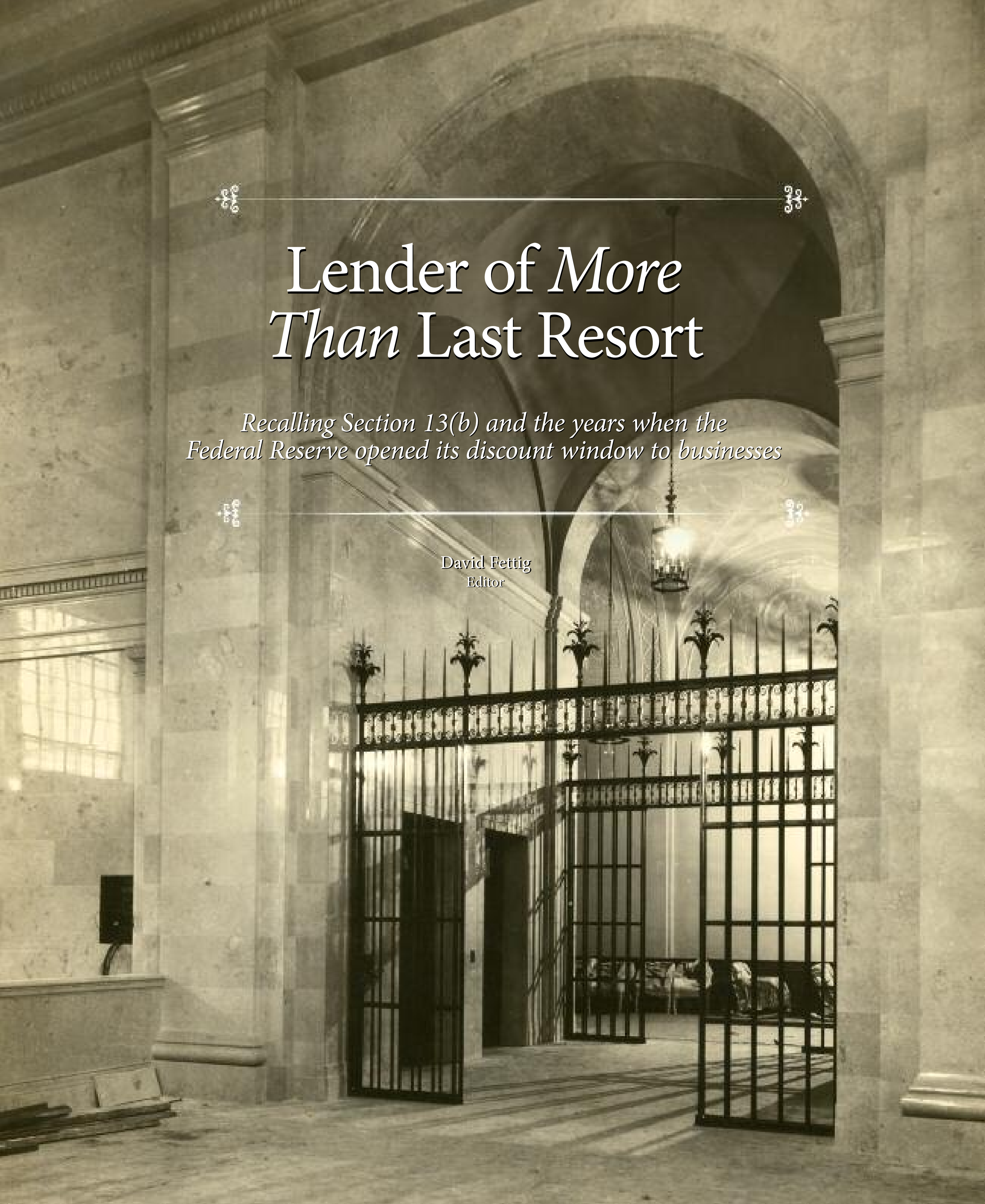


Lender of *More Than* Last Resort

Recalling Section 13(b) and the years when the Federal Reserve opened its discount window to businesses

