longer can, except quite temporarily, control short-term rates, let alone long-term rates. Inflation thus causes central banks to shift to money supply targets, which convey at least a rough idea of how expansionary a given policy is.

The proper measure of such a policy, as you point out in your letter, is the growth of money plus the growth of velocity. Velocity changes in response to numerous factors, one of which is interest rates. In order to obtain a measure of the appropriate growth of the money supply that is independent of interest rates, I view as the growth of the effective money supply the growth of M-1 and M-2 plus that growth of their respective velocities that would occur if interest rates were constant. In assessing the growth of the effective money supply, I take into account, as I believe do my colleagues on the FOMC, (1) the gross overprediction, by mathematical models, of the demand for M-1 and M-2, i.e., their underestimate of the growth of velocity, (2) the reduction in liquidity preference (increase in confidence) that a dampening of inflationary expectations can be presumed to induce, and (3) the progress in payment techniques, the effect of regulatory changes, and the increase in international liquidity through the Euro-dollar market.

At the same time, I am aware of the evidence that the market anticipates an increase in interest rates, as indicated by the configuration of the yield curve which permits calculation of expected future interest rates, by the prices quoted in the Treasury bill option market, and by the evidence of surveys of numerous interest rate forecasts. I am aware that an effort to control rates contrary to market forces, especially during inflation, is bound to be counterproductive within a short period of time. I am aware that the market, during inflation, seeks to re-establish positive real interest rates. Under these conditions, I believe that the only way to achieve the low interest rates I would like to see is to bring down inflation. I believe that the monetary growth ranges established by the FOMC will, over time, work in that direction, but I would, of course, be prepared to change my view if there is evidence that these ranges are inappropriate.

ALB:kak

cc: Catherine Mallardi (2)  
Arthur L. Broida

FEDERAL RESERVE BANK  
OF BOSTONFRANK E. MORRIS  
PRESIDENTBOSTON, MASSACHUSETTS 02106  
TELEPHONE (617) 426-7100

June 7, 1977

The Honorable William Proxmire  
Chairman, Committee on Banking,  
Housing and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Dear Senator Proxmire:

This is in response to your letter of May 25 concerning monetary velocity. Before answering the questions posed in your letter, I would like to offer three preliminary observations.

First, the income velocity of money is a convenient shorthand description of the relationship between money and nominal GNP, but this shorthand description must be used cautiously. On the one hand, for a given level of the money stock, the level of GNP may fluctuate for a variety of reasons. On the other hand, because changes in the money stock affect GNP with a lag, short-run fluctuations in the money stock will ordinarily have little initial impact on GNP and so the ratio of GNP to money--velocity--will change. For these reasons, only about 50 percent of the short-run variation in nominal GNP is associated with fluctuations in the money stock. This conclusion holds for both the  $M_1$  and  $M_2$  definitions of money.

A second important aspect of interpreting velocity changes and velocity forecasts is that nominal GNP itself is not of primary interest. Monetary policy must be concerned with real GNP and the rate of inflation. Nominal GNP is, of course, equal to real GNP times the GNP price deflator, but the relationship between real GNP and changes in the deflator is complex and not well understood. Excessive concentration on velocity can, therefore, be misleading. For example, a prediction of declining velocity would not be cause for concern if the prediction were accompanied by predictions of a healthy expansion of real GNP and a decline in the inflation rate.

Third, because of the lags in the effects of monetary changes on the economy, it is unwise to concentrate attention excessively on the coming year. While monetary policy changes

have some short-run effects on the economy, today's policy changes will also have significant effects on the economy next year and the year after. There is ample evidence that the undesirable effects of today's policy initiatives on next year's economy cannot be expected to be completely neutralized by new policy initiatives next year. This problem is made particularly difficult by the fact that the effects of monetary policy changes appear first in real GNP and only later in the rate of inflation.

With the above comments in mind, let me now address the specific comments in your letter.

1. I would judge that the most probable expectation for  $M_1$  velocity over the next 12 months would be in the 5% to 6% range and for  $M_2$  velocity in the 2% to 3% range.
2. These judgments reflect my interpretation of the evidence from previous business cycle recovery periods, my optimistic interpretation of the recent performance of the economy, and my belief that continuing improvements in payments technology and institutional changes are likely to lead to higher velocity growth than might otherwise be expected. In this respect, my views are similar to those of Chairman Burns as set forth during the May 3 hearing before the Senate Banking Committee.
3. Monetary policy must always be forward looking and flexible. Consequently, if our velocity expectations are not fulfilled, it will be necessary to make a judgment as to whether the future is likely to bring a similar pattern or a reversal. For example, if velocity growth should be lower than expected because a major strike disrupts the economy, then I probably would anticipate a velocity rebound when the strike is settled. In this situation, lower velocity growth would not warrant a more expansionary monetary policy. Another circumstance clearly not calling for a more expansionary policy would arise if inflation were to be less than expected at the same time that real GNP growth were about as expected. The object of these examples is to illustrate that changes in velocity do not in and of themselves provide a clear guide as to how monetary policy should be adjusted. A shortfall in velocity from the expected levels must be appraised in the light of the total context of economic developments and our objectives for the economy both short-run and long-run.

Sincerely yours,



Frank E. Morris

## FEDERAL RESERVE BANK OF CHICAGO



OFFICE OF THE PRESIDENT

June 7, 1977

The Honorable William Proxmire  
 Chairman  
 Committee on Banking, Housing  
 and Urban Affairs  
 United States Senate  
 Washington, D. C. 20510

Dear Senator Proxmire:

As one of those charged with formulating monetary policy within the framework of institutions and goals established by Congress, I obviously share the interest you expressed in your May 25 letter in achieving our common economic objectives. Therefore, I am pleased to respond to your inquiry about uncertainties in the growth of velocity.

I would emphasize at the outset that I do not view velocity as an independent force. It cannot and need not be predicted with precision. It is, rather, a derivative which is useful only as a rough indicator of reasonableness of more substantive economic factors. Neither a particular level of velocity nor a given rate of monetary growth--nor even a certain level of nominal GNP--is the ultimate goal of policy. What we are concerned with is assuring the highest level of real growth and the greatest reduction of unemployment compatible with continued progress in reducing inflation to more tolerable rates within the next few years. In my consideration of alternative policy courses that may appear to achieve these goals, therefore, I do not forecast velocity independently. I review the resulting velocity figures for consistency with historical experience, for reasonableness in the light of ongoing financial innovations, and for whatever implications it may have for interest rate movements. Thus, stated somewhat differently, my judgments on velocity are derived from my views of what policies are required to achieve real growth and price performance objectives over the next few years.

The Hon. William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs

June 7, 1977

Given the present stage of the business cycle, the degree of utilization of resources, the present momentum of the economy--and assuming the moderate stimulus called for in the announced growth paths of the monetary aggregates--I expect a continued increase in real GNP at rates consistent with further efforts to reduce unemployment and to achieve some further slowing in the GNP price deflator over the year ahead. I personally feel that something less than the current published forecast views of a 6 per cent rise in the GNP deflator is appropriate and attainable and should be actively pursued.

Assuming, therefore, a somewhat less expansive monetary growth path in 1977 than occurred in 1976, the implied rise in M-1 velocity to attain these results would be perhaps a bit above the average behavior of velocity in the third year of earlier post-war recoveries, but that is largely attributable to the continuing innovations in financial management which will tend to shrink the relative importance of M-1.

The implied rise in M-2 velocity would not, of course, be rising as rapidly. As suggested earlier, these views are consistent with favorable targets for the price performance.

It is difficult to assign a specific degree of confidence to these velocity expectations given the usual uncertainties that surround the entire forecasting process. But on the tests of reasonableness, I am sufficiently confident of the velocity implications to accept the announced aggregate growth rate ranges for the monetary aggregates as being consistent with attaining sound objectives of real growth and restraint of price increases.

I certainly would not hesitate to revise our money stock growth path if movements in the economy departed substantially from the expectations noted earlier. Indeed, I view this possibility as the basic reason for the Committee's frequent reviews of its 12-month monetary aggregates ranges. However, the money stock growth path should not be changed simply because velocity fails to match expectations. To the extent that monetary policy

The Hon. William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs

June 7, 1977

actions of the past two years have made successful inroads on inflationary expectations, lower-than-expected levels of (1) nominal income, (2) price increases, and (3) interest rates (and therefore of velocity, as well) should be fully compatible with an appropriate rate of real growth.

If, to the contrary, this optimism regarding progress on the price front is not justified, there seems to me even more reason to continue on the moderate course that we set more than two years ago. Indeed, if some semblance of price stability is ever to be restored, we must eventually reduce monetary growth to a rate below that of the past several years. Consequently, although I will be taking note of the velocity figures as they come in over the next several quarters, I will be watching much more closely the breakdown of increases in nominal GNP between real growth and price changes. In my judgment, only evidence of a serious slowing of real growth would justify any acceleration of monetary growth at this point in the cycle.

I hope that you find these thoughts responsive to your concerns. In the event that further clarification would be of value, you may be assured of my full cooperation.

Sincerely,

  
Robert P. Mayo



June 8, 1977

The Honorable William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D. C. 20510

Dear Senator Proxmire:

This is in response to your letter of May 25, 1977.

My policy recommendations at meetings of the Federal Open Market Committee are based primarily on formal and informal models developed at the Federal Reserve Bank of St. Louis. In these models the dominant determinant of nominal GNP is the money stock appropriately lagged. The extent by which changes in the growth rate of money stock affect the growth of nominal GNP depends upon society's demand for money balances. The reciprocal of this demand for money balances is frequently referred to as income velocity.

This velocity, in turn, is determined by a whole host of other factors such as interest rates, wealth, current price levels and expectations of future price levels. Thus, while velocity is implicit in our models, we have not found it necessary to measure it explicitly as a unique variable, or to rely on its projections. Since I do not rely on explicit velocity projections in my policy recommendations at FOMC, I find it impossible to answer your specific questions.

As to our expectations for the remainder of this year, our research indicates that the  $M_1$  growth range of 4.5 to 6.5%, given our expected growth in wealth, projected credit demands and expectations of inflation, should be sufficient to produce a sustainable growth in output without accelerating inflationary pressures this year.

I appreciate your interest in this important subject and hope that my response is clear.

Sincerely,

Lawrence K. Roos

ABF/LKR:ml

FEDERAL RESERVE BANK OF KANSAS CITY  
FEDERAL RESERVE STATION  
KANSAS CITY, MISSOURI 64108

June 8, 1977

The Honorable William Proxmire  
Chairman, Committee on Banking,  
Housing and Urban Affairs  
United States Senate  
Washington, D. C. 20510

Dear Senator Proxmire:

This is in response to your letter of May 25, 1977, in which you expressed your concern regarding the growth of money velocity and its impact on monetary policy objectives for the period ahead. Specifically, you requested my views as a member of the Federal Open Market Committee as to the expected performance of velocity for the M1 and M2 money measures.

I would agree that monetary velocity plays an important role in determining the appropriate level of money stock needed to foster a satisfactory level of economic activity. I would note, however, that velocity is but one of several interrelated variables to which I give consideration at the time the Open Market Committee sets its long-run growth ranges for the monetary aggregates.

In assessing the outlook for M1 velocity, I have taken into consideration several factors which suggest that velocity will grow at a rate above its historical trend of about 3 percent. One of these factors is the structural change taking place in certain deposit-type accounts, such as NOW accounts and business savings accounts, which will tend to stimulate velocity growth. Another factor is my expectation that overall economic activity, as measured by real GNP, will grow at a rate in excess of its long-term trend in the period ahead. Past experience suggests that this expected growth in real GNP is likely to be associated with a growth in velocity above its historical trend. Also, as economic activity accelerates through the remainder of 1977 into 1978, it is reasonable to expect some cyclical increase in interest rates that will further boost velocity growth. Based on these factors, it is my expectation that the growth of M1 velocity will increase at a rate well above its historical trend and within a range that will be consistent with the expected strong growth in the economy.

## FEDERAL RESERVE BANK OF KANSAS CITY

The Honorable William Proxmire  
page 2  
June 8, 1977

The rationale underlying the outlook for M2 velocity incorporates similar considerations. In brief, the trend growth rate in M2 velocity, which is about zero, is expected to continue. Also, the growth rate of M2 velocity has tended to be above its trend rate when the growth of real GNP exceeds its trend rate. And, finally, while financial innovations have tended to have a smaller impact on M2 than on M1 velocity, the velocity of M2—as for M1—is expected to be stimulated by the cyclical rise in market interest rates. For these reasons, I would expect M2 velocity to increase well above its historical trend in the period ahead.

Important ingredients for any economic forecast are the anticipated level of consumer and business confidence and the expectation for price inflation. Since these factors as well as velocity are subject to a large number of uncertainties, there is a need for continual reassessment of our economic performance in order to make appropriate changes in the growth of the money stock. Therefore, I am quite prepared to alter my views in light of changing economic conditions, including any significant change in the outlook for the velocity of money.

Sincerely,



Roger Guffey  
President

## FEDERAL RESERVE BANK OF NEW YORK

June 9, 1977

The Honorable William Proxmire, Chairman  
 Committee on Banking, Housing and Urban Affairs  
 United States Senate  
 5241 Dirksen Senate Office Building  
 Washington, D. C. 20510

Dear Senator Proxmire:

In replying to your letter of May 25 regarding uncertainties in the prospects for monetary velocity, some preliminary comments on these uncertainties and their implications for setting monetary policy objectives seem necessary to put them in context.

As most commonly defined, the velocity of money is merely the level of current dollar GNP divided by the current level of one or another measure of the money stock. Uncertainty about the future course of velocity is therefore nothing more or less than uncertainty about the relationship between prospective money growth and the prospective path of nominal GNP.

The variability of velocity is not something new this year, but is rather a well established phenomenon with a long history. The difficulty of forecasting velocity's future behavior with any great precision over the short run is, in my view, also well established. There is no mechanically precise relationship between the behavior of money and nominal GNP. Chairman Burns noted in his testimony to your Committee that over short periods of time the willingness of the public to use their money balances--i.e., to change the velocity of these money balances--can be the dynamic factor. I believe that it is not always appropriate to think of velocity as a variable independent of what is happening in the short run either to money or to GNP. In other words, with a given money supply, a more or less rapid growth in GNP may occur for other reasons and this will be reflected after the fact in a more or less rapid monetary velocity. Similarly, in the short run a monetary acceleration or deceleration may have little effect on GNP and may therefore be largely reflected in movements in velocity. The uncertainties become even more apparent when attention is turned to the short- to intermediate-run relationships between money growth and growth in the real and price components of nominal GNP taken separately.

2  
FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, NEW YORK 10045

None of these problems are new and they are not at all likely to lessen in the foreseeable future. Indeed, as the Business Week article suggests, recent changes in regulation and technology with regard to certain kinds of accounts at commercial banks and thrift institutions may have complicated further the problem of predicting the relationship between the narrower definitions of money and nominal GNP and therefore the future behavior of velocity for these definitions of money.

It is just because of these uncertainties relating to the behavior of money and the major economic objectives that monetary policy making cannot be reduced to a mechanical process of setting precise monetary targets to achieve predetermined economic goals. Given the uncertainties, I believe it has been highly appropriate for the FOMC (1) to project monetary growth rate ranges rather than precise single-valued monetary targets, (2) to look at several monetary aggregates rather than concentrate exclusive attention on a single concept, and (3) to re-evaluate longer term monetary objectives at frequent intervals in light of ongoing developments in the economy.

Having stressed the uncertainties that always exist about prospective movements in velocity and the consequent need for flexibility in setting monetary objectives, I nevertheless would like also to stress the importance I attach, in the context of greater economic uncertainty and greater inflation in recent years, to the process of setting monetary growth rate objectives for a period ahead--a process that you encouraged and indeed pioneered. In that connection, the longer term strategy of gradually slowing monetary expansion to rates compatible with approximate long-run price stability is also important to my thinking.

Whatever the short-run uncertainties, there seems little doubt that over time there is a significant and substantial relationship between the growth of money and the growth of nominal GNP. Perhaps more to the point, there is little doubt in my mind that over time there is a substantial relationship between the rate of monetary expansion and the behavior of prices. These fundamentals were, I think, much in your thinking, and that of your Committee, in encouraging the use of monetary "targets." Moreover, there is ample evidence that the rates of monetary growth we have experienced over recent years are too high to be consistent with restoring price stability over time.

I do not want to suggest or claim other factors are not relevant in the inflationary process, but I do believe that moderation in monetary growth is a necessary condition for the restoration of reasonable price stability, and that progress in that direction, far from conflicting with growth and employment goals, will over time prove a prerequisite to continued and orderly growth. Put another way, I think the experience of recent years strongly suggests that a resurgence of inflationary pressures would be damaging to our employment goals and to the purpose of sustaining the expansion.

3  
FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, NEW YORK 10045

On this view, I believe that the Federal Reserve's strategy of moderation in monetary growth, and very gradually seeking to reduce monetary growth over time, is consistent with our goals not just for this year, but for the longer run. I also believe that this Federal Reserve strategy has substantial importance as a public symbol of our national commitment to do something about inflation. Inflationary expectations are, unfortunately, deeply imbedded, and these expectations help account for the inflationary momentum we observe. While I cannot quantify the impact, I do believe the progress we have been able to achieve in dampening inflation, and the prospects for further progress on that front and in sustaining expansion are in part dependent on the success of our efforts to contain monetary growth.

Consequently, while the uncertainty attached to the short- to intermediate-run behavior of velocity certainly counsels flexibility in ensuring an adequate rate of monetary expansion to support the economic recovery, I would be very reluctant to see a serious breach in our longer run strategy of gradually reducing monetary growth rates without clear justification.

I think it is also useful to note that the pursuit of objectives for the monetary aggregates does not in itself imply any particular objectives for interest rates. This is not to say of course that Federal Reserve actions will have no influence on interest rates--though even here, short- and long-run influences should be carefully distinguished. But it does mean that whatever interest rates eventuate do so as a by-product of the interaction of the economy with monetary behavior and not as an explicit objective of the central bank. Over time, I would certainly like to see lower interest rates. But that must be achieved consistent with other goals and specifically that objective can be achieved and sustained, I believe, only in a context in which inflation is also brought under control. In that case, gradual reduction in monetary growth rates also seems to me consistent with important and lasting reductions in the average level of interest rates.

To turn to your specific questions, in my own thinking, I do not start with an explicit forecast for velocity for the coming 12 months. However, the current longer term Federal Reserve target ranges for the monetary aggregates, when set against the commonly cited forecasts for GNP, seem to me to imply growth rates for velocity that are attainable in terms of historical behavior and in light of some special circumstances we are currently experiencing. For example, the current consensus estimate of GNP for 1977 suggests about an 11 percent increase in current dollar terms for 1977 over 1976, and a slightly higher figure from year-end to year-end. Given such a rise, the 5 1/2 percent midpoint of the FOMC's current 4 1/2 to 6 1/2 percent M1 range implies a velocity increase of from 5 to 6 percent. (Actually the time horizons covered by the GNP projections and the monetary ranges are not identical, so the

velocity implications should be taken only as suggestive.) While this is higher than the long-run trend growth rate of M1 velocity, velocity growth generally has been higher during expansion periods. For instance, the average rate of increase during the last four economic expansions following the first years of these expansions has been 4.2 percent and during the first years of expansion has averaged over 5 percent.

In fact, M1 velocity growth has averaged a 5.6 percent annual rate of increase over the first two years of the current economic expansion and growth in the most recent quarter was 7.0 percent. The relatively rapid expansion of M1 velocity in the current recovery appears to have been related in part to various regulatory and technical innovations that have caused some shift out of commercial bank demand deposits. Under current conditions, these shifts seem likely to continue. Given this situation and recent patterns, a velocity rise in 1977 somewhat in excess of average historical experience for this stage of the cycle seems a reasonable expectation.

Applying similar computations for M2 to the 11 percent rise in nominal GNP implies a velocity growth for M2 not much above the 2 1/2 percent average rate of M2 expansion in the four previous economic expansions following their first years. I should note explicitly that the substantially lower velocity growth implied for M2 relative to M1 seems reasonable both in terms of the historically more rapid rise in M1 velocity and the special factors noted above that are currently acting to reduce the demand for M1-type balances.

I do not in any way offer these velocity numbers as firm projections, but only as indications that the monetary ranges currently in use by the FOMC coupled with the current consensus GNP projections seem to imply velocity behavior not out of line with historical experience and current circumstances.

In specific response to your final question, I would of course be prepared to adjust monetary objectives if circumstances so warranted, but I do not believe the performance of velocity by itself would be the only relevant factor in that judgment. Obviously, such factors as the performance of prices and real GNP, the composition of GNP, movements in interest rates and other elements in money and capital market conditions would also be relevant. As noted earlier, the use of ranges for the aggregates permits some adjustments of this kind in any event. But in arriving at any judgment about possible changes in the Federal Reserve's monetary objectives, as I suggested earlier, I think we should all feel sensitive to the danger of the central bank reinforcing inflation and

MISC. 140A.2-4/74

5  
FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, NEW YORK 10045

inflationary expectations by accelerating its objectives for monetary growth without persuasive reasons.

