Economic Discipline and the Middle Generation

Washington's "New Discipline" and the Banking Business
The feeling of restiveness prevailing in the United States today has left its impact on the world of economics and banking. The following attempts to analyze this impact are based on talks given during the Spring at a series of meetings of bankers and businessmen throughout the Third Federal Reserve District.
Economic Discipline and the Middle Generation

by David P. Eastburn

With so much attention focused on the plight of the Nation's youth, the forgotten group in these unhappy times is the middle generation. It shares the prevailing frustrations over Vietnam, bitterness about the racial conflict, and despair in the face of an overwhelming urban crisis. But it also has special problems of its own.

Defined as an age group, the middle generation comprises one-fourth of the population. Defined more meaningfully in terms of a state of mind, the term describes a group that is, figuratively, caught in the middle between two ways of thinking. It is ambivalent between a rather clearly delineated set of values it was brought up to believe in and a new, more flexible set of values it is now asked to accept. It is a generation torn between old black-and-white principles of right and wrong and new ethics of the situation.

Nowhere is this more apparent than in the world of economics, the world in which the middle generation spends most of its time and exerts power out of proportion to its size.

The old economic rules stressed concepts like work, thrift, incentives, rewards, and the free market. These all revolved around the idea of discipline. Success came to individuals and nations who disciplined themselves to work hard and to save. Incentive to do so was provided by a free market that distributed rewards according to contribution. The ethic of the system was the ethic of discipline.

The middle generation sees today's economy as denying this ethic. It believes thrift has given way to spending as the driving force. Social programs of government, by-passing the market place, weaken incentives by providing rewards for not producing. Self-discipline and discipline of the free market have been eroded by ad hoc approaches to specific economic problems—a sort of "situation economics."

The old saying that "there ain't no free lunch" has real meaning in the philosophy of the middle generation. An economist would recognize this simply as "the basic economic problem," namely, that use of a given resource to satisfy one
want requires giving up its use for another. The
middle generation tends to believe that this hard
fact of economic life is being forgotten with re-
spect to at least five important current issues: re-
cessions, debt, gold, foreign aid, and poverty.

1. Recessions. Until fairly recently, a recession
was regarded as a chief form of economic dis-
cipline. If individuals, businesses, and govern-
ments could not restrain themselves sufficiently to
prevent prosperity from becoming a boom, a re-
cession which inevitably followed would purge
the economy of its excesses. A recession was the
distasteful medicine to be taken on the morning
after over-indulging in prosperity. It was the
price to be paid for attempting to live beyond
our means.

This clearly was the prevailing view before the
Great Depression, but the experience of the '30's
did much to dispel the idea that recessions are
good for what ails us. Recalling the suffering
during the Great Depression and fearing a pain-
ful economic adjustment after the war, Congress
passed the Employment Act of 1946, pledging
use of governmental powers to maintain maxi-
mum employment, production, and purchasing
power. Experience in the 1950's raised hopes
that the severity of recessions could indeed be
lessened by intelligent governmental action. The
past seven years of continuous prosperity, the
longest on record, now suggests that we need not
have recessions at all. Not only are recessions
not good for what ails us, they are not inevitable.

Most economists have yet to be convinced that
they know enough, or that government can act
intelligently and promptly enough, to eliminate
recessions. The middle generation, long con-
tioned to the view that recessions are the
price of too much prosperity, is not ready to buy
the idea, one suspects, for another reason—a
lingering guilt complex, a feeling that we do not
really deserve to have it so good. Nevertheless,
the idea of recessions as a way of disciplining
the economy has greatly weakened. We are less
willing to subject ourselves to this harsh and
impersonal discipline of the market place.

But unpleasant as it may be, a recession does
serve periodically to force the economy to live
within its means. The danger the middle genera-
tion now fears is that government, in its quest
for eternal prosperity, will perpetuate inflation.
Government seems to act as if some inflation is
preferable to recessions, but the middle genera-
tion has its doubts.

