The Role of a Regional Reserve Bank

remarks of
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to the
Policy Advisory Board
of the
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You have honored me with your invitation to address so distinguished a group as the Policy Advisory Board of the Joint Center for Urban Studies of those two justly revered educational institutions, Massachusetts Institute of Technology and Harvard University. To repay you for that honor — and for the pleasure of a visit to this charming corner of the Sixth Federal Reserve District — I shall attempt to sketch out for you a verbal picture of the role of a regional Reserve Bank within the Federal Reserve System. In particular, I shall discuss the regional banks' role in shaping monetary policy, as I believe that role should be more widely understood.

Before we immerse ourselves in monetary policy, however, perhaps I should briefly mention those areas in which the regional Reserve Banks play more visible roles. From the perspective of the nation's depository institutions, these are, in fact, the Fed's most prominent roles; they require a great deal more in the way of human resources and physical facilities than does monetary policy. I refer, of course, to our roles as a supervisor and regulator of financial institutions and as a provider of a wide range of financial services for these financial institutions and the United States Treasury.

The Fed is part of a tripartite federal banking regulatory apparatus. It shares its supervisory role with the Comptroller of the Currency and with the Federal Deposit

Insurance Corporation. Other supervisors on the scene are the Federal Home Loan Bank, which supervises the savings and loan associations; the National Credit Union Administration, which supervises the credit unions; and the supervisory agencies of the 50 states. The Fed's responsibilities include all state-chartered banks that are members of the Federal Reserve System, all bank holding companies, domestic institutions engaging in any form of international banking or investment, and foreign institutions with banking offices in the United States. That may change within the reasonably near future; you have probably heard a good deal about the recommendations of the task force recently headed by Vice President George Bush. Those recommendations are now in the hands of Congress, and it is too early to predict just what the outcome will be. The recommendations, however, envision a somewhat different but perhaps even larger supervisory role for the Fed in the future. Whatever form the final restructuring may take, the Federal Reserve seems likely to continue to play an important part in assuring the nation that its banks are sound and well managed in compliance with applicable regulations. I personally believe that it is most appropriate for the nation's central bank to play a major role as a regulator of financial institutions.

Closely related to our supervisory role is our role as a "lender of last resort." This, of course, is a function of what has become known as "the discount window." Through the discount window, the Federal Reserve extends short-term credit to enable depository institutions to adjust to temporary reserve deficiencies or to adjust to the seasonal problems that may arise in areas with economies dependent on agriculture or tourism. As the lender of last resort, the Fed occasionally provides longer-term credit to allow a bank time to correct a more serious problem. If the problem cannot be corrected, credit may be extended to allow the supervisory agencies time to arrange an orderly liquidation or sale of the ailing institution.

The Fed's discount rate, of course, determines the cost of the loan to the borrowing institution, but it is also generally considered to have an important secondary function. Changes in the discount rate have come to be generally interpreted as signals of the Fed's intentions with regard to monetary policy. For this reason, changes in that rate usually set the financial press and even the general media abuzz.

As a provider of services to financial institutions, the regional Reserve Banks offer a varied menu of the basic services those institutions must have in order to serve their customers. We provide currency and coin, collect checks and items such as bond coupons, and provide securities services. We also handle electronic fund transfers for them, and we function as the automated clearinghouse for the electronic transactions that are slowly displacing the conventional paper check. In addition, they use their accounts at the Fed to settle with each other for their interbank transactions. To give you an idea of the volume of some of those operations, just within the Sixth Federal Reserve District — the area served by the Atlanta Fed — incoming cash deposits in 1983 exceeded $2 billion. The checks we processed totaled well over $1 trillion, and wire transfers of funds aggregated some $6 trillion.

