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Statement by

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before the

Subcommittee on Domestic Monetary Policy

of the

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and the

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Minority Enterprise Development

of the

Committee on Small Business

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I welcome the opportunity to appear before you to discuss the functioning and effectiveness of the small business and agriculture Advisory Councils to the Federal Reserve Banks. The Board of Governors believes that the Advisory Councils have become a valuable part of the informal structure of the Federal Reserve System, and we are joined in this assessment by the Presidents of the Federal Reserve Banks.

I am pleased to be accompanied today by members from the Advisory Councils of three Districts: Carolyn Draper from the Dallas Reserve Bank's Advisory Council on Small Business and Agriculture, Donald Lynch from the Philadelphia Reserve Bank's Small Business/Agriculture Advisory Council, and William Mathers from the Minneapolis Reserve Bank's Advisory Council on Small Business, Agriculture, and Labor. These Council members have just participated in the meeting of the Board with representatives from the Advisory Councils to the 12 Reserve Districts, which takes place in the fall of each year.

The Advisory Councils to the Federal Reserve Banks were established in 1985, with the encouragement of the Congress, for the purpose of improving communication with various sectors of economic activity within each Federal Reserve District. The Board requested that the membership of the Councils include persons from the small business and agricultural communities in the Districts. Other sectors such as community banks and organized labor were also included in some Districts, and their inclusion depended on the then-existing composition of Reserve Bank and Branch boards of

directors, the existing formal and informal forums for contact with different sectors, and the economic diversity of the particular District. The size and composition of each Council were left to the discretion of the Reserve Bank.

From the perspective of the Board of Governors, the Councils have successfully met the objectives we envisioned when they were established. The benefit to the Federal Reserve lies in the ability of the Councils to provide economic intelligence about current developments in the District to their respective Reserve Bank. The Banks have found that the concerns raised at Council meetings have a distinctly regional flavor that is of importance in the interpretation and analysis of data on economic activity within the District.

At the meeting each year with Council representatives in Washington, the Board is informed firsthand of current and emerging developments around the country, and the Council members also confer to exchange views. The discussion confirms the diversity of economic developments and the variety of market pressures across Districts, even within the agricultural sector or the small business community.

I can also report that the Presidents of the Reserve Banks are of the view that the Council members contribute additional information or insight that only "grass roots" sources can provide. Council meetings have provided a forum for a two-way flow of information -- as the Councils learn about the analysis of data that is performed by the Reserve Banks, and the Banks learn about the perceptions and expectations of the small business and agricultural communities that underlie the data. This additional

information has been helpful to the directors of some of the Reserve Banks, who have considered it in conjunction with their discount rate deliberations.

In your letter of invitation to this hearing, the Subcommittee Chairmen have raised a number of questions about the organization and functioning of the Advisory Councils. I have provided detailed responses in an appendix to this statement. However, let me just briefly indicate that, while there is considerable organizational variation across the Districts, the Reserve Banks all consider a wide range of sources of potential candidates for Council membership. All seek diversity in geographic, industry, and other characteristics in their selection of Council members, and all have integrated the Councils fully into their systems for gathering information about economic activity in their District.

The small business and agricultural Advisory Councils to the Federal Reserve Banks are now in their third year of activity. Last year, at the Board's request, the Council members who met in Washington assessed the activities of the Councils in terms of meeting the objectives for improved communication between the Federal Reserve and leaders of certain sectors of the economy. The Council members unanimously agreed that the activities of the Councils are beneficial and should be continued. They believed that, with the Councils, policymakers within the Federal Reserve are better informed of the nature of the concerns of small business, agriculture, and other sectors, as well as the regional diversity of the problems confronting these sectors.