2. Debt. John Maynard Keynes upset the old
rules some thirty years ago by arguing that sav-
ing could be a bad thing; too much of it could
produce a recession. His prescription for curing
a recession was to go into debt and spend. Al-
though the wisdom of this has long since been
granted by an overwhelming majority of econo-
mists, it is yet to be accepted by the public at
large. What the New Economists have called the
Puritan Ethic is still very much alive in the
minds of the middle generation. Few still believe
that it is evil to go into debt at all; this extreme
is a hangover of the days before cars and other
durables became available to everyone through
the instalment plan. But most of the middle gen-
eration is keenly aware of the limitations of in-
debtedness. You can borrow against tomorrow's
income to spend today, but only up to a point.

The argument that analogies between prin-
ciples of private and public finance are faulty
because government has the power to tax does
not convince the middle generation. Statistics
showing that Federal Government debt is actu-
ally a declining percentage of gross national
product sway it only a little. And the theory
of the New Economics that government debt
should be used when necessary to stimulate the
Why? Because it sees no consistent evidence that government can or will run a surplus when necessary to restrain the economy. The principle of the constantly balanced budget makes no economic sense, but at least it imposes a control on overspending. Until government demonstrates greater flexibility in cutting spending, raising taxes, and paying off debt when the economy is booming, it will not wean the middle generation away from its fear of government debt and its admiration for the discipline of the balanced budget.

3. Gold. Gold is the disciplinarian par excellence. Under the old gold coin standard, the amount of specie was supposed to regulate the domestic economy automatically by placing a ceiling on the expansibility of a nation’s money supply. The public could demand gold for its money if it feared money was losing value, and the Federal Reserve would tighten up if the money supply threatened to expand beyond its proper relationship to the amount of gold behind it. It would be impossible to live beyond our means.

Or so the theory went. In fact, gold proved to be such a harsh and capricious disciplinarian that this Nation decided it could do better without it. The public no longer can demand gold for its money. The Federal Reserve no longer regulates the money supply in accordance with the amount of gold it holds. These facts apparently cause no concern on the part of the middle generation. When the last vestige of the domestic gold standard—the 25 per cent backing of currency by gold certificates—was removed by Congress recently, hardly anyone noticed.

Gold remains an important disciplinarian of the international economy, however. It is still, by common consent, the prime monetary asset and the unit of account for the world’s curren-
that which is already perverse.

Mr. Sproul was speaking of the role of gold in the domestic economy. More and more experts now believe the same can be said of gold in the international economy. Consequently, in working to reform the world’s monetary system, they are moving away from gold as the centerpiece. They have devised a supplement to gold—a new “paper gold”—so that the international financial system will be free from the undesirable restraints imposed by an uncertain supply of metal.

“But where then is the discipline?” asks the middle generation. Whereas a discretionary monetary policy may effectively impose discipline on a single economy, the middle generation sees the nations of the world still a long way from establishing any unified or coordinated monetary authority which could impose discipline on the international financial system.

4. Foreign aid. The greatest need of developing nations is for capital formation, the process of building up plant and equipment which can produce large quantities of goods and services for consumers. To form capital, however, consumers must save—do with less consuming—for a time. This is the “hooker” for developing nations; their standard of living is so low already that further reduction would mean starvation for large numbers of their population.

At one time the U. S., as a developing nation, got over this hump with help from outside in the form of investment by governments and businesses of other nations. Simultaneously, the dominant Puritan Ethic, stressing hard work and thrift, contributed to the accumulation of capital for investment in productive plant and equipment.

Developing nations today, however, seek other solutions. Investment from outside runs counter to their nationalistic ambitions. Their philosophy of life often stresses non-material goals. Accumulation of wealth is likely to take the form of gold and jewelry rather than invested capital. Yet, observing extreme affluence in other parts of the world, these nations chafe under their “have not” status and are unwilling to repeat the time-consuming process by which the developed nations achieved their “have” status.

Foreign aid is a recognition of the fact that the road to economic development today must be different from the one the U.S. traveled. But while the middle generation shares the humanitarian motives behind foreign aid and endorses the political objectives of winning friends for capitalism, it finds it hard to understand why the same old principles of growth are not good still. If hard work, thrift, and a good return on investment did the trick for us, it should for others if they will just be patient. Recurring examples of waste and inefficiency in the foreign aid program only serve to reinforce this view.

