

**Encouragement
of Sound
Methods**

Utilizing the controls of rediscount to encourage sound methods by member banks should not be objected to on the ground of undue interference by reserve banks with member bank activities. Soundly managed member banks will usually find their discount applications accepted as a matter of course. It is only a member bank which is tending to deviate somewhat from the recognized principles of prudent banking, in undermining its liquidity and using borrowed reserve credit unduly for profit purposes, which may find its borrowing powers thus interfered with. By insisting that such a member bank adhere to sound principles and accepted standards and protect its solvency, the reserve banks are acting not only for the benefit of other banks but also for the stockholders and depositors of the bank in question.

Recommendation

The Committee recommends that, in passing upon an application for rediscount accommodation, a reserve bank should be guided by the general condition of the applying bank and the effect of granting the rediscount upon the safety of depositors as well as by the character of the paper which the applying bank tenders.

**Open-Market
Operations**

It was recognized at the time the Federal Reserve Act was framed that the outstanding volume of reserve credit could not be regulated in satisfactory fashion if the only method of influencing it were by changes in the rediscount rate. One reason is that rediscount applications rest upon the initiative of the member bank, and the rate is only one of the factors entering into the decision. There must be at times some way by which the reserve banks, upon their own initiative, can influence the volume of reserve credit more directly and more speedily than by a rate change.

Purpose

Effect

To make this possible, reserve banks were given the privilege of dealing in bills of exchange and government securities in the open market—buying from and selling to other than member banks. They can, by making purchases, place money in the market, and by making sales, take money out of the market, thus producing an immediate effect upon the outstanding volume of reserve credit.

**Counteracting
Activities**

It is to be admitted that the open-market operations of the reserve banks may frequently be countered by the activities of member banks. Funds released to the market by purchases of acceptances and government securities may be employed by member banks to reduce their discount indebtedness with the reserve banks. On the other hand, funds withdrawn from the market by these operations may be offset by increased rediscounting. These processes, however, take time to operate; hence, it would appear that on almost all occasions the reserve banks have it in their power to exercise an influence upon the outstanding quantity of reserve credit.

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