For the United States Treasury, the Fed functions as both bank and financial agent. As the Treasury's bank, we receive tax revenues and other federal income, crediting it to the Treasury's account. When Uncle Sam pays the nation's bills, the checks are charged against that account. As fiscal or financial agent, we help the Treasury borrow whatever funds may be needed to finance the government's operations — and it surely must be the world's biggest business. The government borrows by selling securities, of course; we are the agents who solicit tenders for those securities, receive the bids, then issue, service, and finally redeem the securities. The facilities we have developed for this purpose also enable us to provide our securities services to depository institutions, since those institutions are important buyers and sellers of government securities. When they sell government securities to a distant bank, for example, the securities can be transferred to the buyer through the Fed's wire transfer service; wire transfers of securities through the Atlanta Fed in 1983 totaled well over $700 billion. And depositories may elect to have us serve as custodians of their securities portfolios; we will automatically collect the interest as it becomes due and will redeem the securities at maturity, crediting the proceeds to the owner's account. At the end of 1983, we were holding some $60 billion worth of securities for our customers.

Those operations are vitally important to the smooth functioning of our financial system, and they provide some fascinating sights for those who tour our operations. But I am sure you would agree that the Fed's most important role falls under the heading of monetary policy. Monetary policy affects the buying power of those billions and trillions of dollars we have been talking about. Monetary policy indirectly affects the economic climate within which all business people make their plans and execute their strategies. Of particular concern to you, I should think, is monetary policy's effect on the resources available for urban development. And every one of the 12 Federal Reserve Banks and their branches in the major cities of our nation plays an important part in shaping monetary policy. That is the role I want to discuss with you at some length today.

Within the Federal Reserve System, the body that is responsible for shaping monetary policy is known as the Federal Open Market Committee — the FOMC, for short. The FOMC consists of all 7 members of the Reserve System's Board of Governors plus 5 of the 12 Federal Reserve Bank presidents. The governors are appointed by the President of the United States, with the advice and consent of the Senate, ~~so the~~

~~administrative branch of the government has a voice in shaping monetary policy.~~ It ~~should be noted, however, that the administration represented is not always the current administration.~~ So far, the Reagan administration has had the opportunity to fill only 2 of the 7 slots on the Board of Governors. At present, the only Reagan appointee serving as a governor is Preston Martin, vice chairman of the Board of Governors, although there are rumors that the President has decided on a successor to Governor Nancy Teeters and will make the announcement any day, now. Although Mr. Volcker was redesignated as chairman by President Reagan, it was President Carter who initially appointed him. F~~ive of the current governors were appointed by earlier Presidents, and most of them by a Democrat.~~ I mention this because it is often alleged that the FOMC bows to administration pressure during election years to do a bit of window-dressing that will improve an incumbent President's chances for reelection. Presidents may, in fact, be tempted to exert that pressure, and not all Presidents may successfully resist that temptation. However, the present system makes it highly unlikely that an incumbent President, during his first four years, could stack the Board of Governors with hand-picked governors who would do his bidding. Federal Reserve governors serve staggered, 14-year terms, so only two vacancies will normally occur during a presidential term. I think we may all be thankful that the governors are insulated from short-run political pressures. Even the election year of 1980, when the Board of Governors consisted largely of Carter appointees, may serve as a testimonial to the System's integrity; we need no reminder that the deterioration of the economy contributed importantly to President Carter's defeat. I recall no convincing evidence of window-dressing then, and I see none now.

The fact that 5 Federal Reserve Bank presidents serve on the FOMC also contributes to its insulation from short-run political pressures. Fed presidents are chosen by their Reserve Bank's Board of Directors with the approval of the Bd of Gov. Those directors are regional leaders who represent a variety of business interests as well as a broad range of economic and social interests. Neither they nor the Fed presidents could logically be said to be particularly vulnerable to election-year pressures. I shall have more to say later about the Fed directors' place in the System's scheme of things, because I believe they make a much more important contribution to the shaping of monetary policy than is generally realized.