I hope these comments are responsive to your concerns.

Sincerely yours,

Paul A. Volcker  
President

RCD:PAV/op

C  
O  
P  
Y



JOHN SPANFMAN, ALA.  
 HARRISON A. WILLIAMS, JR., N.J.  
 THOMAS J. MCINTYRE, N.H.  
 ALAN CRANFORD, CALIF.  
 ADLAI E. STEINBERG, N.L.  
 ROBERT WOODMAN, N.D.  
 DONALD W. RUGLEY, IN.  
 PAUL S. BARNHART, IND.

EDWARD W. RYAN, MASS.  
 JOHN TOMER, TEX.  
 JACOB GUIN, UTAH  
 H. JOHN HEINE III, PA.  
 RICHARD C. LUGAN, IND.  
 HARRISON SCHMITZ, N. MEK.

KENNETH A. MCLEAN, STAFF DIRECTOR  
 JEREMIAH S. RUGLEY, MINORITY STAFF DIRECTOR  
 MARY FRANCES DE LA PAVA, CHIEF CLERK

## United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
 WASHINGTON, D.C. 20510

May 25, 1977

The Honorable Arthur F. Burns  
 Chairman of the Board of Governors  
 Federal Reserve System  
 20th & Constitution Avenue, NW  
 Washington, D. C. 20551

Dear Arthur:

I am greatly concerned by the attached article from the May 30, 1977 issue of Business Week entitled "How Velocity Can Fool the Money Watchers." It indicates that economists are not in agreement as to the likely course of velocity and that differences of opinion may also exist among members of the Federal Open Market Committee.

If velocity growth slows down, the monetary aggregate targets that were voted by the Federal Open Market Committee in April, and conveyed to the Senate Committee on Banking, Housing and Urban Affairs on May 3, 1977, may not be sufficient to insure that the recovery will continue at a pace consistent with the growth of real GNP and employment expected by the Administration and the Congress and may result in significant increases in interest rates.

As you know, the Committee on Banking, Housing and Urban Affairs is responsible for oversight and review of monetary policy decisions of the Federal Open Market Committee and for reporting its findings to the Senate. Our oversight and review is made more difficult at a time like this when great uncertainty exists about the growth of velocity. Velocity is an important link between the FOMC's monetary objectives and the ultimate objectives of growth in real GNP, full employment and stable prices. Evidently no consensus on the likely growth of velocity exists among economists.

In order for the Committee to exercise its oversight responsibilities, we need to know what assumptions the members of the FOMC made about velocity when it approved the monetary targets and to what extent there may be divergent viewpoints on the committee. Accordingly, I am asking each member of the Open Market Committee to respond directly to the following questions:

1) What are your expectations for the growth of velocity of M-1 for the next twelve months?

2) What degree of confidence do you attach to those expectations?

3) What is the rationale for those expectations, and on what evidence do you base your judgment?

4) What are your expectations for the growth of velocity of M-2 over the next twelve months?

5) What degree of confidence do you attach to those expectations?

6) What is the rationale for those expectations and on what evidence do you base your judgment? (If your expectations for the behavior of M-1 and M-2 differ significantly, please explain why.)

7) Are you prepared to adjust your goals for money stock growth if velocity growth does not proceed to meet your expectations?

These are important questions that I am sure you must have considered in your preparation for not only the April meeting of the Federal Open Market Committee, but also for the more recent meeting in May. Therefore, I would hope that you can reply without delay.

All best wishes.

Sincerely;

  
William Proxmire  
Chairman

WP:srt

## ECONOMICS

## How velocity can fool the money watchers

The money supply now commands greater attention than any other economic statistic. Congressmen, businessmen, and money managers eye the money numbers as they do no other figures coming out of Washington, some lining up at the Dow-Jones ticker on Thursday at 4:00 p.m. to get the weekly money supply numbers, much like horseplayers trying to get the latest race results. The implication is that control of the money supply leads to stabilization of the economy. And tracing the growth of money yields good forecasts of output, prices, and interest rates.

Yet just as the money supply achieves superstar status, serious questions are being raised about whether money-watching works, either for forecasters or policymakers.

For money to tell the whole story, or even a good part of it, the rate at which money turns over—its velocity—must be reasonably stable or predictable. If velocity is stable, controlling the money supply is an effective tool for influencing the growth of the gross national product, at least in the long run. But if velocity rises, a given amount of money will support a larger volume of economic activity, so there is no longer a simple relationship between money growth and GNP.

Velocity is a concept that economists have used since Irving Fisher (1867 to 1947), probably America's greatest mon-

etary economist, developed the theory at the turn of the century that the supply of money determined the level of national income. Fisher assumed that velocity was reasonably constant. Today's economists know that velocity is in an upward trend. For example, in the first quarter of 1968 GNP reached \$837.3 billion and the narrowly defined money supply,  $M_1$ , averaged \$189.1 billion. So velocity, or the turnover rate, came to 4.42. But by 1973 velocity had risen to 5.04 (chart).

### Its instability means that money is a poor guide to economic performance

Indeed, since World War II velocity has looked predictable, increasing at about 3% a year. But suddenly in the past two years it has risen at almost twice that rate, and the GNP increased at 24% over that period, double the rate of increase in the money supply. Arthur F. Burns, chairman of the Federal Reserve, expects yet another sharp spurt in velocity, and he is basing Fed money policy on that assumption.

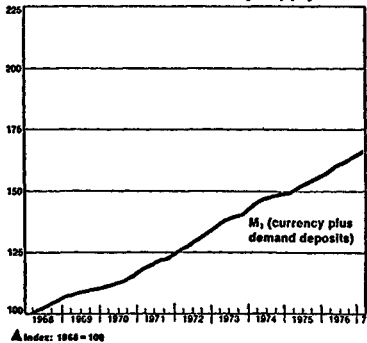
Disagreement, however, few economists agree on just where velocity will end up. The critical issue, therefore, is whether the Federal Reserve can make sound decisions on how much money is adequate to support economic growth without either sending interest rates soaring or reigniting inflation.

Says J. Charles Partee, a governor of the Federal Reserve Board: "Velocity is another element of uncertainty in setting money growth targets. There never was all that much certainty between money and GNP, and now there is less."

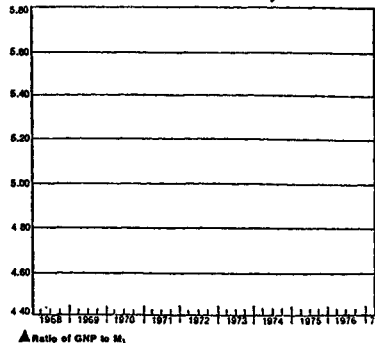
'Deterioration.' Another way to look at velocity is to examine its converse—the demand for holding money. And this, too, has become unstable. Economists say that the amount of currency and checking deposits that individuals and companies want to hold depends primarily on two factors—the level of GNP and interest rates. Rising GNP, say economists, means that individuals and companies will want larger money balances to finance greater purchases of goods and services. On the other hand, rising interest rates make people reluctant to hold money that could be put into interest-bearing accounts or securities. These basic tendencies still hold, but their precise relationship has changed drastically. "We have seen a progressive deterioration of the money demand function," says Partee.

Most economists would agree with Partee, though the exact magnitude of the deterioration is unclear. In the latest issue of the *Brookings Papers on Economic Activity*, Princeton University's Stephen M. Goldfeld finds that the demand for money in the second quarter of 1976 was \$22.4 billion less than was predicted by an equation that success-

The economy has been growing faster than the money supply . . .



. . . so money has been changing hands much faster in recent years



Data: Federal Reserve Board

Source: Federal Reserve Board



The Fed's Partee: "There never was that much certainty between money and GNP."

fully forecast money demand for the period from 1952 to 1972. Another simulation, by Allen Sinai of Data Resources Inc., yielded substantially better results, but it still had an overprediction of \$6 billion for 1976.

Other economists, particularly monetarists, argue that the events of the past few years do not signal a permanent shift in money demand, but rather resulted from a business cycle marked by very sharp swings. "The demand function tends to be stable over the long term," says Anna J. Schwartz of the National Bureau of Economic Research Inc. and co-author, with Milton Friedman, of *A Monetary History of the U.S.*

But even economists who believe there has been no permanent change in the demand function agree that the relationship between money and national income is less stable than it used to be. Monetarist Michael J. Hamburger, for example, a researcher for the New York Federal Reserve, challenges Goldfeld's figure of \$22.4 billion. But he still finds his model overpredicting the actual money supply by \$9 billion in 1976.

**Banking changes.** The narrowly defined money supply,  $M_1$ , consists only of currency in circulation and demand, or checking, deposits at commercial banks. The Fed also keeps statistics on a series of progressively more comprehensive money aggregates.  $M_2$  consists of  $M_1$  plus savings, or time, deposits at commercial banks.  $M_3$  is  $M_2$  plus deposits at savings and loan associations, mutual savings banks, and credit unions.

In the original design of these categories,  $M_1$  consisted of all money that could be used in transactions, while the higher aggregates represented assets that first must be converted into transaction money. But this distinction is breaking down under the pressure of institutional and

technological changes in banking, and this is accelerating the increase in velocity.

Thrifty institutions in many states offer negotiable order of withdrawal (NOW) accounts, which are, for all practical purposes, interest-bearing checking accounts. Deposits in such accounts behave like  $M_1$ , but they are not counted as such.

Similarly, many S&Ls will arrange to pay depositors' bills directly out of a savings account, or they will transfer money from savings to checking with only a telephoned request. Many banks allow automatic overdraft provisions on checking accounts, permitting depositors to maintain smaller balances safely. All of these factors reduce the amount of  $M_1$  individuals must hold to pay for ordinary financial needs. Fed economists estimate that these factors added between one and two percentage points to velocity last year.

Other changes have allowed businesses to reduce their cash balances. Com-

Great Commission—B&W



Princeton's Goldfeld: He finds that money demand has dropped by \$22 billion.

panies are now permitted to keep money in interest-earning savings accounts. Some banks offer plans by which demand deposits above a specified level are automatically transferred to savings or other short-term investments at the end of each business day. Companies also have greatly increased their use of nonmoney assets, such as Treasury bills, as a source of interest-earning liquidity.

In addition, the combination of high interest and inflation rates has led businesses and individuals to hold as little money as possible in noninterest-bearing forms. "It is now easier to move back and forth between  $M_1$  and other forms of money or near-money," says Goldfeld. "People used not to consider the cost and inconvenience of moving between these forms worthwhile. But when short-term interest rates topped 12%, it became attractive, and they discovered that it was not as inconvenient as thought."

Pending changes in regulation and technology are likely to accelerate the move out of  $M_1$  and further cloud both the meaning of the monetary aggregates and their relationship to national income. Congress is now considering legislation that would permit commercial banks in all 50 states to offer NOW accounts, allowing interest to be paid on checking deposits.

**Redefining.** Because of these developments, both monetarists and nonmonetarists think that the time has come for the creation of new classifications for money that will more accurately reflect reality. And the Fed agrees. "We are considering redefining the aggregates," says Partee. "The only thing that has been holding us up is the uncertainty over congressional action on NOW accounts."

For the time being, however, the Fed is stuck with what it has. And to the extent that the monetary aggregates no longer mean what they used to, it is difficult for the agency to determine how

much money growth is needed—or, indeed, how much is occurring. "This is worrisome," says Partee. And while the Fed continues to rely on above-trend growth in velocity to make its money targets work, there is some foreboding that this may not continue forever. "Velocity has led a charmed life," says Partee. "But we have to be prepared for this to come to an end."

Many economists believe that, by relying on velocity to continue to grow well above trend, the Fed is running a serious risk of underestimating money needs, which could send interest rates soaring. Jerry L. Jordan, vice-president of Pittsburgh National Bank and former research director of the St. Louis Fed, believes that the recent surge in velocity is largely a catch-up from a drop in the growth of velocity during the recession. "I expect the growth to slow down in coming months," he says. "This raises a lot of uncertainty about Fed policy."

For its part, the Fed is likely to muddle through by continuing to watch and control the growth of both  $M_1$  and  $M_2$ , while taking its best guess about the impact of changes in the link between money and the level of economic activity. "There is a certain amount of trial and error involved," says Partee. But there are many who worry that a Fed policy that relies on accelerating velocity for another year may dump the economy into a recession in 1978. ■

Mr. NEAL. Mr. Chairman, I have been told by economists, and apparently it is a widely held view among economists, that velocity is a relatively random occurrence; that it is essentially unpredictable. Would you agree with that?

Dr. BURNS. No; I would not agree with that. I would rather say that while velocity has an erratic component, it moves in general with the business cycle. I have preached that lesson repeatedly. And, if I may say so, the reason I have had somewhat better luck than many others in predicting velocity is that I know that velocity tends to reproduce the movement of aggregate economic activity. Therefore, velocity is not a random variable, although it does have a heavy random component.

Mr. NEAL. Well, if it is predictable, then—

Dr. BURNS. No, there are two difficulties. First, the difficulty in predicting the business cycle; second, the difficulty in predicting the random component of velocity that is superimposed upon the cyclical movement in velocity.

It is not a variable that can be predicted by many individuals. Some of us, I think, have been quite lucky in predicting it.

Mr. NEAL. Do you have any objection to trying to predict it, as this bill requires, then?

Dr. BURNS. There is a difference, you see, between predicting the direction of velocity and predicting its actual magnitude. This is a subject I have studied for 50 years.

I have no difficulty in giving you my views as to the general direction that I expect velocity to take, or indicating the margins of error arising from the erratic component in that variable. But I don't know how to predict actual magnitudes, and I don't know of anyone else that does. And certainly the members of the Federal Open Market Committee make no effort to do that.

You see, the Federal Open Market Committee, in the last analysis, deliberates as does a legislative body in the area of monetary policy. There is a range of competence within that committee, and we attempt to quantify only the monetary aggregates.

The CHAIRMAN. The gentleman's time has expired.

Mr. Rousselot?

Mr. ROUSSELOT. Thank you, Mr. Chairman.

Dr. Burns, I am pleased that in your continuing efforts to carry on a continuing of dialog between ourselves and your Board that you are here today.

On page 5 of your testimony you state as follows:

Conceivably, in response to a congressional mandate, the FOMC could vote on some numerical figure for monetary velocity. But any such exercise is not necessary for effective policy formulation.

Now there are many who have suggested that if one had a fair idea of what nominal GNP growth would be in a given period—say it were 12 percent—and if he could estimate the velocity at, say 4 percent, he could subtract the two and come up with an 8 percent target for  $M_1$  growth.

On June 9, Paul Volcker, president of the Federal Reserve Bank of New York responded to a request from Senator Proxmire for the views of the Federal Reserve Board and voting members of the Federal Open

Market Committee, concerning monetary velocity. You have just asked that this letter be placed in the record, and I would like to briefly quote from it: "There is no mechanically precise relationship between the behavior of money and nominal GNP."

Now, my question is twofold: To what extent do members of the Federal Open Market Committee take velocity into account in setting policy? That is one question.

And, two: Would this bill reduce their ability to use their best judgment in this regard?

Dr. BURNS. At our meetings, we discuss two subjects very extensively: first the condition of the economy; second, economic prospects as we see them.

Our staff makes a very detailed presentation. After that, individual members of the committee express their views, particularly if their views diverge from opinions expressed by the staff.

A little later, we discuss what we think monetary policy ought to be, and we try to set objectives for ourselves in terms of the growth of the money supply, and in terms of the one interest rate over which we have substantial control—that is, the Federal funds rate, which is essentially the interbank lending rate.

Now monetary velocity, as such, is not a formal subject for discussion, but I can't recall a meeting when some view on velocity has not been discussed by some members of the Federal Open Market Committee.

Mr. ROUSSELOT. You think it's a factor, then, in setting policy?

Dr. BURNS. I think it plays some role in the thinking of individuals, we give more attention to the money supply, because historically we know that when the money supply stops growing, an economy is likely to falter; and we also know that when the money supply grows excessively, inflation will be generated.

So we pay more attention to the money supply. It is more basic and more predictable a factor than velocity.

Mr. ROUSSELOT. Well, would this bill in any way inhibit the use of the best judgment of members of the FOMC with respect to velocity?

Dr. BURNS. I don't think this bill would inhibit us. It really wouldn't inhibit me; you can't change my economic thinking just because you ask me to do something that I don't see any way of doing at all well.

I do think that if such a law were passed, we would perhaps spend a great deal of time talking about things some of us on the Committee know very little about. I happen to be a student of this subject; without in any way reflecting on my colleagues—that's not my intention—I would have to say that because of different professional backgrounds some know less about this subject. There are other areas where they know vastly more than I do. So you see, we would be spending a great deal of time on a subject that few people really understand and then coming up with a guess. What good would that do anyone? Please don't ask us to do that; we would be chasing ghosts.

Mr. ROUSSELOT. Well, we never chase ghosts here. You understand that.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Blanchard?

Mr. BLANCHARD. Thank you, Mr. Chairman.

Dr. BURNS, two items—two amendments are likely to arise before this committee if and when we mark up this bill. I would like your reaction to them.

The first is the idea of making the term of the Chairman of the Board of the Federal Reserve System coterminous with that of the President.

The second item is one which would shorten the term of members of the Board of Governors from 14 to 8 years.

What is your reaction to those two ideas and the reasoning behind your reaction?

Dr. BURNS. When I testified at length on the first question recently before Congressman Mitchell's subcommittee, I testified against a co-terminous term.

In a sentence: This would introduce a political dimension into the Federal Reserve which might prove injurious, and the need for any such change in the law has not been even remotely demonstrated. Why write a law when there is no problem? Nobody has defined a problem in this area.

As to the second question, about shortening the term of the Federal Reserve Board members, I can't honestly say that 14 years is right and that 16 or 12 or 10 years would be wrong. But, again, I do think that a relatively long term for members of the Federal Reserve Board gives some assurance that they will not be swayed by short-run political considerations. That is what Congress had in mind in setting long terms: To insulate the Federal Reserve from day-to-day, month-to-month political pressures. Therefore I am in favor of a long term for members of the Board; but I am not going to argue that 14 years is right and some other number is necessarily wrong.

Mr. BLANCHARD. I guess those two items get into the whole historic debate that has been going on for the 3 years I have been here on the relation of the Fed to Congress or to the Executive. And it is quite obvious to me that this bill is a product of that debate.

But it would seem to me that there are really two ways to go. If you buy the assumption—and I don't know that you do—that there ought to be some greater coordination of monetary policy with fiscal policy, then there are two ways to go. One is to have greater accountability of the Fed with Congress; and the other, which does not exclude the first, would be to the President.

Do you accept the assumption that there ought to be better coordination of fiscal policy with monetary policy; and how do you perceive the role of Congress in this whole area?

Dr. BURNS. If you mean by "coordination" the interchange of ideas—communication—then I can say to you that there is very effective coordination with the Executive. I meet with the Secretary of the Treasury every week; we had a lengthy breakfast meeting morning. And, my colleagues and I meet with the Council of Economic Advisers, I meet with the President once every few weeks. So there is ample opportunity for exchanging ideas and impressions and knowledge.

As far as communications with Congress is concerned, I commented at some length at the beginning of my formal testimony on the dialog that has been developing between the Federal Reserve and the Con-

gress. That dialog—and I don't say this in any mood of criticism, I am just reporting a fact—has gone further with the Senate committee than it has with this committee.

In addition to having a dialog on monetary policy under the concurrent resolution, we have had with the Senate committee—and I have invited it—a dialog on the condition of the banking system and a dialog on the Federal Reserve budget. In fact, I suggested a dialog upon supervisory policy as well. We are thus learning from each other.

I just invited Mr. Hanley to meet with me. That invitation goes to every member of the committee; I would like to meet with each of you individually or in small groups frequently between oversight meetings. I wish we would find a way of doing this more effectively. For that matter, I am sure my colleagues on the Board would want to do the same. And perhaps we would learn to understand one another better, and by working together we could in time do what after all, each of us is seeking to do: to help this country have a better future for ourselves and for our children.

So, I am open to any new ideas in this area, and I appreciate your raising the question.

Mr. BLANCHARD. I guess my time is expired. Thank you, Dr. Burns.

The CHAIRMAN. Mr. Lundine?

Mr. LUNDINE. Chairman Burns, I am somewhat concerned with the fourth provision in this bill regarding lobbying. Under your interpretation of this provision, what would the Federal Reserve Board be permitted to do with respect to legislation? In other words, do you interpret this to mean that you could never pass a resolution regarding any legislation on banking or finance issues?

Dr. BURNS. I can't answer that; I would have to consult our attorneys. I have to say that that particular paragraph, or set of paragraphs, in the testimony was written sentence-by-sentence and word-by-word on the advice of our legal staff.

These are not just my views; they are the views of a highly trained professional legal staff.

Mr. LUNDINE. Well, I understand your objections; and I think I understand some of the reasons behind them. What I am also trying to come to an understanding of, is, as a practical matter, the extent of the inhibition that this would put upon the Fed and members of the Board.