5. Poverty. “The poor we have with us always” is a sentiment the middle generation understands. It recognizes that an economic system which distributes rewards in accordance with contribution inevitably produces inequality of income, but it believes that inequality is necessary to the system; inequality provides the incentive that makes the system go. If some people are poorer than others, this is a reflection of the value the market puts on their economic worth. The middle generation might regard social programs to alleviate poverty as desirable from the humanitarian point of view but would guard against destroying incentive.

Few of us feel completely comfortable with such a view today. Poverty now is seen as an inexcusable flaw in an economic system capable of producing great affluence. The poor are poor not simply because they are lazy or incapable;
they are victims of a system that prevents them from making their maximum potential contribution.

One current solution is to develop these potentials through better education and training. This the middle generation endorses. Another is to assure everyone a minimum standard of living through a guaranteed annual income, negative income tax, or some such device. This, however, the middle generation views with misgivings. It feels that somehow an economic system as strong as ours should be able to generate a satisfactory income for everyone; but it is unwilling to weaken the incentives which make the economy so strong or to tamper with the market place in which these incentives are expressed.

**Needed: a new discipline**

Such a portrait of the middle generation as seen in these five issues runs the danger, of course, of turning into a caricature—a caricature of a reactionary, cold-hearted advocate of 19th Century *laissez faire*. This is not the case. The middle generation is ambivalent precisely because it does recognize some merit in the new views. It would like to eliminate recessions, sees possibilities in a flexible fiscal policy, recognizes limitations of gold as the basis of our international monetary system, and wants to help the disadvantaged at home and abroad. It is schizophrenic because it is afraid these objectives may be achieved only at the sacrifice of disciplines which it values highly.

But the middle generation is fighting a losing battle; the old disciplines are vanishing for good. We now see them as too harsh and perverse, like Horace Greeley’s prescription for curing a dog of killing sheep: cut off his tail—just behind the ears.

It is unthinkable in this day of rising aspirations of the disadvantaged that recessions should ever again be used deliberately to discipline the economy. The concept of a flexible fiscal policy, although never applied with complete success, is too valuable to permit a return to the old idea of a constantly balanced budget; we need all the ammunition we can get to achieve stable economic growth. The traditional gold standard clearly is inadequate as a basis for a growing world economy. In short, there is no turning back.

This is not to say that discipline is no longer necessary. Indeed, with all the things the U.S. is trying to do—fight a war in Vietnam and a war against poverty, clean up our water and air, solve the problems of the cities, send a man to the moon—discipline is needed more than ever. The middle generation is right in insisting that “there ain’t no free lunch.” The solution is to develop a new kind of discipline—a more flexible, discriminating, humane kind—based, as Allan Sproul said, on men, not a mechanism.

It must be a more mature type of discipline. A child is disciplined by his parents because he doesn’t know how to behave. A mature adult, having learned correct behavior, disciplines himself. A teenager often overthrows imposed discipline before he is completely prepared for self-discipline. In this sense, our economy is going through its teens, groping for a new kind of discipline for which it is not fully prepared.

Progress toward adulthood can be achieved only through better understanding. More people must understand the need for restraining the economy at times as well as stimulating it at others. More people must understand the need for budget surpluses when the economy is booming as well as deficits when it is lagging. Nations must understand the need for cooperating for the good of the world economy rather than
pursuing their own short-run interests. The well-to-do must understand the special problems of developing nations abroad and the poor at home. This understanding will take time and there will be many disillusionments along the way. No better example can be found than the recent reluctance of the U.S. Government to exercise necessary fiscal restraint by raising taxes and cutting spending. The new discipline requires much more courage and intelligence than the old. The schizophrenia now besetting the middle generation may be painful, but it is a first step toward the understanding needed for a new discipline.

