THE FEDERAL RESERVE SYSTEM - AN AMERICAN PRECEDENT?

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Let me tell you, first, how pleased I am to be present and to be on the program with such distinguished economists. However, let me also tell you that pluralism is not within my field of competence. Permit me, therefore, to speak on a subject on which I may have some competence, namely, on the Federal Reserve System -- I have been a member of the Board of Governors for more than twenty-two years. Needless to say, within the time allotted to me I can not hope to give you a complete picture of the purposes and functions of the Federal Reserve System; but I shall be glad to answer questions on that subject during the discussion. In any event, I shall feel satisfied with my efforts if the information I give helps in your discussion of pluralism.

The Federal Reserve System has been related to pluralism by Bishop Alter in an important paper published in the Review of Social Economy in September 1952. Bishop Alter believes that certain aspects of the Federal Reserve System might be considered as a possible model for the organization of economic society; and I would not dare to pronounce judgment on the question whether or not this belief is correct.

It is my understanding that the vocational groups which are to constitute the backbone of the pluralistic system should have the following characteristics:

1. They should be based on a combination of voluntary action with power to impose restraint.

2. They should be autonomous in their field of action, but only within the framework of the authority of the State.

3. They should have statutory jurisdiction in their field.

4. They should act not only in the interest of their members but also in the interests of society as a whole.

In this paper, I shall therefore review very briefly some aspects of the Federal Reserve System that might be considered to correspond with these four points.

I. Combination of Voluntary Action with Power to Impose Restraint

The policies of the Federal Reserve System are to a large extent based on the principle of providing a framework for proper functioning of the credit mechanism, rather than on the idea of directly controlling the activities of the member banks.

When the Federal Reserve System changes the discount rate, it does not compel any member bank to increase or reduce its borrowing or lending; it only makes borrowing at the Federal Reserve Banks more or less attractive, and leaves it to the member banks to adapt their business decisions to the new situation.

Similarly, when the Federal Reserve System buys or sells Treasury bills or bankers' acceptances in the open market, it does not compel anybody to sell or buy such paper. The System leaves it to the decisions of prospective buyers and sellers to adjust their position to the situation created by the new buying or selling offers. And again, when the System's open market operations result in an increase or in a reduction of money in the hands of the public, or of the reserves at the disposal of the banks, the System does not compel anybody to change his business decisions but leaves it to the discretion of the individual bank or business man to adjust his plans to the change in the available money supply.

The System, however, may use more direct methods of intervention. It may change the portion of their deposits that member banks are required to hold as reserves with the Federal Reserve Banks; and it may change the portion of the price of securities listed on an exchange that banks and brokers are permitted to lend for purchasing or carrying such securities. Therefore, while most of the time the credit policy of the Federal Reserve System works through voluntary actions of the member banks and the public, the System has also the power of imposing direct restraint in certain areas whenever it feels such action necessary.

II. Autonomy within the Framework of State Authority

The Federal Reserve System is an independent agency of the Government. It is true that the members of its Board of Governors are appointed by the President of the United States, with the advice and consent of the Senate. Once appointed, however, they cannot be dismissed without cause during the period for which they have been appointed and they are not subject to any directives or orders. Moreover, the twelve Federal Reserve Banks, which serve as the operating arms of the System, have a high degree of autonomy even in relation to the Board of Governors: the Board appoints one-third of their directors -- including the chairman and deputy chairman -- while the member banks select the remaining two-thirds; and the President and First Vice-President are appointed by the directors of each Federal Reserve Bank, although subject to approval by the Board of Governors.

This autonomy is also expressed in the rather complicated rules governing the most important fields in which the Federal Reserve System influences the credit mechanism of the United States. We have just mentioned that the Board has power, within statutory limits, to change the reserve requirements of the member banks, i.e., the portion of their deposits that must be kept as reserves with the Federal Reserve Banks; and that the Board has power to set margin requirements for credits for purchasing or carrying securities listed on an exchange, i.e., to determine what part of a transaction in such securities may be financed by a credit for which these securities are to serve as collateral. However, discount rates are established by the Federal Reserve Banks, although subject to "review and determination" by the Board of Governors. Finally, open market operations, which have become the major instrument of monetary policy used by the Federal Reserve System, are decided by the Federal Open Market Committee, which consists of the seven members of the Board of Governors and five representatives of the Federal Reserve Banks.