Dr. BURNS. I think I can only answer that by saying that on the basis of my reading of the bill, and on the basis of the advice that I have received from our legal staff, the inhibition would be very great indeed. In the last analysis, while we at the Federal Reserve may or may not like what Congress does, we do live by the law very strictly.

Mr. LUNDINE. Thank you, Mr. Chairman.

In the interest of time, I won't ask any further questions.

The CHAIRMAN. I thank the gentleman; and I point out to the members that we are doing fine; and I think every member will get a chance to inquire of Chairman Burns.

But the Chair will keep a close timing, under the 5-minute rule.

Mr. Hyde?

Mr. HYDE. Thank you, Mr. Chairman.



Dr. Burns, I, too, am intrigued by this section 4; and if I could just read it again:

No member of the Board of Governors, director, officer, or employee of the Federal Reserve system may communicate with any director, officer, or employee of any institution subject to the regulatory authority of the Federal Reserve system to influence legislative actions affecting the Federal Reserve System.

Now, in light of that language, we have a law we are living with called the Rehabilitation Act of 1973. Section 504 of that act defines handicapped people, and Griffin Bell has just given it as his formal opinion, that the term "handicapped people" includes alcoholics and drug abusers. And Secretary Califano has issued regulations now that there must be affirmative action to seek out drug abusers and alcoholics in employment with governmental agencies; and you may not give them a physical examination and you may not inquire about their disability, but you may ask them questions that will relate to whether they can perform the job.

Now, how you can do the one with the other, I don't know. And I won't burden us with that speculation. But, as I interpret this language, if some bank director or employee were to ask you whether that meant that you had to go out and affirmatively seek drug abusers, unrehabilitated drug abusers, to work for the Federal Reserve System and what you thought of that idea, you could not answer; could you?

Dr. Burns. I would need the benefit of counsel to speak responsibly. My own view is that I probably couldn't; but my counsel might say it is possible for me to speak.

Mr. Hyde. If that should ever occur, Dr. Burns, you would—and you refer your interrogator to me, I will answer for you as to what my opinion is on that regulation.

Would you explain to us how the Boards of Directors of the various Federal Reserve banks are selected now? Could you tell us something about their general makeup and what proportion of the directors are, themselves, bankers?

Dr. Burns. We have three classes of directors. Class A directors are bankers. There are three of them on each reserve bank, and they are elected by our member banks.

Class B directors are businessmen. Again, they are elected by the member banks, and there are three in each of our reserve banks.

Class C directors are representatives of the public at large.

You see, what the authors of the Federal Reserve Act tried to do was to get a balance on these reserve bank boards. The bankers represent the lenders, and the lenders may possibly have an interest in higher interest rates. Some do and some don't—this varies, as you know.

Borrowers, on the other hand, rather consistently have an interest in low interest rates. These are the business people; they would like to borrow cheaply.

Now, public representatives presumably have no such bias one way or another. The thought was that they would focus on the national interest.

So, one-third of the directors of our Reserve banks are bankers; the others represent a wide range of businesses and professions.

Mr. Hyde. And how are they selected, Dr. Burns?

Dr. BURNS. The class A and class B directors are elected by the member banks. The class C directors, the public representatives, are appointed by the Board; the chairman and the deputy chairman are always class C directors, appointed by the Federal Reserve Board.

Mr. HYDE. Do you make an effort to see that the Board is not dominated by bankers?

Dr. BURNS. Oh, yes.

Mr. HYDE. Do you think that House Concurrent Resolution 133 is in force today? Do you have an opinion on that?

Dr. BURNS. Even though that resolution has lapsed and even though that resolution—being a concurrent resolution—never had the force of law, it has been treated as if it were a part of the Bible by us at the Federal Reserve Board.

Mr. HYDE. Thank you.

I yield back my time.

The CHAIRMAN. Mr. Cavanaugh?

Mr. CAVANAUGH. Thank you, Mr. Chairman.

Chairman Burns, I have long been an admirer of yours; and I think that your concerns about integrity and your representations of your own personal standards are well-taken here today. But I must say that I am surprised that you seem to convey the feeling that although you impose extremely high standards upon yourself that you don't feel that in the case of the Federal Reserve those standards of conduct and ethics should be set out in law in order to be imposed uniformly throughout the entire Federal Reserve System.

If I am wrong about that, if I am wrong about my reading of your testimony, I would like you to comment on that.

But when you say, on page 14, that your objection to inclusion in section 208 is that you feel it would be discriminatory because some other agencies of Government may have been inadvertently overlooked, I find that incomprehensible and somewhat shocking, because if you don't disagree with the standards set out in section 208, I can't frankly understand the fact that some other agencies may have been overlooked as a justification for excluding the Federal Reserve from those standards.

In addition, your argument on page 15, that the imposition of these standards upon Boards of Directors of the Federal Reserve would result in the reluctance of people willing to serve. It seems to me that if we are soliciting and receiving men and women of the highest standards, they would have no objection to serving on the Board under this standard.

I wonder if you would comment on that interpretation.

Dr. BURNS. I want to thank you, first of all, for the very kind remarks that you made about me personally.

Second, let me say that I have no objections whatsoever to writing into law standards of integrity. But let us not do that in a hurry, and let us be sure that we know what we are doing.

I am sorry that I shocked you by being sensitive on this subject; perhaps I am unduly sensitive on this. But in spite of your being shocked, I can only repeat that in my judgment—and I may be mistaken, but I am here to tell you what I think, right or wrong—in my

judgment, it is inappropriate to single out one group in the Federal Government as a special target when there isn't one item of evidence that there has been misconduct.

Mr. CAVANAUGH. Excuse me, Dr. Burns, but section 208 does not single out the Federal Reserve—it adds the Federal Reserve to those other agencies of government that are already expected to serve under that standard.

Dr. BURNS. You are quite right, it adds the Federal Reserve. But amending the criminal code is a very serious matter, and, if you're going to do that there might be a dozen or a score of other agencies that you might want to add with equal propriety. Possibly, a need has actually been demonstrated in some.

But I submit no need has been demonstrated in the case of the Federal Reserve.

Mr. CAVANAUGH. Excuse me, Doctor, but that is the essence of your argument that eludes me. The establishment of a standard is not the same as an accusation of impropriety existent; and clearly, when 208 was established as the standard for executive offices, that was not an indictment of everyone who serves in the executive offices or independent agencies of government. That was the establishment of a proper standard of conduct for all who served there.

Dr. BURNS. I have no question of that.

Mr. CAVANAUGH. If you are going to object to section 208, I think that you can only object to it on the basis of the standard; and I am surprised that you are not willing to confront that issue. And that is where I am shocked—not in your sensitivity but in your apparent insensitivity to that standard, Doctor.

Dr. BURNS. I don't know how to answer that comment, and I am not going to try.

Mr. CAVANAUGH. I would have a further question with regard to my colleague from New York's questions regarding the Boards of Directors' minutes.

I have reviewed much of that material that was provided by the chairman, and I also found the minutes extremely sketchy and incomplete, and really little more than subject head notes.

I would wonder how you would feel about a standard for verbatim minutes for Boards of Directors' meetings and for some mechanism by which they could be made public after an appropriate period of time?

Dr. BURNS. I must say to you in all honesty that if such a requirement were established by law, I would have some fear that, here and there, discussion which should be candid and exploratory would become inhibited; and that would be very unfortunate.

So, I would think very carefully about that kind of a requirement. It might prove counterproductive.

The CHAIRMAN. The time of the gentleman has expired.

Mr. CAVANAUGH. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Mattox?

Mr. MATTOX. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Kelly?

Mr. KELLY. Thank you, Mr. Chairman.

Mr. Chairman, I would like to inquire of you if it is inaccurate or emotional to be concerned that House Concurrent Resolution 133 and the present bill are really just advancing steps toward an encroachment on the independence of the Fed?

I can see this to be the real concern and the thing we ought to be talking about, about the idea of whether the banks are controlling and whether or not everybody down there is a bunch of crooks and you should all go to jail—is very interesting. But the evidence is pretty clear that that is not the issue.

The real thing is, are the same people that are controlling the fiscal policy now going to also control the monetary policy?

Dr. BURNS. Let me say this: I do think that there are people in our country—some are Members of the Congress—who would like to see the Federal Reserve Board open up the tap, become more expansionist, and join the inflationists. Some individuals thinking along those terms will seek out and perhaps devise ways of harassing the Federal Reserve—that goes on.

But, as to basic motivation, as far as this bill is concerned, I don't think that I know enough to express a responsible opinion.

Mr. KELLY. As I recall, House Concurrent Resolution 133 was passed in an atmosphere of—well, my colleague suggested compromise, but that wasn't the atmosphere I was thinking of. I was thinking that there was an awful lot of conversation about there had been a recession, exclusively caused by the Federal Reserve Board policies and that we had had soaring interest rates which had been created exclusively by the Federal Reserve Board policies and the chairman and that labor, industry, the consumer, the Congress, had nothing whatever to do with that, that we had all just been standing there innocent as babes and up galloped the Federal Reserve Board trying to wreck the whole country.

Now, that is the atmosphere that I remember; and what we were trying to do is let Congress manage the Federal Reserve Board and the monetary policy so that we would not have a recurrence of that tragedy.

I know that you have done this several times, but I think this is a good point to do it again: Why is the independence of the Federal Reserve Board probably a good counterbalance, based on recent history?

Dr. BURNS. Let me say only that I hope to address that subject very thoroughly on August 13, and that I will be glad to send you a copy of my speech at that time.

Mr. KELLY. All right. I thank the Chairman for that. I have no further questions and yield back the balance of my time.

The CHAIRMAN. Mr. Vento?

Mr. VENTO. Thank you, Mr. Chairman.

Dr. Burns, I have looked over your testimony as carefully as I could and I think what it boils down to is that you are suggesting that there is a theoretical possibility of some misconduct on the part of members of the Federal Reserve System in terms of this lobbying activity.

Let's get some dates straightened out here with regard to some of the comments you made. You suggested that the Federal Reserve Board adopted a code of ethics under a certain executive order and

then suggested to member units that they adopt rules and regulations implementing that. When did that happen? When did you submit the code of ethics or adopt it at the Federal Reserve System; and when did you send it to the Board members?

Dr. BURNS. I cannot give you those dates.

Mr. VENTO. Well, did it happen recently; or is this something that has been around?

Dr. BURNS. It has been in force for years.

Mr. VENTO. I think for the record, Mr. Chairman, that Dr. Burns ought to also provide the committee with some of the rules and regulations implementing this in the various member banks of the Federal Reserve System. Do you think it is important for our record to understand what types of rules and regulations exist to guide the conduct of these different members?

And then second, you suggested that over the course of time there have been no violations of it? How do you generally enforce it; and again I guess we are going to have to talk in terms of generalities, unless you are adequately prepared to talk about specifics.

For instance, I think that Mr. Hanley's comments with regard to the comments was improper. I don't think the Federal Reserve System should be involved in terms of lobbying. I think that is an improper activity.

Was there any judgment rendered? Were any activities stimulated by that in terms of the thoughts and views of Members of Congress, who express concern such as myself regarding that activity? What did you do?

Dr. BURNS. In preparing for this testimony, I put the question to my legal staff as to what conflict of interest cases have come to the attention of the staff over the past few years. And the response I got is that apart from the concerns expressed by Mr. Reuss regarding Mr. Gilpatrick, a director of the Federal Reserve Bank of New York, no serious questions concerning conflicts of interest have been raised.

From time to time the financial disclosure statements of individuals indicate holdings of stocks or other investments not deemed suitable for Board employees. These investments usually have been acquired by inheritance, or were held by individuals before their employment by the Federal Reserve System. If these cannot be disposed of immediately without hardship, a more gradual disposal of these assets is arranged.

That is the answer I got from my staff. But I want to amplify that answer, if I may, because the answer as it was prepared by my staff says that apart from Mr. Gilpatrick, no serious questions concerning conflicts of interest have been raised.

As for Mr. Gilpatrick, let me only say this. When I read the report by Chairman Reuss, my heart was filled with sorrow. Mr. Gilpatrick served with honor and distinction as Deputy Secretary of Defense under President Kennedy; he is a distinguished member of the New York Bar; he served on the board of the Federal Reserve Bank of New York for 6 years, part of that time as chairman. Nothing that he has done is even remotely questionable.

When I read Mr. Reuss' statement I picked up the telephone and called Mr. Gilpatrick to tell him that my heart was filled with sorrow and that I wanted to apologize to him. He asked me why, and I told him that somebody should apologize to him, and that I in the absence of anyone else was doing it.

Mr. VENTO. Well, my time is expired. But I have other questions which I will put in writing to you, Dr. Burns. And I will look forward to your response.

The CHAIRMAN. Mr. Grassley.

Mr. GRASSLEY. Thank you, Mr. Chairman.

In answer to Congressman Hyde's question, you stated that you consider House Concurrent Resolution 133 a bible. I would think that, as a committee, we could not ask for a better response from any governmental agency than to have that sort of respect accorded our resolutions by that agency.

But as a followup on that—and let me say parenthetically so you don't look at my questions as being unfriendly—because I basically appreciate the job that you are trying to do in controlling the money supply and interest rates, but when House Concurrent Resolution 133 was passed, did you support it?

Let me pose the question in another way: did you want Congress to pass it? And then as a followup on that, what has been accomplished in your judgment by House Concurrent Resolution 133?

Dr. BURNS. Yes; I will be very happy to answer your questions. When the resolution was first proposed, I objected to it; and objected to it with some eloquence. But the resolution as finally adopted is vastly different from the resolution as originally drafted. A great deal of discussion with Members of the Congress and the House and the Senate took place in working out the resolution. As finally drafted, I was quite pleased with it and did support it—and have supported it ever since.

You ask what it has accomplished. I think it has accomplished two things—at least two things that I believe have been beneficial. Because of that resolution, we in the Federal Reserve are perhaps a little more systematic in our discussion of monetary policy than we previously were, or might otherwise have been. I think that is one beneficial result.

Another is that we do have these dialogues with the Congress. I look forward to Friday when we will be discussing monetary policy. I have learned from members of this committee, and I would like to think that now and then, one or another member of the committee may have learned something from me or from my colleagues.

So I think it has been useful, yes.

Mr. GRASSLEY. Dr. Burns, from your judgment of 2 years experience, has it had any bad effects?

Dr. BURNS. I would say not.

Mr. GRASSLEY. Then additionally, on another point, and I don't know whether I would ask this question just because you now appear before Congress because of House Concurrent Resolution 133, or whether it would be just to solicit a general impression from you—and I might be begging for an answer here—but do you see that the Congress, on the one hand, generally wants instant solutions, instant success, and instant responses whereas the Federal Reserve is looking more long-term; and I quote as a basic difference one instance wherein there is reference to a longer-run strategy of gradually reducing monetary growth rates. Will any effects of a resolution, or the enactment of a law force upon the Federal Reserve a greater emphasis upon short-range outlook than on long-range outlook?

Dr. BURNS. I think there is a danger in that direction, yes. But I am not sure whether the basic concern of the Federal Reserve is so very different from the basic concern of the Members of the Congress.

It is true that many Members of the Congress do want instant solutions. Well, that only means they are human. Some of us in the Federal Reserve System also would like instant solutions. But as we ponder the problems that concern us, we often find that instant solutions are illusory. And I think what is true for us is true for Members of the Congress.

There is little difference. You Members of the Congress have—and I have the greatest sympathy for you—you have to know so many different things; you jump from one thing to another, and you have to legislate on all kinds of issues. How you can master all the issues on which you have to legislate, I don't begin to understand. The scope of our activity is much narrower. Therefore, we can take long-term interests into account to a larger degree than Members of the Congress can. There is that difference.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Barnard?

Mr. BARNARD. Thank you, Mr. Chairman.

Dr. Burns, it's always a pleasure to have you before the Banking Committee. I respect your candid, forthright and honest responses to the questions.

I am concerned about a previous question that was asked. In my mind it left dangling the proposition that you were insensitive to this section 5 and its application to members of the Board and officers and employees of the Federal Reserve System. Would you want to respond briefly—and of course the time is getting on—about the difference now between a regular department of Government and the Federal Reserve System in this regard?

Dr. BURNS. In the first place, our Federal Reserve banks are quasi-public and quasi-private institutions but the public interest dominates. Certainly, the amount of time and energy that our directors devote to the Federal Reserve, virtually without compensation, and all the benefits they have brought to the System—for example, the increases in productivity of the Federal Reserve System—are extraordinarily impressive. I would like to have the opportunity sometime to present the facts on that subject to you.

I'm not saying you shouldn't subject these conscientious directors to the criminal code. But I am saying you should think very carefully about doing that and make sure you know precisely what you are doing before you take a step in that direction. Otherwise it may discourage too many highly qualified, honorable, conscientious men from serving their country.

Mr. BARNARD. Thank you, sir. Dr. Burns, on another subject, you mentioned that class B directors—the appointment of class B directors by the Board could very possibly correct the influence of bankers on the various banks—

Dr. BURNS. May I interrupt? That is not quite the point. It could correct the mischievous interpretation concerning the influence of bankers.

Mr. BARNARD. Thank you for that correction.

How do you foresee that class B directors would be appointed? What system would you envision if it was changed to go to the Board?

Dr. BURNS. Instead of the class B directors being elected by member banks of the System, they could be appointed by the Federal Reserve Board, just as are class C directors.

Mr. BARNARD. What steps would you take if this bill was passed to see that all segments of the public were represented?

Dr. BURNS. We have a committee of the Board which devotes itself to this subject. They make an effort to learn about individuals in different parts of the country who can serve in this capacity. I don't know that we would be doing anything more than what we do now in making an intensive search. Two or three of our Board members devote a great deal of time to that.

I do want to take this opportunity once again to thank Chairman Reuss for prodding us in certain directions. We have more minority members on our Boards now and more women than we might have had in the absence of his continual interest in the subject.

Mr. BARNARD. Can a member of the Board serve more than one term? What is the law on that?

Dr. BURNS. Our attorney would have to answer that. I believe that many of them serve two terms. We have also had instances in which a director who had served two terms served an extra year or two. Moreover, I seem to recall that one director from St. Louis served a very long term. So I believe that there is no legal restriction, although by custom we do have the restriction of two terms.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Watkins.

Mr. WATKINS. Mr. Chairman, colleagues of the committee, and Dr. Burns, I appreciate your being here.

I would like to return our thinking a little bit to section 1 where I have a bit of a problem. In the past before I came to Congress, I was in the homebuilding business for a decade or so. Probably the homebuilding business—and this should be very much in the knowledge of this committee since we deal a great deal with homebuilding—is one of the most sensitive industries to the monetary policy of this country.

I am having some difficulty with the fact that having a group estimate and project, in my opinion, might have a reverse effect on the investment nature of business and private industry in this country. We have a little bit of it to a small degree now because sometimes they wait to see what is going to happen.

But I think it would have a tremendous wait-and-see attitude by a lot of people on how they are going to invest their capital if this is injected into the monetary flow, et cetera.

I have two questions. Do you feel that to some degree there would be what I call a Yo-Yo effect on investment by business people having more of an up-and-down situation? And second, if this is true, I think we're probably on the threshold of opening up to some degree some manipulation of the monetary investments of this country.

So this is something that in my judgment, I have some degree of question about, but I would like for you to elaborate upon those two particular questions that I have in my own mind.



Dr. BURNS. I think I can give you an informed answer to your question, at least in part.

We at the Board and the FOMC don't forecast interest rates. We don't vote on interest rates. There is nothing like that. Our staff, however, does make systematic projections continuously—for a month ahead, a year ahead, a year and a half ahead.

We have in the Federal Reserve, I think, an extraordinarily able group of professional economists, well-trained and highly skilled people. Their forecasts of interest rates at times have been miserable, just as the forecasts of private bankers and private economists in this area have often been way off.

If we had adopted the projection of our staff and publicized it, we might at certain times have discouraged investment in the country extensively, and we would have been mistaken in our judgments. We haven't done that, fortunately. So there is a very real danger of the sort that you have just defined.

The CHAIRMAN. The time of the gentleman has expired.

Mrs. Fenwick.

I would remind members that we do want to allow the chairman to go at 12:45, if at all possible.

Mrs. FENWICK. Thank you, Mr. Chairman. I will be brief.

I am startled that we passed so lightly over what I should think would be the governing policy of the Federal Reserve Board. The bill speaks of promoting maximum employment, production, and price stability. But I am puzzled that there is no mention of what I would think is the Federal Reserve's prime responsibility, to promote a sound banking system, and a stable monetary situation so that people can live and invest in this country.

Is there nowhere in the mandate to the Federal Reserve that this should be what they are supposed to do?

Dr. BURNS. You have asked a very good question. And I must say that I did not think of our responsibility in this area in the context of section 1. I was thinking of section 1 as an improvement over the language of the Employment Act. As a general statement concerning broad, economic objectives, it is an improvement on the language of the Employment Act.

I didn't mean to go beyond that. A member of my staff has just handed me a copy of the Federal Reserve Act. The purpose as stated at the beginning is "to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to furnish means of rediscounting commercial paper, and to establish a more effective supervision of banking in the United States, and for other purposes." So we are governed by law in this area.