David Fettig
Editor

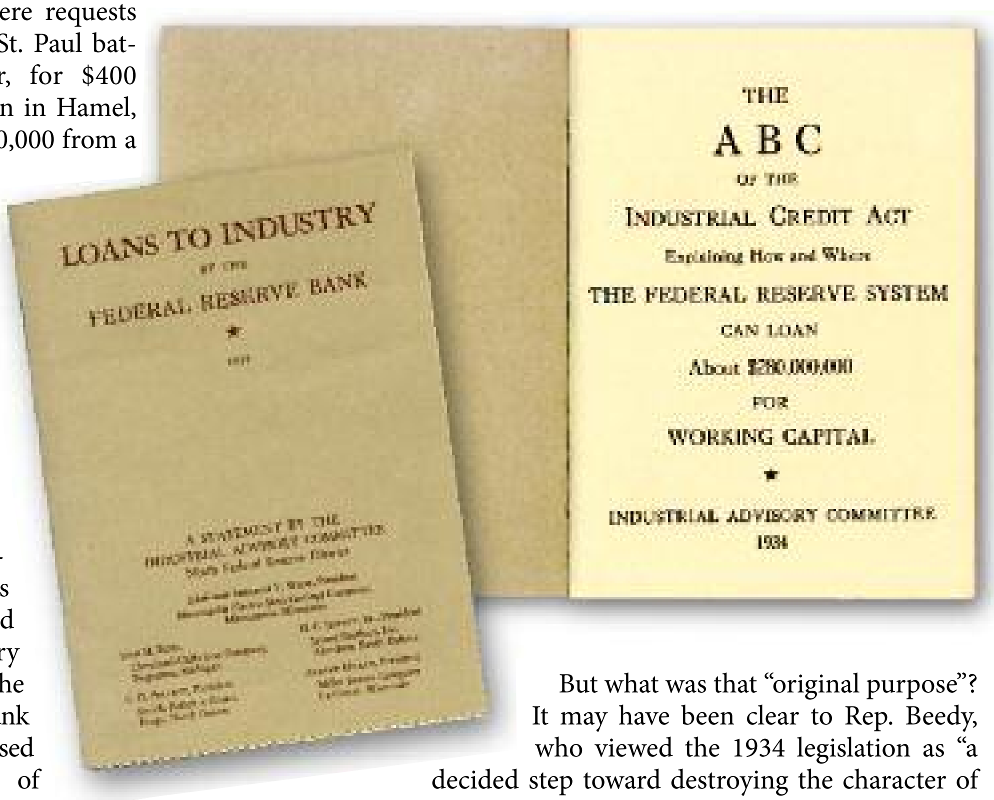
The meeting of bank lenders back in July 1934 seemed routine enough, and the requests for loans were in keeping with the times. There was an application for $100,000 from a St. Paul lumber company, another for $40,000 from a Ladysmith, Wis., manufacturer and one for $3,000 from an Ambrose, N.D., mercantile company, all of which met with the approval of the lending committee and which were remanded for "future investigation that they might give future consideration" to the loans.

Not so lucky were requests for $7,500 from a St. Paul battery manufacturer, for $400 from a businessman in Hamel, Minn., and for $150,000 from a Melrose, Minn., brewery. These loans, among others, were all "duly examined and with the recommendation of the Committee that they be declined."

Business as usual, except that those lending officers were members of the newly formed Industrial Advisory Committee of the Federal Reserve Bank of Minneapolis. Based on a review of Minneapolis Fed records, those loan requests were likely the first that the bank considered under a rather extraordinary piece of legislation passed the previous month. On June 19, 1934, President Franklin Roosevelt signed a bill into law that added Section 13(b) to the Federal Reserve Act, which authorized the Federal Reserve to "make credit available for the purpose of supplying working capital to established industrial and commercial businesses," according to the Federal Reserve Board's 1934 annual report.

In the depths of the Depression, the country's relatively nascent central bank, arguably still struggling to find its role in the U.S. economy, was being asked to get into the lending business, and much to the chagrin of one Rep. C.L. Beedy:

> *The Federal Reserve banks, 12 in number, which were never designed to do business with any individual or any person, but were banks of issue or rediscount to deal with other banks, ought never, in my opinion, to be put into the lending business. It is a perversion of the original purpose for which those banks were established.*



But what was that "original purpose"? It may have been clear to Rep. Beedy, who viewed the 1934 legislation as "a decided step toward destroying the character of the Reserve banks," but not everyone was of the same view. And it's also not clear that there was always a lot of certainty about the Fed's original character. The following quotation is from the Minneapolis Fed's 1921 Annual Report: "More than seven years have elapsed since the establishment of the Federal Reserve Banks, but there is still a surprising lack of knowledge of what they really are and of what their proper functions are, not only on the part of the public at large, but among business men and bankers as well."

