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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 2, 2021

Re: *Freedom of Information Act Request No. G-2021-00053*

This is in response to your email message dated January 5, 2021, and received by the Board's Information Disclosure Section on January 6. Pursuant to the Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, you request, as referenced by Janet Yellen at a September 26, 1995, FOMC meeting:

> a copy of the 1971 memo from the Board's former general counsel Howard Hackley.

Staff searched Board records and located information responsive to your request. Your request, therefore, is granted in full.[1]

Very truly yours,

Michele Taylor Fennell
Deputy Associate Secretary of the Board

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[1] If you have any questions regarding the processing of your request, you may contact the Board's FOIA Public Liaison, Ms. Candace Ambrose, at 202-452-3684 for assistance.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 11, 1971.

To Governor Maisel

From Mr. Hackley

Subject: Responsibilities of the Board under the Employment Act of 1946.

HH

QUESTION

You asked me to reflect upon the question whether the Board is legally obliged to exercise its monetary functions in a manner designed to achieve such specific economic targets as may be set by the President in his Economic Report to Congress under the Employment Act of 1946.

OPINION

The declaration of Congressional policy set forth in section 2 of the Employment Act unquestionably applies to all agencies of the Federal Government, including the Board. The President is required by the Act to submit to the Congress annually a report setting forth "a program for carrying out" that policy. It may be argued that a single Government policy could not be achieved and the purposes of the Act would be defeated if the economic goals or targets set by the President in his report were not regarded as applicable to the Federal Reserve as well as to other parts of the Federal Government. The rationale of this argument is discussed at the end of this memorandum.

It is my opinion, however, that the Employment Act does not require the Board, as a legal matter, to accept or abide by specific economic targets or goals set by the President in his Economic Report and that, in testifying before the Joint Economic Committee, the Board, or the chairman of the Board, is free to express views contrary to those expressed by the President in his Economic Report.

This opinion is based on the fact that there is nothing in the language of the Employment Act or its legislative history that clearly indicates that it was intended to authorize the President to control or direct in any way the Federal Reserve Board's exercise of its monetary and credit functions, and that the Act has been consistently interpreted, not only by the Board itself, but by the President, the Council of Economic Advisers, members of Congress and others (including those who favor subjecting the Board to the direction of the President) as not empowering the President to require coordination of the Board's monetary policies with the views of the President. This interpretation has been reflected on a number of occasions by statements at Congressional hearings and by bills that would specifically amend the law to require coordination of the Board's monetary policies with programs proposed by the President under the Employment Act.

DISCUSSION

Application of policy statement of the Employment Act

At the outset, it should be noted that the Congressional declaration of "the continuing policy and responsibility of the Federal Government" set forth in section 2 of the Employment Act clearly is applicable to the Federal Reserve, since the Board (as well as the Federal Open Market Committee) is a part of the Federal Government. This fact has been expressly recognized by three Reserve Board chairmen. In 1949, Chairman McCabe observed that the "statement of objectives in the Employment Act" applies "to the Federal Reserve as well as to other Federal agencies."1/ In 1952, Chairman Martin stated that the declaration of policy in the Employment Act was "applicable to the Board of Governors as well as to other Government agencies."2/ Finally, in 1966, Dr. Arthur F. Burns made the following statement:3/

> ". . . The President, his Council of Economic Advisers, the Congress, in some degree the entire executive and administrative establishment, including the Federal Reserve Board, now function under this 'constitution' when major economic policies are developed."

The question now at issue, however, is not whether the policy statement of the Act is applicable to the Board but whether the Board must follow specific economic targets or goals set forth by the President in his Economic Report or whether the Board is free to exercise its own judgment as to the best means of achieving the objectives of the Act.

The language of the Employment Act and its legislative history

The functions of the President under the Employment Act are set forth in section 3 of that Act. He is required annually to transmit to Congress an economic report -

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1/ Monetary, Credit, and Fiscal Policies, a Joint Committee Print of the Joint Committee on the Economic Report, 81st Cong., 1st Sess. (Nov. 7, 1949), p. 26. Hereafter cited as Douglas Questionnaire.

2/ Monetary Policy and the Management of the Public Debt, a Joint Committee Print of the Joint Committee on the Economic Report, 82d Cong., 2d Sess. (Feb. 20, 1952), p. 209. Hereafter cited as 1952 Patman Questionnaire.

3/ Twentieth Anniversary of the Employment Act of 1946: An Economic Symposium, Hearing before Joint Economic Committee, 89th Cong., 2d Sess. (Feb. 23, 1966), p. 27. Hereafter cited as 1966 Symposium.

> ". . . setting forth (1) the levels of employment, production, and purchasing power obtaining in the United States and such levels needed to carry out the policy declared in section 2; (2) current and foreseeable trends in the levels of employment, production, and purchasing power; (3) a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States or any considerable portion thereof during the preceding year and of their effect upon employment, production, and purchasing power; and (4) a program for carrying out the policy declared in section 2, together with such recommendations for legislation as he may deem necessary or desirable."

The section further provides that the President may transmit supplementary reports to Congress from time to time which will include such supplementary or revised recommendations as he may deem necessary or desirable to achieve the policy declared in section 2 and that the President's Economic Report and all supplementary reports, when transmitted to Congress, shall be referred to the Joint Economic Committee.

Section 4 of the Act provides for the organization and functions of the Council of Economic Advisers. Briefly, it provides that it shall be the duty and function of the Council to assist and advise the President in the preparation of the Economic Report; to gather information concerning economic developments and trends; to appraise "the various programs and activities of the Federal Government in the light of the policy declared in section 2"; to recommend to the President national economic policies; and to furnish such studies, reports, and recommendations with respect to matters of Federal economic policy and legislation as the President may request.

Section 5 of the Act established a Joint Economic Committee to be composed of seven members of the Senate and seven members of the House. The functions of that Committee are to make a continuing study of matters relating to the Economic Report; to study "means of coordinating programs" in order to further the policy of the Act; and, "as a guide to the several committees of the Congress dealing with legislation relating to the Economic Report", to file a report with the Senate and the House containing its findings with respect to the recommendations made by the President.