The president of the Federal Reserve Bank of New York is a permanent member of the FOMC. The other 4 voting memberships rotate among the presidents of the other 11 Feds. For example, the Atlanta Fed shares a voting membership with the Dallas and St. Louis Feds. The Atlanta Fed last had the vote during the 12-month period ending in March 1983, and the Atlanta Fed's president will again become a voting member about this time next year.

However, Federal Reserve Bank presidents do not lose their voices when they lose their votes. Voting or not, they attend every meeting of the FOMC and contribute to the information and deliberation that regularly shape and reshape monetary policy to keep it responsive to the changing economic situation.

It is obvious that this process must be based on a substantial volume of current and accurate information about what is taking place in virtually every sector of the economy in every part of the nation. It is probably much less obvious that a great deal of this information flows into the FOMC through the 12 regional Reserve Banks and their presidents.

At the Atlanta Fed, we have two major sources of information relevant to monetary policy. One is our economic research program, the other is our directors.

These sources complement each other quite effectively. The economic research program is relatively formal, scientific, objective, and commendably deliberate. One of its approaches relies on sifting and interpreting large volumes of statistical and factual data to develop a neatly quantified picture of the economy. On the other hand, our program for collecting information through our directors is less formal and somewhat more subjective. It usually provides anecdotal evidence, but it takes advantage of the tremendous experience and judgment of our directors and it is <u>current</u>. It is <u>today's</u> view of a particular sector as seen through eyes trained by years of experience to notice such things as incipient trends that have not had time to show up on anyone's charts. I will return to our directors later, but first I want to fill out the sketchy picture I have given you of our research program.

At the Atlanta Fed, our economic research program places heavy emphasis on regional economic analysis. Our largest research team, in fact, is labeled the Regional Team. As its name suggests, it studies all aspects of the Southeast's economy. Our district includes all of Alabama, Florida, and Georgia, and parts of Louisiana, Mississippi, and Tennessee; however, our interest extends into neighboring areas, since economic activity is blind to boundary lines. Our Regional Team is constantly screening data on agriculture, commerce, manufacturing, construction, transportation, imports, exports, government, public utilities, employment and unemployment, average hours worked, demographics, and anything else that may improve our understanding of what is taking place and why. They do not rely on statistics alone, but regularly contact informed sources throughout the region to glean additional facts and insights.

Our research program's emphasis on regional studies pervades other teams, as well. For example, the team that focuses on financial institutions keeps a particularly close eye on developments affecting the banks, savings and loan associations, credit unions, and international banking organizations of the Southeast. Another team closely follows the nation's rapidly evolving payments system, a system that increasingly uses electronic payments made through automated clearinghouses and interfacing computers linked by thousands of miles of wires; while this team's attention is on a particular subject rather than on a region, many significant payments system developments are occurring in the Southeast, particularly in Florida.

One team has a nonregional perspective because its assignment is to track the national and international economies. We call it the National Team. The members of this team coordinate the preparation of briefing materials for me prior to each FOMC meeting. They are our monetary policy specialists.

Unique within our research program is what we call our Database Team. This team has two main concerns; the first is broadening our pool of data and the second is accelerating the analysis of that data. With respect to that second goal, the team's efforts have produced results that have drawn national attention. They have done some pioneering work in the use of microcomputers to cut the statistical lag that has always hampered attempts to monitor economic activity.

Senior economists with doctoral degrees need no longer wait while research assistants run time-consuming regression analyses; the economist has in his own office a computer that makes short work of the problem. Meanwhile, the research assistants can be doing more important and rewarding work on their own computers. Our experience has been that our staff finds this a stimulating experience. It removes much of the drudgery and delay from the task of statistical analysis, and it frees the mind to grapple with the concepts rather than to struggle with the mechanics.

