For release on delivery

Statement of

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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 can not 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 wide-spread 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 without 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 oftener ~~are~~ as 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

Lloyd D. Brace	President, The First National Bank of Boston, Boston, Mass.
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

Milton P. Higgins	President, Norton Company, Worcester, Mass.
Frederick S. Blackall, jr.	President and Treasurer, The Taft-Peirce Manufacturing Company, Woonsocket, R. I.
Harry E. Umphrey	President, Aroostook Potato Growers, Inc., Presque Isle, Me.

Class C

James R. Killian, Jr.	President, Massachusetts Institute of Technology, Cambridge, Mass.
Robert C. Sprague	Chairman and Treasurer, Sprague Electric Company, North Adams, Mass.
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 I. 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	Chairman of the Executive Committee, The First Pennsylvania Banking and Trust Company, Philadelphia, Pa.
W. Elbridge Brown	President and Trust Officer, Clearfield Trust Company, Clearfield, Pa.
Lindley S. Hurff	President and Trust Officer, The First National Bank of Milton, Milton, Pa.

Class B

Warren C. Newton	President, O. A. Newton and Son Company, Bridgeville, Del.
Bayard L. England	President, Atlantic City Electric Company, Atlantic City, N. J.
Charles E. Oakes	President, Pennsylvania Power and Light Company, Allentown, Pa.

Class C

Lester V. Chandler	Professor of Economics, Princeton University, Princeton, N. J.
William J. Meinel	Chairman of the Board, Heintz Manufacturing Company, Philadelphia, Pa.
Henderson Supplee, Jr.	President, The Atlantic Refining Company, Philadelphia, Pa.

District 4 - CLEVELAND

Class A

J. Brenner Root	President, The Harter Bank & Trust Company, Canton, Ohio.
Edison Hobstetter	President and Chairman of the Board, The Pomeroy National Bank, Pomeroy, Ohio.
King E. Fauver	Director, The Savings Deposit Bank and Trust Company, Elyria, Ohio.

Class B

Alexander E. Walker	Chairman of the Board, The National Supply Company, Pittsburgh, Pa.
Joseph B. Hall	President, The Kroger Company, Cincinnati, Ohio.
Charles Z. Hardwick	Executive Vice President, The Ohio Oil Company, Findlay, Ohio.

Class C

John C. Virden	Chairman of the Board, John C. Virden Company, Cleveland, Ohio.
Frank J. Welch	Dean and Director, College of Agriculture and Home Economics, University of Kentucky, Lexington, Ky.
Arthur B. Van Buskirk	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.
Joseph E. Healy	President, The Citizens National Bank of Hampton, Hampton, Va.

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.
John B. Woodward, Jr.	Chairman of the Board, Newport News Shipbuilding & Dry Dock Company, Newport News, Va.

District 6 - ATLANTA

Class A

Roland L. Adams	President, Bank of York, York, Ala.
W. C. Bowman	Chairman of the Board, The First National Bank of Montgomery, Montgomery, Ala.
William C. Carter	Chairman and President, Gulf National Bank, Gulfport, Miss.

Class B

A. B. Freeman	Chairman of the Board, Louisiana Coca-Cola Bottling Company, Ltd., New Orleans, La.
Pollard Turman	President, J. M. Tull Metal & Supply Company, Inc., Atlanta, Ga.
Donald Comer	Chairman of the Board, Avondale Mills, Birmingham, Ala.

Class C

Harllee Branch, Jr.	President, Georgia Power Company, Atlanta, Ga.
Henry G. Chalkley, Jr.	President, The Sweet Lake Land & Oil Company, Lake Charles, La.
Walter M. Mitchell	Vice President, The Draper Corporation, Atlanta, Ga.

District 7 - CHICAGO

Class A

Vivian W. Johnson	President, First National Bank, Cedar Falls, Iowa.
Walter J. Cummings	Chairman, Continental Illinois National Bank and Trust Company of Chicago, Chicago, Ill.
Nugent R. Oberwortmann	President, The North Shore National Bank of Chicago, Chicago, Ill.

Class B

William A. Hanley	Director, Eli Lilly and Company, Indianapolis, Ind.
Walter E. Hawkinson	Vice President in Charge of Finance, and Secretary, Allis-Chalmers Manufacturing Company, Milwaukee, Wis.
William J. Grede	President, Grede Foundries, Inc., Milwaukee, Wis.

Class C

J. Stuart Russell	Farm Editor, The Des Moines Register & Tribune, Des Moines, Iowa.
Bert R. Prall	558 Ridge Road, Winnetka, Ill.
Carl E. Allen, Jr.	President, Campbell, Wyant and Cannon Foundry Company, Muskegon, Mich.

District 8 - ST. LOUIS

Class A

William A. McDonnell	President, First National Bank in St. Louis, St. Louis, Mo.
Phil E. Chappell	President, Planters Bank & Trust Company, Hopkinsville, Ky.
J. E. Etherton	President, The Carbondale National Bank, Carbondale, Ill.

Class B

Louis Ruthenburg	Chairman of the Board, Servel, Inc., Evansville, Ind.
Leo J. Wieck	Vice President and Treasurer, The May Department Stores Company, St. Louis, Mo.
S. J. Beauchamp, Jr.	President, Terminal Warehouse Company, Little Rock, Ark.

Class C

M. Moss Alexander	President, Missouri Portland Cement Company, St. Louis, Mo.
Joseph H. Moore	Farmer, Charleston, Mo.
Caffey Robertson	President, Caffey Robertson Company, Memphis, Tenn.

District 9 - MINNEAPOLIS

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 10 - KANSAS CITY

Class A	
W. L. Bunten	President, Goodland State Bank, Goodland, Kansas.
Harold Kountze	Chairman of the Board, The Colorado National Bank of Denver, Denver, Colo.
W. S. Kennedy	President and Chairman of the Board, The First National Bank of Junction City, Junction City, Kansas.
Class B	
K. S. Adams	Chairman of the Board, Phillips Petroleum Company, Bartlesville, Okla.
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.
Joe W. Seacrest	President, State Journal Company, Lincoln, Neb.
Raymond W. Hall	Vice President and Director, Hallmark Cards, Inc., Kansas City, Mo.

District 11 - DALLAS

Class A

W. L. Peterson	President, The State National Bank of Denison, Denison, Tex.
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.
Henry P. Drought	Attorney at Law, San Antonio, 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.
Carroll F. Byrd	President, The First National Bank of Willows, Willows, Calif.
John A. Schoonover	President, The Idaho First National Bank, Boise, Idaho.

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, W. 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.