

**THE ROLE OF THE REGIONAL FEDERAL RESERVE BANK**  
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I am very pleased to be here today to speak with you about the role of the regional Reserve Banks of the Federal Reserve System. I will also speak briefly about the economic outlook for the United States and its various regions, particularly the South, which is the District covered by the Federal Reserve Bank of Atlanta.

It is also a pleasure for me to be in a country that boasts one of the most independent central banks in the world. In my recent travels to China and Latin America, I have found myself more often preaching the importance of the independence of central banks to countries that are struggling with economic reform. According to a recent study by Harvard economist Robert J. Barro, the central bank of Denmark ranks fifth in terms of its independence, compared with 66 other countries. In that same study, the United States ranks eighth.

As you may well understand from the short history of the United States, independence in its most general sense has always been our guiding light. Our country was created to achieve independence from the king of England. At the same time, we wanted to ensure the freedom to pursue our lives without too many strictures from a centralized government, even one without a royal personage. Thus was born federalism and a sharing of power between the federal government and states.

Fundamentally, the United States has always been a country made up of individualists who do not like to give power to one person or one body to be able to tell us what to do. This American character was probably developed because we have a heterogeneous population, thanks to immigration, as opposed to a homogenous population, like that in many European countries. This same streak of independence was crucial in the formation of our central bank and was also responsible for the form the Federal Reserve System took: a centralized element in the Board of Governors and a decentralized network of 12 separately operated Federal Reserve Banks.

### **Brief History of the Federal Reserve**

In order to discuss the structure and role of the regional banks, let me first set the stage by briefly describing the beginnings of the Federal Reserve, which was founded in 1913. The United States had had a central bank earlier in its history, but after about 40 years, its charter was not renewed for both economic and political reasons. The Bank of the United States, as it was called, kept money and credit rather tight after the Revolutionary War, in which the United States gained its independence from Great Britain. That strategy was deemed necessary because the revolutionary government had printed considerable amounts of money to finance the war, and inflation was the inevitable result.

Farmers throughout the United States and entrepreneurs who were starting new businesses in the western frontier were not enamored of this tight money policy, though. With their ongoing need to borrow to finance seeds, tools, or new ventures, they preferred readily available credit and did not mind moderate inflation. In addition, these populists did not like having a single

institution wielding so much power over their lives. As a result, the Bank of the United States did not survive past the 1830s. During the next 70 years, the United States had an inelastic currency and a series of financial panics that many people believed led to recessions and depressions.

Following the especially severe financial panic in 1907, a consensus began to develop that the nation needed a mechanism to provide an elastic currency. The U.S. Congress set up a special commission that recommended a European-style central bank with considerable independence from the political authorities. But--and this should come as no surprise--many Americans were adamant about having some public control over this new monetary authority. Therefore, the institution they created was a blend of public- and private-sector representatives that was, and is, quite decentralized.

And how did Congress solve the problem of creating a central bank that was independent from political pressures and yet also accountable both to the government and to individuals in society? It did so by creating a structure that parallels the federal structure of American government, in which power is shared between national and regional authorities. At the national level, Congress established a Board of Governors who are appointed by the president of the United States and are subject to congressional approval. In addition, the chairman of the Board of Governors must report to Congress every six months on the outlook for the economy and monetary policy. Ultimately, the accountability of the Federal Reserve to the government is preserved because Congress also has the power to alter or even to abolish the system at any time.

The issue of independence from political pressure was addressed by having the terms of service for each governor run for 14 years. In theory, then, the Board should be insulated from day-to-day swings in political sentiment.

To balance this central oversight by the Board of Governors in Washington with regional and private-sector input, Congress created 12 districts to be served by Federal Reserve Banks. In essence, these regional Banks are the operating arms of the central banking system. One role they play is to carry out the mandates of Congress--as interpreted by the Board of Governors--in the areas of supervision and regulation of banks and the payments system. In a more independent vein, the Reserve Bank presidents, who are not political appointees, also bring a unique insight to monetary policy issues from their in-depth knowledge of business conditions in their own districts to the Board of Governors. You might think of this as the influence of populism within the Federal Reserve System.

Each Reserve Bank has its own corporate charter and board of directors drawn mostly from the private sector. Of the nine directors of each Reserve Bank, three represent banks and six represent the public. These directors oversee management of the Reserve Bank and help to formulate monetary policy. These features should make it clear that Federal Reserve Banks are much more than merely regional offices of the Board of Governors. These features also highlight how the Federal Reserve System was designed to keep the central bank insulated from day-to-day political pressures.

