For release on delivery

Statement of

William McChesney Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Economic Stabilization

of the

Joint Committee on the Economic Report

June 12, 1956
Mr. Chairman:

Your letter of June 4, advising me of the time for this public hearing, and the subcommittee's statement of June 7 for the press, state that you are interested at this time in procedural matters surrounding the recent increases of the discount rate at Federal Reserve Banks, and that you wish to leave for a later date questions as to the merits and wisdom of the action itself.

Your decision not to go immediately into the merits or demerits of this particular action seems to me a wise one. As you know, the Federal Reserve Act specifies a procedure for reporting annually to the Congress, whose agent we are, on the policy actions of the Reserve Board and of the Federal Open Market Committee.

A wider understanding of these procedures is very desirable. Accordingly, this statement will set forth an elementary outline of organization and procedure and will include a statement relative to the 108 directors of the twelve Federal Reserve Banks, who, under the Federal Reserve Act, have initial responsibility for determining discount rates at their respective institutions.

Discussion and full disclosure of monetary policy and action are, of course, essential. The effects of a given step in the development of monetary policy, however, are difficult, if not
impossible, to gauge in the short run. Monetary policy is a fluid, not a static, process. Each separate action is usually a supplemental or complementary step in development of an over-all pattern of policy. Policies are shaped from day to day by a connected series of separate actions, with constant adaptations to the ever-changing factors and forces in the vast economic fabric of the country.

Therefore, it would be illogical and misleading to lift out of context a given step in the process. Debate close to the time of action does not afford a broad enough perspective, particularly when judgments as to timing or as to the economic outlook differ.

Under circumstances of diverse trends, hesitancy and delay in taking monetary action might result if those responsible for action were expected to explain publicly and defend any given step of a continuing or changing pattern, before the economic indicators were so unmistakably clear as to support a unanimity of judgment.

The annual reports to Congress required by law are sufficiently removed from the time the various actions are taken to afford a broader perspective as to their wisdom or lack of it. Thus, a better, calmer appraisal is probable than is apt to be the case if judgments are made around the time action is taken.

A wider understanding of these procedural processes which you are studying today should lead to a better public understanding of policy actions, what they aim to accomplish, and what
they can and cannot do. There is, of course, no magic in Federal Reserve monetary or other governmental measures that will assure perpetual and evenly distributed economic health. Maladjustments, imbalances, excesses in some sectors and shortages in others are inevitable; but partial readjustments should not be postponed at the risk of increasing the general ailments.

Monetary policy is a standard, though limited, remedy for some ills. The discount rate particularly can be greatly overrated as a cause or cure. Open market operations, discount rate changes, and reserve requirement changes are the closely interrelated parts of Federal Reserve monetary mechanism. Confusion often arises because we are apt to talk about the three parts of this mechanism as if we were offered a choice among three separate means of easing or tightening credit. All three must operate together—in a continuing pattern, the supply of reserves always being basic. Open market operations and reserve requirements affect that base. Discount rates do not affect the volume of that base, but only the cost of reserves. It is therefore misleading to think of the three components as if they were alternatives to be used independently of each other. They must be used together.

The use of one component rather than another at a particular moment is explained by the fact that, by its nature, each has a different impact. Reserve requirements are the bluntest of the three,
having the heaviest impact because they directly affect all member banks in varying degree and release or absorb very large sums.

Changes in reserve requirements are best suited to broad basic adjustments, and the impact of such changes is often modified by subsequent Federal Open Market operations.

Open market operations are best suited to day to day adjustments, for they can be used to release or impound small or large sums of reserves in accordance with current conditions. In this way, what have aptly been called "high powered dollars" are added to or taken out of the reserves of the banking system.

It is most important to note here that contrary to a widespread misunderstanding, the Federal Reserve System does not use the reserves deposited with it by the member banks to buy Government securities. For this purpose the Reserve System creates money, and additional reserves are thus put at the disposal of member banks on which loans and investments can be pyramided at a ratio of about six to one. That is why the money created to make such purchases is spoken of as "high powered dollars."