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**FEDERAL RESERVE BANK OF PHILADELPHIA RESEARCH AWARDS, 1968**

The Federal Reserve Bank of Philadelphia takes pleasure in announcing the following research fellowship awards to Third District scholars.

Dr. Gerald C. Fischer, Temple University, for a study of the potential competition issue as it relates to bank merger proposals.

Dr. Dwight Jaffee, Princeton University, for a study of the relations among mortgage rates, the volume of mortgage funds, and housing starts.

Dr. Mark H. Willes, University of Pennsylvania, for a study of the lags associated with monetary policy.

Dr. John H. Wood, University of Pennsylvania, for a study of the dynamics of commercial bank portfolio selection during expansions and recessions.

**Members of the Selection Committee are**

Dr. Albert Ando, University of Pennsylvania
Dr. David P. Eastburn, Federal Reserve Bank of Philadelphia
Dr. Nathaniel Jackendoff, Temple University
Dr. Burton G. Malkiel, Princeton University
Dr. Frank C. Pierson, Swarthmore College
Washington's "New Discipline" and the Banking Business

by David C. Melnicoff

The "restlessness and questioning" of which President Johnson spoke in his State of the Union Message early this year arise out of conflict and change which reach into every segment of our society. In the area of economics and finance, Washington's reactions to this turmoil have often been questioned; but on the whole, and viewed in the context of fast-moving events, responses coming from the Nation's financial authorities—and particularly from the Board of Governors of the Federal Reserve System—have been constructively sensitive to changes in financial structure and the banking environment. In accordance with the "new discipline" in economic affairs—the application of man-made constraints rather than "automatically" operative rules—what appears to be coming from Washington these days is not a doctrinaire approach which blanks current problems, but a careful, point-by-point response to new situations as they develop. This is true in the area of monetary policy; it is also true of problems peculiar to banking as a business.

Monetary policy: 1966 and 1968

For monetary policy, contrary to the situation last year, a time when credit was easing, 1968 has seen an adverse balance-of-payments, high resource utilization, and rising prices combine to require a restrictive approach. Two increases in the discount rate reflected this. The interest rate structure is as high as it has been in 40 years. "Free reserves" of the banking system have been negative for some time. Last year, we enjoyed the luxury of reviewing the 1966 "crunch" from a position of relative ease. This year, there has been a disquieting search for parallels with, and differences from, 1966. We did not have long to consider the lessons learned, if any, from the events of that year. We have been right "up against" for several months. In at least one vital area the Nation was quite obviously not prepared—the area of fiscal responsibility. We tried to meet a wide and expensive range of commitments without paying the tax bill. This has meant a heavy burden for monetary policy and for financial institutions. It remains to be seen how much and how fast the income tax surcharge enacted late in June can offset the damage already done.

What monetary policymakers have been trying to avoid, of course, is the kind of "disintermediation" which occurs as interest rates rise and the market attracts funds away from banks and savings institutions—as the established "inter-
mediaries” in the flow of funds lose their control of a segment of the monies they usually handle, and the established customers of those institutions are put on short rations. In this process, as in 1966, housing usually takes the worst licking, smaller businesses may be squeezed, and some of the affected financial institutions, faced with a loss of deposits, may be forced into liquidation of assets in an unfavorable market.

This situation is not upon us. Disintermediation on an important scale has not begun. If we are fortunate, this time around—and this depends on some most uncertain and unpredictable events—we may not come any closer to it than we are now.

There is some reason to believe that, compared to 1966, there is a little “cushion” between intermediaries and market pressures, which can provide some breathing space, some time for maneuver. For instance, the Savings and Loans have substantially repaid their indebtedness and are generally in a more liquid position than they were in 1966. The Federal Home Loan Bank is in a better position to assist them, if necessary. Their deposits are probably somewhat less volatile than they were. (The “hot” money has been avoided to a great extent.) With the exception of the very large money market banks, the same is probably true of commercial banks. On the average, bank loan-to-deposit ratios are lower than they were prior to the 1966 squeeze—though this “cushion” is being deflated by expanding loan totals.