But I think that if the Congress is going to rephrase objectives, it might be very useful to cover—as one of our responsibilities and one of the objectives of the Congress—the maintenance of a sound banking system.

Mrs. FENWICK. I should think the promotion of employment should be the business of Congress. But the Federal Reserve, I am glad to see, has concern about it. Thank you.

I wondered what is the erratic component in velocity that you referred to several times.

Dr. BURNS. One falls into technical language. If you were to plot velocity on a chart, quarter by quarter, you would find that it exhibits an underlying, upward trend. You would find also a cyclical movement which reproduces more or less faithfully the business cycle in the country. You would also find a jagged contour in the curve quarter by quarter; I was referring to these jagged contours quarter by quarter when I spoke of an erratic component in velocity.

Mrs. FENWICK. I did want to ask a couple of other questions concerned with this lobbying. For example, we are often telephoned by members of the executive and I have never considered that improper, because it never occurred to me that any member of an executive department or the Cabinet would profit by the measures that they were either proposing or protesting. The only way it would seem to me to be true of the Federal Reserve bank Boards would be that there are three members that are bankers, and conceivably the assets or the profits of those institutions might rise or fall, depending upon some legislative action.

There are three bankers on each board, but what proportion of the boards are they?

The CHAIRMAN. The time of the gentlewoman has expired.

I am anxious to enable the Chairman to depart so he will make his date. If he wants to answer this for the record, rather than now he is certainly welcome to.

Dr. BURNS. My answer is short. Bankers constitute one-third of each board, as defined by law.

Mrs. FENWICK. Thank you.

The CHAIRMAN. Now, Mr. Steers, Mr. Evans and Mr. Caputo, I am going to recognize you, and I am sorry that the time has run as it has. Therefore, to the extent that you can, put your question to Dr. Burns to be answered for the record. That would be helpful. We will call Dr. Burns back this afternoon if you desire.

Mr. Steers.

Mr. STEERS. Well, very quickly, I would start by saying I'm glad to hear your favorable attitude toward House Concurrent Resolution 133, and I would like to dissociate myself from an earlier comment when one gentleman said he was shocked at your insensitivity. And I find that something that I don't want to allow to be passed without comment. I simply am not at all shocked. I approve of your attitude.

However, on page 4, where you allude to section 1, you say that the expectations voiced by the Board at a quarterly hearing might change a week or a month later. And in any event they might even be mistaken. I certainly believe that is true.

But don't you think that those who listen might know that the opinions expressed might be wrong, and might be changed? And don't you think that this committee in listening to such views might learn to be at least almost as smart as the people who listen to these opinions already?

Dr. BURNS. You know, I have lived many years. There are all kinds of people in this world, and that is what makes life so interesting and so worthwhile. I have had men who run large enterprises in this country come to my office and look me straight in the eye and say, in effect, if you would only share with me your vision of the future; if you

would only do that, what a bright future I as the head of my company would have then; that is nonsense. But people—some people—believe all sorts of things, and we at the Federal Reserve must not mislead members of the public. That we must not do, since some people do take our word so seriously, they could make fortunes or lose fortunes.

If you say that they shouldn't take our word so seriously, I would say that sometimes they will and sometimes they won't. But we could do a lot of damage to individuals and we ought not to do that.

Mr. STEERS. Well, would it be fair to say that although your desire not to mislead the public is commendable, the public's desire to know, and this Congress' desire to know—to learn what your opinions are—is also important? And wouldn't people rather quickly learn how fallible even the Federal Open Market Committee or the Federal Reserve Board is?

Dr. BURNS. Perhaps, but I would not like to undertake that experiment. It might be very costly to our country.

Mr. STEERS. One last question then, on velocity. You particularly singled it out as being very hard to predict. I am sure it is. On the other hand, you have certain economic objectives. Certainly the administration has an objective with regard to the GNP, and you already make known your views on various monetary aggregates.

Is it really going to be damaging to have the expertise of your organization merely carry out the calculation of velocity—even if it is to some degree a guess. Could you not carry out the division of the GNP by the monetary aggregate that you are projecting in order to come up with your estimate of velocity?

Dr. BURNS. I do not think that the Federal Open Market Committee as a group has the expertise. In a better world, perhaps in a perfect world, we might.

Mr. STEERS. Mr. Chairman, I would love to pursue it, but I imagine my time is up.

The CHAIRMAN. Let me now converse with our witness.

It is now 12 minutes of 1. The witness would like to be on time for his luncheon date. I hear no dissent.

Mr. Evans, Mr. Caputo, and Mr. Wylie have not had an opportunity—let me ask what their wish is. We can ask Chairman Burns to come back later this afternoon.

Mr. EVANS of Delaware. Mr. Chairman, I don't expect Dr. Burns to come back this afternoon. I had some questions, but I will ask them of Dr. Burns, personally.

But I would like to make one comment relating to integrity and relating to legislation. I think there's a great deal of a lack of confidence in Government today, generally speaking, and you can't legislate integrity. And what you have been able to do to improve the integrity and the credibility of Government, I think has been magnificent. And if we had more like you, we would be a lot better off in this country.

Dr. BURNS. Thank you very much, Mr. Evans.

The CHAIRMAN. Mr. Caputo?

Mr. CAPUTO. Mr. Chairman, I would not presume to think any question I might ask would be more important than Dr. Burns's time. And so, of course, I would agree with your suggestion that we let him go, and not come back. But I would like to indicate that this is about the fourth time it has happened to me, and it sort of discourages me from attending meetings, and preparing for meetings. If there were some way to divide the time more equitably, I sure would appreciate it.

The CHAIRMAN. Well, I am entirely sympathetic to the gentleman. I have tried to move things along so we could do that, and have been unsuccessful, but I shall try to make it up to the lower row, who have been very faithful.

Mr. Wylie?

Mr. WYLIE. Mr. Chairman, I might say I slipped out to answer the phone for a minute and missed my turn. I would like to submit four questions for the record, and I would not ask that Dr. Burns come back this afternoon, either.

Do you plan to wait for the record to come back for responses to his questions before markup?

The CHAIRMAN. We have scheduled markup for tomorrow, so the answer would be "no."

Mr. WYLIE. So it doesn't matter whether we put the questions in the record or not, as far as this bill is concerned.

The CHAIRMAN. Well, it is very important that they be in the record, for the Rules Committee and for the floor.

[Chairman Burns submitted the following responses to written questions submitted by Congressman Wylie:]

Question 1

Dr. Burns, two provisions of H.R. 8094 are bothersome to me, and I wonder if you share my concern. The first refers to the language on page 21, line 9, where public notice is to be given to this Committee of the proposed composition of the Federal Reserve portfolio for the next 12 months. I note in your latest bulletin that we are talking in terms of 91 to 100 million dollars worth of investments.

A. Do you think the advance notice of purchases by the Federal Open Market Committee would have an affect on public reaction to the investments in government obligations as well as private investment?

Answer: As I indicated in my formal testimony, advance notice of the intended composition of Federal Reserve securities acquisitions would have an impact on the maturity structure of interest rates. Investors learning of these plans might attempt to buy securities in those maturity areas in which the System indicated it intended to concentrate its purchases. As a result, the structure of current interest rates on both public and private securities would shift in a way that would reflect the market's anticipation of future Federal Reserve open market operations. Thus, the structure of rates might be less reflective of the underlying conditions of supply and demand actually prevailing. Such discounting of future Federal Reserve operations, moreover, may prove invalid. Projections of the course of the economy are subject to a great deal of uncertainty, and, as events unfold, the Federal Reserve could well find that a responsible monetary policy would require revision of its planned pattern of security acquisitions. Thus, the Federal Reserve might be faced with the dilemma of either having to carry out a plan of security acquisition that is no longer appropriate, or of adopting a new plan at variance with market expectations derived from previous Federal Reserve announcements.

B. Are treasury rates of security investments and others related to portfolio composition?

Answer: It is generally agreed in the financial community that the composition of Federal Reserve purchases of Treasury securities can influence the maturity structure of interest rates on both Treasury and private securities. However, very large changes in composition of the System's portfolio probably would be necessary to bring about a substantial shift in the relative levels of yields on securities with different terms to maturity.

Question 2

On page 3 in the second full paragraph of your statement you say that the FED can influence interest rates.

A. What are the mechanics of this "influence?"

Answer: The Federal Reserve is able to exert an influence on interest rates, particularly in the very short run. This influence flows primarily from the System's ability to control the volume of the reserves available to the banking system. For example, when the System cuts back on its provision of reserves through open market operations, this tends to put upward pressures on short term interest rates in the money market. These pressures then tend to spread into other sectors of the credit markets.

B. Are the interest rates influenced the ones in the bond market, money market, stock market or for private transactions?

Answer: Ordinarily, the impact of the System's actions is most pronounced on short term interest rates. Bond and stock market yields, often--but by no means always--tend to move together with short-term yields; but in any event, the movements in longer-term yields are generally of much smaller magnitude.

Although the Federal Reserve is able to influence interest rates in the very short run, it is unable to control either the level or the structure of interest rates over the long run. Over more or less extended time periods, interest rates are determined by fundamental factors such as the productivity of capital, the willingness of people to save out of income, and expectations on the likely course of inflation.

Question 3

Another part of the bill which especially bothers me is Section 4. Innocent communications could be in technical violation of the law. It seems to me that the actions of the Federal Reserve Board and discussions of any legislation that affects the Federal Reserve Board and our banking system, are widely reported by the various news media throughout this country.

A. Isn't it possible for bankers as well as the public to learn by reading the newspaper or listening to the radio or watching television of pending legislation anyhow? My point is that we are attempting to place an unconscionable burden on Members of the Board of Governors, Directors, or employees to divulge information which would otherwise be known.

Answer: It is, of course, entirely possible that bankers or others might learn through the press of a Federal Reserve position on pending legislation and then independently communicate their own views to members of Congress. In such a case it could be argued that the very expression of Federal Reserve views constituted a communication to bankers "to influence legislative actions". Such an argument would obviously be strained and unrealistic, but it indicates the potential mischief of the proposed prohibition on "lobbying" communications. It also suggests that perfectly legitimate and important communications might be inhibited in order to avoid such a charge.



Question 4

You have commented on this before in these hearings but would you object to having a neutral Congressional observer, or two at the Federal Open Market Committee Meetings?

Answer: As I have previously told the House Banking Committee, I would welcome an informal meeting of members of the Congress with members of the Board and Reserve Bank presidents. However, the presence of outside observers at FOMC meetings could have an adverse impact on what is a truly deliberative process, where views and opinions prior to formulation of a final Committee position are exchanged freely and with the understanding that such views and opinions are subject to reversal or modification. The presence of an outside observer would tend to inhibit this free exchange, so that a representative meeting would not in fact be observed.

As you know, I have frequently explained the process of the Open Market Committee's deliberations. Our record of policy actions at a meeting is now released a few days after the next regularly scheduled meeting of the Committee, and thus keeps the Congress and the public fully informed about monetary policy decisions.

Finally, the presence of a Congressional observer at FOMC meetings would, I fear, offer a potential for converting what is presently Congressional oversight of monetary policy formulation into Congressional participation in that process.

Mr. STANTON. Mr. Chairman, do I understand this is the last bill, then, out of our committee this year?

The CHAIRMAN. This, and another bill scheduled for markup session tomorrow, a bill sponsored by Mr. Lundine.

Mr. STANTON. I just wanted to make sure, because the chairman of the subcommittee is here, Mr. St Germain and Mr. Rousselot. If I could have their attention?

The CHAIRMAN. With the exception of the regulation Q legislation.

Mr. STANTON. Well, we can't do the international banking, then. It was said earlier that we had to meet before the August recess in order to get a bill on the House floor. Speaker O'Neill has said we have to have the bill out of committee.

The CHAIRMAN. Thank you very much, Dr. Burns. We appreciate your attendance.

Now if we can continue our colloquy, would the gentleman yield to me?

Mr. STANTON. Surely.

The CHAIRMAN. An exception from the August 6 date has been obtained from the leadership with respect to the regulation Q bill and the international banking bill.

Mr. STANTON. You could not get it for this bill, though? You tried, and you just couldn't get it through?

I mean, somebody asked down below. I was asking a couple of members on our side: Is this the last bill out of our committee, this bill, because you made the statement that legislation, according to the Speaker, had to be passed out of committee.

The CHAIRMAN. With the exceptions I have just enumerated.

Mr. STANTON. But you did not name any exceptions before, so I do not know what the answers to the people on our side would be.

The CHAIRMAN. Well, those are the exceptions, and that is not a firm commitment. It is just that they are not automatic.

If there is no further business, we will stand in recess until 2 o'clock.

[Whereupon, at 12:50 p.m., the hearing was recessed, to reconvene at 2 p.m., this same day.]

#### AFTERNOON SESSION

The CHAIRMAN. Good afternoon. The House Committee on Banking, Finance and Urban Affairs will be in order for a continuation of its hearings on H.R. 8094.

We are happy to have with us this afternoon Jon Brown of the Public Interest Research Group, and David Cohen, president of Common Cause. Both of you have prepared very helpful written statements which, under the rule and without objection, will be received in full into the record.

And now we would like to ask you to proceed in your own way, Mr. Cohen.

#### STATEMENT OF DAVID COHEN, PRESIDENT, COMMON CAUSE, WASHINGTON, D.C.

Mr. COHEN. Thank you, Mr. Chairman.

What I will try and do is summarize my statement so that we can have more time for discussion. I have some additional items that I would like to insert in the record at the appropriate time.

At the heart of our position in support of various sections that we have commented on H.R. 8094 is the recognition that the Federal Reserve System and the Federal Reserve Bank plays a powerful role that is currently largely unrestrained by the political process.

And while we understand fully the need for insulation from politics is considered by some to be necessary in order to insure sound monetary policy, whatever one's view is on that question, the Federal Reserve Bank and the Federal Reserve System should not be excused from the principles of accountability which the political process requires of Government.

No agency or institution should be exempt from such accountability, and currently the Federal Reserve System and its boards are not part of a serious accountability system.

We believe that H.R. 8094 will help clarify the Fed's duty to serve the public interest. What I want to deal with, Mr. Chairman, is some of the discussion that exists over the various directors that appear under the Federal Reserve System. And I particularly want to talk about the class A, class B, and class C directors, with a focus on the class C directors, and a comment on the class B directors.

I noted today, in reading Chairman Burns' testimony, that he thought the Federal Reserve Board ought to appoint the class B directors. And that, theoretically, makes sense only if the Federal Reserve Board will follow a system of really seeking out people, and having a full and open appointments process in making such appointments.

So far, the record of the Fed—where it has been responsible for appointments—has been a shabby and a shoddy one. So, while we agree that the Federal Reserve should be sensitive to the concerns of business, we believe it must also consider the points of view of labor and consumer groups.

The domination of class C directors by business and banking interests is particularly disturbing in light of the membership of the Federal Advisory Council, which by statute has the power to confer directly with the Board of Governors on general business conditions.

And although this statute is silent as to qualifications for appointment to the Advisory Council, in practice membership on the Council seems to be limited to individuals from banking or big business.

Of the 9 individuals on the 12-member council whose backgrounds we could identify, all but one is the chairman or chief executive officer of a bank. The ninth individual is vice president of an oil company.

The Federal Reserve Act contemplates a balanced representation of interests concerned with monetary policy. Implementation of the act, however, has ignored that balanced approach. In effect, the Federal Reserve System has all the earmarks of a kept agency. Banks under the Fed's regulation have become part of the Fed's regulatory structure.

So, we support the various appropriate sections of the bill, and I would like to insert in the record—and I have copies for the committee—a list of members who are class C directors whose companies have admitted to the fact that they made questionable foreign payments, and yet these people serve as directors of class C directorates.

Our source for these are the 8(k) reports filed with the Securities and Exchange Commission. At the minimum, it raises serious questions as to whether such directors who have directorial responsibility

in the businesses that they are involved in should even serve as class C directors, but I think it also makes the point quite clearly—to me, at least—that the Fed does not engage in a serious deliberative open-appointment system to its class C directors.

I would like to comment on the lobbying activities of the Federal Reserve, because I think here we have the sharpest disagreement with Chairman Burns' statement this morning.

It seems almost as if Chairman Burns is seeking a preferred position for the Federal Reserve System, as it applies to lobbying and other matters of accountability. No one here is questioning the integrity of Chairman Burns or the other members, but he constantly talks about why the Fed ought to be exempted from basic accountability systems.

And those of you who remember the battle on the "Sunshine" law just last year when Congress finally enacted the Government in Sunshine Act, which became effective upon March 12th, the most persistent opponent was not anyone on the Hill, it was not anyone in the White House, but it was Chairman Burns.

He constantly sought extra exemptions. And some of his exemptions may have been legitimate, but every time the Congress or the committee responded to one of his concerns, he had another set of demands.

The Fed ought to be covered by lobbying disclosure and lobbying regulations. Excerpts from the minutes of various meetings of the Board of Directors that Chairman Reuss read into the Congressional Record on May 24th, raise important questions about the way in which the Fed wields its power.

The minutes document extensive manipulation of the boards by the Governors to generate grassroot opinion on legislation before Congress. They did that in the Government in Sunshine law, where we have direct experience. The Senators and their staffs told us about it; House Members and their staffs told us about it.

Because of a quirk in the law, the Fed is not covered by existing statutes which prohibit Federal agencies from engaging in lobbying activities. Since the Fed is not appropriated funds by the Congress, but supports itself by assessments from member banks, it is technically exempted from the lobbying prohibition.

Now the Fed used this loophole to mount a massive grassroots lobbying campaign in opposition to legislation which would have subjected the Fed to a greater degree of outside scrutiny by authorizing GAO audits of its activities.

The minutes—record of Governor Mitchell's remarks to the Chicago Federal Reserve Board about the possible amendments to the bill which would make it more palatable to the Fed, and his commendation of the directors for their help in contacting Members of Congress, is one evidence of such activity.

Following his—Governor Mitchell's—remarks, Robert Mays, the president of the Chicago Reserve Bank, called on the directors to make telephone calls to encourage support for the Federal Reserve position.

Although the Fed is technically exempted, the spirit of the law prohibiting lobbying is clear. We agree that the Fed's loophole must be closed. And I think there is a clear difference between lobbying, and the normal kinds of communications that ought to go on between an agency and the Congress. In no way would we inhibit that.

As a regulatory agency, any communication from the Fed to those it regulates about legislative or executive lobbying has implicit in it the fact that the Fed can grant or withhold favors. These communications do more than merely disseminate information.

What is particularly misleading about the Fed's activities in this area is the resulting appearance of grass-roots support for a particular legislative position.

There is no way for a Representative or a Senator to know whether the bankers in his or her district or State oppose a particular bill on its merits, or because they are afraid they will be turned down at the discount window.

Therefore, we would strongly support section 4 of H.R. 8094, and we recommend that a similar prohibition be placed on other agencies for whom Congress does not appropriate funds, and which are within this committee's jurisdiction such as the Federal Home Loan Bank Board, the FDIC, the Comptroller of the Currency, and the National Credit Union Administration.

In addition, we urge that the committee include both civil and criminal penalties for violations. A mere "prohibition" is just hortatory language, and it has just not worked.

I want to stress the need for civil penalties, because that, I think, makes matters enforceable. In addition, Common Cause strongly supports section 5 of the bill, which would resolve existing ambiguities in the law, as to whether Federal Reserve Bank directors, officers, and employees are within the scope of 18 U.S.C. 208, the criminal statute on official acts, which affect a personal financial interest.

Not only should class A directors be covered by the law, but we believe the directors who should not be permitted to make any decision which would specifically affect only their banks.

We believe that, as the law presently operates, it subjects these officials to the criminal law. That is not sufficient. Such officials should be required to make public financial disclosure statements. They should be prohibited from contacts with the reserve banks and the board of governors for at least 1 year after leaving their positions, and should be subject to 18 U.S.C. 207, the criminal post-employment statute.

And we urge that, during the consideration of the ethics and financial disclosure legislation that is currently moving through the Preyer committee, this committee make every effort to insure that reserve bank directors and officials, and employees, are included within the scope of that legislation.

Finally, of course we support the notion of Senate confirmation for the Chairman of the Board of Directors of the Board of Governors.

I am glad that Chairman Burns supports this, but the only cautionary point I want to make is that changing the ground rules to require Senate confirmation doesn't really get you very far down the road to the heart of the problem.

The heart of the problem is: Who serves as class C directors? What the appointment process is on class B directors, if the Fed is to do it; and to begin to put the Federal Reserve System under an accountability system as it applies to lobbying activities and conflict of interest. Thank you.

[Mr. Cohen's prepared statement on behalf of Common Cause follows:]

123

TESTIMONY OF

DAVID COHEN  
PRESIDENT, COMMON CAUSE

on

H.R. 8094

before

HOUSE COMMITTEE ON BANKING, FINANCING AND URBAN AFFAIRS

Tuesday, July 26, 1977

Mr. Chairman, I appreciate this opportunity to testify on behalf of Common Cause on H.R. 8094, a bill which would make the Federal Reserve System more accountable to Congress and the public. I want to commend this Committee for its continuing efforts in this direction.