Of these provisions of the Act, it appears that those most relevant to the present question are the requirement that the President's Economic Report shall set forth such levels of employment, production, and purchasing power as are needed to carry out the policy objectives of the Act and the requirement that the President shall submit a "program for carrying out the policy" of the Act, with such recommendations for legislation as he may deem necessary or desirable. Literally, however, these provisions mean only that the President must make recommendations in his report to Congress; they contain no suggestion that such recommendations shall be binding upon the Congress or upon the Federal Reserve. After the report is submitted, the Joint Economic Committee is required to file its own report with the Senate and House of Representatives containing its findings and recommendations as to each of the main recommendations made by the President in order that the appropriate committees of Congress dealing with legislation relating to the Economic Report may be guided thereby.

Hearings on the bill that became the Employment Act of 1946 contained no specific reference to the question whether the programs proposed by the President in his Economic Report would be binding upon the Federal Reserve. During the hearings before the Senate Banking and Currency Committee, Representative Patman was a witness. He stated that, under the bill, the President would propose "specific economic goals"[4/] and that the President's message would be "the product of the entire Executive branch of the Federal Government working under the direction of the President."[5/] Previously, in a memorandum dated June 11, 1945, to the members of the House of Representatives, he had stated that the President would be required to transmit to Congress an annual message "comprising (a) economic goals; (b) an inventory of economic trends; and (c) a program for administrative and legislative action"[6/] and that the President's program should "draw upon the whole tool kit of Federal policies, such as legislation on banking and currency, wages and working conditions, foreign trade and investments, agriculture, taxation, social security, and development of natural resources."[7/] These statements of Mr. Patman, however, do not require the conclusion that he assumed that the President's recommendations would be binding upon the Federal Reserve. It is significant that Mr. Patman did not even mention the Federal Reserve and that, in later years, as hereafter noted, he introduced bills to require the Federal Reserve to conform to the President's policies - bills that obviously were premised upon the assumption that the Employment Act contained no such requirement.

The reports of the committees of Congress that considered the Employment Act contained no statements that throw any light one way or another on the question here at issue. They made no mention

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4/ Hearing before Senate Banking and Currency Committee on S. 380, 79th Cong., 1st Sess. (1945), p. 62.

5/ Id., p. 70.

6/ Id., p. 77.

7/ Id., p. 78.

of the Federal Reserve System or of monetary policy. In the Conference Report, the statement of the managers on the part of the House indicated that the United States would be required to promote the objectives of the Act by all practical means, "which may well include, but need not be limited to, taxation, banking, credit and currency, foreign trade, public works, and loans."8/ Although this language specifically referred to banking and credit and currency, it did not say or imply that the President was empowered to promote the policy of the Act by actions relating to banking or to credit and currency; it stated only that the United States, i.e., the Federal Government, would be expected to promote the policy of the Act through such means.

A review of the lengthy debates in both houses of Congress on the bills that led to enactment of the Employment Act of 1946 reveals no reference to the Federal Reserve or any statement suggesting that the Act was intended to empower the President to control in any way the determination by the Board of monetary and credit policies necessary to achieve the objectives of the Act. The debates, like the committee reports, focused primarily upon measures to achieve maximum employment and production; and there were frequent indications that the recommendations made by the President in his annual Economic Report would be considered only as a basis for possible implementing legislation by Congress. For example, Senator Murray, sponsor of the bill in the Senate, in describing the procedure set up by the bill, stated:9/

> "Finally, the United States Congress, through a Joint Committee on the National Budget, must take the responsibility for considering and acting upon the President's program as a whole. The Congress must take the responsibility for all legislation to carry out the program for full employment. This provision of the full employment bill has received widespread endorsement."

Similarly, Representative Cochran in the House stated that, after the recommendations of the President had been considered by the Joint Committee, the recommendations would be "referred to the various legislative committees of the House and Senate for their consideration" and that it would "be necessary for the legislative committees to bring in an authorization to carry out the recommendations of the President."10/

8/ Conference Report on S. 380, Rep. No. 1520, House of Representatives, 79th Cong., 2d Sess. (Feb. 5, 1946), p. 5.

9/ 91 CONG. REC. 8965 (Sept. 25, 1945).

10/ *Id.*, at 11978 (Dec. 13, 1945).

Interpretation of the Act since 1946

The remainder of this memorandum is an account of consideration of the responsibilities of the Federal Reserve under the Employment Act of 1946, as reflected by Congressional hearings and by replies to questionnaires prepared by Congressional committees. It covers the so-called Douglas Questionnaire in 1949; the 1952 Patman Questionnaire; hearings in 1958, 1959, and 1960 on bills to amend the Employment Act; the "symposium" on the twentieth anniversary of that Act conducted by the Joint Economic Committee in 1966; a questionnaire prepared by Mr. Patman in 1968; and various bills to require the Federal Reserve to conform to programs set forth in the President's Economic Report.

Although lengthy and repetitious, this account demonstrates, in my opinion, that the Employment Act has been construed as not requiring the Federal Reserve to exercise its functions in order to achieve specific economic targets, such as a certain level of prices or a certain level of employment; as not requiring the Board to conform to specific targets or goals set forth by the President in his Economic Report; and as not overriding the Federal Reserve's "independence", conferred by provisions of the Federal Reserve Act, in its determination of monetary policies.

The 1949 Douglas Questionnaire

Although the question regarding the relationship between the President and the Federal Reserve was not specifically raised, it is interesting to note that, in 1949, Reserve Board Chairman McCabe expressed the view that for the Federal Reserve to base its policy decisions on specific goals, such as the price index or the level of employment, would actually defeat the purposes of the Employment Act. In answer to a question in the so-called Douglas Questionnaire as to whether more specific Congressional guides for monetary policy were desirable, Mr. McCabe replied that the declaration of policy in the Employment Act was sufficiently specific. He added the following statement:[11]

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

11/ Douglas Questionnaire, pp. 26, 27.

This statement as to the necessity for a flexible monetary policy unhampered by specific targets was the predecessor of similar statements by the Board in later years in opposition to legislative proposals to require the inclusion in the President's Economic Report of recommendations regarding monetary policy or to amend the Employment Act to require "coordination" of monetary policies with fiscal policies.