Pardon the cliché, but it seems that the more things change when it comes to the Fed, the more things stay the same. In recent months, commentators and analysts have looked back over the course of the U.S. economy's boom-and-bust stock markets and suggested that the Federal Open Market Committee should have popped the so-called stock bubble. The U.S. central bank should not just concern itself with the money supply, these critics have admonished, but should also worry about all manner of economic and financial instability, however broadly defined. The Fed should be more than just an inflation fighter and should start controlling stock markets, too.

Of course, instability is in the eye of the beholder and, at any rate, is often most recognizable in hindsight. Still, the current debate is reminiscent of many that have occurred over the history of the Federal Reserve System and raises the fundamental question: What is the role of the Fed in the nation's economy? "New eras bring new challenges," Fed Governor Ben S. Bernanke said in a recent speech about the demand for Fed bubble-popping, in which he also looks back at Fed policy leading up to the Great Depression. "A small compensation for the enormous tragedy of the Great Depression is that we learned some valuable lessons about central banking. It would be a shame if those lessons were to be forgotten." This article will put aside most of those lessons and focus on the particular episode of Federal Reserve industrial lending; though brief, the affair is informative, if not instructive.

Dissecting the discount window

But before we do that we need to review the original purpose behind the Fed's discount window, since it

How the Fed Made Section 13(b) Loans

The time is ripe for an alliance of all forces intent upon the business of recovery. In such an alliance will be found business and banking, agriculture and industry, and labor and capital. What an all-American team that is!

Franklin D. Roosevelt, Oct. 24, 1934
Address before the American Bankers Association

President Roosevelt's team included the hard-working members of the Federal Reserve banks' newly created Industrial Loan divisions, which were units of the banks' Discount Departments, and the citizen members of the Reserve banks' Industrial Advisory Committees. Their job? To implement Section 13(b) of the Federal Reserve Act and get the Reserve banks into the business of making working capital loans to industrial and commercial enterprises.

But how was such a task accomplished? It was true, as the accompanying article shows, that the Federal Reserve was already given some lending powers through its discount window in 1932 and 1933, so the banks had some practice in this matter; but those were restrictive programs and little used. The 1934 legislation added a whole new layer of business to the banks. What follows is a brief description of how such loans were handled at the Federal Reserve Bank of Minneapolis. Other than offering perfunctory explanations, no record in "official" histories—Fed publications or other published historical works—was found on this subject, so the following is based on a review of the Minneapolis Fed's archives. It's not clear from those archives that every Reserve bank managed this business in the same way, but it may be safe to assume that there were similarities.

"Men of practical affairs"

First, the Industrial Advisory Committee: Subject to the approval of the Federal Reserve Board, each bank appointed this group, which consisted of not less than three or no more than five individuals "actively engaged in some industrial pursuit." One Minneapolis Fed document called them "men of practical affairs and sound business judgment" who "insist that an enterprise must be *fundamentally sound* to qualify." These practical men received no remuneration for their work, but were reimbursed for expenses relating to their service, and were apparently appointed for indefinite terms. The job of this committee was to review loan applications and make recommendations to the Reserve bank.

At the Minneapolis Fed, records suggest that this group first met on July 30, 1934, about six weeks after the legislation was signed into law. Prior to the meeting, a member of the Federal Reserve Board, Eugene R. Black, made a "brief statement regarding the new functions of the Federal Reserve Banks." Unfortunately, that statement or any discussion that may have ensued, are not recorded in the meeting's minutes. Three members of the bank's Committee were present at this inaugural event, with an additional two joining the group at the subsequent meeting. Also, three members of the bank's Executive Committee—including President J.N. Peyton—were also present at the meeting and "participated in the discussion relative to a number of applications." Again, that discussion is not recorded.