## **The Role of the Regional Federal Reserve Banks**

Now that I have given some background on how the Federal Reserve System came to exist in its present form, let me move on to the role played by the regional Reserve Banks. A Federal Reserve Bank like the one in Atlanta is involved in three main businesses: monetary policy, financial services, and supervision and regulation.

The first important role the regional Banks play is contributing to economic growth with stable prices through the formulation and implementation of monetary policy--a point I will discuss further in a few moments.

The second role, providing financial services, is the largest of our businesses in terms of resources and employs the bulk of our employees. Reserve Banks foster an efficient and safe payments system by providing financial services for depository institutions and the federal government. The Banks supply and process cash, clear checks, and transfer funds and securities electronically. Obviously, we are the sole provider of currency and coin, but the Federal Reserve has also long played the lead role in check clearing, even though the private sector also clears checks. Compared with most European countries, where a few large banks dominate the industry and may clear most checks among themselves, the United States has more than 11,000 banks. As a consequence, the Fed is a major service provider in this area. Thus, the Federal Reserve Banks serve as a "banker's bank." Reserve Banks also serve as the "government's bank," or fiscal agents for the U.S. Treasury, by holding auctions for securities, maintaining Treasury Department checking accounts, and clearing checks drawn on that account.

The third important role the regional Banks play is to promote safety and soundness in the U.S. financial system by supervising and regulating the activities of bank holding companies and certain commercial banks. They also supervise U.S. activities of foreign banks and foreign activities of U.S. banks. In addition to these supervisory duties, the regional Reserve Banks conduct research and make recommendations on applications for bank mergers and acquisitions. They also examine banks for their adherence to certain consumer protection laws passed by Congress, such as the Community Reinvestment Act, which was mandated to ensure that banks meet the credit needs of the entire community within their markets. Without the hands-on knowledge of banking that Reserve Bank staff obtain from regular interaction with large and small banks, our understanding of the financial system would soon become abstract. We would quickly lose our insight into the pressures, demands, and changes taking place in the vitally important process of credit intermediation.

### **The Particular Role the Atlanta Fed Plays**

To give you a better sense of what a regional Reserve Bank does on a daily basis, let me talk briefly about some of the activities we undertake at the Federal Reserve Bank of Atlanta. On a personal level, I spend a good deal of my time meeting with people in the region who can give me their insights about their businesses and the local economy. Some of these meetings take place informally when I am giving a speech or attending a conference, for example, and I strike up a conversation with some of the those in attendance. Other meetings are more formal, as when I meet once a month with our Board of Directors who represent different interests in the region--or when I visit groups of business and community leaders in different cities around the

Southeast. I also meet regularly but less frequently with two other groups: one that has representatives from small business, agriculture, and labor, and one that has representatives from commercial banks, thrifts, and credit unions. I do not think I will be giving away a trade secret to let you know that I first got an inkling of the so-called credit crunch problem that was developing during the 1990-91 recession not from statistics but from my meetings with members of these groups, some of whom were quite vocal about the problems they were facing in finding credit.

Besides being keenly aware of the economic issues facing those who live and do business in the South, we have also worked hard to expand the definition of regional to include international relations. It has long been my belief that free trade and international development can go a long way toward strengthening a regional--and a national--economy. To that end, we have promoted the idea of strong international relations by hosting lunches and dinners with the local consular corps and visiting foreign dignitaries. Last year, for example, five distinguished international figures spoke to audiences of Atlanta business, academic, and community leaders. Chief among these speakers were Mary Robinson, the president of Ireland, and Harri Holkeri, former prime minister of Finland.

We have also sponsored several conferences on international themes, including one last year on the topic of "Latin America and the Caribbean: Opportunities for Trade and Investment." Since we have attracted a fair number of international visitors from central and commercial banks in countries like Peru and Russia, we have also established an Office of International Relations

to coordinate these visits. In addition to this kind of international spadework, our Bank has responded to the mandate from the U.S. Congress, via the Foreign Banking Supervision Enhancement Act, to play the lead role in supervising international banks that wish to do business in the United States. In this regard, the Atlanta Fed has been assigned responsibility to be the specialist within the Federal Reserve System for most of Latin America and the Caribbean. This responsibility entails developing a broad and deep knowledge of the economic and financial systems of these countries.

Another important area of expertise for our Bank is financial services. Some of you may be aware that Congress recently approved nationwide banking, allowing banks in one state to expand to another by adding a branch rather than having to purchase an existing bank. Before, there had been regional pacts that restricted such expansion. In this new era of nationwide banking, the Atlanta Fed is leading the effort toward consolidating our financial services so as to make them more useful for commercial banks that are expanding their geographic scope. Up until recently, you see, each regional Reserve Bank had its own policies for its region. This system worked fine under the old state-based system but would be hopelessly cumbersome and archaic under the new rules.

