Remarks before the New York State Bankers Association

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I am delighted to have this opportunity to meet today with bankers from all parts of New York State for the first time as president of the Federal Reserve Bank of New York. My delight, of course, is related to the nature of the occasion—being back home and talking about matters of common interest—not a claim that we meet in entirely happy circumstances.

The past year has seen unparalleled strains on the finances of our state and its leading city. There have already been consequences for all of us and, unless dealt with effectively, there could be national and even international repercussions as well. Other pressures on our banking and financial structure, building up over several years, have become evident in the aftermath of recession. Right in my own bailiwick, the Federal Reserve System has been in the midst of much controversy, with a spate of proposals for far-reaching changes introduced in the Congress.

In a happy contrast to the beginning of last year, there is upward momentum in economic activity. The rate of price increase has diminished from the peaks of 1974. But unemployment remains close to postwar peaks, with only slow declines in prospect. Our economic prospects remain clouded in other important respects. Inflation still looms as a major threat to sustained prosperity, and investment activity is lagging.

From our somewhat different vantage points, we will be dealing together with all of these challenges as far ahead as I can see. In the circumstances, I hardly knew where to begin as I prepared for my remarks today. But that problem was solved for me by the unprecedented barrage of reports in the press these past two weeks about conditions in the banking system and of individual banks within it—reports that could leave in the public mind some totally unwarranted impressions about the stability of the system. That subject is close to my heart and mind, and I am sure to yours as well.

Perhaps I can best approach the matter by simply stating again my own perspectives. There is no doubt that banks—as businesses generally—have been functioning in a more difficult environment than at any earlier time since the Great Depression. A long period of almost uninterrupted growth and prosperity—accompanied by widespread confidence that we had found the means of preventing serious economic setbacks—had encouraged more aggressive, highly competitive behavior by many financial institutions in the 1960's and the early 1970's. The long period of smooth sailing encouraged banks, as others, to leverage their capital more highly, beyond traditional standards. To many in the investment community and elsewhere, aggressive liability management and exploration of new lending areas became the hallmarks of progressive banking; indeed, those slower to move in these directions were often less favored by the market and chided by their customers. The more competitive banking environment was widely and, in important respects, rightly hailed as bringing clear benefits for depositors, borrowers, and investors alike. Yet, it was also true that some of the trends could not be sustained indefinitely, and some mistakes were made. The brutal combination of inflation and recession has now exposed the excesses in a few areas; they need correction and the process is under way.

None of this has been hidden from you or from any

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careful follower of bank reports. I know the actions and statements of the regulatory authorities—and I can speak directly of the Federal Reserve—have reflected their recognition of potential points of stress for some time, sometimes to the discomfort of bank managements. But the danger now is that reports spread in the general press—citing, in part, fragments of examination reports and other internal working papers designed specifically to ferret out and highlight problems—lend a sensationalized air to these matters that seems to me unwarranted. The clear positive signs of the basic health and strength of the banking system are largely ignored, and perspective is lost.

Let me cite again some simple facts that seem to me to reflect in a more balanced way the banking situation. Loan losses did reach a postwar high last year at a multiple of the levels to which we had grown accustomed in more settled times. Even so, for the larger New York banks, the losses can be estimated at about ¾ of 1 percent of loan portfolios. For the leading national and international banks for which I have seen reports, loan write-offs have without exception been matched by fresh provisions to loan loss reserves, maintaining that important element of protection against future contingencies. In fact, every large bank in New York City now has loan loss reserves at a higher level than at the beginning of 1975 averaging almost twice last year's actual losses.

At the same time, the basic earning power of banks appears to have improved significantly. Preliminary indications are that, after making their provisions for loan losses, earnings for the year were maintained by the large banks as a group—although not for every individual bank—above the record levels of 1974. With growth in loans and deposits slowing substantially and retained earnings high in 1975, these banks have also begun to improve their capital ratios.