1958 hearings

As far as I know, the Federal Reserve was not specifically mentioned in Congressional hearings in relation to the Employment Act until July 1958 when hearings were held before a subcommittee of the House Committee on Government Operations on a bill[12/] introduced by Congressman Reuss to amend that Act in order to require the President's recommendations to include specific mention of "monetary and credit policies". Reuss argued that the President's "program" could not be complete without recommendations regarding monetary and credit activities but that, as the result of "administrative practice", the Employment Act had been regarded as not imposing upon the Present any responsibility to make recommendations in these areas. He made it clear that his proposed amendment would only require the President to make recommendations in the monetary policy area and would not require the Federal Reserve to abide by those recommendations.

In his testimony, Mr. Reuss reviewed instances in which the Administration, as well as the Federal Reserve, had interpreted the Employment Act as not requiring the President to make recommendations in his Economic Report with respect to monetary policy:[13/]

> "(1) The President has formally renounced any responsibility to advise the Federal Reserve Board and its Open Market Committee of the administration's position on monetary and credit policy. This has been made clear over a period of years.
>
> "In the 1952 campaign, Mr. Eisenhower advocated 'a Federal Reserve System which exercises its functions in the money and credit system without pressure for political purposes from the Treasury or the White House' (testimony of Secretary of Treasury Humphrey, Senate Finance Committee, Investigation of the Financial Condition of the United States, pt. 1, p. 16, June 18, 1957).

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

13/ Hearings before Subcommittee of Committee on Government Operations on H.R. 12785, 85th Cong., 2d Sess. (July 21, 22, 1958), pp. 4, 5.

"In a similar vein, Under Secretary of the Treasury W. Randolph Burgess recently said:

"'The job of the bank of issue is making money scarcer and costlier when boom psychology appears. This takes courage and judgment. That is the reason why it can't be done safely or well by politicians. The usefulness of the bank of issue is exactly in doing the unpopular things at the right time. The wise government knows this and leaves these unpopular jobs to the bank of issue' (ibid., pt. 2, p. 960, Aug. 3, 1957).

"It is apparent from numerous utterances of President Eisenhower that he regards the independence of the Federal Reserve as a reason for refraining from even making administration recommendations in the field of monetary and credit policy. Discussing the Federal Reserve's April 1956 increase in the discount rate, the President said at a press conference:

"'The Federal Reserve Board is set up as a separate agency of Government. It is not under the authority of the President, and I, personally, believe it would be a mistake to make it definitely and directly responsible to the political head of state - I do have this confidence in the Federal Reserve Board: * * * They are watching it very closely, and I, personally, believe that, if money gets to what is normally referred to as too tight, they will move in the other direction in some way or other as soon as they can' (New York Times, Apr. 26, 1956, p. 16).

* * * * *

"(2) Not only has the President thus repeatedly used the Federal Reserve's 'independence' as a reason for renouncing the responsibility of making recommendations in monetary and credit policy. In fact, since 1953, the President's statutory programs, as contained in the Economic Report, have omitted any recommendations for action by the Federal Reserve or the Open Market Committee.

* * * * *

"In this year's 1958 Economic Report of the President, dozens of specific recommendations for action were made to the Congress and to State and local governments - see 1958 Economic Report, pages 77-80 - but not a single recommendation or suggestion to the Federal Reserve Board or to the

Open Market Committee. Chairman Raymond J. Saulnier, of the CEA, has since testified - Joint Economic Committee hearings, January 27, 1958, page 29:

"'In the economic report we have expressed no judgments as to the adequacy or inadequacy of credit policy. We have done the best we can to describe that policy and to describe the movement of our economy, and have left evaluations of it completely out of the story.'

"Similarly, in the 1955, 1956, and 1957 economic reports, State and local governments were advised to rewrite their tax and debt limitation statutes in order to relieve the problems caused by tight money. Yet no recommendations were made to the Federal Reserve concerning tight money itself.

"(3) In their adverse reports to the Committee on Government Operations on H.R. 12785, both Federal Reserve Chairman William McChesney Martin, Jr., and Council of Economic Advisers Chairman Raymond J. Saulnier, in opposing H.R. 12785's requirement for Presidential recommendations regarding monetary and credit policies, indicate clearly that the act at present contains no such requirement."

Although Reuss stated that his amendment would not affect the independence of the Federal Reserve Board or require the Board to follow the President's recommendations as to monetary policy, Chairman Martin of the Board strongly opposed the Reuss amendment. In a letter of June 27, 1958, Mr. Martin said:[14]

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

14/ Id., p. 5.

"Decisions in the area of monetary and credit policy are the responsibility of the Board of Governors of the Federal Reserve System, entrusted to it pursuant to the constitutional powers of Congress in this field. A mandate to the Executive in other legislation to make recommendations in the field of monetary and credit policy would conflict with the statutory relationships of the Federal Reserve System to the Congress and the independent performance of the duties that are entrusted to its administration."

Other witnesses during the 1958 hearings agreed that the Reuss amendment would not give the President power to determine monetary policy;15/ but they felt that, as stated by Mr. Keyserling, it "would be incongruous if he [the President] should evaluate private economic policies and not evaluate the vast nationwide banking, fiscal, and monetary policies."16/

Another witness, Professor Seymour E. Harris, frankly favored an end to the Federal Reserve's so-called "independence" and felt that the Reuss amendment would be "a sound step in the right direction." He stated:17/

". . . It forces the President to take cognizance of monetary policies. It forces the President to admit monetary policy is a weapon, but that it is not the only weapon. If he makes recommendations for monetary policy, he will have to take another good look at some of the other weapons he has at his command.

"I would say the independence of the Federal Reserve belongs to a bygone age. I simply put my neck out here, as I have for years, and say to the Congress: How can you justify independence of the Federal Reserve?

"One step in the direction of removing independence, perhaps the only step you can take politically now, is the step suggested by Congressman Reuss."

15/ Id., p. 23 (Leon Keyserling) and p. 33 (Edwin E. Nourse).

16/ Id., p. 23.

17/ Id., pp. 81, 82.

Obviously, all of the above statements were premised on the assumption that the Employment Act did not authorize the President to fix monetary targets or goals that would be binding upon the Federal Reserve; indeed, they reflected an assumption that the Act did not authorize the President even to make recommendations as to monetary policy.