By far the most hopeful contrast with 1966 is the better balance which now obtains among the various demands for credit. Mortgage credit has become more difficult to obtain, but it is still available. (In a few states, including Pennsylvania and New Jersey, usury ceilings have been revised; and the Federal National Mortgage Association has made helpful changes in its procedure.) Banks have not experienced the almost frenzied business loan demand they knew in early 1966. Offsetting this to some unknown extent is the likelihood that there are probably more fixed and paid-for commitments to lend—stand-by commitments—outstanding, which could reduce commercial bank flexibility as business borrowing picks up.

To help control the expansion and flow of domestic credit in 1966, the Board of Governors rewrote the textbooks with a new and creative use of Regulations Q (governing interest paid on time deposits) and A (governing member bank borrowing from the Federal Reserve Banks.) This year, facing a similar situation, but in a somewhat different environment, the System’s strategy was again revised. Taking advantage of a new law permitting regulatory differentiation among time deposits by size, the Board altered the structure of time deposit ceilings to help ease disintermediation pressure on the banking system.

In any event, whether these “cushions” hold up or not, whether action by the Congress on fiscal matters is timely or not, whether the “talks” in Vietnam move ahead or not, every effort will be made to avoid the disruption which large-scale disintermediation can bring—not by overlooking the need for discipline, but by applying it in a calculated, pragmatic way. Thus, Washington’s reaction to continued balance-of-payments deficits, for instance, was not the classical move to the “old” discipline of forced deflation, but a variety of measures, including not only general monetary restraint, but also the voluntary foreign credit restraint program. Faced with continued deficits in the Nation’s balance-of-payments, that program was revised and tightened at the beginning of this year. Certain controls over direct foreign investment, administered by the Depart-
ment of Commerce, were made mandatory. Controls over foreign lending by banks and other financial institutions, administered by the Federal Reserve System, remain voluntary. Everyone knows, of course, that the foreign credit restraint program has drawbacks, both administrative and substantive, which become more serious as time goes on. Hopefully, we shall be able to make a basic adjustment before these drawbacks become self-defeating. For the time being, however, and, probably, for some time to come, we are balancing conflicting forces with a specially constructed, selective expedient.

The banking business
Banking has not fared badly amid the growing pressures of the past year—at least, as one looks at the earnings reports and reads the financial analysts’ columns, there is little evidence that all is not going well. I invite your attention, however, to the operating ratios for 1967, which were published a few months ago. These will not contradict the earnings statements—on the whole the national averages reflect moderate progress—but some of the results may temper the euphoria. You will see, in the summary of earnings and expenses of member banks in the Third Federal Reserve District, for instance, that for the first time since the upsurge beginning in 1962, the ratio of net current earnings to total capital accounts has declined—from 13.3% in 1966 to 12.6% in 1967. Net income to total capital has declined from 8.4% to 8.1%. The ratio of capital accounts to total assets stopped declining, thus shutting off a further increase in “operating leverage.” Time deposits rose proportionately more than demand deposits, and higher interest costs could not be offset elsewhere. Capital accounts—not overly full in recent years—continued their steady, gradual decline as a percentage of deposits and as a percentage of total assets less cash and Governments.

One should not read too much into these figures. Many banks show no such trend; and one year’s results are not necessarily a portent of things to come. The outlook for banking is good. But these and many other signs, including higher expenses and greater demands on management, point to changes in banking structure and in the business and social environment which are leading many banks into new and sometimes untried paths. It is to these developments that Washington’s reaction is often questioned; but more often, these days, close scrutiny reveals that Washington is becoming sensitive to developing needs.

Mergers and diversification
One of the paths which some banks have been investigating is not by any means untried—the path to merger—but the guideposts are new. The latest decision to come out of the Supreme Court on this subject—on the proposed Nashville merger—seems to confirm that the Bank Merger Act of 1966 did not really make a big difference in the impact of the Clayton and Sherman Acts. The concept of damage to competition which occurs when banks merge is being rather strictly applied; and the burden of showing that a merger will better serve the “convenience and needs of the community” requires evidence of a sort that is hard to come by. Nor is the Court sympathetic to vague complaints of a merging bank about the difficulty of obtaining personnel and of solving other management problems. The evidence must be clear that management really tried and failed. Every merger case is different, of course, and the only authoritative judgment a banker can get is from his attorney. I merely point out here that experience has shown the merger route to be a tough one to travel, especially for sizable banks.
operating in the same trading area.

