

STATEMENT OF HON. GEORGE W. MITCHELL, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND CHAIRMAN INTRASYSTEM COMMITTEE ON REAPPRAISAL OF THE FEDERAL RESERVE DISCOUNT MECHANISM; ACCOMPANIED BY HOWARD H. HACKLEY, ASSISTANT TO THE BOARD, FEDERAL RESERVE; AND ROBERT HOLLAND, SECRETARY OF THE FEDERAL RESERVE BOARD

Mr. MITCHELL. Thank you, sir. It is a pleasure to be here and testify before you once again on this day to talk about our report on the proposed changes in lending facilities to member banks.¹

The studies and research on which the Report is based were undertaken to be sure our lending operations—properly called our discount mechanism—were appropriate to present-day banking institutions and environment. To be more effective in meeting changing community credit needs, commercial banks need central bank assistance as well as supervision. We are pleased to discuss our findings with you.

The redesign suggested by the Report would represent the latest in a whole series of evolutionary changes in Federal Reserve lending policies and procedures. When first established by the Federal Reserve Act in 1913, the discount mechanism was expected to operate by member banks presenting certain types of short-term customer notes—termed “eligible paper”—as collateral for borrowing at the Reserve banks. During most of the first 20 years of Federal Reserve operation, member banks borrowed a sizable proportion of their total required reserves on the security of such customer notes.

After 1934, however, member banks accumulated large amounts of Government securities and other liquid assets; accordingly, they did very little borrowing from their Federal Reserve banks, and collateralized such borrowing as they did with Government securities. This marginal role for the discount window was formally recognized in a change in 1955 in the Board's regulation A covering loans to member banks; under that revision, bank borrowings from the Federal Reserve were to be limited to assistance over the peaks of temporary, seasonal, or emergency needs for funds that exceeded the dimensions that the banks could reasonably be expected to meet out of their own resources.

In the last decade or so, however, credit demands on banks have grown and loan-to-deposit ratios are much higher, rising from 47 percent to 60 percent. Moreover, at many banks portfolio management has pared liquidity positions substantially, and borrowings from sources other than the Federal Reserve have expanded enormously. In addition, a small but growing number of banks has also been led to withdraw from membership in the Federal Reserve System, chiefly in order to avoid reserve requirements and thus enable them to invest a greater portion of their resources in earning assets. In view of these developments, the proposed redesign of the discount mechanism is aimed at relating Federal Reserve lending more clearly and closely to the changing banking and community needs.

Before I outline the new proposals which have been made for our lending facilities, it might be well for me to mention three longstand-

¹ Report: “Reappraisal of the Federal Reserve Discount Mechanism.”