The Federal Reserve System occupies a unique position in our government's structure. Unlike virtually every other agency, the Fed's operations are subject to little Congressional and Executive Branch control. For example, it is not dependent on appropriations from Congress, nor is it subject to GAO audits. The extent of its "independence" is brought home by the fact that even Presidents hesitate to publicly criticize its actions.

The Fed's peculiar status, coupled with its enormous authority over the nation's economy, gives the Federal Reserve a powerful role largely unrestrained by the political process. While insulation from politics is considered necessary by some in order to assure sound monetary policy, the Fed should not be excused from the principles of accountability which the political process requires of government. No agency or institution should be exempt from such accountability. Currently the Federal Reserve System and its Boards are not part of a serious accountability system.

We believe that H.R. 8094 will bring accountability to the Federal Reserve System, and will help clarify the Fed's

duty to serve the public interest. The public's interest cannot be served by looking solely to corporate board rooms for information and advice.

I.

Structure of the Federal Reserve System

The Federal Reserve System has three components: the Board of Governors, the Federal Open Market Committee, and the 12 Federal Reserve Banks and their branches. The Board of Governors influences credit conditions and supervises the Federal Reserve Banks and the member banks. The Federal Open Market Committee, on which five Reserve Bank presidents serve, directs the purchases and sales of securities to regulate the money supply, which in turn influences credit conditions.

The Reserve Banks have important responsibilities at both Federal and State banking levels. They help determine discount rates, report on "problem" banks in their districts, and provide representatives to the Federal Open Market Committee. Federal Reserve Chairman Arthur Burns has noted the important contribution of the Reserve Banks to the Fed's grass roots information collection system. For the Board of Governors and the FOMC, the Reserve Banks are the first line of contact with economic developments across the nation.

By statute, each Reserve Bank board is composed of three classes of directors. Class A directors are elected by and serve as representatives of the stockholding member banks. Class B directors have been the borrowers' representatives and must be actively engaged in industry, commerce or agriculture. They,



too, are elected by the member banks. Class C directors were supposed to be the public's representatives, and are appointed by the Board of Governors. Class C directors, like Class B directors, may not be officers, directors, employees or stockholders of any bank.

#### Interlocks with Big Business

The study released by this Committee in August 1976 revealed that, in practice, there is little difference between Class A, Class B and Class C directors. Of the 35 Class C positions filled at the time of the study, 14 individuals had backgrounds in banking, 15 in industry, and only 6 -- less than 20% -- could be said to represent another point of view. Some of the corporations represented on the "public's" slate through their officers, directors and law firms are Kennecott Copper Corporation, Westinghouse Electric Corp., First National City Corporation, General Mills, Inc., and Honeywell, Inc. The list is a condensed version of Who's Who in Big Corporate America. Agriculture is represented by a Kentucky farmer who also happens to be president of a bank. Labor and consumer representatives are conspicuously absent.

While we agree that the Federal Reserve should be sensitive to the concerns of business, we believe it must also consider the points of view of labor and consumer groups. The domination of Class C directors by big business and banking is particularly disturbing in light of the membership of the Federal Advisory Council, which by statute has the power to confer directly with the Board of Governors on general business conditions. Although the statute is silent as to qualifications for appointment to

the Advisory Council, in practice, membership on the Council seems to be limited to individuals from banking or big business. Of the 9 individuals on the twelve-member Council whose backgrounds we could identify, all but one is the chairman or chief executive officer of a bank. The ninth individual is vice president of an oil company.

The Federal Reserve Act contemplates a balanced representation of interests concerned with monetary policy. Implementation of the Act, however, has ignored that balanced approach. The Federal Reserve System has become a kept agency; banks under the Fed's regulation have become part of the Fed's regulatory structure.

As the Class B and Class C directors comprise a major link -- however indirect -- that the public has to the nation's monetary policymaker, it is imperative that it not be subverted. Inflation, unemployment, housing, credit -- all of these are matters of vital importance to consumers. Decisions on these issues must not be left solely to bankers and corporate executives.

Common Cause strongly supports sections 2 (b) and (c) of H.R. 8094, which would restore that balance by emphasizing that Class B and Class C directors are to represent the public, and not exclusively the lenders and borrowers. Individuals appointed to be Class B or Class C directors should be distinguishable from the persons appointed to be Class A directors. We reject the idea that appropriate talent and expertise can be found only in Standard & Poors or Martindale & Hubbell.

The August 1976 study also found that the Board of Governors

apparently does not include women or minorities in its definition of the public. At the time the study was completed, no women served on the boards of the Reserve Banks, and only six on the boards of the branch banks. Minorities had only token representation.

As of June 1977, a greater number of women and minorities are serving on Reserve Bank boards. We believe that this improvement is largely due to this Committee's work in revealing the Fed's poor record. Nevertheless, additional steps can be taken.

Section 2 of H.R. 8094 would amend the Federal Reserve Act to prohibit discrimination in the appointment of persons to serve on the boards of directors of the Reserve Banks. We fully support this provision.

We recognize, however, that such prohibitions are not self-executing. It will be the obligation of this Committee to continue to monitor appointments, a process in which we would be happy to assist.

## II.

### Lobbying Activities of the Federal Reserve

Excerpts from the minutes of various meetings of the Boards of Directors which Chairman Reuss read into the Congressional Record on May 24 raise important questions about the way in which the Fed wields its power. The minutes document extensive manipulation of the boards by the Governors to generate "grass roots" opinion on legislation before Congress.

Because of a quirk in the law, the Fed is not covered by

existing statutes which prohibit Federal agencies from engaging in lobbying activities. 18 U.S.C. 1913 prohibits the use of appropriated funds for lobbying activities. Since the Fed is not appropriated funds by Congress, but supports itself by assessments against member banks, it is technically exempted from the lobbying prohibition.

The Fed used this loophole to mount a massive grass-roots lobbying campaign in opposition to legislation which would have subjected the Fed to a greater degree of outside scrutiny by authorizing GAO audits of its activities. The minutes record Governor Mitchell's remarks to the Chicago Federal Reserve board about possible amendments to the bill which would make it more palatable to the Fed, and his commendation of the directors for their help in contacting Members of Congress. Following his comments, Robert Mays, President of the Chicago Reserve Bank, called on the directors to make telephone calls to encourage support for the "Federal Reserve position."

A similar lobbying effort to exempt the Board of Governors and the FOMC from the Government in the Sunshine Act also took place. According to the minutes of the December 11, 1975 meeting of the Chicago Reserve Bank Board, President Mayo asked "each director to think about possible contacts to explain Federal Reserve concern and indicated that Mr. Larson (senior vice president, general counsel, and secretary to the board of the Chicago Fed) would be in touch with each director tomorrow as a follow-up."

Although the Fed is technically exempted, the spirit of the law prohibiting lobbying is clear. We agree that the Fed's loophole must be closed.

As a regulatory agency, any communication from the Fed to those it regulates about legislative or executive lobbying has implicit in it the fact that the Fed can grant or withhold favors. These communications do more than merely disseminate information.

What is particularly misleading about the Fed's activities in this area is the resulting appearance of grass roots support for a particular legislative position. There is no way for a Representative to know whether the bankers in his or her District oppose a particular bill on its merits, or because they are afraid they will be turned down at the discount window.

Common Cause strongly supports section 4 of H.R. 8094, which would prohibit officials and employees of the Federal Reserve System from communicating with any director, officer or employee of any institution subject to the regulatory authority of the Fed in order to influence legislation affecting the Federal Reserve System.

We recommend that a similar prohibition be placed on other agencies for whom Congress does not appropriate funds and which are within this Committee's jurisdiction, such as the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the National Credit Union Administration.

In addition, we urge that the Committee include both civil

and criminal penalties for violations. A mere prohibition is not enough; the prohibition must be enforceable.

### III.

#### Conflicts of Interest

Common Cause strongly supports section 5 of the bill, which would resolve existing ambiguities in the law as to whether Federal Reserve Bank directors, officers, and employees are within the scope of 18 U.S.C. 208, the criminal statute on official acts which affect a personal financial interest. We fully agree that these individuals should be covered by the law, particularly Class A directors, who by statute must be bankers. These directors should not be permitted to make any decisions which would specifically affect only their banks.

The potential for the unsatisfactory resolution of conflicts of interest is demonstrated by the minutes of the meeting of the New York Reserve Bank directors on October 7, 1974, in which a director is recorded as voting on a resolution affecting one of his law firm's clients.

In our view, subjecting these officials to the criminal laws is not enough. They should be required to make public financial disclosure statements, should be prohibited from contacts with Reserve Banks and the Board of Governors for at least one year after leaving their positions, and should be subject to 18 U.S.C. 207, the criminal post-employment statute. We urge that during consideration of President Carter's ethics and financial disclosure legislation, this Committee make every effort to insure that Reserve Bank

directors, officials and employees are included within the scope of that legislation.

#### IV.

##### Senate Confirmation of the Chairman of the Board of Governors

Finally, Common Cause supports section 3 of H.R. 8094, which would require that the Chairman of the Board of Governors be confirmed by the Senate to serve as Chairman. Although each Governor is now confirmed by the Senate, the Chairman of the Board may have been confirmed to serve only as a Governor and subsequently be appointed Chairman. The position of Chairman deserves particular attention as the highest official of the Federal Reserve System.

A recent report by the Senate Governmental Affairs Committee, "The Regulatory Appointments Process," recommends that "when a chairman is selected from within the commission's membership, the designation be subject to advice and consent of the Senate." ("The Regulatory Appointments Process," at 175) We support that recommendation.

We agree with the report's conclusion that permitting this designation to be made solely by the President is an "unusual and unwise exception" to the general rule that high officials of the government be subject to the advice and consent of the Senate. We believe this is particularly true for the Chairman of the Federal Reserve System, whose responsibilities, duties, and powers affect every facet of the economy.

Subjecting the designee to the confirmation process would give the Senate the opportunity to examine the individual's

record, and to get answers and pledges from the person who will head the Federal Reserve. It would give the public an opportunity to express its views on the directions in which it believes the Federal Reserve should move. We strongly believe that such an opportunity ought to be provided.

I appreciated this opportunity to present Common Cause's views on H.R. 8094, and look forward to working for its early enactment with this Committee.



Mr. COHEN. If I may, Mr. Chairman, I would just like to add the names to the record, and send this up for the staff and the members to have.

Mr. HANLEY [presiding]. Without objection, so ordered.

[A list of class C directors of Federal Reserve banks submitted for the record by Mr. Cohen follows:]

CLASS C DIRECTORS

<u>NAME</u>	<u>FEDERAL RESERVE BANK</u>	<u>YEARS INVESTIGATED</u>	<u>AMOUNT**</u>
Robert Knight General Counsel to Board of Directors, United Technologies	New York	1970-1975	\$1,950,000
Werner Brown President, Hercules Corp.	Philadelphia	1971-1975	\$597,000
John Eckman President, Rorer-Amchem, Inc.	Philadelphia	1973-1975	unstated
Robert E. Kirby Chairman & Chief Executive Officer Westinghouse Electric Corporation	Cleveland	1971-1975	\$119,000
Leo H. Schoenhofen Chairman, Marcor Inc. Director, Abbott Laboratories Director, Honeywell	Chicago	1971-1976 1973-1975 1971-1975	\$635,517 763,123 1,840,000
Stephen F. Keating Chairman, Honeywell	Minneapolis	1971-1975	\$1,840,000
John Lawrence Chairman, Dresser Industries	Dallas	1975	\$24,000
Joseph Alibrandi President and Chief Executive Officer, Whittaker Corp.	San Francisco	1970-1975	\$433,425

\*\* Source: 8K reports filed with SEC

Mr. HANLEY. I understand that Mr. Brown is required to be on the Senate side reasonably soon. Is that correct?

Mr. BROWN. Yes, sir.

Mr. HANLEY. Well, that being the case, if you so desire, without objection your statement can be entered into the minutes of this hearing, and we would do that prior to asking Mr. Cohen his questions.

Mr. BROWN. Well, that's fine.

Should I briefly summarize it?

Mr. HANLEY. We are attempting to accommodate you. I guess my question is: How much time do you have prior to your commitment for the Senate?

Mr. BROWN. I have ample time.

Mr. HANLEY. Well, we will go back to Mr. Cohen.

The list of directors that you alluded to, could you describe them for us? We have already agreed that that will be in the record.

Mr. COHEN. What the chart shows is the names of class C directors, their functions—their corporate functions—and the companies they are part of, which Federal Reserve bank they serve as a class C director of, what years their companies were investigated, and disclosed their questionable foreign payments; and what the amount was in each instance except in the case of John Eckman, because that was unstated.

The point being that I think, in this instance, when companies disclose such questionable foreign payments, and when each of these directors of these companies have a responsible position in their company, and in addition just as directors that carry the responsibility for knowing what is going on, I think this is really a black mark on the appointment process of how the class C directors are appointed.

There is no indication that questions were asked. There is no indication that any effort was made to find out what these people knew about it, or what their responsibility ought to be. Even if they knew nothing about it, they certainly have some responsibilities as directors.

I point this out because I think a careful system would have raised questions, at the minimum.

I think there is no deliberative, open appointment system to the class C directors. I think part of the mission of this committee is to try to set up some ground rules in legislation on the appointment of class C directors. And if you choose to let the Federal Reserve Board do it for class B directors, to do it for them as well.

Mr. HANLEY. You especially cover section 4 quite well in your testimony, and I assume that your position is that the committee hold that language intact?

Mr. COHEN. Yes, sir.

Mr. HANLEY. Is that a correct assumption?

Mr. COHEN. Yes.

Mr. HANLEY. Well, it was rather interesting to note Chairman Burns' response to my question this morning—when admittedly the fact that the overhead of the Fed is sustained by non-appropriated moneys—that the Fed isn't required to adhere to legality. It certainly was not the intention of Congress when Congress vested that agency with its authority, that because it would be a self-funding entity it would not be subject to the law.

So you cover that very well in your testimony, and I think that the colloquy we had here this morning suggests the essentiality of the committees moving in the direction to close that loophole.

Mr. Mitchell?

Mr. MITCHELL. Thank you, Mr. Chairman.

It's good to see you again, Mr. Cohen. I just have two brief questions. Although I was not here this morning, I understand that Chairman Burns—and I have a copy of his testimony—raises some issues with reference to the provision of the proposed law which would prohibit the Federal Reserve Board and/or its individual members from doing lobbying to influence legislative actions.

On page 9 in his testimony he says, and I quote, "The Board seriously doubts whether such a provision is consistent with the first amendment to the Constitution, which commands that Congress shall make no law abridging freedom of speech."

My own reaction is that the language of the law—the bill that we have before us—in no way is violative of the first amendment.

I would like to get your reaction to Chairman Burns' position on this.

Mr. COHEN. I disagree with Chairman Burns. As I have read the bill, I don't think it prohibits free speech at all. I think it is an effort at recognizing that the function of the Fed is not to engage in what is a new growth industry in this country, artificial and indirect lobbying, particularly indirect lobbying.

I think it goes to overt action, rather than to speech. And I think that it is such a fundamental point, and we have done some of our own groundwork on this, that I would like if we may, Congressman Mitchell—and with the permission of Congressman Hanley—if we could submit a brief legal memorandum on this very point?

Mr. MITCHELL. I think it would be helpful, not only to me but to all the members of the committee.

Mr. HANLEY. Without objection, so ordered.

[The legal memorandum submitted for the record by Mr. Cohen regarding whether "Section 4 of H.R. 8094 is in violation of the First Amendment" follows:]



common cause

2030 M STREET, N.W., WASHINGTON, D. C. 20036 (202) 833-1200

NAN F. WATERMAN  
Chairwoman

DAVID COHEN  
President

JOHN W. GARDNER  
Founding Chairman

MEMORANDUM

July 27, 1977

TO: David Cohen  
President

FROM: Kenneth J. Guido, Jr.  
General Counsel

RE: Whether Section 4 of H.R. 8094 Is in Violation of  
the First Amendment.

Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System, questioned the constitutionality of Section 4 of H.R. 8094. Section 4 would prohibit officials and employees of the Federal Reserve System from seeking the assistance of those subject to its regulatory authority in lobbying on legislation affecting the Federal Reserve System. Specifically, he argued that the prohibition is so broadly worded as to have a chilling effect on innocent communication and, therefore, is inconsistent with the First Amendment.

At your request I have examined the pertinent case law on the subject, and it is my view Mr. Burns is incorrect. Congress may constitutionally prohibit officials and employees of the Federal Reserve System from seeking assistance in lobbying Congress from those subject to its regulatory authority.

In Civil Service Commission v. Letter Carriers, 413 U.S. 548 (1973), the U.S. Supreme Court upheld the Hatch Act provision forbidding federal employees from taking "an active part in political management or in political campaigns." Hatch Act § 9(A), 5 U.S.C. § 7324(a)(2). In holding that the impairment of federal employee's First Amendment rights was justified by a substantial governmental interest, the Supreme Court observed:

It seems fundamental in the first place that employees in the Executive Branch of the Government, or those working for any of its agencies, should administer the law in accordance with the will of Congress, rather than in accordance with their own or the will or a political party.

Supra at 564-65.

The purposes of restricting the partisan political activities of federal employees are somewhat different than the purposes underlying Section 4 of H.R. 8094, but they are sufficiently similar to be controlled by the same precedent. Any communication from employees or officials of the Federal Reserve System to those it regulates urging legislative or executive branch lobbying carries with it the implicit threat of the granting or withholding of favors depending upon the recipient's response. Moreover, it places the employees or the officials of the Federal Reserve System in a position of not only administering the statutes under which the Federal Reserve System operates, but providing them with a tool to exert substantial influence over congressional

policy. In upholding the Hatch Act prohibition against partisan political activity by federal employees, the U.S. Supreme Court stressed the need to keep those who administer the law from exerting undue influence over the processes which establish the laws they are to administer. The same reasoning applies to Section 4 of H.R. 8094.

Mr. Burns makes two arguments to support his contention that Section 4 of H.R. 8094 is unconstitutionally overbroad. First, he contends that limiting the bill's scope to legislation "affecting the Federal Reserve System" is insufficiently precise. Second, he argues it is impossible to determine which communications are made with the "intention to influence" the actions of those regulated by the Federal Reserve System.

Both of his contentions are without merit. In Broadrick v. Oklahoma, 413 U.S. 601 (1973), the Court observed that application of the overbreadth doctrine is "manifestly strong medicine . . . . [I]t has been employed by the Court sparingly and only as a last resort." Supra at 613. Accordingly, the Supreme Court held that for a statute to be invalidated on this basis, "overbreadth of a statute must not only be real, but substantial as well, judged in relation to the statute's plainly legitimate scope." Supra at 615.

Mr. Burns' first overbreadth contention -- that limiting the prohibition to legislative actions "affecting" the Federal Reserve System is constitutionally overbroad -- is without merit. The Board of Governors of the Federal Reserve System periodically publishes a document entitled Federal Reserve Act. The document is described as a compilation of the Federal Reserve Act and "other acts of Congress that affect the Federal Reserve System."<sup>1/</sup> If the staff of the Federal Reserve System is capable of identifying legislation which will affect the Federal Reserve System for purposes of producing the document, it surely is able to do so in order to ascertain whether the prohibitions of Section 4 are applicable.

Mr. Burns' second contention -- that it is difficult to ascertain whether a communication is made with the "intention of influencing" legislative action -- is also without merit. Section 4 is drafted to prevent employees and officials of the Federal Reserve System from seeking the assistance of those it regulates in lobbying on legislation affecting the Federal Reserve System.

The central thrust of Section 4 is to prohibit communications made with the intention of enlisting support in a lobbying campaign. In any given case this may depend on the specific facts. However, it is not impossible for an official or an employee to know his own intentions. This is why Mr. Burns' second overbreadth assertion is without merit.

---

<sup>1/</sup> A copy of the title page, preface, and tables of contents and statutes are attached to this memorandum.



# FEDERAL RESERVE ACT

(APPROVED DECEMBER 23, 1913)

AS AMENDED THROUGH 1971

WITH AN APPENDIX

Containing provisions of certain other  
Acts of Congress that affect  
the Federal Reserve System

---

COMPILED UNDER THE  
DIRECTION OF THE BOARD OF GOVERNORS  
OF THE FEDERAL RESERVE SYSTEM  
IN ITS LEGAL DIVISION



## PREFACE

This edition of the Federal Reserve Act incorporates amendments thereto through 1971. It includes in Appendix provisions of other laws affecting the Federal Reserve System, also current through 1971.

The paragraphs of each section of the Act are numbered consecutively to facilitate easy reference. Each paragraph is preceded by a catch line indicative of its subject matter and is followed by an editorial note stating the statutory history of the paragraph, cross references to the United States Code, and other explanatory comments that may be pertinent. A similar arrangement is followed with respect to the laws published in the Appendix. In this connection, it should be noted that paragraph numbers, catch lines, and notes

are not a part of the law and should not be regarded as affecting the construction of the law. Also, the captions to sections 1, 6, 8, 10(a), 10(b), 11, 12A, 13a, 17, 20, 22, 23A, 24A, 25(b), 26, 27, 28, 29, and 30 of the Act were added editorially and likewise should not be regarded as a part of the law.

