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FEDERAL RESERVE BANK of PHILADELPHIA

TRANSMITTAL SLIP

10/23/73
DATE

TO All Officers

FROM J. R. Joyce

At the Board of Directors meeting in Washington last week, Dave Eastburn made an oral presentation on "The State of the Federal Reserve System" before presenting the State-of-The-Bank Report. I thought that you might be interested in his thoughts, and a copy of the presentation is attached.

Dave plans to distribute the State-of-The-Bank Report later this week.

Eastburn, David P.
October 1973

Before discussing the state of the Bank, let me take a moment to describe the state of the Federal Reserve System, as I see it. To do this it is important to have some conception of the state of the world confronting the System. I detect at least three dominant characteristics of society which shape the task of the System today:

1. A demanding society. The public may not be exactly sure what it wants, but it is impatient to get it and is intolerant of institutions which fail to provide it.
2. An innovating society. Under the pressure of competition to satisfy those wants, institutions are rapidly changing ways of doing business.
3. A compacting society, which is another way of saying that the world is growing smaller.

A demanding society impacts on the Fed in several ways. It imposes on monetary policy an impossible task of simultaneously achieving full employment and a stable dollar. This is nothing new, but the precision expected is new. Even minor recessions are now intolerable. Even a price performance better than that of any other major nation is inexcusable. In addition to these economic demands, the public requires high performance in the solution of social problems. It is impatient, for example, with an anti-inflation policy that impinges heavily on housing.

The Fed is used to being cast in an inherently unpopular role (as Chairman Martin used to say, like the chaperone who removes the punch bowl just when the party is getting good). But, in addition, the public now is looking to the Fed for fine tuning of which the Fed is incapable. Experience in recent years has been disillusioning as to our ability to move intelligently and promptly enough to smooth out every wrinkle in the economy. One course is to try to educate the public to which is possible. We should do all we can to accomplish this, but I'm skeptical as to the likely success. The best course is to sharpen our minds and our tools in an effort to produce, as nearly as we can, what is expected of us.

A demanding society makes the relationship between Congress and the Fed more critical. As the public's watchdog, Congress is more aware of its responsibilities in overseeing the System, not only with respect to monetary policy but also operations. Mr. Patman's current drive to have the Fed audited by the GAO for example, seems to have more support than did his earlier efforts. Our own self-examination into procedures and costs reflects an awareness of stricter accountability to the public.

I suspect that a demanding society tends to put the Fed under more political pressure. I mean this not in the sense of involvement in narrow party politics, but in the sense of identification with, or against, the policies of a given administration. Chairman Burns' outspoken comments on economic policies beyond the monetary sphere certainly have not reflected a narrow view of the Fed's role. It may be that a posture of political isolation is no longer possible for the Fed.

An innovating society also puts pressure on the System. An obvious example is in techniques of making money payments. We are now in the throes--and only the beginning throes--of changes to meet future payments needs. The System will have to move fast if it is to keep up, let alone lead. And it will have to be more searching than it has been in the question of its role vis-a-vis private enterprise.

In the process of innovating, financial institutions have made monetary policy more difficult. Techniques of liability management, for example, have raised questions as to whether the Fed has lost complete control of credit extended by large banks.

Innovation is proceeding in ways that can radically alter the prevailing institutional structure. Clear distinctions among various kinds of institutions are disappearing, a development that obviously raises difficult questions for supervision. We are just beginning to come to grips with some of the supervisory problems presented, for example, by bank holding companies. When savings and loans take on characteristics of commercial banks, when commercial banks take on some of the characteristics, say, of investment companies, and so on, the Fed will face additional problems involving standards of supervision. The question of the Fed's role vis-a-vis other supervisory authorities must surely become increasingly critical.

Finally, a compacting society places new demands on coordination within the System. The concept of the System as a federation of autonomous units has been eroded over the years, and rightly so. Funds are too fluid, transportation and communications too rapid, the performance expected of the System too demanding to permit the individual units to go completely independent ways. Yet the complexity of our tasks is so great--and becoming still greater-- that it would be disastrous to try to run the System from one central place. The challenge the System is only barely beginning to face is how to accomplish the necessary degree of coordination in planning what to do and the necessary degree of decentralization in doing it. The Board of Directors of the Reserve Banks can play a critical role in finding a solution.

DPE-10/9/73