It would be ironic, indeed, if that kind of broadly favorable and distinctly reassuring information, routinely reported in the financial pages of only a few papers, were to be lost to readers of many newspaper stories that focus, in the name of full disclosure, on the problem areas. The recent publicity—leaning heavily on leaks of internal papers protected by law from unauthorized disclosure—does call attention to important questions about the public's right to know, the privacy and confidentiality necessary to the internal work of the supervisory agencies and the banks themselves, and even the effectiveness with which the supervisory agencies are discharging their responsibilities for the stability of our banking system. These questions demand answers.

Accurate, adequate disclosure of material facts about sizable business firms has long been an accepted concept in the American business system, providing fundamental protection for the investor and ensuring effective discipline through market processes. Standards in that respect have been toughened in recent years, and banks have not been exempt. In a number of instances, banking institutions have voluntarily moved beyond required standards, and the standards have themselves been raised by the efforts of the SEC, the banking authorities, and the accounting and legal professions. Thinking is still evolving in this area, and it seems to me possible that more can be done to provide meaningful, consistent information, without violating the confidentiality of customer relationships or smothering business initiative. Information beyond the purely financial may be relevant when sensitivity to such matters as business ethics, employment practices and standards, and consumer protection is understandably high. I am also convinced that disclosure will be both more meaningful and less burdensome to the extent banks themselves consider, in a forward-looking way, what should and can be done. I welcome the fact that at least a few institutions are prepared to do just that.

These disclosure efforts, developed primarily to protect the investor, inevitably overlap with, but can be distinguished from, the overall responsibilities of the supervisory authorities. The supervisor can help ensure that disclosure standards designed primarily to help the investor are enforced, and that the information is accurate. But the responsibility of the bank supervisor is still broader. Our basic job is not to serve the investment analyst or to serve the stockholder interest, but to protect the interest of the public generally, and the depositors directly, in the integrity and stability of the banking and payments system as a whole. As part of that responsibility, we need to be concerned with the safety and soundness of individual banks, because it has long been recognized that failure of a bank can have repercussions locally, nationally, or even internationally, extending far beyond the impact on the owners and creditors of the particular institution involved. Concerned as we must be with the safety of banks, our responsibilities do not stop with meaningful disclosure to the investor, but extend to developing and enforcing appropriate safeguards against excessive risk.

Given these responsibilities, we are naturally concerned with searching out problem areas. The individual examiner is trained to probe into institutions as far as he can to identify potential problems before they threaten the soundness of the bank and to bring them to the attention both of his superiors and of the bank's management. The examiner should, in the vernacular, "holler and scream" to get his point across. And he will be more successful to the extent banks feel comfortable in volunteering free and full access not just to their records but to their thinking, and the examiner feels free to form judgments partly on the basis of intangibles. All of this demands an atmosphere of confidentiality and mutual trust, because private customer relationships, proprietary information, and public confidence are all deeply involved.

In the end, the measure of how well the examiner does his job is how successfully problems can be identified and resolved before they reach damaging proportions. We have not always been successful—but one of the more interesting statistics I have learned in my new job is the very limited number of loans classified as "substandard" or "doubtful" that ever need to be written off in whole or substantial part after those credits have been identified and bank management seized of the task of following them closely and taking the actions necessary to bolster the credit.

A bank could always avoid mistakes, in the narrowest sense, by drawing back to only those credits that involve no discernible risk, by maintaining tight ceilings on interest rates paid depositors, by maintaining high and rigid capital standards, and by similar devices. But, carried to an extreme, such a course of action would hardly serve the interest of individual institutions and their customers, or more fundamentally, the requirements for an expanding economy dependent on a free flow of bank credit and risk taking. The supervisor, in the end, is not concerned with safety alone, but also with promoting competition and initiative. We want a variety of lending outlets for businesses whose fortunes are never altogether certain. We want savers to earn a reasonable reward. And we want banks to seek out profits, because profits both measure their effectiveness in serving their community and provide the base for growth.

