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GOLDEN ANNIVERSARY CONVENTION

OREGON BANKERS ASSOCIATION

TUESDAY, JUNE 7, 1955

VICTORIA, B. C., CANADA

THE MEANING OF THE FEDERAL RESERVE SYSTEM

As seasoned bankers, you are so familiar with the operational services of the Federal Reserve Banks that anything that might be said on that topic would be an old story to you. Your banks are, in fact, part and parcel of the System's check collection service, its facilities for safekeeping securities, for telegraphic transfers of funds, and so on.

It may be fruitful, however, to discuss the reciprocal nature of the System's various functions — reciprocal in the sense that there is an interchange back and forth of public and private services and values among the member banks, the Federal Reserve Banks, and the general public, which in toto adds up to the considerable contribution that the vast financial mechanism of our private and public banking system makes to the national welfare.

Both in law and in practice banks have long since been held to be vested with a public interest that ranks with the more directly expressed public interest embodied in the activities and duties of the Federal Reserve System. There is no doubt but that the nation's commercial banks and the Federal Reserve System share mutual responsibilities for making our contribution to the general welfare as great as we possibly can, within the limits of human capability. In speaking today on "The Meaning of the Federal Reserve System," it is my purpose to discuss the sources of these joint responsibilities and how they are fulfilled.

The Federal Reserve System was created by Congress as the agency with which the Congress shares by delegation its constitutional powers over money. It follows that in owing its birthright to the

Congress, the System also owes filial obedience to the legal mandates of Congress as expressed in statutes governing the scope of the System's activities. What is sometimes overlooked is that the chain of duties and responsibilities entrusted in the Federal Reserve Act extends through the Federal Reserve Banks to the 6,660 commercial banks who have chosen to qualify for membership in the Federal Reserve System.

Thus it comes about that with the privilege of membership in the System there devolves upon the member banks an obligation to be guided by the System's rules and regulations and the laws from which they stem. This obligation is enhanced in that, viewed in the manner described, member banks are the indirect agents of Congress for exercising those powers over money that have been delegated to the Federal Reserve System, because the member banks are the medium through which the System's monetary and credit policies are registered.

Federal Reserve monetary and credit policies are designed to influence the extension of credit in such ways that the use of credit will be a constructive and stabilizing factor, rather than the reverse, in a dynamic and growing economy operating at a high level of activity. The importance of this undertaking, in which you share, is great. So much of the nation's business is transacted through the use of credit that any form of action that is taken to expand or contract the outstanding volume of credit is shortly reflected in those plans of the business community that depend for consummation on the use of credit. And as the affairs of non-users of credit are interrelated with the affairs of those to whom credit is of paramount importance, the economic effects of your actions and those of the Federal Reserve are far-reaching and pervasive.

Because credit policies do have so great an impact on economic activity, their formulation must be undertaken with careful deliberation and in the light of the best information obtainable regarding the current state of the economy and what are or may be developing trends, so that monetary and credit policy decisions can be made with the greatest attainable degree of certainty that their effects will be in tune with the nation's economic necessities. In the excellence of its sources of economic information and of its resources for interpretation, the Federal Reserve has been fortunate, and fortified in its efforts toward prompt adaptation of policy to meet changes in economic needs. Thus, when the System's economic intelligence indicated in late 1953 and on into 1954 that business was flagging, a policy of credit ease was put into effect promptly as a means of stimulating the wider use of credit and in that way encouraging greater economic activity. Subsequently, in late 1954 and thence forward when it became evident that a solid foundation was being built under economic recovery, the System altered its credit policy in recognition that, as the economy was generating its own forces of recovery, further stimulus from credit policy was no longer necessary.

With the passage of time, the progress of business recovery has come to assert itself in a rising demand for bank and other forms of credit which has been reflected in higher interest rates. In turn, the increase in interest rates has acted somewhat as a governor to hold down a speed of economic expansion that might become too rapid if fed too largely by credit.

However, Federal Reserve policy actions for supplying or withdrawing reserves only set the broad limits within which credit can expand or contract. It is the commercial banks of the country who must decide how the available supply of credit shall be allotted among its claimants, and that being the case, they are clearly the instruments through which Federal Reserve credit policy is ultimately manifested. It is in this way that the member banks share in the responsibility of making Federal Reserve credit policy effective and carry out their vital parts in the interplay of all of the nation's economic activities.

The choice of how an individual bank will employ its credit resources rests with that bank, in keeping with the democratic and decentralized character of the Federal Reserve System, which places ultimate responsibility for the effectuation of its policies at its remotest parts and not at the center. And so it is that the member banks of the Federal Reserve System, through the allocation of their credit resources, become the final arbiters of how credit shall be used for the constructive benefit of the nation. In fulfilling its responsibilities, it is expected that the individual member bank will have an eye both on its own position as a granter of credit and on the bearing its lending and investing activities have on the entire scheme of commercial bank credit activities. For example, are its consumer loans made on conservative terms? Has its real estate mortgage loan and investment portfolio been devised both in the light of high quality and adequate bank liquidity? Is it refraining from making loans of a speculative character?

By conscientiously living up to this dual responsibility, a member bank attains the distinction that membership in the Federal Reserve System confers.