Discount rate changes, in respect to frequency of use, are less frequent than open market sales and purchases, but more frequent than reserve requirement changes. For example, the rates of discount were revised downward twice in 1954, during a comparatively short and mild business downturn, and have been revised upward five
times over the last 12 or 13 months as the economy rose toward its production capacity, and demand for credit strained the limits of supply.

The initiative as to discount rates rests with the directors at each of the twelve banks. They meet regularly, different Reserve Banks having different days, in some instances, for directors' meetings; but each bank acts every fourteen days, either to re-establish or change its existing discount rate. The action taken, whether to continue the same or to change the rates, is immediately reported to the Board of Governors, and acted upon at a regular or special Board meeting.

Since System procedure is based on organization, it seems relevant and appropriate to outline briefly the way in which the Reserve System is organized. It is essentially a regional system, made up of twelve Reserve Banks with 24 branches, and having a total of 260 directors. The Board of Governors has responsibility for coordinating policy of the twelve banks, and in some instances supervises operations as well.

The Federal Reserve Act spells out, in detail, how the directors of the banks and branches are to be chosen. At the head offices, there are nine directors, six elected by member banks. Three (Class A, in the law) are chosen from local member banks, so grouped as to provide representation for the larger, medium-sized, and
smaller banks in each district. And the bulk of the member banks are, in fact, small businesses, engaged in serving small businesses in their communities. Three (Class B) are required to "be actively engaged in their district in commerce, agriculture, or some other industrial pursuit." The first three may be considered as lenders, the second three may be looked upon as representative of borrowers. The remaining three (Class C) are chosen by the Board of Governors with a view to providing a still broader representation, and they cannot be bankers. Of the Class C directors, the Board of Governors designates one as the Chairman and another as the Deputy Chairman for each Reserve Bank.

In this blending of public and private participation, the Act vests the regional banks with as large a degree of autonomy as is feasible in an organized System. While each President and First Vice President of a Reserve Bank is initially selected by the local directors for a term of five years, the selections are subject to approval by the Board of Governors, a procedure that, in my judgment, gives these officers a very desirable freedom from domination by the Governors, the directors, or by others.

Similarly, the functions of the System are distributed. Thus reserve requirements are the sole responsibility of the Federal Reserve Board. Open market operations are the responsibility of the Federal Open Market Committee, a statutory body consisting of the seven members of the Reserve Board and five Reserve Bank
presidents. And the law specifies that all the presidents shall serve on
the committee at intervals. Discount rates are a joint responsibility of
the Reserve Board and the Reserve Bank directors.

These provisions have been carefully thought out in the
legislative process and have worked reasonably well in practice. I do
not mean to say that the System is perfect—it is not—but I am confident
that the Congress would not wish to make important changes in it with­
out thorough study and deliberation.

Although the discount rate is fixed periodically by each bank
subject to the Board of Governors' approval, in the actual granting of
discount accommodation to individual member banks, the Federal
Reserve Bank directors act on their own initiative and responsibility,
free from intervention or pressures by the Board of Governors or by
other Reserve Banks. These directors are always in close touch with
conditions in their districts, and the discount operations, including the
rates, take account of local economic needs and trends. At the same
time, through the constant stream of intercommunication among
Governors, Directors, Presidents and their staffs, all who have
responsibilities in the System, are in touch with and advised of the
economic picture nationally and the needs of the over-all economy.

Through the medium of frequent meetings of the Federal
Open Market Committee--meetings are held every three weeks or
often circumstances require--there is an interchange of
economic information and operational experience that keeps Board members and the Reserve Bank presidents and directors informed on the course of the economy, both regional and national.