Finally, I would like to mention two other ongoing efforts of our Bank that help the public to understand what we do and keep the Bank in the public eye. We regularly publish the research of our 15 or so staff economists in terms that a non-academic person can understand. We also provide three periodicals on the topics of finance, economics, and regional news for the general

public and media. One of our most impressive efforts recently was a financial derivatives reader, which gathered our most up-to-date research on this subject into one book. The last item I would like to mention is our commitment to being a good corporate citizen. In this respect, members of our staff have contributed their time to enhancing the cities in which we have our headquarters and our five branches.

### **The Reserve Bank as a Link Between the Regional and National Economy**

Now that I have explained some of the programs at our Reserve Bank, let me return to the role the 12 Reserve Banks play in monetary policy. I see that role as being a link between the regional and national economy; between real people who have businesses in places like Birmingham, Alabama, and Miami, Florida, and the legislators and civil servants in Washington, D.C. Originally, the most important function carried out by the regional Reserve Banks was to set the discount rate for their regions, resulting sometimes in different rates for different regions. As the United States shifted from regional credit markets to a national credit market, though, we have also moved to a national discount rate. This rate is suggested by various regional Reserve Banks and becomes official once approved by the Board of Governors. Although the discount rate no longer serves the same purpose, it is still important because it can often signal a lasting shift in monetary policy.

But, by far, the most important role the regional Reserve Banks play in monetary policy is through the Federal Open Market Committee, or FOMC. The forerunner of this committee was actually created by the regional Reserve Banks in 1922 to coordinate their open market

operations. In 1935 it was formalized by Congress and its membership modified with seven governors and the president of the New York Fed having a permanent vote on the FOMC, while the other Reserve Bank presidents rotate the vote among four of them each year. Again, we can see how the Fed has been structured to reflect the deep-seated American distrust of centralized authority.

At any rate, since the other 11 Reserve Bank presidents and I take the pulse of the American economy by talking directly with those people who make our economy run each day, we are well qualified to contribute to the debate on the direction of monetary policy. I firmly believe that this system of combining the hands-on knowledge of the Reserve Banks with the more centralized structure of the Board of Governors serves our nation extremely well. In this fashion, the Federal Reserve manages to incorporate the views of the minority with those of the majority to find a balance that serves the whole country better.

### **The U.S. Economy**

Now that I have covered the role of the regional Reserve Banks, let me turn quickly to the U.S. economy to set the economic context for the regions. Growth in U.S. output last year was 4 percent, and this year also looks like another good year, but with a more moderate growth rate of about 3 percent on an annual average basis. Considering that the U.S. expansion has been going on for four years, a slower rate of growth this year is absolutely appropriate and necessary. In fact, we welcome this development since we would like to ensure that current pressures on prices will prove to be a temporary and cyclical phenomenon. With growth decelerating, it is unlikely that the unemployment rate will decline much further. My best guess

is that it will be close to 5-1/2 percent, but it could run above this level at times. Inflation may rise to somewhat above 3 percent, since price pressures tend to increase as the economy operates at capacity over time.

As has been true the past few years, the main areas of strengths and weaknesses in the U.S. economy will not change much in 1995. Certain components of gross domestic product that have been growing strongly through 1994, such as personal consumption, capital spending, and construction, will still be growing--but at a slower rate.

The same holds true in the area of investment by businesses in productive capital, such as plant and equipment. Capital spending has been growing in the double-digit range for two years now. Although this investment will be decelerating, it is a retreat from a very high pace. I would like to add that this aspect of growth is quite significant. That is because it expands the capacity of the economy, a matter which is quite vital at this time when we seem to be very near our capacity--whether measured in terms of the unemployment rate or factory use. This rapid addition to productive capacity can help to temper price pressures from strong demand.

Government spending is likely to be flat after shrinking somewhat last year. Ongoing pressure to reduce the federal budget deficit should help to keep government spending down.

In the area of foreign trade, a number of issues should affect U.S. exports and imports. With U.S. economic growth decelerating, demand from domestic sectors for all goods--imported

goods as well as those produced in the United States--should slow. Many European economies are on a moderate growth path now, while the dollar is lower than it was last year at this time. These circumstances should help our net export position.

