

demands and interest rates rise sharply. Such periods of high demand for bank funds, however, are not without concern to commercial banks. Under these circumstances banks frequently must sell securities from their portfolios at substantial losses in order to meet their formal and informal commitments to valued customers. If there are heavy Treasury demands for credit at such times the problem of financial institutions is further compounded. When banks respond within the free market mechanism by rationing credit on the basis of price (interest rate) rather than by arbitrary decisions, they frequently incur unjustified criticism for raising rates charged to customers.<sup>1</sup> Yet when the banks, whose ability to meet expanded borrowing demands of their customers requires them to be able to attract funds, succeed in increasing their time and savings accounts, they are sometimes said to be "obtaining more than their fair share of the savings market."

It should be recognized that the disruptive strains upon our financial system are not caused by commercial banks nor by specialized financial institutions. Rather, they arise from the fact the economy can generate more uses of credit under an outlook for relatively full employment than it is possible to supply at current interest rate levels. The problem is compounded by inflation which both increases the demand for funds and reduces the motives to save. To the extent that monetary policy is successful in holding down price increases, the measure of its success may be the shortage of credit itself. To the extent that price increases occur, credit demands that are satisfied compound inflation. The administration and Congress have often been sympathetic but at times they have added to public misunderstanding of the role commercial banks play in supplying credit by viewing dimly either interest rate increases made necessary by market pressures or by suggesting that banks are obtaining greater than their arbitrarily assumed share of the "market for savings."

The American Bankers Association recommends that the administration and Congress bear in mind the strains placed upon financial institutions in times of excess demand. To this end an active policy should be pursued to cut back Treasury and Federal agency demands for funds when the economy achieves rapid growth of demand and high employment as a result of a strong private sector. Furthermore, recognition is essential that monetary policy should appropriately be concerned with both interest rates and the volume of bank credit. Finally, attention may well be directed toward determining whether the present structure of financial institutions is appropriate to provide the optimal flow of credit needed for a high employment economy in the long run.

## II

The statement of the incoming Council of Economic Advisers presented to the Joint Economic Committee on February 17, indicates the priority given to the problem of inflation by the present administration. The statement rejected the economic projection of the retired Council and instead indicated that a greater attempt would be made

<sup>1</sup> In 1966 the American Bankers Association published and distributed to all of its members a brochure entitled *The Banker's Role in Reinforcing Monetary Policy* which pointed out procedures the bankers could use in determining loan priorities. This publication pointed out the beneficial effects that could be produced by responsible bank management decisions which would obviate both the need for Government guidelines and ever higher interest rates. Consideration is now being given to reissuing this publication.