As discount policy is closely interwoven with open market policy, it is among the important subjects discussed at the frequent meetings of the Federal Open Market Committee, and the presidents of the Reserve Banks generally express their individual views as to whether they feel they should recommend to their boards of directors changes in discount rates. A consensus may emerge from the round table discussion, but--and this is important to bear in mind--there is no effort on the part of any member of the committee to dictate to any individual Reserve Bank, its president or directors what those rates should be.

That there should be differences--as evidenced at the moment by different rates in two of the districts--reflects not only different judgments, but also the absence of dictation or undue influence. This, I believe, is the way in which this function was expected to be performed, based primarily on the judgments of directors familiar with local conditions, and with coordination effected through the Board of Governors.

Finally, let me point out that discount rates are the interest rates paid by member banks, when they borrow from their district Federal Reserve Bank. It should be emphasized that such
borrowing is intended to meet only temporary needs of member banks for reserve funds, and not long term needs geared to the normal growth of the economy, or to the annually recurring seasonal requirements of commerce, industry and agriculture in the twelve districts. Reserves necessary for such general and repetitive purposes are predetermined as closely as possible by the Federal Open Market Committee and ordinarily supplied by Federal Open Market operations or occasionally by the Board of Governors through changes in reserve requirements.

In arriving at policy decisions, great care is taken to obtain and evaluate all relevant views, including, of course, the views of officials of the Government who have responsibilities in the economic field. These consultations frequently develop differences of view. That is to be expected. Our final decision, however, under the law, must be our own and represent, as closely as human relations can, our judgment on the direction of action that will contribute most to the public welfare.
June 6, 1956

DIRECTORS OF FEDERAL RESERVE BANKS

District 1 - BOSTON

Class A
Harold I. Chandler        President, The Keene National Bank, Keene, N. H.
Oliver B. Ellsworth       President and Trust Officer, Riverside Trust Company, Hartford, Conn.

Class B
Frederick S. Blackall, Jr. President and Treasurer, The Taft-Peirce Manufacturing Company, Woonsocket, R. I.
Harry E. Uphrey           President, Aroostock Potato Growers, Inc., Presque Isle, Me.

Class C
Harvey P. Hood            President, H. P. Hood & Sons, Inc., Boston, Mass.

District 2 - NEW YORK

Class A
John R. Evans             President, The First National Bank of Poughkeepsie, Poughkeepsie, N. Y.
Ferd 1. Collins           President and Trust Officer, Bound Brook Trust Company, Bound Brook, N. J.
Howard C. Sheperd         Chairman of the Board, The First National City Bank of New York, New York, N. Y.

Class B
Lansing P. Shield         President, The Grand Union Company, East Paterson, N. J.
John E. Bierwirth         President, National Distillers Products Corporation, New York, N. Y.
Clarence Francis          Director, General Foods Corporation, New York, N. Y.

Class C
Jay E. Crane              Vice President, Standard Oil Company (New Jersey), New York, N. Y.
Forrest F. Hill           Vice President, The Ford Foundation, New York, N. Y.
Franz Schneider           Consultant to Newmont Mining Corporation, New York, N. Y.
District 3 - PHILADELPHIA

Class A

Wm. Fulton Kurtz
W. Elbridge Brown
Lindley S. Hurff

Class A

Chairman of the Executive Committee,
The First Pennsylvania Banking and

President and Trust Officer, Clearfield
Trust Company, Clearfield, Pa.

President and Trust Officer, The First

Class B

Warren C. Newton
Bayard L. England
Charles E. Oakes

Class B

President, D. A. Newton and Son Company,
Bridgeville, Del.

President, Atlantic City Electric
Company, Atlantic City, N. J.

President, Pennsylvania Power and
Light Company, Allentown, Pa.

Class C

Lester V. Chandler
William J. Meinel
Henderson Supplee, Jr.

Class C

Professor of Economics, Princeton
University, Princeton, N. J.