Minutes of these meetings largely consist of lists of loan requests and the Committee's action, whether it was a "request for final application and further investigation" or a denial.

is this function that allowed Congress to more broadly expand the Fed's lending role. The Federal Reserve System was established, in part, "to afford means of rediscounting commercial paper," according to the 1913 Act. Essentially, this means that member banks of the Federal Reserve System would borrow money from their district Reserve bank based on loans made at the member bank, and it worked like this:

- A bank makes loans to business customers.
- This bank eventually comes under high demand for loans and finds that its reserves are running low.
- The bank then takes some of its business loans, or paper, and borrows from its Federal Reserve bank, using the paper as security; this was known as rediscounting.
- Reserves at the bank would thus increase and, likewise, so would the reserves of the entire banking system in accordance with the economy's needs at the time.
- When the loans at the bank reached maturity, or were paid off, the bank would then be flush with reserves and would likewise pay off the Federal Reserve bank; this resulting decrease in bank reserves would keep reserves in line with the needs of the economy.

This was how the Fed was intended to provide an elastic currency for the economy, that is, a currency that could respond to the ups and downs of an economic cycle. An important point for our discussion is that this discount policy, which was based on high-quality bank loans backed by good collateral, was administered by the individual Reserve banks.

Minneapolis Fed records indicate that these meetings were held through 1955 (Section 13(b) was repealed in 1958), but with increasingly less frequency and with very little business. Although they began as twice-monthly meetings in 1934 with numerous applicants, they sometimes occurred just once a year in the early 1950s with as few as two items on the agenda. Also, two original members of the group—Chairman Sheldon Wood and John Bush—remained on the Committee throughout its tenure (although the chairman was absent from the final two gatherings).

Putting on the commercial banker hat

When an applicant submitted a request for a Minneapolis Fed working capital loan, the Reserve Bank would record the receipt of the application, acknowledge receipt to the applicant and then turn over the application to Dun & Bradstreet for a credit report. After the credit report was received, the bank would then assign an "investigator" to the "case," who—after making a determination that the application met with the requirements of the law—would make a field investigation.

This field investigation included a verification of financial statements and an examination of the applicant's books and records "to assure that applicant has not failed to disclose any of his liabilities." Assets were also appraised to determine liquidation value.

During the examination the investigator studied "the applicant himself" to determine management skill and efficiency and would interview local bankers, if any, and others familiar with the business. "When all possible information" was assembled, the investigator would prepare a report for the Industrial Advisory Committee, a copy of which was mailed to each member in advance of a meeting.

Following the Advisory Committee meeting, the Minneapolis Fed's Discount Committee would further review the Advisory Committee's recommendation; this Discount Committee was the final arbiter on whether credit would be extended to an applicant. If approved, the applicant would then receive a letter stating terms and conditions of the loan. Security on such loans included stocks and bonds, town real estate, farm real estate, chattel mortgages on furniture and fixtures, logging equipment and "various other types of security."

The above quote, along with other quotations in this section, are taken from a staff presentation given at the Minneapolis Fed in December 1936 by E.F. Klein, head of the Discount Department. We conclude with an extended passage from Klein's lecture (collected in an internal publication called "Staff Lectures on Federal Reserve Operations"), which gives a sense for the way in which central bankers in the 1930s—just 20 years from the Federal Reserve's creation—were beginning to act a lot like commercial bankers.

> *In conjunction with our duties as investigators we service all loans. Borrowers are required to furnish periodical financial statements. Their statements are analyzed by our department. We visit all borrowers, usually once a year, at which time we re-examine the books and records, re-appraise the collateral and re-investigate the character and ability of the management in an endeavor to determine the progress of the business.*

—David Fettig

Did the banking system need more reserves? Did the economy need more money? In effect—and drastically different from today—the answers to those questions came from the 12 Federal Reserve banks as they managed requests for rediscounts. (And yes, there were literally discount windows in Fed lobbies. We should also note here that by the 1930s the discount window had given way to open market operations as the preferred method of controlling the nation's supply of credit—but that story is the subject of another article.)

Again, it is important to understand why the discount window was established and how it was used in its formative years, because without this function the Fed would not have been able to extend loans directly to businesses during the Great Depression.

Tucked inside a highway bill

The 1934 bill that would open the Fed to industrial lending had its genesis under the Hoover administration two years earlier. Tucked inside a highway construction bill in 1932 was an amendment to the Federal Reserve Act allowing the Fed to allocate credit to individuals, partnerships and corporations in emergency situations. This language, amended again in 1991, as we shall see later, is still with us today. The major difference between this enduring legislation and Section 13(b) passed two years later is that the 1932 amendment is only meant to address crisis situations.