1959 hearings

The assumption that the Employment Act did not impose upon the Federal Reserve any obligation to follow the President's views as to monetary policy was again made clear in 1959 when hearings were held by a subcommittee of the House Committee on Government Operations on several bills to amend that Act. One of them was a bill introduced by Congressman Reuss,[18/] a successor to his 1958 bill and with the same purpose. It would have added to the Employment Act a new section 6 stating it to be the sense of Congress that the President and the Federal Government should give due effect to certain provisions of the Act, including -[19/]

> "(d) The provisions of section 3(a)(3) for a review, and of sections 3(a)(4) and 3(b) for program and recommendations, including therein monetary and credit policies to the same extent as all other policies affecting employment, production, and purchasing power: Provided, That if the Federal agency directly responsible for the execution of such monetary and credit policies disagrees with such program and recommendations, the President shall report such disagreement to the Congress, together with a statement from the disagreeing agency of its reasons."

After the hearings, Reuss introduced a revised bill that would have made specific reference to the Federal Reserve Board by changing the proviso in the above-quoted language to read as follows:[20/]

> ". . . Provided, That if the Federal Reserve Board disagrees with the monetary and credit policies included in such program and recommendations, the President in his report to the Congress shall include the Board's views and reasons."

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

19/ Hearings before Subcommittee of House Committee on Government Operations, 86th Cong., 1st Sess. (March 25, 26, and April 9, 1959), p. 3.

20/ Id., p. 5.

Senator Joseph S. Clark, who had introduced a similar bill in the Senate and testified at the House hearings, emphasized that the bill was not intended to attack the independence of the Federal Reserve:21/

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

With respect to the effect upon the relationships between the President and the Federal Reserve, Reuss again made it clear that the President's recommendations would not be binding upon the Board:22/

"Mr. Fascell. Now on the question of monetary policies, suppose the President takes the position: I just do not have a monetary policy and whatever the Federal Reserve Board does is OK with me, that is my policy.

"Mr. Reuss. That is his present policy. Senator Clark and I think that is not enough. We think he should use the services of the Council of Economic Advisers to develop a policy so that his total policy compounded of monetary and fiscal and credit and tax and spending policies can be a congruent whole. If he leaves out monetary policy, he has lost control of the helm. He should tell the Federal Reserve what he thinks is a sound monetary policy.

"Mr. Fascell. Whether they do anything about it or not?

"Mr. Reuss. Whether they agree with him or not. They do not have to do what he says, but he should say.

* * * * *

"Mr. Reuss. . . . What the Congress ought to have is a coherent program from the President and the Council of Economic Advisers. If the Federal Reserve Board disagrees, Congress can review it and perhaps advise one or the other what it thinks the proper policy to be.

21/ Id., p. 26.

22/ Id., p. 37.

"Mr. Fascell. In other words, you see nothing wrong with having the Council as such recommend to the President certain actions which he would in turn recommend to the Federal Reserve Board, not only after the fact but before the fact or at any given time.

"Mr. Reuss. I think this is essential, yes."

Dr. Leon Keyserling supported the Reuss bill. He said:[23/]

"Now, while I feel that the President should not be required to set forth publicly disagreements between him and other agencies of Government, the Federal Reserve Board presents a special problem. The Federal Reserve Board, as is pointed out in Mr. Saulnier's letter, may be regarded as the only agency intended to be referred to by the provision of the bill. I think it should be the only agency referred to, because it is the only agency which creates a real problem. The problem created, with respect to the Federal Reserve Board, is that we have gotten into a nonsensical situation where on the one hand we say that the Federal Reserve Board is one of the most powerful instruments in national economic policy, and on the other hand we say that it should be independent. . . ."

A little later, he said:[24/]

". . . All this bill is trying to do is to find some way to say that we should start to put the Federal Reserve Board under the limited scrutiny of the President."

He emphasized again that the bill would not give the President "any control over monetary policy."[25/]

In a letter to the chairman of the Committee on Government Operations dated March 13, 1959, Dr. Raymond J. Saulnier, chairman of the Council, opposed the Reuss bill. Among other things, his letter stated:[26/]

23/ *Id.*, p. 76.

24/ *Id.*, p. 77.

25/ *Id.*, p. 78.

26/ *Id.*, p. 203.

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

The Federal Reserve Board, in a letter signed by Vice Chairman Balderston dated April 1, 1959, strongly opposed the Reuss bill for reasons like those given by the Board in 1958. That letter stated in part:27/

"The Board believes that a review of monetary and credit developments and an appraisal of their contribution to the attainment of the objectives of the act is an essential part of the President's review of general economic developments. In fact, every economic report submitted to date has included a discussion both of past monetary and credit developments and also of the actions taken by the monetary authorities. The Board therefore questions the need for this change in the law.

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

27/ Id., pp. 206, 207.

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

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

"There can be no doubt that the Congress at any time can limit or withdraw the trusteeship it has granted to the Federal Reserve System to carry out constitutional responsibilities of Congress in the field of money and credit. However, any action that might reduce the independence of the Federal Reserve from the Executive should be considered with great care, especially in the light of the experience in other countries which have followed a similar course. The Board sincerely believes that the reasoning which led the Congress to provide for an independent monetary authority in the original Federal Reserve Act is just as relevant and valid today as it was when the act was passed in 1913.

* * * * *

"The Board believes that the proposed changes in the Employment Act with respect to the formation of monetary and credit policy could only result in reducing the effectiveness of such policy as an instrument for furthering the objectives of the act. For these reasons, the Board would not favor enactment of H.R. 4870."

All of these statements regarding a proposal merely to require the President to include in his Economic Report recommendations as to monetary policy clearly were premised on the position that the Employment Act did not require the Federal Reserve to accept the views of the President either as to monetary policy in general or as to specific targets of monetary policy.

1960 hearings

This construction of the Employment Act was again apparent during 1960 hearings before a subcommittee of the Senate Banking and Currency Committee on two bills to amend that Act. One of these bills,[28] introduced by Senator Clark, was identical with the 1959 Reuss bill H.R. 4870, as revised (H.R. 6263). In a letter dated February 19, 1960, the Board strongly opposed the bill. Chairman Martin's letter stated:[29]

> "4. The Board is concerned with the provisions of S. 2382 which would commit the President to incorporating, in the program recommendations of the Economic Report, recommendations on monetary and credit policies 'to the same extent as all other policies affecting employment, production, and purchasing power.' Furthermore, the bill provides that 'if the Federal Reserve Board disagrees * * * the President in his report to the Congress shall include the Board's views and reasons.' In essence, these provisions were included in H.R. 4870, and the Board commented extensively on them in a letter to Hon. William L. Dawson, chairman, Committee on Government Operations, House of Representatives, dated April 1, 1959.
>
> "The Board continues to believe that proposed changes of this kind of the Employment Act are undesirable on the grounds that they are both unnecessary and capable of generating mischievous consequences - whether through hampering the flexibility essential to the Federal Reserve in adapting monetary and credit policies to changing conditions, or through stimulation of speculative tendencies in the use of bank credit. The proposed changes, furthermore, are contrary in spirit both to the legislative foundation and the subsequent development of the Federal Reserve System.