For convenient reference, there are inserted immediately after the Table of Contents three Tables of Statutes listing respectively (1) statutes amending the Federal Reserve Act, (2) other statutory provisions published in the Appendix, and (3) sections of the United States Code containing provisions of the Federal Reserve Act.

December 1971

## TABLE OF CONTENTS

## FEDERAL RESERVE ACT

	Page		Page
Sec. 1. Short title and definitions .....	1	Sec. 14. Open-market operations .....	30
Sec. 2. Federal Reserve districts .....	1	Sec. 15. Government deposits .....	32
Sec. 3. Branch offices .....	4	Sec. 16. Note issues .....	32
Sec. 4. Federal Reserve banks .....	4	Sec. 17. Deposit of bonds by national banks .....	36
Sec. 5. Stock issues: increase and decrease of capital .....	8	Sec. 18. Refunding bonds .....	36
Sec. 6. Insolvency of member banks .....	9	Sec. 19. Bank reserves .....	38
Sec. 7. Division of earnings .....	9	Sec. 20. National bank notes redemption fund as reserve .....	41
Sec. 8. Conversion of State banks into national banks .....	10	Sec. 21. Bank examinations .....	41
Sec. 9. State banks as members .....	11	Sec. 22. Offenses of examiners, member banks, officers, and directors .....	43
Sec. 9A. Participation in lotteries prohibited .....	17	Sec. 23A. Relations with affiliates .....	45
Sec. 10. Board of Governors of the Federal Reserve System .....	17	Sec. 24. Loans on farm lands .....	47
Sec. 10(a). Emergency advances to groups of member banks .....	20	Sec. 24A. Investments in bank premises .....	49
Sec. 10(b). Advances to individual member banks .....	21	Sec. 25. Foreign branches .....	49
Sec. 11. Powers of Board of Governors of the Federal Reserve System .....	21	Sec. 25(a). Banking corporations authorized to do foreign banking business .....	51
Sec. 12. Federal Advisory Council .....	23	Sec. 25(b). Jurisdiction of suits .....	57
Sec. 12A. Federal Open Market Committee .....	24	Sec. 26. Repeal of conflicting laws .....	59
Sec. 13. Powers of Federal Reserve banks .....	24	Sec. 27. Tax on national bank notes .....	59
Sec. 13a. Discount of agricultural paper .....	28	Sec. 28. Reduction of capital of national banks .....	60
		Sec. 29. Saving clause .....	60
		Sec. 30. Reservation of right to amend .....	60

## APPENDIX

## I. PROVISIONS AFFECTING FEDERAL RESERVE BANKS

Fiscal agents and depositaries .....	63
Functions of former subtreasuries .....	63
Receipt of taxes .....	63
Redemption of United States savings bonds—liability for losses .....	64
Issuance of duplicates of Government checks .....	64
Checking accounts of Government-owned corporations .....	64
Depositaries for Federal Deposit Insurance Corporation .....	64
Depositaries for Federal Home Loan Banks .....	65
Depositaries for Federal Savings and Loan Insurance Corporation .....	65
Depositaries for Public Housing Administration .....	65
Depositaries for Small Business Administration .....	65
Depositaries for Small Business Investment Companies .....	65
Depositaries for Federal National Mortgage Association and Government National Mortgage Association .....	65
Depositaries for Commodity Credit Corporation .....	65
Depositaries for Federal Crop Insurance Corporation .....	65
Depositaries for International Fund and Bank .....	66

## A. Fiscal agents and depositaries (cont.)

Depositaries for Inter-American Development Bank .....	66
Depositaries for International Development Association .....	66
Expenses incident to Post Office Department operations .....	66
Depositaries for Asian Development Bank .....	67
Depositaries for International Finance Corporation .....	67
Deposits of conservators .....	67
Fiscal agents in connection with guarantees of defense production loans .....	67
Fiscal agents in connection with guarantees of flood loans .....	68
B. Availability of records to Government agencies .....	68
To Federal Home Loan Banks .....	68
To Farm Credit Administration .....	69
To Federal Deposit Insurance Corporation .....	69
To Securities and Exchange Commission .....	69
To Federal National Mortgage Association .....	69
To Comptroller General .....	70
C. Discounts and purchases .....	70
Purchase and sale of farm loan bonds .....	70
Paper of regional agricultural credit corporations .....	70
Special Drawing Right certificates .....	70
D. Exemption from Labor Management Relations Act .....	70

## TABLE OF CONTENTS

	Page		Page
<b>II. GENERAL PROVISIONS AFFECTING MEMBER BANKS</b>		<b>III. DEPOSIT INSURANCE (cont.)</b>	
A. Directors and officers		Enforcement of orders	96
Number of directors	71	Penalties	96
False certification of checks	71	Finality of orders and meaning of "violation"	96
B. Branches of national banks	71	Notice of service	96
C. Loans and investments		Notice to State authorities	97
Investment securities and corporate stocks	73	Subpena power	97
Capital contributions to Federal National Mortgage Association	74	Termination of membership in Federal Reserve System	97
Shares of stock in Small Business Investment Companies	75	Examination of member banks; appointment and duties of examiners	97
Obligations issued under Farm Credit Act	75	Authority to administer oaths and issue subpoenas	98
Limitation on loans to one person	75	Deposits with Federal Reserve Banks	98
Loans on purchase of own stock	77	Mergers and consolidations	98
Purchase of farm loan bonds	78	Interest on deposits	100
D. Capital structure		Conversion to an insured State bank	101
Minimum capital of national banks	78	Affiliates of nonmember insured banks	102
Dividends; accumulation of surplus	78		
Withdrawal of capital—unearned dividends	79	<b>IV. ANTITRUST LAWS</b>	
Impairment of capital	79	A. Sherman Antitrust Act	
E. Affiliates		Restraint of trade	103
Definition of terms	80	B. Clayton Antitrust Act	
F. Relations with securities companies		Acquisitions of stock	103
Interlocking directorates	80	Interlocking directorates	104
Affiliation with organizations dealing in securities	80	Enforcement	105
Receipt of deposits by securities companies and other institutions	81	Powers of Attorney General	107
G. Depositories of public moneys			
Insured banks as depositories	82	<b>V. BANK HOLDING COMPANIES</b>	
Depositories of proceeds of sale of Government obligations	82	A. Bank Holding Company Act of 1956	
National banks as depositories	83	Definitions	109
Depositories of funds of Federal land banks	83	Acquisition of bank shares or assets	111
Deposits of bankrupt estates	83	Interests in nonbanking organizations	113
Deposits of Indian funds	84	Administration	115
II. Exemptions from Federal Reports Act	84	Reservation of rights to States	116
Emergency restrictions on business	85	Penalties	116
1. Bank Service Corporations	85	Judicial review	116
		Amendments to Internal Revenue Code of 1954	117
		Savings provision	122
		Separability of provisions	123
		B. Bank Holding Company Act Amendments of 1970	
		Party in interest	123
<b>III. DEPOSIT INSURANCE</b>		<b>VI. CONDITIONAL TRANSACTION</b>	
Deposits defined	87	Definitions	125
Definition of "appropriate Federal banking agency"	87	Lie-in arrangements	125
Insurance of member banks	87	Judicial proceedings	125
Factors to be considered	88	Subpoenas in actions by United States	125
Reports of condition; access to examination reports	88	Civil actions	125
Change in control of banks	89	Injunctions	126
Termination of insurance	90	Limitation of actions	126
Cease-and-desist proceedings	91	Actions under other Federal or State laws	126
Temporary cease-and-desist orders	92		
Injunction to enforce temporary cease-and-desist order	92		
Removal of director or officer	92		
Stay of suspension or prohibition from participation in bank affairs	94		
Felony charge as cause for removal	94		
Hearing and judicial review	95		

## TABLE OF CONTENTS

	Page		Page
<b>VII. MONEY AND CREDIT</b>		<b>X. CRIMES AND BANK PROTECTION (cont.)</b>	
A. Legal tender .....	127	A. Criminal Code (cont.):	
B. Discontinuance of gold payments .....	127	Embezzlements .....	162
C. Use of monetary gold stock of United States .....	127	False advertising .....	163
D. Purchase of United States obligations .....	130	Financial transactions with foreign governments .....	163
E. Redemption of currency not identifiable as to bank of issue .....	131	False statements .....	164
F. Redemption of old series currency .....	131	False certification of checks .....	164
G. Conversion of foreign currency into U.S. currency .....	132	False entries .....	164
H. Trading with the Enemy Act .....	133	False statements to influence action .....	164
		Participation in lotteries .....	165
		Disclosure of information by bank examiner .....	165
		Examiner performing other services .....	165
		Bank robbery and theft .....	165
<b>VIII. OBLIGATIONS OF UNITED STATES AND GOVERNMENT AGENCIES</b>		B. Bank Protection Act .....	166
A. Certificates of indebtedness and Treasury bills as "bonds and notes" .....	135		
B. Deposit of U.S. bonds and notes in lieu of surety .....	135	<b>XI. BRETTON WOODS AGREEMENT ACT</b> .....	167
C. Obligations guaranteed as to principal and or interest by United States .....	136		
<b>IX. FEDERAL SECURITIES LAWS</b>		<b>XII. ADMINISTRATIVE PROCEDURE</b> .....	173
A. Exemption of banks from Securities Act of 1933 .....	137		
B. Securities Exchange Act of 1934 .....	138	<b>XIII. ECONOMIC POLICY, ASSIGNMENT OF CLAIMS, AND CREDIT CONTROLS</b>	
C. Bank acting as trustee under trust indenture .....	159	A. Policy declaration in Employment Act of 1946 .....	181
D. Exemption of banks from definitions of "investment company" and "investment adviser" .....	160	B. Assignment of Claims Act of 1940 .....	181
E. Interlocking directorates between banks and investment companies .....	160	C. National Voluntary Mortgage Credit Extension Committee .....	182
		D. Authority for selective credit control	
		Defense Production Act of 1950 .....	182
		Credit Control Act .....	183
		Economic Stabilization Act Amendments of 1971 .....	185
		E. Emergency Loan Guarantee Act .....	185
<b>X. CRIMES AND BANK PROTECTION</b>			
A. Criminal Code .....		<b>XIV. CONSUMER CREDIT PROTECTION LAWS</b>	
Offenses classified .....	161	A. Truth in Lending .....	189
Department and agency defined .....	161	B. Fair Credit Reporting .....	200
Offer of loan or gratuity to bank examiner .....	161		
Acceptance of loan or gratuity by bank examiner .....	161	<b>INDEX</b> .....	209
Fees for procuring loans .....	161		
Receipt of commissions or gifts for procuring loans .....	162		
Wrongful issuance of currency .....	162		
Theft by bank examiner .....	162		

## TABLES OF STATUTES

## TABLE I

## ACTS PUBLISHED IN APPENDIX

Act of	Beginning Page
May 29, 1920 (Subtreasuries abolished)	63
May 12, 1933: section 43, 43(a) (Purchase of obligations)	130
June 5, 1933 (Pub. Res.) (Gold payments discontinued)	127
June 13, 1933 (Redemption of currency)	131
March 8, 1938: section 4 (Commodity Credit Corporation obligations)	136
June 24, 1938: sections 1 and 3 (Deposits of Indian funds)	134
June 11, 1942: section 10 (Depositories of public moneys)	134
July 16, 1943: section 3 (Depositories for Commodity Credit Corporation)	66
July 30, 1947: section 15 (Bonds in lieu of surety)	134
May 20, 1966: section 5 (Audit of destruction of currency)	70
Asian Development Bank Act: section 6	67
Assignment of Claims Act of 1940	181
Bank Holding Company Act of 1956	109
Bank Holding Company Act: Amendments of 1970:	
Section 105	121
Section 106	125
Bank Protection Act	166
Bank Service Corporation Act	85
Banking Act of 1933:	
Section 2	80
Sections 20, 24, and 32	80
Section 31	71
Banking Act of 1935: section 345	79
Bankruptcy Act: sections 47 and 61	83
Bretton Woods Agreements Act:	
Sections 1-5, 7(b), 8, 10-23	167
Section 6	66
Clayton Antitrust Act: sections 7, 8, 14, and 15	103
Coinage Act of 1965: section 102	122
Credit Control Act	183
Criminal Code: sections 1, 6, 212-215, 334, 655, 656, 709, 955, 1001, 1004, 1005, 1014, 1306, 1906, 1909, 2113	161
Defense Production Act of 1950:	
Section 301	64
Section 708	182
Economic Stabilization Act: Amendments of 1971	185
Emergency Banking Act of March 9, 1933:	
Section 4	85
Section 206	67
Emergency Loan Guarantee Act	185
Emergency Relief and Construction Act of 1932:	
Section 2011(c)	70
Employment Act of 1946: section 2	130
Fair Credit Reporting Act	200
Farm Credit Act of 1971: section 41	75
Federal Crop Insurance Act: section 510	106
Federal Deposit Insurance Act:	
Sections 3(i) and (j), 4(b), 6, 7(a) and (i), 8(a)-(c), 10(b) and (c), 18(c), (e), (i), and (j)	87
Section 13(b)	64
Federal Farm Loan Act:	
Sections 5 and 13	83
Section 27	70
Section 208(c)	69
Federal Flood Insurance Act of 1958: section 3(c) and (d)	68
Federal Home Loan Bank Act:	
Section 15	65
Section 22(a)	68
Federal Reports Act: section 3(c)	84
Financial Institutions Supervisory Act of 1966:	
Section 201	87
Section 202	91
Section 203	97
Section 204	90
Gold Reserve Act of 1934: sections 2-11, 13, 14(c), and 15	127
Government Corporation Control Act: section 302	64
Government Organization and Employees Code: sections 551-559, 701-706	173
Housing Act of 1954: section 603	182
Inter-American Development Bank Act, 1959: section 6	66
Internal Revenue Code of 1954:	
Sections 1101-1103	117
Sections 5703 and 6302	63
International Development Association Act, 1960: section 6	66
International Finance Corporation Act: section 6	67
Investment Advisors Act: section 202(a)(11)	160
Investment Company Act of 1940:	
Section 26(a)	159
Sections 3(c) and 10(c)	160
Labor Management Relations Act: section 2	70
National Housing Act:	
Sections 204(d), 207(i), and 604(d)	136
Section 303(i)	74
Section 309(d)	66
Section 309(e)	66
Section 402(d)	65
Old Series Currency Adjustment Act, 1961: sections 2, 7, 9, 10	131
Second Liberty Bond Act, 1917:	
Section 5(c)	135
Section 8	82
Section 22(i)	64
Securities Act of 1933: section 3(a)(2) and (3)	137
Securities Exchange Act of 1934: sections 3, 6(b) and 7, 8, 11(d), 12-14, 15(c)(4), 16-21, 23-30, 32, 34	138

## TABLES OF STATUTES

TABLE I (cont.)

	<i>Beginning Page</i>		<i>Beginning Page</i>
Sherman Antitrust Act, 1890: section 1 .....	103	United States Revised Statutes:	
Small Business Act, 1958: section 6 .....	65	Section 3646(h) .....	64
Small Business Investment Act, 1958:		Section 3699 .....	129
Section 302(b) .....	75	Section 3700 .....	129
Section 308(b) .....	65	Section 5136 Seventh .....	73
Special Drawing Rights Act: section 4 .....	70	Section 5138 .....	78
Tariff Act of 1930: Title IV, section 522 .....	132	Section 5153 .....	83
Trading with the Enemy Act, 1917: section 5(b) ..	133	Section 5155 .....	71
Treasury, Post Office, and Executive Office Appropria-		Section 5199 .....	78
tion Act, 1971 .....	66	Section 5200 .....	75
Trust Indenture Act:		Section 5201 .....	77
Section 310(a) .....	159	Section 5204 .....	79
Section 321(b) .....	69	Section 5205 .....	79
Truth in Lending Act .....	189	Section 5208 .....	71
United States Housing Act: section 21(a) and (b) ..	65		

## TABLES OF STATUTES

**TABLE II**  
**ACTS AMENDING FEDERAL RESERVE ACT**  
**(By date)**

<i>Amending Acts</i>	<i>Sections Amended</i>	<i>Amending Acts</i>	<i>Sections Amended</i>
August 4, 1914 (38 Stat. 682) .....	27	June 14, 1935 (49 Stat. 375) .....	22
August 15, 1914 (38 Stat. 691) .....	19	June 28, 1935 (49 Stat. 435) .....	12B
March 3, 1915 (38 Stat. 958) .....	13	August 23, 1935 (49 Stat. 684) .....	4, 5, 6, 8 [85154, R.S.], 9, 10, 10(b), 11, 12A, 12B, 13, 13b, 14, 19, 21 [85240, R.S.], 22, 23A, 24, 25, 25(a), 28 [85143, R.S.]
September 7, 1916 (39 Stat. 752) .....	11, 13, 14, 16, 24, 25		
June 21, 1917 (40 Stat. 232) .....	3, 4, 9, 13, 14, 16, 17, 19, 22	April 21, 1936 (49 Stat. 1237) .....	12B
April 5, 1918 (40 Stat. 506) .....	13 [85202, R.S.]	March 1, 1937 (50 Stat. 23) .....	16
September 26, 1918 (40 Stat. 967) .....	4, 11, 16, 19, 22	April 25, 1938 (52 Stat. 223) .....	22(g)
March 3, 1919 (40 Stat. 1314) .....	7, 10, 11	May 25, 1938 (52 Stat. 442) .....	12B
September 17, 1919 (41 Stat. 285) .....	25	June 16, 1938 (52 Stat. 767) .....	12B
October 22, 1919 (41 Stat. 296) .....	13 [85202, R.S.]	June 20, 1939 (53 Stat. 842) .....	22(g), 12B
December 24, 1919 (41 Stat. 378) .....	25(a)	June 30, 1939 (53 Stat. 991) .....	16
April 13, 1920 (41 Stat. 550) .....	14	March 28, 1941 (55 Stat. 55) .....	24
February 27, 1921 (41 Stat. 1145) .....	25(a)	April 7, 1941 (55 Stat. 131) .....	14(c), 25(b)
February 27, 1921 (41 Stat. 1146) .....	11	June 30, 1941 (55 Stat. 395) .....	16
June 14, 1921 (42 Stat. 28) .....	25(a)	March 27, 1942 (56 Stat. 176) .....	14(b)
June 3, 1922 (42 Stat. 620) .....	10	March 28, 1942 (56 Stat. 189) .....	7 (in effect)
July 1, 1922 (42 Stat. 821) .....	9	June 11, 1942 (56 Stat. 351) .....	15 (in effect)
February 6, 1923 (42 Stat. 1223) .....	10	July 7, 1942 (56 Stat. 647) .....	12A, 19
March 4, 1923 (42 Stat. 1454) .....	9, 13, 13a, 14, 15	April 13, 1943 (57 Stat. 65) .....	12B, 19
February 25, 1927 (44 Stat. 1224) .....	3, 4, 9, 13 [85202, R.S.], 22, 24	May 25, 1943 (57 Stat. 85) .....	16
May 7, 1928 (45 Stat. 492) .....	9	June 12, 1945 (59 Stat. 237) .....	11(c), 16, 18 (in effect)
May 29, 1928 (45 Stat. 975) .....	13	August 14, 1946 (60 Stat. 1062) .....	24
April 12, 1930 (46 Stat. 162) .....	13	April 28, 1947 (61 Stat. 56) .....	14(b)
April 17, 1930 (46 Stat. 170) .....	9	July 30, 1947 (61 Stat. 520) .....	10
April 23, 1930 (46 Stat. 250) .....	6, 9	August 5, 1947 (61 Stat. 773) .....	12B
June 26, 1930 (46 Stat. 814) .....	9, 21 [85240, R.S.]	May 25, 1948 (62 Stat. 261) .....	24
June 26, 1930 (46 Stat. 815) .....	11	June 25, 1948 (62 Stat. 683) .....	12B, 22
January 22, 1932 (47 Stat. 5) .....	4	June 30, 1948 (62 Stat. 1163) .....	21 [85240, R.S.]
February 27, 1932 (47 Stat. 56) .....	13 [85202, R.S.]	August 16, 1948 (62 Stat. 1291) .....	19
May 19, 1932 (47 Stat. 159) .....	10(a), 10(b), 16	October 15, 1949 (63 Stat. 880) .....	10 (in effect), 12B (in effect)
July 2, 1932 (47 Stat. 568) .....	13, 13a		
July 21, 1932 (47 Stat. 709) .....	21 [85240, R.S.]	October 25, 1949 (63 Stat. 905) .....	24
February 3, 1933 (47 Stat. 794) .....	10(b), 16	April 20, 1950 (64 Stat. 48) .....	24
March 9, 1933 (48 Stat. 1) .....	10(b), 11, 13, 18	June 30, 1950 (64 Stat. 307) .....	14(b)
May 12, 1933 (48 Stat. 31) .....	13, 19	August 17, 1950 (64 Stat. 455) .....	9, 12B
May 20, 1933 (48 Stat. 72) .....	13 [85202, R.S.]	September 21, 1950 (64 Stat. 873) .....	12B
June 16, 1933 (48 Stat. 162) .....	4, 7, 9, 10, 11, 12A, 12B, 13, 14, 19, 21 [85240, R.S.], 22, 23A, 24A, 25(b)	September 1, 1951 (65 Stat. 293) .....	24
January 30, 1934 (48 Stat. 337) .....	16	June 23, 1952 (66 Stat. 154) .....	14(b)
January 31, 1934 (48 Stat. 344) .....	13, 14	July 15, 1952 (66 Stat. 633) .....	9
March 6, 1934 (48 Stat. 398) .....	16	May 29, 1953 (67 Stat. 41) .....	10
April 27, 1934 (48 Stat. 643) .....	13, 14	August 15, 1953 (67 Stat. 613) .....	24
June 16, 1934 (48 Stat. 969) .....	9, 12B	June 29, 1954 (68 Stat. 329) .....	14(b)
June 19, 1934 (48 Stat. 1105) .....	10, 13 [85202, R.S.], 13b, 22	June 30, 1954 (68 Stat. 358) .....	23A, 24A
June 27, 1934 (48 Stat. 1246) .....	24	July 19, 1954 (68 Stat. 495) .....	16
		July 22, 1954 (68 Stat. 525) .....	24
		August 17, 1954 (68 Stat. 734) .....	24
		September 3, 1954 (68 Stat. 1226) .....	9, 22(f)



## TABLES OF STATUTES

TABLE II (cont.)