The 1932 bill became law on July 21, 10 days after President Hoover had vetoed similar legislation, arguing that such a plan would "violate the very principle of public relations upon which we have builded *[sic]* our Nation, and render insecure its very foundations."

Clearly, though, many in Congress did not agree with the president. It's useful to recall that the Fed was still less than 20 years old and many likely remembered the arguments put forth during the System's founding, when some advocated that the discount window should be open to all comers, not just member banks. That essential question—what is the role of the Fed in the economy?—was very much alive, especially during those years of economic decline.

This 1932 emergency authority for discounts "in unusual and exigent circumstances" for individuals, partnerships and corporations was used sparingly, and just 123 loans were made over four years by all 12 banks, totaling about $1.5 million; the largest single loan was for $300,000. Perhaps the main reason so few loans were made was because forthcoming legislation would trump its effect. Other reasons were the substantially higher interest rate for such discounts and the number of restrictions placed on such loans.

The 1932 bill was quickly overshadowed by the passage of the Emergency Banking Act of March 9, 1933, signed by newly elected President Roosevelt at the height of the banking crisis. Among many other things, the bill "briefly but explicitly author-

ized the Federal Reserve Banks to make advances to individuals, partnerships, and corporations on their promissory notes secured by direct obligations of the United States," according to Howard H. Hackley's *Lending Functions of the Federal Reserve Banks*, a very useful but out-of-print history. These advances were only for 90 days and at rates set by the Reserve banks and reviewed by the Federal Reserve Board (as it was then known—the 1935 Banking Act would change the name to the Board of Governors).

The idea of the Reserve banks as merely bankers' banks was fast losing ground, as Sen. Carter Glass—one of the intellectual founders of the original Federal Reserve Act—observed, noting that under the 1932 and 1933 provisions, individuals were

> *… permitted to do business with the Federal Reserve banks, something that has never been done before since they were organized, individuals who have eligible paper in their possession, and who can not get accommodation at the member bank, permitted to take it directly to the Federal Reserve banks and be accommodated.*

But the cat wasn't completely out of the bag just yet. The ink had barely dried on the 1933 bill when the Fed, once again, became a player in the government's attempt to revitalize the U.S. economy.

You say RFC, I say FRS

Though Sen. Glass was certainly right that the 1932 and 1933 bills moved the Fed in a new direction, they arguably did not destroy the very foundations of the country, as Hoover had warned, perhaps largely because the loans were limited to certain types of commercial paper, with penalty rates of interest, for short duration and with other restrictions. The figurative floodgates opened in 1934 when the Reserve banks were authorized to extend credit, either directly or through banks, to business enterprises "for working capital purposes with permissible maturities of up to 5 years and without any limitations as to the type of security," according to Hackley.

Much like the story that is told today during economic slowdowns, many people in the early 1930s observed that the economy was suffering from a severe credit crunch. Banks, still reeling from the banking crisis of the previous year and under the more vigilant gaze of bank regulators, were apparently not meeting the needs of businesses, especially of the small- and medium-size variety. Roosevelt, in March 1934, wrote to the chairmen of the Banking and Currency committees of both houses of Congress: "I have been deeply concerned with the situation in our small industries. In numberless cases their working capital has been lost or seriously depleted."

And the Federal Reserve Board agreed with this assessment. In a letter the following month to the Senate Banking and Currency Committee, the