Citing the diversity of issues across Reserve Districts, the Council members also agreed that decisions as to how the Councils should function should continue to be made within the Districts. The Board specifically raised the possibility of formal reporting to the Board, and received a unanimous reply that uniform reporting requirements need not, indeed should not, be imposed by the Board. The Council members felt that flexibility at the District level would best serve the purpose of the Advisory Councils, and that the economic intelligence provided by Council members to the Reserve Banks appropriately makes its way into the policymaking process through the participation of the Reserve Bank Presidents in FOMC deliberations and in other forums. In fact, the Council members argued persuasively that increased formality would be counterproductive to the advisory process that has developed.

The Board appreciates your interest in the Advisory Councils. I will be happy to answer any questions you may have.

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## APPENDIX: Advisory Councils to the Federal Reserve Banks

### I. Administrative features of the Advisory Councils

#### A. Membership selection

##### 1. Appointment/election process

Reserve Banks select Advisory Council members in various ways. At some Banks, the President appoints the members, sometimes with the approval of the board of directors. In at least one Federal Reserve District, the board of directors elects Council members.

##### 2. Recruitment of candidates

Reserve Banks obtain the names of candidates from various sources, including unsolicited resumes, small business associations, agricultural associations, labor unions, women's organizations, current and former directors, existing contacts in the small-business and agricultural communities, newspaper articles, and former Council members.

All Reserve Banks attempt to achieve diversity with respect to geography, gender, race, ethnic origin, economic sector, and nature and size of business or farm.

##### 3. Chairmanship

At most Reserve Banks, the President designates the Council chairman; at a few Banks, the President or a director serves as chairman.

#### B. Conduct of Council meetings

Council meetings typically begin with presentations by Reserve Bank officials on monetary policy and the regional and national economy, followed by a go-around in which Council members report on conditions in their respective regions and industries. The next item on the agenda is typically a brief roundtable discussion of the information presented. The Council then turns to topics suggested by Council members themselves or by the Reserve Bank.

#### C. Number of meetings per year

Most Advisory Councils meet twice per year, but a few meet three or four times.

D. Compensation

Reserve Banks are authorized to pay Council members a fee of up to \$100 per day for meetings in addition to reimbursement for actual expenses incurred, but most only reimburse members for actual expenses.

E. Staffing

Support is provided by the staff of the Secretary's Office, the Public Affairs Office, or the Community Affairs Office of the Reserve Bank. Other Reserve Bank departments provide assistance as needed. Staff support is coordinated by an officer with oversight responsibility for the Councils.

II. Nature of contact between Advisory Council members and Reserve Banks

Contact between Council members and Reserve Banks takes various forms, including the following:

- Reserve Bank officials solicit information and views from Council members for the Beige Book (a summary of economic conditions prepared by the Reserve Bank prior to an F.O.M.C. meeting), and for surveys and other projects.
- Council members regularly take the initiative to provide information and views to Reserve Bank officers and/or to the board of directors.
- Council members are invited to various Reserve Bank lunches, conferences, and meetings.
- Numerous Reserve Bank officers and staff members attend every Advisory Council meeting.
- Directors attend Advisory Council meetings.
- At some Reserve Banks, a director serves as chairman of the Advisory Council.
- Reserve Bank officials regularly make oral and written presentations to the board of directors on the Council's deliberations.
- The Chairman and/or other members of the Council meet with the Bank's board of directors.

III. Comments by Federal Reserve Bank officials on the value of the Advisory Councils to the Reserve Banks

"[Reserve Bank] economists benefit from discussion of local industries, particularly agriculture, and from comparisons between published data and grass-roots observations. Views offered provide a supplement to the Beige Book [a summary of economic conditions prepared by the Reserve Bank prior to an F.O.M.C. meeting] and very sensitive insight into local labor market conditions."

"The Council provides an opportunity for the Bank to become acquainted with potential future directors. The directors have shown considerable interest in reports on [Council deliberations]."

" . . . it provides a regular forum for senior [Reserve Bank] officials to learn about conditions in the small business and agricultural sectors and to exchange with them views on current economic conditions."

