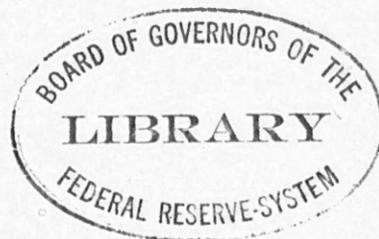


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CURRENT BANKING PROBLEMS

Banking is never without problems, so, to speak of "Current Banking Problems" means no more than to ask what banking problems deserve particular attention at the present time. By and large, today's problems are those that, in greater or less degree, are always with us and have their source in the banker's responsibility as a public servant to safeguard the deposits entrusted to his custody at the same time that he is employing those same deposits in loans and investments of constructive benefit to his community.

Fundamentally, a successful solution of these problems depends on the banker's ability to make loans and investments of a quality that will insure adequate protection to the bank's depositors -- the certainty that deposits can be repaid -- while at the same time the safety of loans and investments as an objective is not carried so far as to eliminate the assumption of that element of risk that in banking spells the difference between a bank's capacity for community usefulness and mere passive functioning.

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Bank capital is the essential link between these two relative opposites -- responsibility to depositors and responsibility to provide adequate community credit services -- for it is bank capital that must absorb loan and investment losses if the banker's primary liability to his depositors is to be fulfilled.

To enlarge on the importance of bank capital, it is only necessary to point to the change that has taken place in the composition of bank assets during the postwar period. Business activity has risen sharply over these years as the nation made good the deficiencies left by the war and then went on to rearm against potential foreign aggression at the same time that the American standard of living was sustained. Truly, miracles have been worked and in no small part can be traced to constructive bank loan and investment policies. However, the banking system's share in the nation's accomplishments has involved risk-taking in the best sense of the word, and as reviewed in the light of bank statements has witnessed a vast expansion of bank loans. As the increase in bank loans has been financed in part by a liquidation of U. S. Government securities, bank liquidity has fallen off at a time when risk assets have risen and the desirability of strengthening bank capital has been enhanced.

Bankers have been the first to recognize the problem of increasing the capital of their banks in keeping with the additional risks that have been underwritten. Conservative dividend policies and the retention of the greater part of earnings in bank capital structures

gives eloquent testimony of the efforts that have been made to meet the problems of building bank capital against an unknown future. Even so, more remains to be done and bankers are not, and cannot be, entirely complacent about their capital situations.

Those banks are to be commended that have further strengthened their capital structures through the sale of common stock, where such action has been considered advisable. Advantage taken of the Bureau of Internal Revenue's authority to set up bad debt reserves as a charge against taxable income has also served the purpose of arming banks against the possibility of future losses.

In last resort, however, the banker's ability to select sound loans and investments stands as the solution to the overriding bank problems of making sure and certain that bank depositors are properly protected. Such selectivity goes a long distance toward making good real and technical deficiencies in bank capital, in that prudent loan and investment policies automatically restrain bankers from overreaching and assuming risks that are incompatible to the fulfillment of their contractual responsibility to safeguard the deposits entrusted to their custody and to provide for their repayment as required.

The characteristics thus far discussed of current, or perennial, banking problems, depending on how they are viewed, have been those whose solution is largely in the hands of the individual banker. Although not as clearly apparent as a corrective to banking problems, Federal Reserve System monetary policy has a vital part to play. Monetary policy serves

as a preventive to the occurrence of banking problems rather than as a cure to those that may already exist. As you are aware, monetary policy engages either to expand or contract the capacity of banks to lend or invest by way of supplying or withdrawing the cash reserves that they must carry against their deposits. Inasmuch as bank deposits are so largely the product of bank loans and investments, it follows that by increasing or decreasing bank reserves, the execution of monetary policy can influence the expansion or contraction of bank loan and investment activity. In a period such as the present, monetary policy has been aimed at holding bank loans and investments to levels consistent with the credit needs of a defense-activated economy operating under conditions of full employment and at the same time preventing any over-expansion of bank credit that could lead to future debt burden difficulties or inflationary excesses. Current Federal Reserve System monetary policy, by its very nature, has complemented the policies of the aggregate of individual banks in seeking the mutual objective of conservative and constructive banking practices.

In conclusion, allow me to say the self-evident. Private and public banking share the responsibility of providing a banking system that will serve the public interest through the constructive use of bank credit fitted to a national economy freed from exposure to the damaging influences either of deflation or inflation.