One might wish, as I do, that the recent merger cases had included presentations which made better use of modern marketing concepts. (It is ironic that the application of the "marketing approach" now receiving so much attention by bank managements, apparently has stopped short of this vital area of decision.) George W. Mitchell, a member of the Board of Governors of the Federal Reserve System, has expressed his dissatisfaction with current standards in a speech before the Maine Bankers Association on June 14, 1968. He states that to identify a banking market by the "cluster of services" available to commercial bank customers, is unrealistic. "Nor is it true," he continues, "that for most financial services these customers do not have other real alternatives in nonbank financial institutions or nonlocal banks. . . . The geographic markets for different classes of customers are not coterminous —some are worldwide, others nationwide, others regional, others local and still others are limited to a single neighborhood." Despite these views, administrative agencies involved in merger decisions, including the Comptroller and the Federal Reserve, cannot help but respond to the Surpreme Court's stated views.

Responses to change

Another path banks are well embarked on is the diversification and expansion of bank services. For a while it appeared that banking agencies might be at odds on some aspects of this expansion, with one being aggressive and approving and others more cautious and conservative. Three recent responses by the Federal Reserve System may indicate the direction in which the wind is blowing now.

One response concerns a U.S. Senate bill to authorize commercial banks to underwrite certain revenue bonds. This was a matter on which the former Comptroller of the Currency differed with the Federal Reserve—and, ultimately, with the courts. Governor Mitchell recently testified on this legislation. "The question before you now," said the Governor, "is whether, given the fact that banks are allowed to underwrite most municipal obligations, they should nevertheless be prohibited from underwriting a particular kind of municipal obligation, which was of little consequence in 1933 but which is now of major importance." The Governor concludes that they should not be so prohibited. The Board recognizes that an important change has taken place in municipal financing and, having considered all the surrounding circumstances and difficulties, concludes that the banks must be permitted to play a part.

A second response concerns a bill sponsored by Representative Patman to prohibit banks from making unsolicited commitments to extend credit through the medium of the credit card and which might hobble the development of that form of consumer credit. Board of Governors’ member Andrew F. Brimmer testified on this bill as follows:

We, too, have been concerned about certain aspects of this development, and we have taken several steps to keep ourselves better informed and to strengthen our bank examination procedures. At the same time, however, the Board also believes that any decision as to whether legislation is needed in this field should take into account not only the necessity for assuring the safety and soundness of the banking system, but also other considerations—such as the need to avoid discouraging innovations in banking that will contribute to public convenience. The Board is studying credit cards carefully.
Some information regarding that study will be made available from time to time. In the meantime, the Board does not want to stifle new developments which banking may devise to meet new consumer demands.

The third response concerns a bill which would enable banks to establish and operate funds that would be similar to and would compete with mutual funds. It is especially significant because it involves a very large business potential and competition with very large nonbank financial institutions. Chairman of the Board of Governors, William McChesney Martin, wrote to the Chairman of the House Committee on Interstate and Foreign Commerce on this subject.

The Board continues to believe that the principle of separation of commercial banking from investment banking, which was recognized by the Congress in the Banking Act of 1933, is a sound and significant one. The Board recognizes that the operation of collective funds by banks involves elements of risk. This is true, however, whenever banks—or other organizations—expand the services they offer. If the possibility of adverse consequences, however slight or remote, were regarded as sufficient ground for prohibiting such expansion of activities, regulated industries could not adapt to changed circumstances and the new needs and demands of our economy.

With respect to the instant proposal, the Board of Governors concludes that the probable benefits to the public from increased competition are substantial and that the risks are relatively less significant.

Thus, where expansion and diversification of bank services are concerned, the weather vane at the Board of Governors points in the direction of change and growth. Here, again, old doctrines are not being permitted to stand in the way of current needs.