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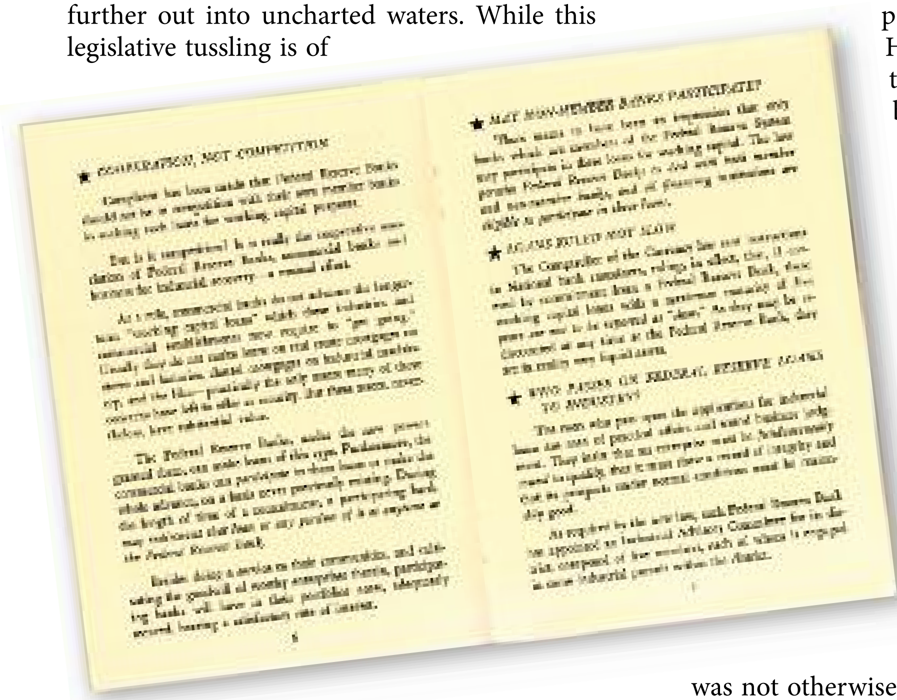
Board said there was an "undoubted need" for credit facilities beyond those available from commercial banks or from the Federal Reserve Act as it then stood. "In brief, the need is for loans to provide working capital for commerce and industry, and such loans necessarily must have a longer maturity than those rediscountable by Federal reserve banks."

The stage was thus set for a political wrangle over the precise wording of a bill that would push the Fed further out into uncharted waters. While this legislative tussling is of



interest, we will note only one alteration in the House version of the bill that was made just before the bill was passed. But before we do, we have to introduce the Reconstruction Finance Corp. (RFC) into the mix. Although it's mostly remembered as the industrial lending arm of Roosevelt's New Deal, the RFC was formed by the Hoover administration in 1932 to make loans only to banks and insurance companies—not businesses. It was during the 1934 debate to get the government more involved in business lending, a debate that was then mostly centered on the Federal Reserve, that the RFC was considered as a possible industrial lender.

Ultimately, the debate about whether the RFC or the Fed should engage in commercial lending was resolved in un-Solomonlike fashion, with both agencies granted such power. But it was the finer points of that debate which would set the course of the country's industrial lending policy. Initially, it was expected that the Fed would be the primary lender and the RFC the secondary source; also, since in 1934 the RFC was still thought of as an emergency agency (no one could predict it would last another 23 years), the Fed's authority would be permanent and the RFC's temporary.

A bill with those provisions passed the Senate and went to the House. On May 23, the day that the House was set to vote on the bill, an amendment was offered from the aforementioned Rep. Beedy (obviously no fan of this whole idea), which struck words from the bill that would have directed loan applicants to the Federal Reserve banks first, that is, before the RFC. In other words, according to the change, the Reserve banks would no longer be the first source for government credit. The amendment, Section 13(b), was adopted. And, as Hackley stated: "So it was that, as finally enacted, the statute authorized business loans by the RFC when credit was not otherwise available at banks, thereby indicating that, despite all that had been said earlier, the RFC's authority was not to be merely supplemental to that of the Reserve Banks."

This was a small wording change with a big impact, and for many, the resultant change in lending activity was unintended. Advocates of Fed primacy in this regard, including Rep. H.B. Steagall, still assumed that the Fed would become the primary agency lender—despite the wording change—but time would prove otherwise. Far from being a short-lived emergency agency, the RFC would become a fixture in Washington; also, it became something of a preferred government lender as Congress eased its lending restrictions, thus making RFC loans more attractive than those from Reserve banks.

However, all of those considerations would come later. On June 19, 1934, it was believed that the Reserve banks would lead the country's industrial lending policy over the long run; further, the nature and function of the nation's central bank were fundamentally reshaped.

A new Federal Reserve

Here, then, are the basic provisions of Section 13(b):

- Reserve banks could make loans to any established businesses, including businesses begun that year (a change from earlier legislation that limited funds to more established enterprises).
- Reserve banks were permitted to participate with lending institutions, but only if the latter assumed 20 percent of the risk.
- No limitation was placed on the amount of a single loan.
- A Reserve bank could make a direct loan only to a business in its district.