However, the autonomy of the Federal Reserve System is not unlimited. The Federal Reserve System is subject to the constitutional authority of the Congress: the Congress has created the System and it can at any time change the Federal Reserve Act and therefore modify, or completely eliminate, the powers of the System. From time to time the members of the Board of Governors are requested to appear before Congressional Committees to explain and justify the policies of the System. Moreover, the Board of Governors is required to make an annual report to the Congress, in which all policy actions of the Board and of the Federal Open Market Committee must be recorded. There are thus powerful safeguards to prevent the Federal Reserve System from becoming a "State within the State", or abusing the powers which it has received from the Congress, or usurping any function not delegated to the System by statute. The System is independent within the Government, not independent of it.

III. Statutory Jurisdiction

Membership in the Federal Reserve System is voluntary. It is true that all banks that engage in their business on the basis of a Federal charter must also be members of the Federal Reserve System. However, any bank that does not wish to take on the responsibilities of membership may give up its Federal charter and apply for a State charter instead.

And banks that engage in their business on the basis of a State charter are completely free to decide whether or not they wish to become members of the System. Most of the large banks, and a considerable number of small banks, have become convinced that membership in the System is in their best interest; but they no doubt would not hesitate to leave the System if that conviction disappeared.

As long as a bank is a member of the System, it must abide by the System's rules. State member banks are subject to periodic examination by the Federal Reserve Banks. If a member bank engages in unsafe or unsound practices, or if it violates the Federal law, the System can expel it from membership; the System also can remove the bank's directors and officers from their positions. The fact that the Federal Reserve System practically never has had to enforce such sanctions, and only very rarely has had to threaten their use, is the best proof of the extent to which member banks have been willing to observe the System's rules and regulations.

It may be noted that the jurisdiction of the System extends in some cases beyond its members. For instance, Federal Reserve regulations concerning margin requirements are binding upon security dealers and banks even though they are not members of the System.

IV. Combination of the Interest of the Members with the Interest of Society as a Whole

The Federal Reserve System serves the interests of the banking community by giving its members access to Federal Reserve credit and by making available to its members a great number of important services such as providing for check clearing facilities, furnishing currency for circulation, and collecting and interpreting information on the economic and financial situation of the United States and foreign countries. In a broader and more decisive sense, the System serves the banking community in that it helps to make banking practices in this country safe and sound.

Even more important, however, are the services rendered by the System to society as a whole. The main function of the Federal Reserve System is to provide the nation with a flow of money and credit that helps to make possible the maintenance of economic stability and the full use of the country's resources of labor and capital. Moreover, the System serves the nation as a whole by acting as fiscal agent for the Federal Government and its agencies. The Federal Reserve System cannot by itself create prosperity and bring about economic progress; however, it can aim at creating in the money and credit sectors of the economy conditions that are conducive to prosperity and progress. It does so by restricting credit expansion whenever there is a danger of inflationary developments -- even though some member banks might believe that further credit expansion would be in their immediate interest, by increasing their business volume and thus their profit opportunities. Similarly, the System attempts to stimulate credit expansion whenever there is a danger of deflationary developments -- even though some member banks might believe that a scarcity of credit would be in their immediate interest, by increasing their profit margin. The public interest must and does prevail in all Federal Reserve actions. There can be no other guide.

For this reason, those directors of the Federal Reserve Banks that are appointed by the Board of Governors, and half of the directors selected by the member banks, are required by law to be taken from occupations other than the banking business, so as to represent the public and the economy at large. And also for this reason, policy decisions of the Board of Governors as well as the operations of the Federal Reserve Banks must take into consideration not only the credit needs of potential borrowers, but also the effect of Federal Reserve actions on the maintenance of sound credit conditions in the nation as a whole.

Conclusion

You may see from this brief review that the Federal Reserve System is indeed an institution founded on a combination of voluntary action and restraint, enjoying autonomy within the framework of the Government of our country, exercising statutory jurisdiction over some sectors of the banking community, and designed to promote the interests of the society as a whole.

I repeat, I do not know whether these characteristics are essentially sufficient to make the Federal Reserve System a precedent for a pluralistic economy. This, however, I do know: that the System has played an important part (though only a part) in keeping our economic system healthy and well-balanced.