Our Publications and Information Team, which is responsible for sharing the results of our economic research with the outside world, is aided by a sophisticated word processing system. Their main publication is our monthly Economic Review. One of their specialties is making complex material both interesting and intelligible to business people and bankers. Articles prepared by other teams are copied into the Publications Team's word processing system to expedite editing. When the article is ready for publication, it is transmitted directly into a computer-controlled phototypesetter. This produces camera-ready proofs without having to type the text into another keyboard. That phototypesetter paid for itself in less than a year in reduced typesetting costs alone, and it has also saved us a great deal of time.

I have brought with me a supply of the most recent issue of our Economic Review to give you an idea of the nature of our research and our effort to share it with the public.

Now let me return to the role of our directors. There are 9 directors of the parent organization in Atlanta, and 7 on the board of each of our branches in Birmingham, Jacksonville, Miami, Nashville, and New Orleans. That makes a total of 44 directors who live and work throughout the Sixth Federal Reserve District. They represent banking, commerce, industry, the legal profession, public service, labor, the academic world, journalism, and — over time — virtually every calling that exists in our complex society. Each one of them has risen to a position of preeminence in his or her field as a result of demonstrated ability. Most are also civic leaders deeply involved in the charitable, cultural, and developmental programs of their communities. They are, in short, the sort of people whose opinions, insights, judgments, and even intuitive hunches can provide an extremely valuable supplement to the formal research carried out by our economists.

Our board meets only once a month, but our directors are available for consultation whenever needed. We remain in touch with many of our past directors, too. Furthermore, through an ongoing program of business leaders' meetings, we constantly develop new contacts with still others of proven judgment and experience.

Before each meeting of the FOMC, I am thoroughly briefed by our economists. In addition, I carry with me a great deal of information imparted by this remarkable group of counselors, our directors. The other Fed presidents are similarly prepared by their economists and directors. The result is a monetary policy-shaping organization that, in effect, can see into virtually every sector of the economy and every region of the nation through eyes that are trained to see more than the average person might see — and to interpret it more perceptively as well. I cannot conceive of any centralized bureaucracy that could match the wealth of informed judgment that this structure brings to bear on monetary policy.

A moment ago, I briefly mentioned our regular meetings with business leaders. Some of these meetings are built around speakers eminently worth hearing — speakers of the caliber of Paul Volcker, Preston Martin, Sir Oliver Wright, the Ambassador of Great Britain, and Congressman Newt Gingrich, as well as many of equal stature from the private sector. This program, therefore, not only reinforces our ties with the business leaders who come to hear these speakers, it also broadens their exposure to the world of ideas and facilitates the dialogue that generates the new ideas on which we all depend. We have also initiated another series of somewhat similar meetings that will be held at various sites around the Sixth District and are designed to foster discussion of current economic issues with leading citizens of the area.

Another way we contribute to that dialogue is through our program of conferences on current issues in economics and banking. Perhaps the best example was our conference on supply-side economics, which we held early in the Reagan administration, when the entire nation was struggling to understand the concept. At that conference, speakers such as Milton Friedman and Lawrence Klein, both Nobel laureates, attracted hundreds of participants, as well as journalists representing most of the nation's major business publications. Next month, we will hold our sixth conference of this type, this time exploring the question of how businesses may compete beyond the 1980s. It will offer perspectives from high-performance companies that are already thinking years ahead of most.

In addition, we are involved citizens of the communities within which we operate. For example, I am currently serving as chairman of a group of local bankers who are providing guidance and funding for an innovative program within the Atlanta public school system. This program offers specific job training for high school students interested in careers in the financial services. It is proving to be particularly helpful to disadvantaged students, and we have good reason to hope it will substantially improve the quality of their lives.

With that, I think I have sketched out the role of at least one regional Reserve Bank in reasonable detail. Having heard me out, I hope you would now agree that the Federal Reserve System's insulation from short-term political pressures must be preserved, and that the role currently being played by the Reserve Banks contributes importantly to that insulation. I believe it also adds tremendously to the quality of the information upon which decisions on monetary policy must be based.