The constant challenge—the dilemma, if you will—of the supervisor is to assure needed safety without stifling initiative and competition. We are helped in resolving that dilemma by the broad array of support that can be made available through the FDIC and the Fed to protect, in the last analysis, the stability of the banking system and the individual depositors. But the first line of defense lies in the soundness of the individual banks—and I frankly do not see how we can maintain the necessary balance in that job if the supervisor and the banks cannot work in confidentiality and mutual trust. Exposure in a public forum of confidential working papers—papers designed to surface potential problem areas—can only destroy that essential condition.

Short of revealing sensitive, confidential information about individual banking institutions and their customers, I welcome considered Congressional and public inquiry into the way we go about our job. As you know, proposals for reorganization of the responsibilities for Federal banking supervision are now being reviewed in the Congress, with their inquiry focusing particularly on the question of some or even complete consolidation of the overlapping supervisory authorities of the FDIC, the Comptroller of the Currency, and the Federal Reserve. The present arrangements grew out of a long period of historical evolution, and follow no clear or obvious principle of administrative organization. There are overlapping and potentially confusing elements. The consequent possibility of inconsistency, and even a competitive instinct, among the agencies has often been cited.

But the system also has enormous strengths and historical logic of its own. It reflects our national suspicion about the danger of concentrated power. It can help encourage a useful measure of innovation. And I suspect it also helps protect against a certain insulation—a bureaucratic arteriosclerosis—that may over time erode ability of a dominating regulatory agency to distinguish between the public interest and its institutional interest.

In responding to the Congressional concern, the Federal Reserve and other supervisory agencies have been rethinking this matter. No consensus has yet emerged. One possibility is that, even under present law, there may well still be areas in which a further degree of coordination—for instance, in examination standards and procedures—could usefully be achieved. I would not myself resist some further consolidation through legislative reorganization, provided—and it is a large proviso—that the Federal Reserve maintains a substantial role in the supervisory and regulatory process.

The proposals sometimes made to insulate monetary policy from supervisory policy would, in my judgment, be a disservice to both. In particular situations, it is easy to imagine that people concerned wholly with bank supervision, and therefore the way particular banking institutions are meeting their responsibilities, might have a different perspective and reach somewhat different conclusions from those concerned wholly with monetary policy, and therefore aggregate economic activity. Both are important. But it doesn't make sense to me to try to resolve these different perspectives by trying to place them in water-tight compartments.

The potential conflicts have to be reconciled. That best can be done, in my judgment, by those who are forced by their responsibilities to recognize the legitimacy of both concerns.

To my mind, decisions on monetary policy will themselves only benefit from the fact that those responsible are forced to involve themselves in the "nitty-gritty" of banking—with a flow of first-hand information about lending policies and trends, the condition of the credit markets, and the capacity of banks and other institutions to respond and adapt to policy initiatives. In other words, I am not a believer in monetary policy from an ivory tower.

The vague charge has often been made of regulatory agencies that they may become a captive of the industry they regulate. Whether that charge has any merit in other areas or not, I suspect this audience could testify rather eloquently that no case to that effect can be made against the Federal Reserve. And I suspect one fundamental reason is that our supervisory and regulatory responsibilities, important as they are, are not our entire "raison d'être". They must be performed in the context of other still larger purposes and responsibilities.

It will not surprise you that I have deep concerns about the nature of other criticism directed at the Federal Reserve in recent months. I am not thinking so much about debates on monetary policy conducted in the press, in the academic community, and most importantly in the Congress. Those debates are natural and even healthy when the economy is troubled. I am thinking rather of what I can only judge as an attack on some of the underlying premises of the Federal Reserve as an institution. I will take my remaining time to talk with you about them, for there are issues here that seem to me fundamental to our economy and even to the nature of our processes of government.

I have lost count of the number of times in recent months that one or another committee of the Congress has been presented with proposals for changes in the structure and organization of the Federal Reserve. What these proposals have in common is that, almost without exception, they seem to be designed, contrary to past intent and tradition, to bring monetary policy much more directly under "political" control.

