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THE FEDERAL RESERVE SYSTEM

Forty years ago the representatives of the people of the United States, in Congress assembled, completed an examination of the banking system as then organized and found it wanting. The deliberations of the Congress thereupon resulted in the passage of the Federal Reserve Act and its signature by President Wilson into law on December 23, 1913. For the United States a new concept of banking was then established -- "central banking", or perhaps more accurately, "reserve banking" -- which drew for its origins on the First and Second Banks of the United States and on the long experience of European nations.

With the passage of forty years, the time is appropriate to assess the value to the United States of the concept of banking that was thus formulated -- the Federal Reserve System. Searching questions must be asked:

1. Has the Federal Reserve System, a decentralized central banking system, served the purposes for which it was created?
2. Has the Federal Reserve System grown with the times?
3. Has the Federal Reserve System lived up to its responsibilities?

Primarily, the answers to these questions lend themselves to general rather than specific answers. During the forty years of its existence the Federal Reserve System has not only come through, but helped bring this country through, the fire of two devastating world wars, the battering storm of rampant speculation, the corrosive calm of unparalleled depression, and the social and economic turbulence of our present age.

For any national institution to have met the problems with which it was confronted in these four decades and in the process to have maintained public confidence -- as I believe the Federal Reserve System has -- is a testimonial to the genius of its creators and to the dedicated men and women who have stood steadfast in their resolve that this institution should unswervingly serve the public interest.

First of all, survival unscathed over the past forty years is proof that the concept of a decentralized central banking system is in keeping with the American way of life. The organization of twelve Federal Reserve Banks, each located in a distinct geographical district of the continental United States, and each operated by a board of directors and officers representative of the economic interests of the district, has made possible the kind of inter-district exchange of opinions and merging of judgments that has led to the development of truly national monetary and credit policies. The Federal Reserve System is deeply indebted to the private citizens who have given freely of their time and energy to serve on the boards of directors of the twelve Federal Reserve Banks and their branches. The System's contribution to the nation's over-all economic progress would have been far less in their absence.

Any national institution that looks beyond its own official circle for guidance and the critical stimulus of outside opinion must, of course, possess the coordinating ties of a continuing expert personnel that keeps the purposes and functions of the institution clearly in the vision of those who are more temporarily recruited to its ranks, while at the same time drawing on the freshening outlook of their individual experiences. The Federal Reserve System has been fortunate in having an official personnel devoted to the public service -- one that, in association with the public-spirited citizens who have

served on the boards of directors of the Federal Reserve Banks and on the Federal Advisory Council, has provided a blend of public and private direction that has been of immeasurable value. It is safe to say that there is general agreement that the Federal Reserve System has satisfied the concept of a decentralized central banking system that was envisioned by its founders.

If, then, it can be agreed that the Federal Reserve System is structurally acceptable, has it grown and progressed with the times? The genius of the Founding Fathers of the Constitution of the United States of America supplied a document whose stated principles are unchallengeable in their fairness to the rights of man. And yet that document has of itself become a framework into which can be fitted a democratic people's evolving theories of government without sacrifice of fundamental principles, but, rather, with those principles more firmly established with the passage of time.

Within a lesser sphere and span of years, somewhat the same claim can be made for the Federal Reserve Act. The administration of the Federal Reserve Act has from the outset undertaken to serve the requirements of commerce, industry, and agriculture as expressed through the medium of the commercial banks in meeting the credit needs of their customers. It was originally planned that the Federal Reserve Banks would provide the national economy with an elastic currency whose stabilizing influence would greatly mitigate the wide economic fluctuations which had been experienced in the past.

Although progress was made in this direction, the experience of two wars, rampant speculation, spiraling depression, and an armed and unstable peace showed that these expectations exceeded the power of attainment. Therefore, there came to be a gradual awareness that the Federal Reserve Act should

be directed more toward preventing the kind of financial disturbances it had been designed originally to cure. This led to amendments of the Act and to the adoption of administrative procedures, all within the spirit of the original legislation, that have kept Federal Reserve policies and practices closely attuned to the needs of the day. Throughout its history, experience has been the Federal Reserve's best teacher, as, for example, when it learned the practical lesson that the too rigid definition of eligible paper prevented fulfillment of its true central bank mission of "banker of last resort."

From the lesson of this experience came the Banking Act of 1935 and its authority to the Federal Reserve Banks to make loans to member banks "on notes secured to the satisfaction of such Federal Reserve Banks." This provided insurance against a contraction of bank credit feeding on itself as a consequence of bank liquidity problems. At the same time, it allowed the Federal Reserve Banks an area of discretion through adequate bank supervision sufficient to forestall improvident banking practices that, if not checked, would lead to the accumulation of paper that could not qualify as security for Federal Reserve Bank loans.