How much money was available for Reserve bank lending and where did the money come from? The first answer is nearly $280 million, or about 0.43 percent of gross national product, with each district apportioned a partial amount; in the Ninth District, for example, $7 million was available (with approval by the Federal Reserve Board, though a district could exceed its allotment). Those funds came from two sources: The first, about half, came from the surplus of the Reserve banks as of July 1, 1934, with the other half coming from the Treasury Department as a payback to the Federal Reserve System on its required subscription to the newly created Federal Deposit Insurance Corp. (FDIC). Under the Banking Act of 1933, which established the FDIC, the Reserve banks were required to subscribe to FDIC stock in an amount equal to one-half of their respective surpluses as of Jan. 1, 1933.

A rather extraordinary little pamphlet published by the Minneapolis Fed's Industrial Advisory Committee trumpets these funds on its title page: "The ABC of the Industrial Credit Act, Explaining How and Where the Federal Reserve System Can Loan about $280,000,000 for Working Capital." Inside the pamphlet, this figure—which, in part, was meant to assure the American public that its government was serious about jump-starting the economy—is discussed further:

> *The entire Federal Reserve System has almost $280,000,000 to lend for working capital, constituting virtually a revolving loan fund of that amount for the use of industrial and commercial units.*

In the end, $280 million proved more than adequate. There was a considerable flurry of activity in the first year and a half after Section 13(b) became a part of the Federal Reserve Act, with 1,993 applications totaling about $124.5 million that met with Reserve bank approval. The following year, though, just 287 applications were approved, and just 126 made the cut in 1937. And this drop-off wasn't because Reserve banks were applying tougher loan standards; it was because fewer applicants were seeking Fed loans. (Section 13(b) would reap its largest single-year total in 1942, when war production spurred over $128 million in loans; however, activity quickly ebbed in ensuing years.)

As mentioned earlier, Section 13(b)'s relative unpopularity is explained by the increasingly attractive RFC loans. The Fed's Board of Governors, in 1938, tried to get some of the 13(b) restrictions relaxed, but these attempts failed. "This was the beginning of a long and fruitless effort to liberalize the authority of the Reserve banks to make loans to business enterprises," Hackley wrote. Such politicking would make a modern Fed policymaker blush, but there were a number of attempts to expand the Fed's role in commercial lending—World War II saw new proposals emerge, as did the postwar recessionary years, all of which failed.

It wasn't until the 1950s that the Board of Governors began to shift away from its industrial lending advocacy role. A bill offered in 1951 to liberalize, once again, Section 13(b) was not supported by the Board because of concerns about inflationary impact. This was similar to a 1947 bill that the Board had supported. By 1955, while still endorsing legislation to establish national investment institutions to make long-term loans, the Board started to suggest that the Fed should stay out of the game. Finally, in 1957, Fed Chairman William McChesney Martin exorcised most of the demons of Section 13(b) when he appeared before a subcommittee of the Senate Banking and Currency Committee to discuss the "problem of small business financing":

> *… the Board would favor neither the financing of such institutions by the Federal Reserve by pur-*

chase of stock or otherwise, nor the exercise by the System of any proprietary functions.

… Basically, our concern stems from the belief that it is good government as well as good central banking for the Federal Reserve to devote itself primarily to objectives set for it by the Congress, namely, guiding monetary policy and credit policy so as to exert its influence toward maintaining the value of the dollar and fostering orderly economic growth.

One year later, legislation creating the Small Business Investment Company Act, subject to regulation by the relatively new Small Business Administration, officially repealed Section 13(b), thus ending what economist Anna J. Schwartz has termed "a sorry reflection on both Congress's and the Fed's understanding of the System's essential monetary control function."

It took time, but the Fed came to see Schwartz's point. Thus, over 40 years after its creation, the Fed was again re-creating itself in the image of the original act, but this time—in the likely opinion of most modern viewers—correctly.

Industrial Lending at the Fed

A Legislative Recap

1932 Emergency Relief and Construction Act: Added paragraph 3 to Section 13 of the Federal Reserve Act, opening the discount window to nonbanks "in unusual and exigent circumstances."

1933 Emergency Banking Act: Allowed 90-day advances to nonbanks on the security of direct obligations of the U.S. government, at interest rates fixed by the Reserve banks.

1934 Industrial Advances Act: Added Section 13(b) to the Federal Reserve Act, allowing Federal Reserve district banks to make advances of working capital to established businesses if those enterprises were unable to find such capital from usual sources. These loans were made either in partnership with a commercial bank or directly to a business, with maturities up to five years and no loan limits.