<i>Amending Acts</i>	<i>Sections Amended</i>	<i>Amending Acts</i>	<i>Sections Amended</i>
August 14, 1955 (69 Stat. 633) .....	24	March 3, 1965 (79 Stat. 53) .....	16
April 30, 1956 (70 Stat. 124) .....	21	July 21, 1965 (79 Stat. 244) .....	19
June 25, 1956 (70 Stat. 339) .....	14(b)	August 10, 1965 (79 Stat. 351) .....	24
July 31, 1956 (70 Stat. 736) .....	10 (in effect)	May 20, 1966 (80 Stat. 161) .....	10 [§ 323, R.S.]
June 30, 1958 (72 Stat. 261) .....	14(b)	.....	11(d), 16
July 7, 1958 (72 Stat. 339) .....	2	June 30, 1966 (80 Stat. 235) .....	14(b)
July 18, 1958 (72 Stat. 384) .....	24	July 1, 1966 (80 Stat. 236) .....	4, 9, 23A, 25
August 21, 1958 (72 Stat. 689) .....	13b	September 21, 1966 (80 Stat. 823) .....	14(b), 19
March 18, 1959 (73 Stat. 4) .....	2	November 3, 1966 (80 Stat. 1255) .....	24
June 25, 1959 (73 Stat. 141) .....	1, 19	November 5, 1966 (80 Stat. 1314) .....	11(c)
July 28, 1959 (73 Stat. 263) .....	2, 11(c), 19	May 25, 1967 (81 Stat. 17) .....	24
September 8, 1959 (73 Stat. 457) .....	9, 23, 23A	July 3, 1967 (81 Stat. 109) .....	22(g)
September 9, 1959 (73 Stat. 487) .....	11(m), 24	September 21, 1967 (81 Stat. 226) .....	14(b), 19
July 1, 1960 (74 Stat. 295) .....	14(b)	December 18, 1967 (81 Stat. 608) .....	9A
June 30, 1961 (75 Stat. 146) .....	16	March 18, 1968 (82 Stat. 50) .....	11(c), 15, 16
June 30, 1961 (75 Stat. 149) .....	24	May 4, 1968 (82 Stat. 113) .....	14(b)
October 4, 1961 (75 Stat. 773) .....	13, 14(b)	June 19, 1968 (82 Stat. 188) .....	16
June 28, 1962 (76 Stat. 112) .....	14(b)	August 1, 1968 (82 Stat. 476) .....	24
August 15, 1962 (76 Stat. 388) .....	25	September 21, 1968 (82 Stat. 856) .....	13, 14(b), 19
August 31, 1962 (76 Stat. 418) .....	3, 10	September 22, 1969 (83 Stat. 115) .....	19(f)
September 28, 1962 (76 Stat. 662) .....	24	December 23, 1969 (83 Stat. 371) .....	19(a), 19(b), 19(c)
September 28, 1962 (76 Stat. 668) .....	11(k)	July 24, 1970 (84 Stat. 450) .....	24
October 15, 1962 (76 Stat. 953) .....	19	July 31, 1970 (84 Stat. 688) .....	14(b)
June 4, 1963 (77 Stat. 53) .....	16	December 31, 1970 (84 Stat. 1770) .....	24
June 30, 1964 (78 Stat. 233) .....	24	March 31, 1971 (85 Stat. 13) .....	19
June 30, 1964 (78 Stat. 235) .....	14(b)	May 18, 1971 (85 Stat. 38) .....	19
August 14, 1964 (78 Stat. 400) .....	10	July 2, 1971 (85 Stat. 100) .....	14
September 2, 1964 (78 Stat. 769) .....	24	December 10, 1971 (85 Stat. 625) .....	15

Mr. MITCHELL. My second question again deals with the position that Chairman Burns has taken with regard to that section of the law which calls for a forecasting of interest rates by the Federal Reserve Board.

The essential problem, of course, is that the whole economic system does swing back and forth, dependent upon where interest rates are pegged. Chairman Burns takes the position that if the Board should forecast interest rates over a year's period, at the end of the year there would be havoc in the money market. This is because persons, corporations, and businesses having knowledge of future interest rates would be inclined to sell or buy in unusual volume simply because they have that knowledge.

What is your position on this subject? How do you react to Chairman Burns' position?

Mr. COHEN. Let me say, straight off, Congressman Mitchell, I feel distinctly unqualified to comment on the monetary aspects, and I do not feel—nor does Common Cause know enough about the economics of monetary policy, to be fully helpful.

One point I want to make is that I think there is a problem of credibility in some of Chairman Burns' assertions. The ones that go to process. And this in part goes back to Congressman Hanley's point. It is precisely when you have an independent system in which the Governors are appointed for 14-year terms, that you have to have greater accountability requirements.

That means that you need—and this goes to a philosophic point of view that I do feel comfortable about—it means that you need, you constantly need, openness. You constantly need discussion. You need information. And it means that matters should not be husbanded and hoarded and kept in the dark.

The Feds are trying to create their own mysterious tribal rites of monetary policy, and that makes me, as a citizen who is not an expert on this matter, very, very distrustful and skeptical. And I guess as a lay person I would say I don't know why you can't forecast interest rates. I don't know why you can't be in a position of talking about ranges, and alternatives, and consequences if step A is taken this might happen, or this might happen to the market if step B is taken this might happen to the market.

Mr. MITCHELL. Do I have time for one other question, Mr. Chairman?

Mr. HANLEY. The gentleman will proceed.

Mr. MITCHELL. I have introduced a bill upon which we have had hearings in my subcommittee, which is designed to accomplish two things. One, to make the term of the Chairman of the Federal Reserve Board not coterminous, but consonant with an administration.

And, two, to require that the Chairman and Vice Chairman of the Federal Reserve Board be approved by the Senate.

Really, one of the intents behind my legislation is to try to bring about a better degree of coordination between fiscal and monetary policy without in any way usurping the power of the Federal Reserve Board to make monetary policy. It is just a better coordination between the two.

If you are generally familiar with that proposed legislation, would you share your reaction with me and the members of the committee?

Mr. COHEN. We would support it. I think one of the things we have certainly learned—particularly as a result of all of the efforts made in the 1960's on the part of economic policy questions—that things interact, and intersect, and intertwine in ways that no one could have imagined some years back. And therefore I think it is appropriate to make the Chairman of the Federal Reserve Board's appointment consonant with a President's term.

I think confirmation goes without saying. We have worked hard at trying to improve the Senate confirmation process. The Senate Banking Committee is one of the better committees, one of the few committees that at least probes—as we witnessed in the recent McKinney nomination for the Federal Home Loan Bank Board.

All I can say is, if the confirmation part is adopted, Congressman, I think the work of your committee will not end in urging the Senate side to do a more thorough job in the confirmation process, and needless to say, the confirmation process is not a substitute for oversight.

Mr. MITCHELL. Thank you very much. My time has expired.

Mr. HANLEY. Mr. Kelly?

Mr. KELLY. Thank you, Mr. Chairman.

Mr. Chairman, I want to, if I may, be certain of the record. I believe that I understood the chairman to attribute the comment to Dr. Burns in his testimony before this Committee this morning to the effect that Dr. Burns said that the Fed and the directors don't have to comply with the legality because they are not dealing with appropriated funds.

Mr. HANLEY. If I may respond, that is exactly what Chairman Burns said, that, by virtue of the fact that the agency is self-funded and doesn't use appropriated funds, that then it is not subject to the provision in the law; whereas, we say that any agency using appropriated funds cannot engage in lobbying per se.

Mr. KELLY. I understood the Chairman's exact language to be: "It doesn't have to comply with legality."

Mr. HANLEY. I'm sorry.

Mr. KELLY. "It doesn't have to comply with legality"—referring to the comment by Chairman Burns.

Mr. HANLEY. Well, what we are saying here is that an agency—

Mr. KELLY. Mr. Chairman, I am just trying to understand what you were saying, not what we were saying.

Mr. HANLEY. Well, I think, very simply put, I have attempted to explain it—that what Chairman Burns has said, that by virtue of the fact that the Fed is a self-funded agency, it is not subject to the restriction ordinary to other agencies of Government who do use appropriated funds.

Mr. KELLY. Was the chairman here in this public meeting representing that the Chairman of the Federal Reserve Board was saying that the Federal Reserve Board is free to operate outside the law and illegally?

Mr. HANLEY. Well, that would be my interpretation of his response to my question.

Let me qualify that by saying this: No, it is not illegal but it certainly is not within the spirit of the law; and obviously we have uncovered a loophole here that I believe the majority of the Congress would be interested in taking care of.

Mr. KELLEY. Well, is the chairman suggesting that the Federal Reserve Board has been operating illegally?

Mr. HANLEY. I am not saying it was operating illegally. Apparently, on the basis of this testimony, it has not been operating in accord with the spirit of the law, though it has not done something illegal.

Mr. KELLEY. Now, is that the law in its broad spectrum, or some specific provision?

Mr. BLANCHARD. Mr. Chairman, this dialog is interesting, but we do have two witnesses here, and other members of the committee.

Mr. KELLEY. Mr. Chairman, may we have regular order?

Mr. HANLEY. We are working on Mr. Kelly's time, Mr. Blanchard.

Mr. KELLEY. I thank the chairman. May I have credit on my time for the interruption?

Mr. HANLEY. All right; you get 21 seconds in addition.

Mr. KELLEY. I thank the chairman.

Now, Mr. Cohen, do you have any information that would permit you to testify here that the Federal Reserve Board is operating illegally?

Mr. COHEN. I don't think the question, Congressman Kelly, is as to—

Mr. KELLEY. That is the question. What I want is the answer to that question.

Mr. COHEN. I think they are operating in an unaccountable way, that may be legal or illegal; but regardless of which it is, it is unaccountable.

Mr. KELLEY. But you don't have any information about any illegal operations of the Fed; do you?

Mr. COHEN. I don't claim to have any such information.

Mr. KELLEY. Fine. I thank you.

Now, you indicated that you wanted openness with regard to the operations of the Federal Reserve Board. Is that your statement?

Mr. COHEN. Yes.

Mr. KELLEY. Now, would that include the Federal Reserve Board making judgments and then rendering those judgments public on a periodic basis?

Mr. COHEN. Well, that is only part of openness.

Mr. KELLEY. But that is a part that you want?

Mr. COHEN. No; I think one wants more than that.

Mr. KELLEY. But you do want that much.

Mr. COHEN. But I do want a lot more, too.

Mr. KELLEY. But you do want that much?

Mr. COHEN. Yes, but if you stop with that, that is unacceptable.

Mr. KELLEY. Well, I don't know how much further I want to go. I want to know, do you want to go that far?

Mr. COHEN. Yes, and further.

Mr. KELLEY. Mr. Chairman, I have been advised my time has expired; so I would yield back the balance.

Mr. HANLEY. Thank you, Mr. Kelly. You are very generous.

Mr. Blanchard.

Mr. BLANCHARD. Thank you, Mr. Chairman.

First, I want to commend Common Cause for its position on this bill and most of the other previous legislation relating to lobbying and opening up the process of government.

I have the same problems with the current practices of the Fed that you do and that our chairman, Henry Reuss, does. Mechanically, I am a little concerned as to how we approach it. I understand that according to law, Federal agencies aren't supposed to lobby, but I see no evidence that that is really complied with.

I happen to be big on disclosure, and I hope we get our lobbying bill through this session, as going a great distance toward making everyone aware of lobbying and who is doing what and for what reason.

Do you think, though, Mr. Cohen, that it is realistic to expect Federal agencies to refrain from lobbying? I separate lobbying those they regulate. But is it really realistic to expect the Secretary of State not to want to advocate certain positions with Members of Congress?

Mr. COHEN. Of course not. And I think when you deal with lobbying, the various lobbying disclosure bills that are before the Congress, of course, don't deal with the executive branch; and there is a problem because of what the United States Code says; and everyone knows that that is not followed.

I think there needs to really be an overall look at that. Obviously, lobbying or communications with House Members and Senators and their offices goes beyond just formal testimony; and all of you know that you probably often learn a lot more in informal settings than you do in formal settings and no one wants to cut that off, or no one should want to cut that off.

I think there needs to be a certain amount—there clearly needs to be disclosure on that end; and there also needs to be a look at what often some of the relationships are of people who are in various offices which are not limited to just the legislative liaison offices, as they drum up the agencies' business and, in effect, engage in all the indirect activities.

So, I think that is a problem that clearly needs to be addressed, and there is no getting away from that.

Mr. BLANCHARD. You responded to Congressman Mitchell's suggestion in his bill, of making the Chairman—the term of the Chairman of the Board coterminous with that the President.

Mr. COHEN. I think he said “consonant with.” Was it “coterminous”?

Mr. MITCHELL. Not “coterminous”—“consonant.” If the gentleman would yield—we deliberately designed it so there would be a year's difference between the confirmation of the Chairman of the Board and the time that the President is sworn in.

Mr. BLANCHARD. That would seem to suggest the greater accountability that all of us desire. And I understand you support that.

I am wondering—there has also been a suggestion to shorten the term of members of the Board of Governors from what is currently 14 years to something less, perhaps 8.

Has Common Cause, or have you, looked into this question? Again, we are getting back at accountability and sensitivity to the public.

Mr. COHEN. We have not looked into that precise question. We have done a lot of work on other regulatory agencies which often have 7-year appointments, and we have tried to address the problem of having people serve out their terms and then not wander off into the very industries they were regulating.

I think that is not only obviously important, I think there is something to be said for reduced terms. I think there is something to be said for having some responsibility in the executive, branch, and particularly in the White House, for much more deliberation and openness in the Fed appointments themselves as well as the other regulatory appointments.

These are often—a lot of the action takes place before the appointment is sent up; and I think that has to be—that clearly has to be built into the process.

We made some suggestions to the White House and before other committees about logging the various efforts about lobbying these appointments; and I think that would clearly be useful for all regulatory agencies and independent agencies such as the Fed.

Mr. BLANCHARD. Thank you. My time has expired.

Mr. HANLEY. Thank you, Mr. Blanchard.

Mr. DERRICK?

Mr. DERRICK. Thank you, Mr. Chairman.

Mr. Cohen, I thank you for your testimony.

Let me understand exactly what your limit would be for the lobbying activities.

You, in your statement to Mr. Blanchard, used the term "learn." Are you going to prohibit a free flow of communication between the Federal Reserve and Members of Congress, either in a private or a public forum?

Mr. COHEN. No.

Mr. DERRICK. You would not?

Mr. COHEN. No.

Mr. DERRICK. What you are objecting to is—to them going back to the grassroots route of the banks?

Mr. COHEN. That is right. The people that they are regulating.

Mr. DERRICK. You would prohibit them from having this forum with their bankers back home, or, if they did, then the bankers would not be allowed to communicate that to their Congressmen?

Mr. COHEN. Well, I don't think you can ever stop bankers or anybody else from wanting to communicate with their legislators. I think you have to start—the restraints have to be placed upon the Governors themselves.

Mr. DERRICK. Well, I know, in the structure of the Federal Reserve and in the banking system, you know, we are approached by lobbyists every day, and we are called upon every day to use our judgment in evaluating the information that they give us. So, I fail to see why the Fed should not have that right also to communicate with the bankers and say, "Listen, if this legislation is going to affect you in this manner . . ." And why should I be limited from having a free flow of information with my constituents? I think that I would have the judgment, as most Members of Congress would, to evaluate that information and say, "All right, it is coming from a bank, and the bank's stockholders are not the least of their concern," and you evaluate it accordingly.

Mr. COHEN. I think the problem, Congressman Derrick, goes with the relationship that the banks have with the Fed itself, and it is

because of that relationship that it is the fact that they can be dependent upon actions taken by the Governors and that I think you need to have that kind of restriction.

The banking interests and all other organized interests in this country—and when I talk about “organized interests,” I mean all of us—I mean, people like what I represent are all pretty capable of knowing when our interests are affected adversely or otherwise.

Therefore, the banks do not need to be dependent upon the Fed to be told that, “You ought to do this about Sunshine,” or “You ought to do this about GAO audits,” or “You ought to do this about something else.”

Mr. DERRICK. Where are they going to get the information?

Mr. COHEN. Well, I think they are very well represented by the American Bankers Association; and, indeed, many of the banks—some of the banks, at least—have their own representatives here. They monitor what is going on.

Mr. DERRICK. Well, since I have been up here, I certainly have not agreed with everything the Fed has done, but it appears to me that the Fed over the years has probably been one of the most stable agencies or institutions that we have.

It seems to me that if we are going to go jump on someone or try to restructure some area, that there are a lot more that would have a priority before we get to the Federal Reserve.

I just fail to see where there is any great damage. Now, I have heard quite a bit of discussion here this afternoon, and innuendos about illegal acts and all of this; but I have never heard of any of this. There is no scandal at the Fed; though I realize you try not to wait until it happens.

Mr. COHEN. That is clearly right. But, apart from that, I think one of the things that goes with stability, Congressman Derrick, is that often institutions are relatively unexamined; and I think that is one of the things that has been missing. And we sometimes—you know, the Federal Reserve Act of 1914 was clearly one of the important reforms in this country; and like many reforms, it can become rigidified and stultified and perhaps no longer even serve the purpose it was intended to, or even the purpose it was first intended to may no longer be valid.

And I think it is healthy to put the Fed under the kind of scrutiny it is being placed under now. But I also think that it is a public institution even as it is independent, and, therefore, some ground rules need to be applied to it. And the very fact that you have on the 8(k) reports filed with the Securities and Exchange Commission, by admission, these are questionable foreign payments by admission of the filers, the fact that as far as we know—and perhaps it would be useful for the committee to pursue this with the Fed—when they learned this, what steps were taken to find out what those directors knew, if anything, what should they have known?

Something just like that doesn't suggest scandal; it doesn't suggest instability. But it suggests, especially if the Fed did not do anything, it suggests carelessness.

Mr. DERRICK. In other words, you just want to know more?

Mr. COHEN. I think it is more than knowing more. I think you are asking for an exercise of responsibility that so far has not been forthcoming from the Fed, at least as we see it, in the naming of the various class C directors.

Mr. DERRICK. Is there any indication from the final results that they have not taken care of their house in proper order or kept it in proper order? I mean, is there anything you can point to, other than a difference, possibly, in monetary policy as you would have it?

Mr. COHEN. Well, I was careful not to comment on monetary policy, because we don't have a position on it.

Mr. DERRICK. Well, I disagree with them on monetary policy from time to time.

Mr. COHEN. Well, I think what we were saying here is, here is the Federal Reserve System that intertwines with both the private and public sectors. It is clearly important. It affects our governance; and we learned something that we did not learn, that we did not know back in the 1950's and the 1960's and even in the early 1970's—that certain rules of accountability ought to apply to our various institutions.

I think those rules of accountability, the thrust of them, certainly ought to apply to this agency; and one of them would include the limits on their ability to stimulate the kind of lobbying they do with the regulated institution.

Mr. DERRICK. I thank you, Mr. Cohen. I yield back the balance of my time.

Mr. HANLEY. Thank you, Mr. Derrick.

Mr. EVANS (Indiana). Mr. Chairman, I have no questions.

Mr. HANLEY. Mr. Lundine?

Mr. LUNDINE. I would like to pursue this matter of lobbying a little bit further, because of your strong advocacy for section 4 of the bill and because I have some concern about it.

Would you prevent the Fed from passing resolutions as to their judgment on legislation, either affecting the Federal Reserve System itself, or other financial questions?

Mr. COHEN. I would not. I think I view a resolution as a formal communication, much in the same way as you would view testimony or a report or something of that sort, and, therefore, to me, a resolution is an appropriate action.

Mr. LUNDINE. And if they passed resolutions, there would be no prohibition on those resolutions being opened to public knowledge?

