CHECKS AND BALANCES

Delivered by
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The Federal Reserve Banks have been described as Bankers Banks and, in a sense, this is fair because we perform a number of services for commercial banks similar to those which the commercial banks perform for you and me. Reserve Banks hold deposits of their member banks, collect checks, supply currency and coin, and hold securities in safekeeping.

We have also been referred to as Government Banks and, in a sense, this is accurate for we hold a large portion of Uncle Sam's checking account and aid the United States Treasury in the issuance and redemption of Government securities.

We are also known collectively as a Central Bank. This we certainly are because of our statutory authority over monetary policy. Our objective is to exercise this authority so as to contribute to sustainable growth in the economy with reasonable stability in prices and a workable balance in our international payments position.

A few years ago I was visiting with a Governor of the Bank of England. He made the observation that the Federal Reserve System cannot work---but it does---and very well. What he meant was, from his point of view, our central banking organization was cumbersome and unwieldy and did not facilitate immediate decision making. This is not a surprising view for a non-American.

In all economically advanced countries the guiding power over money is a Central Bank. In most instances, including England, Canada, Germany and France, this power is concentrated in a single institution which is strictly a governmental agency and ordinarily subordinate to the Treasury.

Our Central Bank, on the other hand, is a System of five component parts, each having certain powers and responsibilities.

(1) Board of Governors

(2) Twelve Federal Reserve Banks and Twenty-four Branches.

(3) Federal Advisory Committee

(4) Open Market Committee

(5) 6,000 member banks

The Board of Governors in Washington is composed of seven members, each of whom is appointed by the President, confirmed by the Senate for 14-year terms. This Board supervises and coordinates the entire System's operations.

The twelve Federal Reserve Banks and twenty-four branches reflect the regional flavor of the System. They have more than 250 directors who come from many walks of life. Each of the twelve head offices has nine directors; three are appointed by the Board of Governors and six are elected by the member banks.

The Reserve Banks function in the public interest and are instrumentalities of the Government. They conduct operations for the System and participate in policy making. On the other hand, they have a private nature as evidence by the fact that the officers and employees of the banks are not under Civil Service and are paid out of the operating revenues of the individual banks, and no funds for System operations are appropriated by the Congress.

The Federal Advisory Council has twelve members, one from each Reserve District and appointed by the Board of Directors of the Reserve Bank. The Council is simply what the name implies. It confers with the Board of Governors and makes only advisory recommendations.

There are a little better than 6,000 member banks. These, too, are an important part of the System. It is through these banks that the Federal Reserve carries out many of its responsibilities and implements its decisions regarding monetary policy.

The Open Market Committee is particularly significant and I would like to refer to it later. However, at this point I am sure you are aware that the powers and responsibilities of the System are decentralized by the mechanics of organization.

Earlier I mentioned that the System's principal concerns are to contribute to sustainable growth in our economy with reasonable stability in prices and a workable balance in our international payments position. This we attempt to do by providing reserves to the member banks.

In less technical terms our business can be described as increasing or decreasing the supply of money, and in some respects our business is not dissimilar from yours. You have your products and we have ours. Ours is money.

Both of us watch closely the supply and demand for our products. If there is an over production of your products for any length of time, this will tend to put downward pressure on your prices. On the other hand, if there is an under production, or shortage relative to demand, there will tend to be upward pressures on your prices.

So it is with money. Congress has delegated to the Federal Reserve System the responsibility for regulating the money supply, and we must maintain an appropriate balance between the supply and the demand for money. If more money is supplied than is demanded, credit conditions would ease and total spending would tend to increase. Should this increased spending result not in greater real output, but in a higher price level we would take steps to dampen excess expenditures. That is, we would restrict the quantity of our product---money---and permit interest rates---the price for borrowed money---to rise. Conversely, in times of recession, the economy needs a stimulus. This can be brought about in part by increasing the supply of money; the price for borrowed money would fall, total spending would tend to increase, and total production would rise.

The System, through monetary policy, can not accomplish all things. Other factors such as fiscal policy and taxation are equally important. The System, however, does play an important role and can create an environment conducive to balanced growth. It can not, however, make people produce or buy goods. This is where the private sector of the economy plays an important, even vital, role.

The three principal tools used to stimulate or limit demand are:

(1) Reserve requirements. The Board of Governors has the power to raise and lower the proportion of their deposits that member banks must keep on deposit with the Federal Reserve. By raising the requirements, funds are, in effect, taken from the market and the availability of credit is reduced. Conversely by lowering requirements, reserves are released to the member banks, thereby making credit more readily available.

(2) Discount rate. This is the rate of interest charged member banks for loans made to them by the Federal Reserve Bank. These rates are established by the Board of Directors of the Reserve Banks subject to the approval of the Board of Governors. Increases in the discount rate tend to restrict member bank borrowing and, consequently, the availability of credit. Lower rates would tend to have the opposite effect.