Chairman of the Board, Heintz Manu-

District 4 - CLEVELAND

Class A

J. Brenner Root
Edison Hobstetter
King E. Fauver

Class A

President, The Harter Bank & Trust
Company, Canton, Ohio.

President and Chairman of the Board,
The Pomeroy National Bank, Pomeroy,
Ohio.

Director, The Savings Deposit Bank and
Trust Company, Elyria, Ohio.

Class B

Alexander E. Walker
Joseph B. Hall
Charles Z. Hardwick

Class B

Chairman of the Board, The National
Supply Company, Pittsburgh, Pa.

President, The Kroger Company, Cincinnati,
Ohio.

Executive Vice President, The Ohio Oil
Company, Findlay, Ohio.

Class C

John C. Virden
Frank J. Welch
Arthur B. Van Buskirk

Class C

Chairman of the Board, John C. Virden
Company, Cleveland, Ohio.

Dean and Director, College of Agriculture
and Home Economics, University of
Kentucky, Lexington, Ky.

Vice President and Governor, T. Mellon
& Sons, Pittsburgh, Pa.
District 5 - RICHMOND

Class A
J. K. Palmer    Executive Vice President and Cashier, Greenbrier Valley Bank, Lewisburg, W. Va.
Daniel W. Bell  President and Chairman of the Board, American Security and Trust Company, Washington, D. C.

Class B
W. A. L. Sibley Vice President and Treasurer, Monarch Mills, Union, S. C.
Robert O. Huffman President, Drexel Furniture Company, Drexel, N. C.
L. Vinton Hershey President, Hagerstown Shoe Company, Hagerstown, Md.

Class C
Alonzo G. Decker, Jr. Executive Vice President, The Black & Decker Manufacturing Company, Towson, Md.
D. W. Colvard    Dean of Agriculture, North Carolina State College of Agriculture and Engineering, Raleigh, N. C.

District 6 - ATLANTA

Class A
Roland L. Adams President, Bank of York, York, Ala.
William C. Carter Chairman and President, Gulf National Bank, Gulfport, Miss.

Class B
Donald Comer    Chairman of the Board, Avondale Mills, Birmingham, Ala.

Class C
Harllee Branch, Jr. President, Georgia Power Company, Atlanta, Ga.
Walter M. Mitchell Vice President, The Draper Corporation, Atlanta, Ga.
District 7 - CHICAGO

Class A
Vivian W. Johnson
Walter J. Cummings
Nugent R. Oberwortmann

President, First National Bank, Cedar Falls, Iowa.
Chairman, Continental Illinois National Bank and Trust Company of Chicago, Chicago, Ill.

Class B
William A. Kanley
Walter E. Hawkinson
William J. Grede

Director, Eli Lilly and Company, Indianapolis, Ind.
Vice President in Charge of Finance, and Secretary, Allis-Chalmers Manufacturing Company, Milwaukee, Wis.
President, Grede Foundries, Inc., Milwaukee, Wis.

Class C
J. Stuart Russell
Bert R. Prall
Carl E. Allen, Jr.

Farm Editor, The Des Moines Register & Tribune, Des Moines, Iowa.
558 Ridge Road, Winnetka, Ill.

District 8 - ST. LOUIS

Class A
William A. McDonnell
Phil E. Chappell
J. E. Etherton

President, First National Bank in St. Louis, St. Louis, Mo.
President, Planters Bank & Trust Company, Hopkinsville, Ky.
President, The Carbondale National Bank, Carbondale, Ill.

Class B
Louis Ruthenburg
Leo J. Wieck
S. J. Beauchamp, Jr.

Chairman of the Board, Servel, Inc., Evansville, Ind.
Vice President and Treasurer, The May Department Stores Company, St. Louis, Mo.
President, Terminal Warehouse Company, Little Rock, Ark.