"The Bank's president, the Research officers and other staff members receive valuable information about economic conditions in specific industries and areas of the District, and about the ideas and opinions of business and agricultural leaders."

"Our Small Business/Agricultural Advisory Council was established to provide a two-way flow of information and we think it has been very successful in meeting this objective."

"This [Reserve] Bank finds the Small Business Advisory Council useful in obtaining anecdotal evidence about current economic activity in the District. The person who prepares the Beige Book for the Bank attends the meeting and often members' comments are used in articles prepared for the Beige Book. When the Beige Book focuses on a specific issue, such as the effect of the decline of the value of the dollar on our District, members are asked to comment on the issue."

"Through the Council, this [Reserve] Bank has made valuable contacts in the small business community."

"The reports on the Council meetings that the president has made to the Board of Directors have provided the Board with additional information about the District's economy. The directors have generally found this information helpful."

" . . . selected members of the Advisory Council . . . serve as a source of information for [reports] on District economic conditions."

" . . . the Council serves as a valuable link with the small business and agriculture community in the District and . . . members of the Council provide economic and financial information that the Bank often would not receive through traditional sources."

"The Chairman of the Council usually meets twice each year with the [Reserve Bank's] board of directors to discuss concerns and issues raised by the Council . . . it appears that the [board of directors] is favorably impressed with the work of the Council."

"The formation of the Council met the objective of providing increased communication between the [Reserve] Bank and small business, farm, and labor groups . . . and the meetings have provided useful exchanges of information and points of view . . . Indeed, the Council has proven most helpful to the Bank in providing a regular channel for bringing the concerns of small business owners, farmers, and organized labor to the attention of the Reserve Bank and [in] developing a closer dialogue with members of these important sectors. Information gained from the Council has enhanced the economic intelligence used by the Bank's . . . president in recommending and formulating monetary policy."

"Council members provide first-hand, grass-roots information on current conditions and economic developments and prospects in the . . . District, especially as they relate to small business and agriculture. The information they provide . . . serves as a valuable supplement to the Bank's various sources of regional economic information and thus provides very useful input . . . in connection with economic policymaking."

"Input from Council members provides a District-wide, grass-roots perspective of problems affecting small business and agriculture. This perspective, which includes insight on particular operations unique to the District, also provides our . . . economists useful data for analysis of District trends."

" . . . their role has been extremely valuable especially in underscoring the local impact of national and international policy actions."

"The information provided to directors has been valuable . . . The periodic meetings between Board members and Council members are particularly valuable in forming or confirming Board perspectives on the implications of policy for particular sectors."

"It is difficult to quantify or qualify the value of the Council . . . The Council does represent additional sources of input to the Bank and its Directors, but it is difficult to justify at times why special emphasis is being put on agriculture and small business when both areas are well-represented on our . . . Boards of Directors. Also the Bank's staff has diligently worked to make contacts in the community which represent a balance of all sectors, and the Council may create the appearance of bias . . . "

"Council meetings and other contacts with Council members provide useful additional 'grassroots' and anecdotal reports on District economic developments and the impacts of various public economic policies."

"The anecdotal economic information provided by the Council has proved to be a valuable source of input to the Bank for gauging regional economic conditions and is used for FOMC purposes and in making recommendations for the Board of Directors regarding discount rate actions."

"Council members provide . . . a flavor of conditions, especially in the rural and small communities of this District. They also provide hands-on experience from individuals directly involved in the management of small business activities and agricultural production. This tends to provide focus to the Bank's overall assessment of the District's conditions and provides some basis for determining where and how the Bank's resources should be deployed for carrying out the Bank's mission. Council members have been instrumental in improving the Research Department's awareness of important pressure points and issues that require additional research effort . . . "

"Council members provide . . . additional input to the Bank's Board of Directors on conditions throughout the District in general and, to some extent, how well the Bank is performing its responsibilities."