1958 Small Business Investment Act: Repealed Section 13(b).

1991 FDIC Improvement Act: Amended Section 13 paragraph 3 to allow the Fed to lend directly to securities firms during times of emergency.

Depression-era hangover

However, while most would agree with then-Chairman Martin that the Fed should concern itself primarily with a monetary policy in keeping with economic growth (low-inflationary growth, we would stress today), that doesn't mean that the Fed's discount window hasn't come into political play during the ensuing years. Viewed as a source of off-budget funds, it can prove tempting to lawmakers. Schwartz, in a 1992 article, described some episodes:

- The Nixon administration asked for discount window assistance in 1970 in response to the financial problems of Penn Central Railroad. This request stalled in Congress, but the Fed worried that the company's default would spark a financial crisis, and it made clear that it would assist banks that needed help with businesses caught up in Penn Central paper. Schwartz wrote:

  The Penn Central episode fostered the view that bankruptcy proceedings by a large firm created a financial crisis, and that, if possible, bankruptcy should be prevented by loans and loan guarantees: the "too big to fail" doctrine in embryo.

- In 1975, the financial difficulties faced by the city of New York raised questions about whether the Fed might serve as a source of emergency credit. Fed officials cautioned against such an idea and, in the end, the Federal Reserve served only as a fiscal agent for the government's eventual loans to the city. (The Fed also served as fiscal agent for loan guarantees made to Lockheed in 1971 and Chrysler in 1979.)
- In 1991, the Fed discount window was invoked to dispense $25 billion as a direct loan to the FDIC's Bank Insurance Fund. Then-FDIC Chairman L. William Seidman requested the loan, through Congress, but Fed Chairman Alan Greenspan testified in opposition. Undeterred, the Treasury Department made another pitch to Congress for the $25 billion based, in part, on the initial Fed subscription imposed by Congress in 1933, but Congress didn't buy it.

However, the eventual 1991 legislation meant to address the Bank Insurance Fund's problems (the FDIC Improvement Act) amended Section 13 to allow the Fed to lend, in essence, directly to securities firms during financial emergencies. Typically, during a stock market crash, Schwartz explained, banks would lend to securities firms knowing the discount window was available to them (the banks). "In my view," Schwartz concluded, "the provision in the FDIC Improvement Act of 1991 portends expanded misuse of the discount window."

Ten years later, Schwartz's prediction was tested. In the days following the terrorist attacks of Sept. 11, 2001, some observers suggested that—based on the 1991 amendment—the U.S. airline industry could receive emergency loans. "[T]his sector's key economic role and the unpredictable after-effects of September 11 justify putting discount-window loans on the table while discussing the carriers' current crisis," the Financial Markets Center said in a Sept. 18, 2001, statement. The Fed did not make such loans.

One final note on the 1991 changes to Section 13 that broadened the Fed's lending capability to nonbanks in time of crisis. Cleveland Fed economist and general counsel Walker F. Todd wrote in 1993 that this "little-noticed amendment" went against the very intention of the FDIC Improvement Act: "Ironically, while the principal thrust of FDICIA was to limit or reduce the size and scope of the federal financial safety net, this provision effectively *expanded* the safety net."

Section 13(b) is dead! Long live Section 13[3]!

Section 13(b) may be a memory, and a discomfiting one at that, but Section 13 paragraph 3 (that language originally found in a 1932 highway bill) is alive and well in the Federal Reserve Act. As we've seen from the above illustrations, this amendment allows, "in unusual and exigent circumstances," a Reserve bank to advance credit to individuals, partnerships and corporations that are not depository institutions. At least five members of the Federal Reserve Board must agree with the credit advance, and the Reserve bank must show that such credit was not available elsewhere.

To some this lending legacy is likely a harmless anachronism, to others it's still a useful insurance policy, and to others it's a ticking time bomb of political chicanery. Doubtless, the discount window will continue to evolve.

Indeed, the discount window made news again recently when the Federal Reserve approved a rule that sets the discount rate above the federal funds rate to eliminate the incentive for institutions to exploit the positive spread of money markets over the discount rate. One newspaper, when reporting this change, described the discount rate as "largely symbolic," and that's likely true. But it's a symbolism with a long history and latent power that is still available to the Federal Reserve and the federal government. R

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