In approaching this question, I do not want to be misunderstood. The Federal Reserve is a public institution. It is a creature of the Congress, and the Congress is free to change it. Congressional review of our policies and our operations is neither new nor disturbing, even given the pitch of intensity it has reached in recent years. We are, after all, charged with responsibilities of great national importance. We should be—and I think we are—sensitive to the broad national priorities, and aware of the problems and needs of all parts of our country. In that broadest sense, we are a part of the fundamental political processes of the nation.

What is at issue seems to me something else: whether the Federal Reserve should be exposed to—even controlled by—direct, day-to-day and potentially partisan political pressure, whether originating in the Administration, with individual members of the Congress, or elsewhere.

That was not the view of the founders. The Federal Reserve Act was a product of political genius. In going about the job of constructing a central bank, the Congress built a unique institution, without precise parallel in the United States or other countries. Some concepts were, of course, borrowed from earlier experience here and abroad. The genius lay in blending them together in a manner fitted to the vast size, the heterogeneity, and the traditions of the United States.

The structure of the Federal Reserve defies simple description. It is a part of government; yet, it is not an agency like other agencies. It is firmly controlled by public officials; yet, it has been able to draw upon a degree of participation and support from the private sector that is perhaps unique in government. Monetary policy by its nature is a function of the central government; yet, there is regional participation in policy development and implementation.

The original Federal Reserve Act has been amended many times. There was a sweeping modernization in 1935, and the act has been thoroughly reviewed in the Congress a number of times since. But throughout this process, three fundamental and related elements have been retained.

(1) The process of policy formulation and implementation has been protected from partisan and short-term political control and influence. The Congress, in delegating its own Constitutional authority over money, established an independent authority free of executive domination and removed from the immediate pressures of the day-by-day Congressional processes. A number of reinforcing methods have been used to assure that result. Members of the Board of Governors with general supervisory power over the System are appointed for long terms; they share certain important policy responsibilities with the Federal Reserve Banks, whose officials are appointed outside the political process; and the System is self-financed.

(2) Policy and operating responsibility is widely dispersed. Washington is the center, but the System is nourished by roots throughout the country. Awareness of, and sensitivity to, the concern of different regions and different interests have been built into the structure. Thus,

operations are conducted by the twelve Reserve Banks, under the direct supervision of boards of directors drawn from their own region. The Bank officials participate in the process of policy formulation, with the presidents (who must be approved by the Board of Governors) directly represented on the body that formulates open market policies. Members of the Board of Governors themselves are drawn from different regions.

(3) As implied by the previous point, the System has checks and balances within itself. In the end, a single monetary policy must prevail. But a diversity of views can be brought to the policy table—each supported by independent research and filtered through the differing perspectives of different parts of the country and different individuals, by direct contact with the marketplace, with economic decision makers, and with local opinion. A consensus must be reached among men dependent on each other only by the general interest in achieving coherent and intelligent policy.

The Federal Reserve is a living institution—the precise balance of forces within the System, and between the System and other elements of government, is almost always shifting at the margin as needs change and particular personalities come and go. But these constants of independence in judgment, regional participation and decentralization, and internal checks and balances have remained. I believe they have stood the test of time.

I cannot take the position that the Federal Reserve should be exempt from legislative changes—that improvements are not possible. Some of the proposals now before the Congress—and others made in the past—certainly deserve careful hearing. But I do object vigorously to the common thread that runs through many of the current proposals.

For instance, one family of bills would bring the Board of Governors and the individual Federal Reserve Banks within the process of Congressional authorization and appropriation—and with the purse goes the power. With both the Board and Banks already carefully audited, proposals that would subject the System to further audits by the GAO inevitably raise the suspicion that the real intent is to intrude into policy areas. Other bills would drastically shorten the terms of Board members. Power would be centralized by eliminating voting participation of the presidents of the regional Reserve Banks from the Open Market Committee, by abolishing the boards of directors of the regional Banks, and by curbing the ability of the Reserve Banks to attract and retain the kind of exceptionally able career officials that have notably marked the System from its first days.

Taken together, or even in substantial part, these proposals, if adopted, would mark a reversal of the historic judgment of the Congress about the proper role for itself and for the central bank in the conduct of monetary policy. The question must be asked: To what end?