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

29/ Hearings before Subcommittee of Senate Committee on Banking and Currency, 86th Cong., 2d Sess. (Feb. 24-26, 1960), pp. 9, 10.

"The Board's policy decisions are made on the basis of continuous scrutiny of the complex of economic forces, non-financial as well as financial, and there is the fullest possible disclosure of the information on which decisions are made. The Board endeavors to keep in close touch with the Executive offices of the Government, and there is ample opportunity for exchange of views. It may be noted that the chairman has appeared in recent years before the Joint Economic Committee to testify on the President's Economic Report. Testimony on behalf of the Board before committees of Congress frequently has stressed monetary and credit developments and their relationship to policy.

"Congress has heretofore entrusted to the Federal Reserve System responsibilities for decisions in the area of monetary and credit policy. A separate mandate from the Congress to the Executive, as contained in this bill, to make recommendations in this area and to report to the Congress differences between him and the Federal Reserve would - we believe - jeopardize the ability of the System, as an agent of Congress, to perform its duties and responsibilities in an independent, objective, nonpartisan, and impartial manner. There can be no doubt that the Congress at any time can limit or withdraw the trusteeship it has granted to the Federal Reserve System to carry out constitutional responsibilities of Congress in the field of money and credit. However, any action that might reduce the independence of the Federal Reserve from the Executive should be considered with great care - in the context of hearings and studies devoted primarily to this subject.

"For these various reasons, the Board does not favor the enactment of S. 2382."

During the hearings, Mr. Reuss again emphasized that the bill would not affect the independence of the Board. He stated:[30/]

"I know that there is objection to this provision both from the Federal Reserve and from the administration. The objection seems to boil down to this: That requiring the President to make the kind of gentle admonition we are talking about would somehow impair the independence of the Federal Reserve Board.

"With all due respect, I think this objection is really a ridiculous one.

30/ *Id.*, p. 17.

> "As it is now, the President in his annual report tells not only Congress but State governments, local governments, private business organizations, and labor how they shall walk, and wherein they can conduct themselves in order to contribute best to the national economic good. I do not see why the Federal Reserve, an organization which I dearly love, should be so sacrosanct as to escape even a friendly word from the President.
>
> "I should emphasize again that this bill in no way says that the Federal Reserve Board has to do what the President thinks it ought to do.
>
> "If the President, for example, says, just to take an example out of the blue, 'You, the Federal Reserve Board, should increase the money supply at a faster or slower rate than you are doing' - and I would hope he would not say that, but if he did - the Federal Reserve Board would be perfectly justified under this bill in saying, 'No, we believe that we must assert our independence there, and, Mr. President, we are not going to follow your advice on that.'"

<u>1966 symposium</u>

In December 1965, the Board asserted its freedom from the President's views as to monetary policy when it increased the discount rate. Shortly thereafter, in February 1966, the Joint Economic Committee, under the chairmanship of Representative Patman, held a unique hearing in the form of a "symposium" at the Washington Hilton Hotel in celebration of the twentieth anniversary of the Employment Act. Only one or two statements by the participants had any relation to the question whether the Federal Reserve is bound by the policy goals stated by the President in his Economic Report under that Act. It is worth noting, however, that Dr. Walter W. Heller referred to the Board's discount rate action in December 1965 as an illustration of the fact that the Federal Reserve had not always gone along with the President as to monetary policy. Dr. Heller said:[31/]

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

31/ <u>1966 Symposium</u>, p. 43.

Only one participant in the symposium specifically referred to the possibility of a change in the Employment Act to require the Board to follow the President's policy goals. Dr. Neil H. Jacoby, dean of the Graduate School of Business Administration, University of California, rejected such a proposal. He said:[32/]

> ". . . The well-publicized dispute of the Federal Reserve Board over increases in the discount rates of Federal Reserve banks again raised the question whether present machinery for coordinating economic policy is adequate. Some of those who considered the Board's decision to be wrong argued that the President should have final authority over monetary policy.
>
> "We are not here concerned with the merits of a particular monetary action, but with the basic propriety of present organizational arrangements. These were studied at length by the Commission on Money and Credit. It concluded that the semiautonomous authority of the Federal Reserve Board over U. S. monetary policy should be preserved. [Footnote omitted.] I agree. Present informal consultations between the Federal Reserve authorities and the principal economic and fiscal officers of the administration have, in fact, nearly always produced consensus on appropriate monetary actions and their coordination with fiscal and other policies. Since the famous 'accord' of March 1951, instances of divergent judgments by the President and the Board have been very rare.
>
> "The Federal Reserve Board was properly given a measure of autonomy in order to remove monetary policy decisions one step from the political arena. It constitutes a kind of 'monetary judiciary' that is compatible with our federal system of divided powers, checks, and balances. A semiautonomous monetary authority is an accepted part of governmental organization in the leading nations of the West. If the United States were to abandon this principle now, foreign confidence in the dollar would be impaired."

Following the symposium, the JEC had printed a "supplement" to the symposium containing statements from economists who had not been participants. That supplement, unlike the symposium itself, contained a number of statements regarding the relationship between the President and the Federal Reserve, all clearly indicating that under existing law the President could not control or even influence the monetary policies of the Board.

32/ *Id.*, pp. 85, 86.

Professor James W. Angell of Columbia University felt that the existing situation was "absurd" and should be changed by legislation. He said:33/

"The most serious gap in the act, I believe, is its failure to make any explicit provision for orderly incorporation of the policies and actions of the Board of Governors of the Federal Reserve System into its own framework. Legally, in its operations the Board is independent of the Federal Government as such. But this is an absurd situation, found in no other major country. Monetary policy and fiscal policy are in many if not all situations only two sides of the same coin. They should be directed toward the same general objectives, and should be implemented by mutually consistent measures. Yet only too frequently we have witnessed virtually head-on conflicts over current goals and methods, between the Board, on the one side, and the Treasury or other organs of the administration, on the other. Such conflicts at best produce uncertainty and a probable retardation of our growth rate, and at worst could inflict really serious damage on the economy. They should be completely prevented, presumably by new legislation."