On the negative side, the Mexican peso depreciated considerably in the early part of 1995. The currencies of some other Latin American countries have also been under pressure at times. This development, along with more restrictive economic policies in that country and possibly others in Latin America, will probably restrain demand for U.S. exports from those areas. However, I should point out that although this situation will have a negative effect on trade, it should not be a huge negative effect because exports to Latin America are a relatively small part of U.S. trade. In broader terms, I can say that the gap between exports and imports should not get much bigger during this year and may actually begin to narrow toward the end of the year.

Overall, then, the U.S. economy should be healthy, although it is true that some areas will not be growing as quickly as before.

### **Regional Economic Outlook**

Now let me move on to the regional economies in the United States. The western states were hit particularly hard during the last recession and are also affected negatively by cuts to the U.S. defense budget. Many of the military bases that are slated to close are in the West. However, the economy in this region, which has a strong agricultural and electronics manufacturing base, did finally rebound from the recession and has been growing moderately.

The part of the Midwest that is heavily agricultural has been beset off and on by floods. However, this area basically is doing fine and exporting much of what it produces. The industrial Midwest has been transforming its economy over the years from one dependent on manufacturing, particularly of automobiles, to one that is becoming more versatile as an exporter of sophisticated equipment. In the northeastern United States, it has been a long and slow climb out of the sharp drop in real estate activities that followed the boom of the 1980s. The region has also been affected by cutbacks in civilian military expenditures.

Let me now go into more detail for the South while giving you my economic outlook. The South is a region that has moved from an agrarian economy to a manufacturing-based economy and is now, like the United States, proceeding toward a service-based economy. Its recent economic performance during and after the recession has been nothing short of spectacular. After three years of leading the nation in job growth, the southern region will see a leveling off of employment creation through the rest of 1995. However, the South should still enjoy healthy job growth this year. Gains in employment in our Federal Reserve District have slowed from a peak of 3-1/2 percent in 1993 to around 3 percent annually last year. Payroll expansion may continue to decelerate modestly to a rate of about 2-1/2 percent to 3 percent during this year. Although the nation had been lagging behind the South, the two have converged a bit of late.

Since the recession, the South has shown strength because it is home to a concentration of industries that grow quickly when the national economy emerges from recession. One of these areas is durable goods purchased by consumers. Building-related industries, such as wood

products, furniture, and appliances as well as textiles used for carpets, draperies, and the like, have benefited from the growth in residential construction, both in the South and across the nation. Although construction and manufacturing of consumer durables helped the South to outpace the country early in the recovery, it is still wise to remember the cyclical nature of these major industries. Fortunately, the South can depend on a strong underlying, or long-term, growth trend thanks to some demographic factors, such as the continued in-migration of people and businesses from other regions of the country, as well as a diversified economy and dynamic industries, including the service sector. Health care, business services (such as temporary agencies), and tourism account for the bulk of these new service jobs. Employment in these services stopped accelerating in 1994 but has maintained a strong growth rate of about 6 percent. These service jobs should continue to grow at a faster rate than manufacturing in 1995.

The two states in the district of the Atlanta Fed that have the brightest outlook are Georgia and Florida. The upcoming Centennial Olympic Games, which will be held in Atlanta next summer, are spurring a great deal of construction, ranging from housing for athletes to the Olympic stadium--not to mention the ancillary construction for retail, vendors, and tourism that will expand because of the Games. Although this construction is an obvious sign of economic growth, it will account directly for only a small portion of the overall growth in the state. Tourism in Florida, an important part of the economy of that state, has strengthened this year after a down year in 1994, which followed a period of economic weakness abroad. The other states in our region should continue to expand moderately although not at the pace that Georgia and Florida will.

The one new characteristic of the southern economy that I might mention is automobile and parts manufacturing. BMW has located a plant in South Carolina, Nissan and Saturn are in Tennessee, Georgia has long been home to GM and Ford, and Mercedes will be building in Alabama. This renewed economic development comes in the face of the continuing decline of the mostly rural apparel industry, which has been hit hard and continues to lose jobs, mainly to the Pacific Rim countries.

### **Conclusion**

In conclusion, in a country as large as the United States, it is important to recognize the differences among the regional economies while also remembering that these parts are intricately linked in the whole of the U.S. economy. I believe the role played by the regional Federal Reserve Banks fits the needs of our nation very well. Without such a decentralized structure, the Federal Reserve System would not be so well informed as to the conditions of each of the regions in the United States nor so responsive to the differing views of the people who live in these regions. I am proud to have served as a representative of the business people, bankers, and community leaders who make up the southeastern district. Without the structure that was set up by Congress in 1913 with the Federal Reserve Act, I do not believe it would be possible to formulate a truly informed and well-considered monetary policy for such a complex and dynamic economy as that of the United States.