The idea that the basic powers of the Federal Reserve are to be directed toward certain basic, well-established goals of public policy is not at issue. Those goals of stability, growth, and employment—implicit in the Federal Reserve Act and embodied in the Employment Act of 1946—are essentially noncontroversial.

What is bound to be controversial is how best to meet those goals through monetary policy. At best, monetary policy is a complex and difficult mixture of science and art. The results are never certain, and the relevant time horizon may be relatively long.

The Congress, in delegating its ultimate authority, implicitly recognized that policy decisions heavily weighted by their immediate impact and by public appreciation and response may often be distorted and counterproductive. By their nature, decisions on monetary policy must sometimes run against the grain of the illusive hope that more money can be equated with more production or more real welfare. Effective policy takes a high degree of expertise, and continuous attention. While there is a clear need to work with the Administration of the day to the extent possible, there are also times when their judgments need to be sharply challenged. And these considerations all support the continuing validity of the judgment that the decision making should not be conducted directly by those engaged fully in the rough and tumble of the political arena.

The other side of the coin is that the policymaker needs to be sensitive to the broad needs of the economy and continuing national priorities. I have already stated my belief that such sensitivity is built into the organization of the Federal Reserve System. Within that general framework, there are still more opportunities for enlarging our perspective—through, for instance, encouraging appointment of Reserve Board members and Reserve Bank directors from a wide spectrum of our national life. What I fail to see is how narrowing the base of the System—for instance, by abolishing the boards of directors of the Banks or curbing the voice of the Banks themselves—would contribute to that end. Nor do I see how it will help to place Reserve Banks or their officials in a position to be hostages to political fortune through the appropriations process or otherwise, or to undermine their ability to take and defend viewpoints that may not coincide in all respects with the current fashion in Washington. My observation, from an earlier time than when I took my present position, is that individual Reserve Banks have often played an avant-garde role in prodding the System to reexamine the premise of its policies, to explore and experiment with new techniques, and to recognize in its policy making new currents of opinion.

Finally, the proposals to reorganize the System in the name of "responsiveness" seems to me to overlook the effectiveness with which the Congress has learned to exercise its power of review and oversight. Never before have Federal Reserve policies been scrutinized and challenged so continuously and forcefully by the relevant committees. It is a tough process—one that forces the policymaker to think and rethink the premises of his actions and their consistency and effectiveness. A mass of information is diligently supplied in response to the legitimate demands of the Congress and the public to be fully informed both as to the substance of policy and the factors bearing upon the decisions.

Last year saw a potentially important new initiative in this respect. After Congressional prodding, the Federal Reserve undertook to quantify its longer range objectives with respect to important monetary aggregates. I am not one who believes that monetary policy can be reduced to a question of maintaining a given rate of growth in the money supply—the economy is much too complex for that. But at least in present circumstances, when the economy has been so unsettled, this discipline of quantifying can perform an important service in both clarifying our objectives for the public and providing a focus for informed Congressional debate.

The constructive elements in this process would end, and the damage to the basic concept of the Federal Reserve would begin, in my judgment, if the essential base for the independent judgment of the System were to be eroded. That is why I am concerned about the number of proposals in the Congress that would do just that, and why I wanted to leave these thoughts with you on my maiden appearance today. History is, after all, replete with the wreckage of economies that lost sight of monetary discipline. We have had a glimpse of what that process can mean in recent years, not just in the United States but elsewhere.

I readily confess to a special interest in the Federal Reserve. I know that, as we work together in the years ahead, there can be many particular issues upon which our views will diverge, our interests may differ, and new approaches will be needed. Within the Federal Reserve itself, there is ample room for debate and even dissent. I am here today only because I firmly believe the Federal Reserve Bank of New York has played—and can continue to play—a constructive and even vital role in this entire process.

That may sound parochial. But I do not think it parochial to assert that the chances for dealing successfully with our troubled economy this year—and maintaining a healthy economy and banking system through the years ahead—will be enhanced by maintaining the independence and vitality of the Federal Reserve System.