Similarly, Professor Leo Fishman of West Virginia University urged that the independence of the Federal Reserve be modified, clearly on the premise that under existing law the Federal Reserve was not bound by the President's economic goals. He stated:34/

"In recent years, however, the President has been prevented from acting in a manner consistent with the effective discharge of his responsibility for coordinating all 'plans, functions, and resources' of the Federal Government, because the Board of Governors of the Federal Reserve System has claimed (and has on several occasions exercised) complete autonomy with respect to monetary policy.

"The tools of monetary policy are both speedy and flexible. They can also be quite potent, especially when used in restrictive fashion. If used for restrictive purposes, they cannot fail to counteract, at least to some extent, the effect of any fiscal policy deliberately adopted for the purpose of stimulating or sustaining an expansion of economic activity.

33/ Id., Supplement, p. 24.

34/ Id., Supplement, p. 51.

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

Fishman felt at that time that new legislation would not be necessary and that the President already had power under the Employment Act to coordinate monetary policy with fiscal policy. He said:35/

> "The Employment Act of 1946, although it does contain an explicit mandate to the President, does not contain either an explicit or an implicit mandate to the Board of Governors. In the debates preceding passage of the act no reference was made to the powers of the Board of Governors, nor was any mention made of its right to exercise its powers independently of the President. In fact, on one or two occasions it was observed that monetary policy would be used by the President to promote the purposes of the legislation.
>
> "If the President is to discharge the responsibilities assigned to him in the Employment Act of 1946, he must exercise the power to coordinate national monetary policy with national fiscal policy. The basis for such exercise of power by the President already exists. Passage of new legislation is not necessary."

Another who felt that the Federal Reserve should not be "independent" was Professor Seymour E. Harris of the University of California. He suggested that the Employment Act be amended to make it clear that, while monetary policy is a responsibility of the Federal Reserve, the ultimate responsibility for such authority resides in the Congress and that "no policymakers have the right to withdraw their instruments or to use them in a manner to negate the overall effects of policy."36/

In favor of the Federal Reserve's independence, Professor C. A. Matthews of the University of Florida pointed out that it was desirable that an independent agency should have the right to present its own position to Congress and the public even though different from that taken by the President. He said:37/

35/ Id., Supplement, p. 52.

36/ Id., Supplement, p. 62.

37/ Id., Supplement, p. 108.

"While discussing the desirability of providing the electorate with the various points of view involved in reaching decisions with respect to the implementation of economic policy, it seems appropriate to comment on the continuing recommendation to make the Federal Reserve System a part of the executive branch of the Government. One overwhelming argument against such a proposal is that it would reduce the freedom of the Federal Reserve authorities to make their position on questions of policy known to the Congress and to the public. As a part of the executive branch of the Government the 'official' position would become the Fed's position. As an 'independent' agency, the Fed's position may or may not be the same as that of the administration. It would, at least, be an independently derived position."

In a somewhat similar vein, former CEA Chairman Edwin G. Nourse expressed the view that the Federal Reserve was a desirable "balancing device". He said:[38/]

"Any balancing device, to be reliable, needs to be free running. The 'independence of the Fed' was relinquished during World War II and Korea in order to peg U.S. bonds at par but was restored by 'the accord of 1951,' allowing the money market again to exercise its aggregate supply-and-demand adjusting role. Recent interpreters and implementers of the Employment Act, however, are restive under any such concept and practice of shared responsibility for national economic growth and stability. With 'coordination' as their watchword, they extol Executive Office primacy in governance of the whole economy rather than coordinate right and responsibility for differentiated policymaking toward a common purpose.

"When, in December 1965, the Board of Governors of the Fed lingeringly responded to its responsibility to check a fiscally overstimulated economy with a mild, testing monetary brake, the Chairman of the Economic Advisers and also the Secretary of the Treasury and the chairman of the Joint Economic Committee denounced this challenge to unitary judgment. There was publicly expressed 'regret [over this] blemish on the record. * * * [linked to] hope that the pattern of coordination which has been the rule through the past 5 years can be resumed and strengthened.' Even by the time of the February 23 symposium, there was widespread agreement that the Reserve Board's action had been timely and salutary - indeed that more of the same might soon be needed, since fiscal devices were patently defective in their reverse gear."

38/ *Id.*, Supplement, pp. 121, 122.

On the other hand, Professor Frank C. Pierson cited the Federal Reserve's discount action in December 1965 as a reason for closer administrative coordination between the CEA and the Federal Reserve:[39/]

> "Second, closer administrative coordination between the Council of Economic Advisers, Treasury, Federal Reserve, and Budget Bureau would help implement the decisionmaking process. The advantages of decentralized or independent policymaking should not be allowed to be emphasized to the point where unified action on major policies becomes impossible. The Federal Reserve's independent move last December in raising the rediscount rate before a broader governmental decision on stabilization policy could be reached may well have been defensible on substantive grounds but it left unanswered the procedural question whether a single agency should be permitted to exercise this degree of authority in such a vital area."

Mr. Walter S. Salant of the Brookings Institution opposed any legislation that would make the Board subject to the dictate of the President. He said:[40/]

> "I also do not consider it necessary or even desirable to amend the legislation in a manner that makes the Board of Governors of the Federal Reserve System more directly subject to the wishes of the President. The Board's present degree of legal independence has not been, and is not likely to be, exercised in a way that has a serious adverse effect on national policy. Its present degree of independence enforces a more thorough discussion and threshing out of issues within the Government than might otherwise occur. This appears to me to be generally healthy, however inconvenient and frustrating it may be to the officials concerned. The present arrangements have not worked out badly, on the whole, and much of value would be lost if the Board were placed under a tighter rein. This view does not, of course, preclude some of the changes that have been suggested by others, such as changes in the timing of nominations of the Chairman of the Board or in his term of office as Chairman."

Professor G. J. Viksnins of Georgetown University objectively discussed the arguments for and against the independence of the Federal Reserve. He said:[41/]

39/ Id., Supplement, p. 125.

40/ Id., Supplement, pp. 130, 131.

41/ Id., Supplement, p. 173.

