Speech delivered before
Social Science Institute at Catholic University
Washington, D. C.
August 1, 1941

I. General Survey of the Federal Reserve System.

A. The System was set up by Congress in 1914 to establish a central banking system for this country, capable of influencing monetary and credit conditions in the interests of economic stability and full employment, as well as to provide numerous essential services to the Government, the public and the banks. The System is operated specifically in the public interest, and not for the private profit of the member banks which hold stock in it.

1. The governmental nature of the System is indicated by its direct responsibility to Congress, and by the fact that its governing Board is directly appointed by the President with the advice and consent of the Senate. This fact was made even clearer by the Banking Act of 1935 which greatly increased the power of the Board of Governors to take measures over the System and elsewhere to further the public interest.

B. Make-up of System:

1. Board of Governors - 7 members (now 2 vacancies) with general supervisory powers and the specific monetary control powers noted below.

2. Twelve Federal Reserve Banks - stock owned by member banks, but ownership of stock does not imply the right of control. Major policies of the Banks are coordinated with that of the Board in the public interest. These Banks render numerous routine but essential services to the member banks.

3. Open Market Committee - 12 members, including all Board members and 5 representing the Federal Reserve Banks. This Committee determines policies of the System in regard to purchase and sale of (primarily) Government securities to influence bank credit and to steady the securities market.

4. Federal Advisory Council - one member appointed by each Federal Reserve Bank. Council meets with and makes recommendations to the Board at least 4 times per year.

5. Member banks - at present 6,556, including all national banks and 1,426 State banks. Membership is compulsory for national banks, optional for State banks. Approximately half the nation's banks are members; but the nonmembers are primarily small country banks, so the System includes better than three-quarters of the nation's banking deposits and assets.

II. Major methods available to influence monetary and credit conditions.

A. Open market operations - by selling securities in the market the Federal Reserve draws down member bank reserves (as payment is made to the Federal Reserve) and thereby decreases the powers of the banks to make new loans and investments. By buying securities, the Federal Reserve obtains the opposite effect.

B. Rediscount rate charges - by increasing the interest (discount) rate member banks have to pay in borrowing from the Federal Reserve, borrowing may be discouraged; and vice versa. However, member banks ordinarily borrow very little, and this is now not an important means of influencing credit conditions.

C. Changes in reserve requirements - by raising the reserve requirements which member banks must hold against deposits, the Federal Reserve can decrease the excess reserves held by the banks against which new loans and investments can be made; and the reverse by lowering requirements. However, the extent to which the reserve requirements may be changed is closely limited by law.

D. Direct pressure and publicity - the Federal Reserve may make direct requests to bankers to carry out desirable credit policies; and to some extent these policies may be enforced through bank examination policies.

E. Changing margin requirements - by raising margin requirements for the purchase of securities on listed exchanges, the Federal Reserve may restrain the speculative use of credit in the securities markets.

III. Possible anti-inflation measures in the present picture.

A. The fundamental danger of inflation thus far has been primarily from increased incomes in relation to limited supply of consumer goods available, rather than from expansion of bank credit. However, the banking system has very large (approximately $5,000,000,000) excess reserves on hand, which may be used to extend new credit through loans and investments.

1. Therefore fundamental steps now must come through fiscal policy (taxation and borrowing out of current incomes) sufficient to hold down consumer purchasing power to the level of available supplies.

2. But this fiscal program will not suffice unless supplemented by steps to check the vast expansion of bank credit now possible on the excess reserves available.

a. To this end, the Federal Reserve may raise reserve requirements somewhat further and might conceivably sell its government securities in the open market (though this would seriously injure the attempts of the Treasury to sell new bonds)--but the powers of the Federal Reserve are now inadequate to control the credit situation. For this reason, the System has asked Congress (in the Special Report of January 1, 1941) for additional powers, especially to raise reserve requirements sufficiently to use up the present dangerous excess reserves, if such restraint becomes necessary.

3. Although fiscal and monetary restraints must be the primary anti-inflation steps, in cases of especially limited supplies of resources vital to national defense individual price controls will have to be established and supplies diverted to defense uses by priorities. The limited supply remaining for consumers may have to be rationed.

IV. Special activities of the Federal Reserve in the defense program.

A. Proposed control of installment credit - the Board contemplates the likelihood that it will be designated the agency to establish controls to limit the extension of installment credit. This restriction is necessary to restrain consumer purchases of durable goods competing for resources vital to the defense effort. By holding down consumer purchasing power, it will play a vital part in the anti-inflation program.

B. Special assistance to the Treasury in fiscal affairs, in addition to its large scale regular services.

1. Sale of Defense Savings Bonds.

2. Program to extend the use of Tax Anticipation Notes.

3. Foreign property control activities of the Federal Reserve Banks in handling "frozen" assets of nationals of all continental European countries except Russia and Turkey.

C. Defense Contracts Service - the Federal Reserve has cooperated with O. P. M. in making available information and services to all potential defense contractors throughout the country, to expedite the letting of contracts and subcontracts and to bring together demanders and suppliers of defense resources. Each Federal Reserve Bank has set up a substantial staff for this service.

D. Participation in the proposed Inter-American Bank - it is expected that the Federal Reserve will play a central role in the establishment of the Bank to promote closer relations with and the economic development of South and Central America, and that it will cooperate closely in the activities of the proposed Bank.

E. Participation in the Canadian-United States Economic Commission - the Board has detailed some of its most competent personnel to participate in the work of this Commission to coordinate Canadian and United States economic activity in furthering the production of vital materials and goods.

F. Special study of post-war problems - the Board has engaged one of the country's outstanding economists especially to direct a study of possible measures to ease the post-war readjustment of our economy from wartime activities to a peacetime organization. The aims are both to maintain economic stability and full employment and to bring about in the process basic economic improvements, such as new low cost housing to replace slum districts.