Mr. COHEN. I would hope not. Although, at least from our initial looking at the Federal Register, since the Government in Sunshine Act has been adopted, there doesn't seem to be an overeagerness to welcome that law by the Fed. But obviously, if they want to publicize their resolutions, I would assume they would.

Mr. LUNDINE. Therefore, the lobby groups such as the ABA and others representing the banks would have an opportunity to know what the Federal Reserve's position is on these matters and take any action they thought was appropriate in the interests of their members?

Mr. COHEN. That is right.



Mr. LUNDINE. So, your argument is, you are not really cutting down on the freedom of expression of viewpoints to Members of Congress or others who may set policies, but rather, you simply want to cut off the direct contact between the officers and directors of the Fed and the member banks.

Mr. COHEN. That is right. I think there is an unstated demand placed on the member banks under the present ground rules and one sees the evidence of it in some of the minutes and certainly in the experience we had directly on the Sunshine legislation.

Mr. LUNDINE. I was sorry I was late, and this may have already been covered, but turning to another aspect of this bill, in section 1, the Chairman of the Federal Reserve Board expressed his grave reservations about the requirement that he be called to account or give estimates of his opinion as to what interest rates will do in the future.

What is your viewpoint on that?

Mr. COHEN. Well, Congressman Mitchell posed that question to me, and I indicated that I was a layperson, and we don't have a position on that point. But I think it goes to what philosophy you want to follow. Chairman Burns—this is not a new tack that he is taking. And what I indicated to Congressman Mitchell was that I think it is important for us to begin to strip away some of the tribal rites of the Federal Reserve Board and the Federal Reserve System, and that we work, and as a layperson, I could not understand why one could not give forecasts with ranges and consequences and what alternatives might be. And I think that just comes as a layperson's opinion.

Mr. LUNDINE. You wouldn't think that those would tend to become self-fulfilling prophecies?

Mr. COHEN. I don't think they have to become self-fulfilling; and that's why I talk about alternatives and consequences.

Self-fulfilling prophecies come about when people choose to do nothing, and they just let it happen; and if we talk about alternatives and consequences, then you are talking about the steps that would either hinder or speed up or change various aspects of economic policy. And I think it becomes important because there is much more recognition of the intermeshing of fiscal policy and how it affects monetary policy and vice versa.

Mr. LUNDINE. Do I understand it is your basic position that you don't question the integrity of the Federal Reserve?

Mr. COHEN. Right.

Mr. LUNDINE. But what you want is openness so that we can have the facts upon which to assess that integrity?

Mr. COHEN. That is right. Just as we worked at building an accountability system in the Congress, as you recently did with your ethics code, the ethics code that the House and Senate adopted and the various procedures that the majority party does in caucus, in open meetings and open markups. Just as we are working at doing that in the executive branch, you have to do it in those agencies which are neither.

Mr. LUNDINE. Thank you very much.

Mr. HANLEY. Thank you, Mr. Lundine.

Mr. Vento?

Mr. VENTO. Thank you, Mr. Chairman.

I have looked at your statement, Mr. Cohen, with some interest; and I would like to congratulate both of you on your statements. They are excellent. They get to the key of the problem.

In a number of instances here today, this committee has seen examples where it has tried to get you into the crossfire of different philosophies with regard to the Federal Reserve System.

It is imperative, as we address this particular problem, that we try to disassociate our philosophies with regard to monetary or fiscal policy from the actions that we take in terms of these reforms—these much-needed reforms.

Mr. Cohen, today I asked the Federal Reserve Board Chairman, Dr. Burns, to submit to us the rules and regulations that have been adopted by the 12 member units, the boards of the banks, regarding standards of ethics that they have set up. And he said that, in a certain time—I don't know what year because he did not understand what year, but he gave the impression that they have adopted codes of ethics. Are you aware of any of these codes of ethics? The reason I ask is, I know you did not take this position without looking into the background to see what standards they hold themselves accountable on and the basis of what standards they hold themselves accountable, so I am interested in any research you might have done in order to pursue that.

Mr. COHEN. I would be happy to share with you, and anyone else, the working papers we have on this. I can tell you that the standards we urge them to adopt in this testimony, such as the financial disclosure and the various conflict regulations, are not part of their existing regulations. And that is a serious omission in this day and age.

And you see the problem is, Congressman, that they are not even serious debating this inside the Fed—at least from what we have learned. Now if I am wrong, I would be glad to be corrected.

Mr. VENTO. Well, I don't know if you are wrong or if you are right, but I think if they are doing it, they are keeping it a good secret. Until this morning's testimony, I had heard nothing about these rules and regulations that have been developed, or that guide them. And I think at the very least that they ought to be overt, and they ought to be open so that we can look at them and judge whether or not the conduct is within those guidelines that they have set down.

Maybe they are there, but we don't know about them. And I was interested in whether or not you did.

In looking through the bill, there have been a number of references to lobbying and trying to impose requirements in terms of disclosure, and proper conduct of individuals, in terms of their official responsibilities as regulators. These are not unusual arguments, are they, in terms of what constitutes political influence?

Isn't there a pretty good base for case law that exists now that we could plug in that would be workable? So that, for instance, these Federal Reserve banks would not be paralyzed?

Mr. COHEN. I would think so.

Mr. VENTO. In other words, you are confident that many of the actions that your organization has initiated that we have not paralyzed State officials in the exercise of their responsibilities, have we?

Mr. COHEN. No; not at all.

Mr. VENTO. And that some of the contentions that were raised, this morning for instance, the Federal Reserve Board Chairman Dr. Burns, suggested that maybe we could solve the representation problem by further appointment of individuals, rather than by election of individuals as class A and class B officers. Did you observe that in his testimony, and what is your reaction?

Mr. COHEN. I did, and I indicated that I thought it theoretically may make a lot of sense—the suggestion as it applies to the class B directors—but only if there is evidence that the Fed itself is undergoing an open and deliberative, and seeking out—reaching out appointment system. There is no indication that they are, as we point out on our study of the class C directors who are supposed to represent consumers and interests other than business and labor—or other than business and banking. And from what we can tell it is not a very balanced group.

So they are doing a poor job.

Mr. VENTO. Well, we have some real problems. You know I am a freshman Member of Congress, and I note that our chairman has been working on this problem for some time, and asked for the minutes of the meetings, and he received minutes from 3 years that had 900 deletions.

Do you think that Congress can properly exercise its role in terms of oversight unless it, for instance, can actually have complete access to that type of information? Whether or not it is made open to the public is another question that the chairman and Dr. Burns have been discussing. But don't you think that Congress should at the very least require that it have access?

Mr. COHEN. I do. Let me go by an example which preceded your entrance into the Congress, while you were in the State legislature.

When the Budget Act was considered, and Congress adopted the Budget which we see as an important and really a constructive and helpful change, one of the things we urged was that a lot of the early working papers be available to the various committees that have jurisdiction over the various programs and agencies.

And that way, you would begin to get a sense of how the executive branch was sorting out its own priorities. I think the same kind of principle can be applied in this instance.

Mr. VENTO. Well, thank you. My time has expired, Mr. Chairman. I appreciate the opportunity to question the witness.

Mr. HANLEY. Thank you, Mr. Vento.

There is a record vote on the floor, and therefore the hearing will stand in recess for 10 minutes.

[Brief recess.]

Mr. VENTO [presiding]. The committee will come to order. I understand both of our witnesses have a time problem. And because of that, we will ask that the statement of Jon Brown be submitted for the record, and without objection it is so ordered.

[The statement of Jon Brown on behalf of the Public Interest Research Group follows:]

Statement of Jon Brown  
before the  
COMMITTEE ON BANKING, PANANCE AND URBAN AFFAIRS  
U.S. HOUSE OF REPRESENTATIVES  
July 26, 1977

My name is Jon Brown. I am a Staff Attorney with the Public Interest Research Group, a Ralph Nader organization. My principal assignment is to monitor the Federal banking agencies.

H.R. 8094 seeks to remedy weaknesses in the Federal Reserve System that have resulted from unrestrained bureaucratic power, excessive secrecy, and a sweetheart relationship between the Federal Reserve System and the commercial banks it regulates. PIRG supports the basic thrust of H.R. 8094, but believes that several sections must be strengthened if the bill is to bring genuine accountability to the Federal Reserve System.

Section 1 of the bill would declare that the goal of monetary policy is to "promote maximum employment, production, and price stability." This provision would inform the Federal Reserve that control of the money supply is not an end in itself, but rather a means to the end of a strong economy - a concept that the Board has at times forgotten. However, Section 1 could be strengthened if it were amended to declare that the Federal Reserve "shall pursue monetary policies designed to implement the production, employment, and price policies established by the Congress and the President." This would insure that the Federal Reserve would not use its control of the money supply to follow economic policies different from those established by the Congress and the President.

Section 1 would also require the Federal Reserve to disclose to Congress at quarterly hearings its twelve month money supply targets, proposed composition of the Federal Reserve's portfolio, anticipated money velocity, and estimated interest rates. The disclosure of monetary aggregates and interest rates is important, but it is essential that Section 1 be amended to require in addition the disclosure of the Federal Reserve's twelve month estimates of gross national product, unemployment, and inflation. This would bring an end to the Federal Reserve's repeated and unfortunate refusals to provide this information to Congress.

The Federal Reserve estimates gross national product, unemployment, and inflation projections for alternative rates of growth of the money supply, and these projections are used in the selection of a twelve month money supply target. Arriving at these projections requires an analysis of the relationship between changes in the money supply and changes in production, price levels, and interest rates. Rather than hide this analysis from public scrutiny, the Federal Reserve should make it available for constructive criticism by scholars and market analysts. In the present economic environment of uncertainty the relationship between money supply and production and prices is subject to change, and this makes the conduct of monetary policy a hazardous task, as witnessed by the Federal Reserve's unfortunate reinforcement of inflationary tendencies in 1972-73 and recessionary tendencies in 1974. To allow the Federal Reserve to continue to estimate this complex economic relationship without the benefit of comment from scholars and market analysts is an exercise in bureaucratic pampering that we can no longer afford.

The disclosure of twelve month estimates of interest rates, gross national product, unemployment, and inflation is also essential to insure co-ordination of fiscal and monetary policy. The Council of Economic Advisors and various committees of Congress make public their annual estimates of gross national product, unemployment, and inflation. The Federal Reserve's failure to make similar disclosures places Congress at a disadvantage in establishing fiscal policy. Moreover, by keeping secret its estimates of gross national product, unemployment, and inflation, it is possible for the Federal Reserve to improperly pursue economic goals that are inconsistent with those established by the Congress. Thus, disclosure is necessary in order to insure that the Federal Reserve does not exceed its statutory authority.

Section 2 of the bill provides that Class A and Class B directors of the Federal Reserve Banks shall be elected and Class C directors selected "without discrimination on the basis of race, creed, color, sex, or national origin." Although the goal of this provision is lauditory, it is difficult to see how the provision would significantly change the election of selection process, since these processes do not appear to be amenable to the discrimination tests that have been developed in such areas as employment or voting rights. This defect could be cured if the section were amended to include an "affirmative action" obligation.

Section 2(c) of the bill provides that Class C directors of the Federal Reserve Banks shall be selected by the Board of Governors to "represent the public...with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers." The Federal Reserve Act currently imposes no

representational qualifications on Class C directors. The introduction of explicit representational categories is necessary because the Board of Governors has demonstrated a strong bias in favor of large corporations in its selection of Class C directors. According to the Committee Staff Report of August, 1976, 29 of 35 Class C directors are executives or directors of corporations, mostly large.

Under Section 2(b), Federal Reserve System member banks would elect Class B directors to represent "services, labor, and consumers" as well as the present categories of agriculture, commerce, and industry. Section 2(b) would also declare that the Class B directors shall be elected to "represent the public." This language is extremely ill-advised. It is in the nature of a legislative fraud to designate directors elected by commercial banks as representatives of the public, and this fraud is not mitigated by broadening the economic spectrum from which the directors are elected, since they will continue to be beholden to the bankers. Imagine the public reaction were Congress to designate the American Bankers Association as a representative of the public interest. Yet this is essentially what Section 2(b) would do, since according to the Committee Staff Report of August 1976, five Federal Reserve Banks channel nominations for both Class A and Class B directors through state bankers associations.

The only way to transform the Federal Reserve Banks from spokespersons for commercial banks and large corporations into institutions that operate in the public interest is to provide for Presidential appointment of the Federal Reserve Bank Presidents. The Federal Reserve Reform Act of 1976 (H.R. 1293) contained such a provision. The Committee should return to its earlier approach.

The public responsibilities of the Federal Reserve Banks are so great that it is inappropriate to view them as regional banking facilities co-operatively owned and controlled by their member commercial banks. Their primary function is not to serve as self support mechanisms for their members. For example, they are very dissimilar from the Banks for Co-operatives of the Farm Credit System whose primary role is to provide members with access to the credit market. Rather, Federal Reserve Banks have pervasive public responsibilities, including monetary policy, check-clearing, automated clearinghouses, collection and analysis of regional economic data, supervision of state member banks, and administration of the Bank Holding Company and Bank Merger Acts. Permitting commercial banks to elect 6 of 9 directors and thereby control the selection of Federal Reserve Bank Presidents is completely at odds with these broad public duties. In reference to their bank supervision responsibilities, allowing the regulatees to select the regulators involves a gross conflict of interest.

Presidential nomination and Senate confirmation of the Federal Reserve Bank Presidents is the proper way to remedy this unsatisfactory situation. Once Federal Reserve Bank Presidents are chosen by the President, the composition of Federal Reserve Bank boards of directors will become less significant. In fact, these boards of directors would become merely glorified Advisory Committees.

Section 3 of the bill provides for Senate confirmation of the President's appointee for Chairperson of the Federal Reserve Board. This would enable the Senate to review the record of a Board member who is elevated to the Chairpersonship, a review which may prove valuable in view of the 14 year terms of Board members.

Section 5 would extend the conflict of interest provisions of 19 U.S.C 208(a) to Federal Reserve Bank directors, officers, and employees. It is appropriate to prohibit Federal Reserve Bank personnel from participating in decisions in which they have a personal interest.



Mr. VENTO. Now we have just a couple of members that have not had a chance to ask questions, so we will try to move as quickly as we can. The gentleman from Georgia, Mr. Barnard.

Mr. BARNARD. Mr. Cohen, how do you settle the flagrancy of the lobbying efforts of the Fed, at this point?

Mr. COHEN. First let me thank both you, and Congressman Vento, and Congressman Hanley for moving along. I appreciate that.

I think the examples we cited, particularly the one on the Sunshine Act, was really quite intense. I was struck by the intensity of it; and the fact that it was not isolated, that legislators commented on it and noted it.

I think it is quite possible—I don't know if anyone has done a study of all of the Fed's minutes in toto——

Mr. BARNARD. Let me interrupt you, at that point. That is the point I was making. It was brought out this morning that in examining all of the minutes of the Fed which happen to be something like 388 meetings, there was only 6 instances where this was developed. And I am interested to know whether or not you think this is sufficient to cast guilt on the whole Federal Reserve System.

Mr. COHEN. Well, I don't think we are trying to cast guilt on the whole Federal Reserve System. And I don't think it's solely a numbers situation, Congressman Barnard.

It is interesting that the items that we know about from our own readings of the minutes was the GAO audit question. Now, however one comes out from a policy viewpoint on the GAO audit, the lobbying was engaged in, and stimulated. And it is certainly true on the Sunshine issue.

The point is, it goes to the items that go to the procedures and ground rules that the Federal Reserve Board, and the Governors, and the entire system will operate under. And that is what is disturbing.

And you combine that with the fact that the member banks have a direct relationship with what the decisions that the Fed makes, not only in general policy but in specific matters as well, then I think that is where you run into it.

And I think what we are trying to suggest are some cautionary, preventive items that could be taken that would not in any way hinder, impede, or chill the free flow of communication.

I find it hard to believe that Chairman Burns or anybody else who is a Governor of the Federal Reserve Board would ever feel "chilled" in their communications.

Mr. BARNARD. Well, the other aspect that I asked that question is with reference to section 5: Is Common Cause advocating a reorganization of the Federal Reserve System? And I say that, in view of the fact that if you impose conflict-of-interest rules and regulations on class A directors, then you are asking that bankers no longer become—be eligible for membership on the board.

And I think that has to be considered in the makeup, and this is something that, so much of the time, escapes us. The bankers of this country finance the Federal Reserve. They are the ones that buy stock. And they are the ones that have put the capital up for the Federal Reserve. It is not the Federal Government.

And, on top of that, there's a lot of other things involved in this other than just monetary policy. I mean, have you studied the other aspects of responsibilities of the Fed's boards?

Mr. COHEN. Well, we certainly are not unfamiliar with what the Fed does, as our statement tries to make clear.

Let me just make a point on the question of financial disclosure, and various conflicts of interest. And I want to go back to a point that Congressman Vento made—and I know he did it, in part, out of his experience as a State legislator.

There is nothing new in the various aspects that is suggested here on the financial disclosure and conflicts of interest. Numerous States—well over half, as a matter of fact, when the ethics code was before the Congress, we counted 38 States that have some form of financial disclosure legislation that affects executive branch, and people who serve on State boards, whether they are commissions of higher education, or sanitation commissions, and so forth. This is along those lines.

And I do not think that, one, we are not in the business of reorganizing the Federal Reserve System. We don't know anything about that part. And you don't reorganize the System through disclosure legislation.

And I don't think it would be reorganized through disclosure legislation. But you do run into various problems. The New York Times, and other papers, commented on the Gilpatrick situation of some months ago, and it is I think a matter of prudence that it would not be a bad thing to require these financial disclosures.

Mr. BARNARD. I hate to interrupt you, but my time is about to expire.

The point I am trying to make, though, is that every decision that is made in these regional banks has to be concerned with banks. It may be made with reference to Reserve requirements. It has to be made with reference to margin on loans. There are so many technical things that take place that it appears to me that bankers should be the ones making those decisions. But every decision that is made does affect a bank.

So it looks like to me that if you impose the stringency of your argument, that you are going to have to reorganize class A directors. And I don't mean from the standpoint of disclosure. I am speaking from the standpoint of the things that are passed that are regulating the banks.

Mr. COHEN. It is for precisely the duties that you describe what we think these minimal conflict regulations ought to exist and people ought not to decide questions about which their own bank is involved. And I think those steps are steps of prudence, not steps of reorganization.

Mr. BARNARD. But you can't escape. The banks are set up so that every decision it makes would affect your bank. If it is a reserve requirement, if it has to do with the reserves for losses on loans, if it has to do with the makeup of how much you can invest in banking fixtures and buildings—it has to affect your bank. There is no decision that can be made like it.

That is why I think a lot of consideration must be given to section 5 as to how it could apply to the Federal Reserve. It is just unlike any other branch of Government, as was brought out this morning. It is a quasi-branch of Government. And I don't think it applies.

I think we might restructure it to apply; but I don't think we just can throw it in that gap.

Mr. HANLEY [presiding]. Thank you, Mr. Barnard.

Do any committee members have any further questions?

Mr. VENTO. Mr. Chairman, just one comment, and that is that Dr. Burns did point out this morning that there are only six instances where there apparently was some conflict of interest in the 3 years of minutes that were submitted to the chairman. But there were 900 deletions.

Mr. BARNARD. Would the gentleman yield?

Mr. VENTO. With 900 deletions in 3 years, plus the fact that I understand, in talking with staff members, that they did not take every instance; they just took some examples to share with us.

That's what he is referring to; but that is the point, that ought not to be missed in this whole discussion.

Mr. BARNARD. Did you mean conflicts of interest or lobbying efforts?

Mr. VENTO. Well, lobbying efforts.

The point is, there are 900 delegations that affect those minutes, plus the fact that the staff did not necessarily articulate each one that they found. They just had so much time to go through there.

We also have to think of the impact upon a particular State, for instance, within that Federal Reserve System and how it is affected. Not all of this was aimed at Congress. Some of it was aimed at State legislatures. That gives one great cause for pause in terms of what their activity is.

It would not be even as serious if, in fact, it were reported and we were aware of it. But the fact it is often covert—in fact, there's an unwillingness to even make it public. There's a legitimate question as to whether they should be involved in this. There could be a difference of opinion on that.

But to keep these types of activities under cover just points up the greater need, for instance, for some legislation along these lines; and I don't think there should be any disagreement with regard to that particular aspect.

Fiduciary institutions and banks have a right to be represented before this Congress, and I think they have all the capabilities to do it without necessarily the Federal Reserve System being the point-dog, for instance, in a legislative proposal.

The Federal Reserve should function at arm's length in terms of the traditional relationships between regulatory agencies and the units that they regulate.

It is a serious problem. We want to restore the credibility that this organization needs and deserves in order to function effectively in our economy. I don't think the attitude that we saw this morning is necessarily going to restore that type of confidence.

Mr. HANLEY. Thank you, Mr. Vento.

Mr. Cohen, on behalf of the committee, our deep appreciation for your appearance and effort and your excellent testimony.

With that, the hearing will stand adjourned, pending call of the Chair.

[Whereupon, at 3:25 p.m., the hearing was adjourned, subject to the call of the Chair.]