(3) Open Market Operations. This term refers to the System's purchases and sales of Government securities. As I have indicated, these purchases and sales are made for the purpose of affecting the amount of bank reserves. If, in the judgment of the Open Market Committee, more funds should be supplied, the Committee would buy securities in the open market. On the other hand, if it would appear appropriate to tighten policy, i.e., reduce reserves, securities would be sold.

Again, I am sure that you have noted that the tools of power are in separate hands.

The Committee, which is provided for by statute, is composed of 12 members, including the 7 members of the Board of Governors and 5 Presidents of Federal Reserve Banks. The President of the Federal Reserve Bank of New York is a permanent member of the Committee while the other 4 presidential positions are supplied on a rotating basis from the other Federal Reserve Banks. St. Louis is grouped with Dallas and Atlanta. Currently, the President of the Dallas Bank is a member of the Committee, and I am the alternate member and, in ordinary circumstances and procedures, would be a member next year.

The formulation of policy by the Open Market Committee is not done in a vacuum nor on the spur of the moment nor by any one or two people. The members of the Board of Governors and the presidents of each of the 12 Federal Reserve Banks are continually studying reports, statistics, and all available information in an effort to keep up with developments nationally and internationally. Each of the banks and the Board of Governors is supported in this undertaking by staffs who are specialists in their fields. These staffs are regularly engaged in gathering statistics, making surveys, analyzing reports and formulating views and considerations for their respective principals.

In addition, the Directors of the Reserve Banks also are important sources, not only of current business and statistical information, but also of grassroot, practical understanding and judgment.

The Open Market Committee meets at the offices of the Board of Governors of the Federal Reserve System in Washington, D. C. approximately each three weeks and more often when it is advisable. These meetings are attended by the 7 members of the Board of Governors and the 12 presidents of the Federal Reserve Banks. In addition, selected and key members of the staffs of the Banks and the Board are present.

The Chairman of the Committee opens the meeting and calls on members of the staff of the Board of Governors for reports. These include information on the general economic situation, the banking and financial picture, and regarding our balance of payments. This is followed by a report made by the Manager of the Open Market Account who is the staff member responsible for carrying out the policies established by the Open Market Committee for the purchase and sale of government securities. Another report on international activities and operations is submitted by the Special Manager for foreign currency operations for the Account.

Following the staff reports, the President of the Federal Reserve Bank of New York makes a report and concludes by making a statement with respect to what he thinks monetary policy should be. The Chairman then calls on each President and each member of the Board of Governors for his comments and statement. The President of each Federal Reserve Bank comments specifically on the economic and financial situation in his district in addition to making such other observations as he may choose, and also makes a statement as to what, if any, changes should be made in monetary policy. The last observations are made by the Chairman of the Committee.

If a consensus for monetary policy is apparent, this becomes the Committee policy. If there is no consensus and a difference of opinion exists, the Chairman calls for a vote and the majority view is established as the current monetary policy. The Committee then formulates a written directive addressed to the Manager of the Open Market Account which guides him in the administration and operation of the Open Market Account until that policy is changed at a subsequent meeting of the Committee. An account of the deliberations of the Federal Open Market Committee appears each year in the annual report of the Board of Governors of the Federal Reserve System.

This arrangement, which appeared complex to the Governor of the Bank of England, is typically American. It is a unique blending of the public and private participation, and of both local and central views in an important Governmental function.

Out of bitter experience the Founders of our Republican form of Government were suspicious of every form of all-powerful central control. They sought to guarantee that such a government would never exist in this country by setting up a Federal System established with a separation of powers and with checks and balances. One-Hundred-Twenty-Four years following the ratification of our Constitution these same fundamental concepts were in the mind of the Congress when, under the leadership of Woodrow Wilson and Carter Glass, it delegated responsibility for monetary policy to an independent Federal Reserve System. Independent within the Government and not independent of Government. For Congress created the System and can, of course, modify or change it.

While there have been changes in the System since the original enactment of the Federal Reserve Act, these basic principles of our Government have been adhered to.

The Federal Reserve Act became law on December 24, 1913, and the banks were established the next year. The System will observe its 50th Anniversary in 1964.

I think we can all regard the past 50 years with some satisfaction. Economic growth, under competitive enterprise, has been remarkable and would not have been possible without the partnership of the banking system and competitive enterprise. Our rising standard of living would not have been possible without the creative design and mechanizing of new and better products and services. True, there have been some rough spots, but in the broad view our System has worked---and worked well.

No doubt there will be changes in the future, for change is life but, in my judgment, any changes should continue to be made in the light of the high values of checks and balances and separation of power.