

In this environment, the discount window served only a marginal role as a supplier of reserves. It was designed to give banks assistance over the peaks of temporary, emergency, or seasonal needs for funds that exceeded the dimensions that the banks themselves were capable of reasonably meeting out of their own resources. To foster this kind of bank use of the discount window, chief reliance was placed upon the tradition against bank borrowing, buttressed as when necessary by disciplinary contacts by discount officers. Given this kind of discount policy, open market operations could be undertaken with a new degree of vigor and precision, secure in the knowledge that only marginal reserve additions would be introduced through the discount window—in effect, just enough to lubricate the many joints in the banking machinery.

The financial environment has changed markedly in the past decade, and increasing evidence suggests that the discount mechanism may be in need of modernization. Banks no longer hold large amounts of Government securities. In recent years non-Federal debt has increased far more rapidly than Federal debt, and bank portfolios have reflected this development. The supplies of liquid assets available for reserve adjustment have been further curtailed by the rise in the total of public deposits which typically must be collateralized by the hypothecation of these assets.

In the absence of ample supplies of liquid assets, many banks find themselves adjusting their reserve positions more and more through the issuance of short-term liquid liabilities. This can be seen in the rapid growth of the Federal funds market, the intense competition for certificates of deposit, and the heavy reliance of some banks on the Eurodollar market. Meanwhile, the preponderant System dependence upon open market operations for the execution of monetary policy, while still working generally well, has at times involved market strains of a type that might have been ameliorated by a different kind of discount window assistance.

It was in the light of these developments, criticisms, and questions coming from both within the System and without, and the general belief that the tools of monetary policy should be periodically examined to evaluate their effectiveness in developing financial conditions, that the current study of the discount mechanism was undertaken. Participants in the study include the broadest cross-section of interests, opinions, background, and geographic assignments. The operation is headed by a Steering Committee composed of members of the Board and Presidents of Federal Reserve Banks. Under this Steering Committee was established a high-level staff Secretariat charged with the responsibility for conducting research and developing proposals for consideration by the Steering Committee and, in turn, by other principal System policy-making bodies.

Approximately two dozen separate research projects are presently in various stages of completion. These projects cover a wide variety of issues, some exploring the past history of the discount mechanism, others examining the discount window and other aspects of the financial system as they operate and interact today, and still others evaluating various changes and improvements which have been proposed in the light of the economic environment today and that expected to exist in the foreseeable future. One segment of these studies is examining the discount mechanisms employed by central banks in the other major industrial countries and evaluating the guidance they can offer for our own window. In this connection, the officials of these central banks have been contacted both by letter and in some cases by personal visits from our staff.

The views of a number of outstanding academic economists have also been obtained in connection with this study. One academic seminar on proposed changes in the discount mechanism has already been held, and another is contemplated shortly. In addition, a few academic economists have been commissioned to prepare papers on particular aspects of the subject.

At the end of a year of concentrated effort on this ambitious undertaking, significant progress has been made. However, the time is only now approaching when the results of this research are being interpreted and evaluated in terms of policy alternatives. Hence it is premature to do more than touch on possible findings of a policy nature.

Nevertheless, to try to be as responsive as possible to your inquiry, I can report that several possible implications of the findings have already begun to emerge, some of a general nature and others pertaining to more specific areas. Perhaps the most significant possibility is that the discount mechanism could be converted to a more active role. It could be more useful both to the Federal Reserve