In much the same way that these lessons of adversity strengthened the Federal Reserve System's capacity for public service, the accumulation of Federal debt in depression and war has led to a more flexible and effective use of open market operations as a means for fostering stable economic conditions. Changes in the discount rate and in reserve requirements were familiar instruments of Federal Reserve monetary and credit policy before the full import of the usefulness of open market operations came to be understood. As, however, the techniques of open market operations were mastered both in the United States and abroad, there came central bank appreciation that the ability to increase or reduce the cash reserves of the commercial banking system in this manner also

embodied the ability to encourage or discourage the use of bank credit.

Given the enormous volume of a nation's business transactions that are carried on through the use of credit, it follows that monetary policy, by fixing the boundaries within which bank credit can expand or contract, exerts a powerful influence on businessmen's decisions and hence on business conditions. The Federal Reserve System's monetary and credit policy in recent times has illustrated the uses to which open market policy can be put, first, in acting to restrain the use of credit so as to damp down the threat of inflation and, then, in acting to ease credit so as to combat recession.

The answer to the question, "Has the Federal Reserve System grown with the times?", would assuredly seem to be yes. Its growth has been by way of adaptation to changing economic circumstances in ways that have put to constructive use the lessons learned from experience, to the end that monetary policy can be used to anticipate and forestall the recurrence of conditions that are inherently destructive to the maintenance of a stable, yet progressive, economy.

To be sure, the Federal Reserve System has also grown physically with the times. Considering the growth of the national economy, it could not be otherwise, but this physical growth has been limited strictly to functional necessities and has not been the product of any ambitious desire for added power or authority. It is in moral stature, rather than in physical size, that the Federal Reserve System has really grown with the times, if we may judge from the apparent public acceptance that the performance of the Federal Reserve System over the years has met the standards and hopes of its creators. Most people appear to recognize that the Federal Reserve has, at the least, made a conscientious effort to discharge its duties impersonally and impartially and to work in the interest of the public as a whole.

The record, like that of other human institutions, is by no means flawless. Hindsight delineates the faults in even sharper perspective. Certainly no friend of the System would like to claim that it has been or can be infallible. Yet it seems fair to appraise its record as one of useful, necessary, and valuable public service.

That the Federal Reserve System has a good name redounds to the lasting credit of the men and women who are enlisted in its service. If the Federal Reserve System has lived up to its responsibilities, and I believe it has, it is because of the high morale of its personnel, which has meant the subordination of person to cause and a willingness to contribute as a group to objectives decided upon by debate, trial, error, and accomplishment.

Over the years a national institution develops a character of its own whose strength is the product of its accomplishments and the reflection of the individual personalities who go to make up its collective whole. Respect for character is in itself a reward and can be shown in diverse ways. In my opinion, the Federal Reserve System's reward for public service is to be found in the willingness of the public to accept its independent judgments even though they may at times be vexatious to large groups. This is not to say that Federal Reserve actions should not be challenged or to claim for its judgments more than a high average of correctness. It is only to say that the public seems to have been convinced that these actions and judgments were arrived at honestly and, when and where they have been found to be in error, corrective steps have been taken promptly.

If, however, the Federal Reserve System is to continue to merit public confidence, its independence of action must be preserved. The Federal Reserve

System is a governmental institution and as such must be attentive to the overall policies of the national government. But, being delegated authority by the Congress in the specialized field of monetary policy, it is essential for the Federal Reserve System to exercise that authority so as to discharge the responsibility it must bear alone. That means, among other things, the System must be able to voice its professional views and opinions with such sound reasoning that they will be generally accepted as fitting and proper, and thus assure monetary policy a harmonious part in the composite of current governmental policy. The essence of effective Federal Reserve policy lies in this authority independently to decide and carry out policy judgments manifestly designed to serve the best interests of the general public.

In conclusion, it must be said that the Federal Reserve System cannot continue to justify the public confidence it now enjoys unless it adheres firmly to certain cardinal principles that have characterized its past history:

1. Its actions must always be understandable.
2. Public scrutiny and criticism of its policies must always be invited.
3. Its policies must be based upon and justified by their logical reasonableness, and never by other considerations.
4. The kind of institutional conservatism that resists warranted change must be shunned at the same time that the influence of some caprice of the moment is avoided.
5. The Federal Reserve System must unremittingly discharge its duties solely in the general public interest.

The Federal Reserve System has, I believe, met the test of public service and responsibility for forty years by holding fast to the principles for which it was created, while at the same time enlarging the horizon of its operations to meet the challenge of changing conditions. On the roots of its past, it will grow in the future.