"There can be little question that there is a grain of truth in both of the sharply differing views. There definitely does exist a potentiality in the independent Federal Reserve for largely frustrating the policy of the executive branch. A tax cut, say, could be largely nullified by a restrictive monetary policy and under present legal arrangements there is really little that could be done to stop the Federal Reserve if it were bent on a destructive or even a definitely undesirable policy. On the other hand, it can be argued fairly persuasively that the executive branch is politically quite sensitive, which means considerably more attention to employment than prices. To support every expenditure program and deny every tax increase constitutes demagoguery, which is too often politically profitable, however. Since the Federal Reserve need not respond to moment-by-moment political pressure, it may be one of the last few checks against demagoguery. While this argument may seem antidemocratic, in the last analysis the System is a creature of Congress and a destructive credit policy would surely not be tolerated for a long period."

Again, the net effect of all of these statements (except that by Leo Fishman), whether for or against the "independence" of the Federal Reserve, was that, under existing law, the President has no authority to direct the Board in the formulation of monetary policies.

1968 Patman Questionnaire

In 1968, a bill introduced by Mr. Patman[42/] to reorganize the Federal Reserve System would have abolished the Open Market Committee and transferred its functions to the Board. In this connection, section 12A of the Federal Reserve Act would have been amended to require that open market operations, "as well as all other actions and policies of the Federal Reserve Banks and the Board in the field of monetary affairs, shall be conducted in accordance with the programs and policies of the President pursuant to the Employment Act of 1946 and other provisions of law." The bill would have also amended the Employment Act by adding the following sentence at the end of section 3(a):

"Such program shall include the President's recommendations on fiscal and debt management policy and guidelines concerning monetary policy, domestic and foreign, including the growth of the money supply as defined by him."

This bill was the first explicit effort to make the President's recommendations under the Employment Act binding upon the Federal Reserve. It was not enacted.

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

In July 1968, Mr. Patman, as chairman of the Subcommittee on Domestic Finance of the House Banking and Currency Committee, utilized this bill as a basis for a questionnaire sent to the members of the Board, the Secretary of the Treasury, the Reserve Bank presidents, and a large number of academic and research monetary economists. The replies to this questionnaire were printed in a "Compendium on Monetary Policy Guidelines and Federal Reserve Structure".43/

The first two questions were the following:44/

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

The staff of the Subcommittee on Domestic Finance submitted a report to Mr. Patman summarizing responses to the questionnaire. As to these two questions, the staff summary indicated that a great majority of the respondents favored a "coordinated program" such as that contemplated by question 1 and were opposed "to the present regime wherein the Federal Reserve is neither guided by a program coordinating monetary and fiscal policies on a provisional basis, nor constrained by monetary rule." The staff summary showed that only 14 respondents (including Chairman Martin and Secretary Fowler) were "in favor of the present regime."45/ Clearly, the Subcommittee staff construed the Employment Act as <u>not</u> requiring the Federal Reserve to adhere to a program of monetary policy set forth by the President.

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

43/ A Subcommittee Print of the Subcommittee on Domestic Finance of the House Banking and Currency Committee, 90th Cong., 2d Sess. (Dec. 1968), hereafter cited as <u>1968 Compendium</u>.

44/ <u>1968 Compendium</u>, p. 7.

45/ <u>Id</u>., p. 8.

reversible adjustments, and that, whereas responsibility for fiscal policy should remain with the President, monetary policy should be determined by the Federal Reserve. Chairman Martin's letter stated that "This division of responsibilities in the field of economic policy is one of the desirable checks and balances in our system of government."46/ In response, the staff report argued to the contrary:47/

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

The System's reply to question 2 regarding responsibility for drawing up an economic policy program was as follows:48/

> "The responsibility for recommending to the Congress changes in Federal expenditure and revenue programs clearly rests with the President. Suggestions and advice may be sought from interested Federal agencies as to specific content, of course, and frequently the Federal Reserve has contributed to this process.
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> "In the President's report there often is reference to monetary as well as fiscal policy, and the Council's report customarily discusses monetary policy developments

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46/ Id., p. 11.

47/ Ibid.

48/ Id., p. 31.

at some length. We believe that such references are wholly appropriate, in view of the importance of financial developments to economic conditions generally, and in recognition of the role of monetary policy in the Government's economic stabilization effort. Views as to what constitutes appropriate monetary policies must of necessity be provisional for the reasons stated in answer to question I.1, but such policies must be taken into account as an important factor conditioning, and conditioned by, the economy's prospects.

"We believe, however, that <u>any specifications as to monetary policy should continue to be regarded in the nature of suggestions of what constitutes appropriate policy under clearly stated assumptions - which may or may not prove correct - rather than as instructions to the Federal Reserve System</u>. The System was created by Congress, and is answerable for its actions to the Congress; its role is that of advising and cooperating with the executive branch of Government in the public management of economic affairs, without being formally a part of it. This division of responsibilities in the field of economic policy is one of the desirable checks and balances of our system of government, and we do not believe that the Congress should cede its ultimate authority in the monetary sphere to the executive branch." (Underscoring supplied.)

Secretary Fowler's reply was somewhat similar:[49]

"Treasury response. The President already has the responsibility for drawing up, at the beginning of each year, a detailed economic program that is incorporated in his budget and Economic Report messages. In this context, he usually does spell out, in a general way, his assumptions regarding the monetary policies that would be consistent with the proposed fiscal and economic program and that he would regard as appropriate. In working out these assumptions, the President usually takes account of the views of various agencies as well as those of the Federal Reserve.

"Responsibility for the presentation of such a set of economic recommendations, based on specified assumptions with respect to financial developments and policies, should in our view continue to rest with the President. For the reasons spelled out in our response to the previous question, however, statements regarding assumed or desired monetary policies must necessarily be provisional and leave ample

49/ *Id.*, p. 57.

room for the flexible use of such policies. Moreover, given the traditional arrangements under which the Federal Reserve is directly answerable to the Congress, formal responsibility for the determination and execution of monetary policy must remain with the Federal Reserve and, ultimately, the Congress."