Class C
M. Moss Alexander
Joseph H. Moore
Caffey Robertson

President, Missouri Portland Cement Company, St. Louis, Mo.
Farmer, Charleston, Mo.
President, Caffey Robertson Company, Memphis, Tenn.
Class A
Harold N. Thomson  Vice President, Farmers & Merchants Bank, Presho, S. D.
Harold C. Refling  Cashier, First National Bank in Bottineau, Bottineau, N. D.
Joseph F. Ringland  President and Chairman of the Board, Northwestern National Bank of Minneapolis, Minneapolis, Minn.

Class B
John E. Corette  President and General Manager, Montana Power Company, Butte, Mont.
Ray C. Lange  President, Chippewa Canning Company, Inc., Chippewa Falls, Wis.
Thomas G. Harrison  President, Super Valu Stores, Inc., Hopkins, Minn.

Class C
Leslie N. Perrin  Director, General Mills, Inc., Minneapolis, Minn.
O. B. Jesness  Head, Department of Agricultural Economics, University of Minnesota Institute of Agriculture, St. Paul, Minn.
F. Albee Flodin  President and General Manager, Lake Shore, Inc., Iron Mountain, Mich.

District 9 - MINNEAPOLIS

Class A
  W. L. Bunten  President, Goodland State Bank, Goodland, Kansas.
  W. S. Kennedy  President and Chairman of the Board, The First National Bank of Junction City, Junction City, Kansas.

Class B
  Max A. Miller  Livestock rancher, Omaha, Neb.
  E. M. Dodds  Chairman of the Board, United States Cold Storage Corporation, Kansas City, Mo.

Class C
  Oliver S. Willham  President, Oklahoma A. & M. College, Stillwater, Okla.
  Raymond W. Hall  Vice President and Director, Hallmark Cards, Inc., Kansas City, Mo.

District 10 - KANSAS CITY

Class A
  W. L. Bunten  President, Goodland State Bank, Goodland, Kansas.
  W. S. Kennedy  President and Chairman of the Board, The First National Bank of Junction City, Junction City, Kansas.

Class B
  Max A. Miller  Livestock rancher, Omaha, Neb.
  E. M. Dodds  Chairman of the Board, United States Cold Storage Corporation, Kansas City, Mo.

Class C
  Oliver S. Willham  President, Oklahoma A. & M. College, Stillwater, Okla.
  Raymond W. Hall  Vice President and Director, Hallmark Cards, Inc., Kansas City, Mo.
District 11 - DALLAS

Class A
Sam D. Young  President, El Paso National Bank, El Paso, Tex.
J. Edd McLaughlin  President, Security State Bank & Trust Company, Ralls, Tex.

Class B
John R. Alford  Industrialist and farmer, Henderson, Tex.
D. A. Hulcy  Chairman of the Board and President, Lone Star Gas Company, Dallas, Tex.
J. B. Thomas  President and General Manager and Director, Texas Electric Service Company, Fort Worth, Tex.

Class C
Hal Bogle  Rancher and feeder, Dexter, N. Mex.
Robert J. Smith  Chairman of the Board and President, Pioneer Aeronautical Services, Inc., Dallas, Tex.

District 12 - SAN FRANCISCO

Class A
M. Vilas Hubbard  President and Chairman of the Board, Citizens Commercial Trust and Savings Bank of Pasadena, Pasadena, Calif.

Class B
Alden G. Roach  President, Columbia-Geneva Steel Division, United States Steel Corporation, San Francisco, Calif.
Reese H. Taylor  President, Union Oil Company of California, Los Angeles, Calif.
Walter S. Johnson  Chairman of the Board, American Forest Products Corporation, San Francisco, Calif.

Class C
A. H. Brawner  Chairman of the Board, F. P. Fuller & Company, San Francisco, Calif.
Philip I. Welk  President, Preston-Shaffer Milling Company, Walla Walla, Wash.
Y. Frank Freeman  Vice President, Paramount Pictures Corporation, Hollywood, Calif.