ber bank, for example, on its own initiative or at the instance of the reserve bank, repays indebtedness to the reserve bank by withdrawing funds lent on the stock exchange, the effect may be to cause the borrower to seek accommodation at another bank, member or nonmember, that is not indebted to the reserve bank. For the purpose of meeting the demand thus transferred without borrowing at the reserve bank, the bank to which the borrower applies may borrow from a member bank, which in turn may borrow from the reserve bank. As the result of this series of transactions there would be no reduction in security loans or in borrowings at the reserve bank. The importance of banking policy lies in promoting the soundness of member banks, and cooperation of these banks with the federal reserve system in carrying out banking policy is essential to the maintenance of sound banking conditions. For influencing general credit conditions, however, the federal reserve system relies on credit policy rather than on banking policy.

Credit Policy

"Credit policy is essentially impersonal and finds expression chiefly through the influence that the federal reserve system may exert on the volume and cost of bank credit through its policy of sales or purchases in the open market and through discount rates on member-bank borrowings and buying rates on acceptances. In determining upon credit policy the federal reserve system is always under the necessity of balancing the advantages and disadvantages that are likely to follow a given course of action. Low money rates may have a favorable effect on domestic business, but at the same time may stimulate speculation in securities, commodities, or real estate. High money rates, on the other hand, may exert a moderating influence on speculation, but at the same time may result in a higher cost of credit to all lines of business, and thus be detrimental to commerce and industry; ultimately they may draw gold from abroad, which would tend to ease the domestic situation. It is impossible to foresee all the effects of a credit policy and difficult to appraise them even after they have developed. It is certain, however, that the federal reserve system must steer its course with reference to broader developments and longer time objectives than day-to-day or month-to-month changes in any particular line of credit. Principal among such objectives are the continuous provision of credit at reasonable cost in amounts adequate for the requirements of trade and industry and the safeguarding of our gold reserves, which are held in trust to meet future needs, against unduly rapid absorption through expansion of credit."

Elastic Currency

A major purpose in the creation of the federal reserve system was to substitute an elastic currency for the inelastic currency which had been used since the establishment of national banks. The issue of currency against gold and against paper bought by the reserve banks in the open market introduces inelasticity.

Original Law

The Federal Reserve Act as it became law contemplated the issue of currency by the reserve banks against paper arising from commercial transactions which were financed by member banks. When commerce expanded and there were correspondingly larger needs for currency, the currency would expand in amount, and when activities in commerce and trade declined the volume of currency would contract through the self-liquidating character of the paper upon which it was based. In other words, the needs of business as those needs actually existed, and not as they were assumed by any board or official, would be the significant factor in determining the volume of currency. Of course, the plan provided for a percentage of gold as a reserve against this currency and afforded means for a holder of the notes to have them redeemed in gold.

Gold Certificates

When notes are issued against gold itself, however, they have no necessary relation to the trend of business and instead of being so secured that they are promptly

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