The reply of Professor Leo Fishman of West Virginia University argued that the Employment Act assigned to the President primary responsibility for coordinating all plans and functions of the Federal Government for the purpose of promoting the objectives of that Act and that it is "impossible for the President to discharge the responsibilities assigned to him in the Employment Act of 1946 unless he exercises the power to coordinate national monetary policy with national fiscal policy."[50/] However, he recognized that the Federal Reserve continued to assert its complete autonomy and that the question of the President's power had not yet been resolved; that there was question as to the steps the President might take to enforce his power if he were challenged by Federal Reserve authorities. Accordingly, contrary to the views expressed by him in 1966, Fishman favored the passage of H.R. 11 that would deal explicitly with the independent status of the Federal Reserve.

Professor William J. Frazer, Jr., of the University of Florida, in answering question 2, favored division of responsibility between the President and the Federal Reserve. He said:[51/]

"The responsibility for drawing up programs concerning economic policies should be a function of the respective agencies. The Council of Economic Advisers should be responsible for coordinating programs of agencies in the executive branch, for presenting a general economic forecast, and for expressing its views on rates of change in bank credit and the money stock. The Federal Reserve should be responsible at least for increasing the money stock during any quarter at an annual rate, say, of not less than 2 percent or more than 6 percent (27, p. 230, and 28, pp. 16-17), subject to other qualifications given later (secs. I.3. and I.3.D to F).

"As is presently the case, the Federal Reserve System should be accountable to the Congress (and the Joint Economic Committee in particular) for the achievement of national economic goals. The executive branch of the Government, too, subscribes to national economic goals,

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50/ Id., p. 161.

51/ Id., p. 170.

but due to its essentially political character its relation to the Congress will be more tenuous than that of the Federal Reserve, even a revitalized Federal Reserve.

"The Congress is responsible for specifying the national economic goals to which all agencies of the Government subscribe. Any major departure from the goals as defined by past interpretations, such as a long-term goal of faster economic growth (that is, a higher rate of change in gross national product per capita in constant dollars) should be approved by the Joint Economic Committee, and possibly by congressional statute."

Once more, the material contained in Mr. Patman's "Compendium" of 1968 provided cumulative evidence that the Employment Act was construed as authorizing the President to submit "programs" to Congress but not as obliging the Federal Reserve to accept such programs insofar as they might relate to monetary policies.

Mr. Patman's latest bill

On January 22, 1971, Representative Patman introduced a revised version of his bill to reorganize the Federal Reserve System.[52] Like his 1968 bill, it would drastically restrict the "independence" of the Federal Reserve. But, more explicitly than the 1968 bill, it would make Federal Reserve monetary policies subject to the President's recommendations under the Employment Act of 1946. It provides, for example, that, in his Economic Report, the President "shall prescribe those programs and policies relating to monetary policy matters which he wishes the Board to carry out in order to assist in implementing his monetary policy." It also provides, like Mr. Patman's 1968 bill, that open market operations and "all other actions and policies of the Federal Reserve banks and the Board in the field of monetary affairs, shall be conducted in accordance with the programs and policies of the President pursuant to the Employment Act of 1946 and other provisions of law." Finally, having provided that the Federal Reserve shall conduct monetary policies in accordance with the "programs" of the President, the Patman bill would specifically amend the Employment Act to provide that such programs "shall include the President's recommendations on fiscal and debt management policy and guidelines concerning monetary policy, domestic and foreign, including the growth of the money supply as defined by him."

The latest Patman bill carries the clear implication that the Federal Reserve is not presently bound by monetary policies recommended by the President or by specific goals or targets, such as the rate of growth in the money supply, that may be suggested by the President.

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

The arguments on the other side

Despite the opinion stated at the beginning of this memorandum, it is conceded that arguments may be made in support of a contrary opinion.

In the first place, it may be contended that making the Board subject to the economic targets or goals specified by the President would not impair the "independence" of the Federal Reserve. In other words, while seeking to achieve the goals set by the President, the System would not be subject to his direction or control in the exercise of its statutory functions, including open market operations, the fixing of discount rates, and prescribing reserve requirements.

The answer to this argument, it seems to me, is that, if the System were obliged to exercise its functions in a manner designed to achieve the goals set by the President, such as a specified gross national product, a specified level of unemployment, or a specified rate of inflation, the System's discretion in the exercise of its monetary powers of necessity would be restricted.

The counterargument would be that, even if the result would be to limit the System's independence in this manner, the Employment Act to this extent supersedes other provisions of law regarding the Federal Reserve. That Act was designed to establish a single economic policy for the Federal Government and it expressly requires the President to set forth "programs" to achieve that policy. The purposes of the Act would be defeated if the President should set certain targets and the Federal Reserve should adopt different targets.

This argument was forcefully stated by Professor Angell of Columbia University during the 1960 hearings previously discussed. He pointed out that monetary policy and fiscal policy are "only two sides of the same coin" and they should be directed toward "the same general objectives". He observed, however, that "only too frequently we have witnessed virtually head-on conflicts over current goals and methods, between the Board, on the one side, and the Treasury or other organs of the administration, on the other." He felt that such conflicts produce uncertainty and "could inflict really serious damage on the economy."

Similarly, Professor Leo Fishman of West Virginia University, during the same 1960 hearings, stated that, as long as the Board continues to exercise complete autonomy in matters pertaining to national economic policy, it "is possible for U. S. monetary policy to be oriented toward different and incompatible sets of goals." In such a situation he felt that it is "impossible for the President to coordinate all 'plans, functions, and resources' of the Federal Government for the purpose of promoting 'maximum employment, production, and purchasing power.'"

Along the same line, the staff report printed in Mr. Patman's 1968 "Compendium", already quoted, argued that, if the President could not control or at least guide the monetary authorities in the use of their flexible instruments, it would be "impossible for the President to discharge the responsibilities assigned him by the Employment Act of 1946 if he cannot guide the use of the only effective tool at the Government's disposal for achieving 'Maximum employment, output and' purchasing power.'"

These are plausible arguments. The fact remains, however, as has been demonstrated, that the Employment Act in its present form has been consistently interpreted as not imposing upon the Federal Reserve any obligation to follow the views of the President with respect to economic policy. Even Professors Angell and Fishman admitted that the possibility of conflicts between the President and the Federal Reserve could not be prevented without new legislation.

Whether the Federal Reserve should be bound by economic targets or goals set by the President is, of course, a question of policy and one to which this memorandum is not directed. I cannot escape the conclusion, however, that, as a strictly legal matter, the Board is not obliged to agree with the President's targets or goals under provisions of existing law.