**New approaches to reserves and the discount window**

The Board of Governors is responding, too, to changing banking conditions bearing on the management of reserves and—a closely related matter—the use of the discount window. Member banks recently received a new amendment to Regulation D governing reserves. This puts reserve periods on a weekly basis and requires the calculation of weekly average required reserves based on average deposits and average vault cash held, two weeks earlier. A two per cent carryover of excesses or deficiencies is also provided. In this way, member banks are given a stable target to meet, and an appreciable leeway. Once this new procedure is adopted and shaken down, reserve administration should be easier, more efficient, and in tune with the times.

This is only one step in a more comprehensive reform of the reserve structure proposed by the Board of Governors. Its full implementation will require passage of legislation now before the Congress. That legislation provides that the Federal Reserve be given authority to set reserve requirements for all insured banks rather than only for member banks in the Federal Reserve System, and that all insured banks have equal access to the Federal Reserve Banks’ discount windows. At the present time, as members of the Board have frequently pointed out, the various state requirements create a hodge-podge pattern in which some banks are given competitive advantages over their neighbors. Moreover—and this is especially true during the periods of monetary restraint—efforts to moderate the growth of bank credit bear progressively heavier on member banks, since nonmember banks’ private demand
deposits do not respond as directly and quickly as those of member banks to the Federal Reserve's general instruments of credit control. In a recent speech, Governor Andrew F. Brimmer stated his personal convictions that a rational system of universal reserve requirements established by the Board of Governors—and this means a graduated system, with smaller reserve requirements for smaller banks—might well lighten the reserve burden on all insured banks, member and non-member, and eliminate discrimination among banks.

The discount window to which all banks would have access will probably soon be somewhat different than the present one. It has been previously reported to you that a large-scale reappraisal of the discount mechanism was under way. That reappraisal has now been completed, and a report on it will be published soon. I do not want to anticipate the proposals which will be set forth; but I can say that the redesigned discount window is intended to be more useful and more frequently used; that its administration will be somewhat more liberal in the sense that total credit outstanding probably will be greater; and that there will be a provision of special interest to rural banks and others whose normal operations are hampered by wide seasonal swings. Such a redesign of the discount window would not change the basic strategy of monetary policy, but it would make it more flexible and would give member banks—all banks, if the universal reserve requirements are enacted into law—much greater flexibility in serving the credit needs of their communities.

Conclusion

These are some of the ways in which Washington has responded to the “restlessness and questioning” of which the President spoke in his annual message. No one would claim that it is a sufficient response: in an era of rapid change and strong social and political pressures, it is inevitable that Government regulatory policies will lag events. Old rules and standards are not easily abandoned—and should not be. But it is clear that monetary authorities are not hidebound, and that positive and constructive changes are being made. As the Federal Reserve System confronts the financial repercussions of the tremendous issues and events of 1968, it seeks to shape their consequences in the public interest, rather than to transmit them through a rigid policy conduit. This posture demands no less discipline—though it is a different kind of discipline—than the old rules of the game. Its greater sensitivity to the economy’s needs augurs well for banking and for the Nation.
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BUSINESS

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CONSUMER PRICES, PHILA. (1957-1959=100)

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BILLIONS $ MEMBER BANKS, 3RD. F.R.B.

LOCAL CHANGES

Per cent change
May 1968 from 5 mos. May 1968 from 5 mos.
May 1968 from year ago year ago ago ago

MANUFACTURING

MANUFACTURING

MANUFACTURING

MANUFACTURING

BANKING

(All member banks)

Deposits

Loans

Investments

U.S. Govt. securities

Other

Check payments***

MANUFACTURING

Manufacturing Payrolls Check Payments*** Total Deposits***

Wilmington

Atlantic City

Trenton

Altoona

Philadelphia

Reading

Scranton

Wilkes-Barre

York

*Not restricted to corporate limits of cities but covers areas of one or more counties.
**All commercial banks. Adjusted for seasonal variation.
***Member banks only. Last Wednesday of the month.

For The Record...