Speeches

Where the Fed Needs to Go

Remarks by Jack Guynn
President and Chief Executive Officer
Federal Reserve Bank of Atlanta
Alabama Bankers Association Annual Convention
Colorado Springs, Colorado
May 24, 1996

Good morning! You've just heard from Jim Rogers, the "investment biker." Since I grew up in Virginia and the part of the world famous for the Appalachian Trail, perhaps you can think of me as the "investment hiker." Somehow I think that image is closer to what people expect from a central banker. Today I would like to fill in that picture a little by giving you a chance to get to know me better and to hear some of my thoughts about how the Fed is changing and needs to change to reflect what's going on in the industry and in the world.

I've been with the Federal Reserve Bank of Atlanta for nearly 32 years now, and, as you would guess, I'm really excited to have the chance to lead the organization that has been such an important part of my life. Some of the excitement I feel is due to the fact that this is a time when the financial services industry and the overall economy are really being reshaped. As I have moved into my new CEO role, I have felt a new responsibility to do some fresh thinking about the Federal Reserve System and its role. A good deal of my musing has been retrospective, looking back at how things have already changed and what I've learned along the way. I've also been thinking a great deal about the Fed's future in the larger context of the changes going on around us.

In the process of this thinking, I've developed some pretty strong opinions on how the Fed has got to change in order to provide continuing leadership in this changing environment. However, I feel equally strongly that we must be careful to preserve and reinforce those things that have made the U.S. central bank a model for many emerging free-market economies. We've got to preserve the basic principles, if not the specific forms, that have made us effective over the years. That's what I'd like to talk with you about today, beginning with a few lessons I've learned as I look back over my last three decades with the Fed.

Lessons from the Past

Lesson number 1 is that the cost of controlling inflation and working towards true price stability is worth it. Like most of you, I lived through the high-inflation days of the 1970s. There are lots of fancy economic terms to describe the negatives associated with high rates of inflation, terms like income redistribution and inflation tax, but there are real-life stories that make the point even more vividly. I had occasion recently to review the financial circumstances of one of our own senior officers of the Federal Reserve Bank of Atlanta who worked in the Fed System for nearly 40 years and retired some 17 years ago with what looked like a very livable pension. I was almost embarrassed to realize what inflation over the last 17 years has done to that person's current income. That pension today represents only 46% of its 1979 purchasing power--a dramatic reminder of the ravages of inflation. Of course, there are other real-life examples of the cruel distortions caused by inflation.

Sure, the soaring prices and high interest rates were great for a few people who were positioned to make money on gold or art or some other inflation hedge. But they were not great for most people trying to buy homes, put kids through college, and save for retirement. Nor did banks tend to fare well. In general, high rates of inflation are not good for banks. Historically, profits have been higher in low interest rate periods than in high rate periods. Finally, this period was not at all good for the economy as a whole. The subsequent recession we went through to wring the 1970s' inflation out of the system positioned the economy to get back on track. But it was devastatingly hard. This experience convinced me that unstable prices are like summer in the South--too much rain one moment and not enough the next. I've lived through too many such summers and prefer the steadier climate of low inflation.

Another lesson I learned came from the period during which I headed our Supervision and Regulation Division. In 1982, you may recall, a chain of Tennessee banks controlled by the Butcher brothers failed. You will remember that this debacle turned a page of the history books--from the 1930s model of banking, with regulation and stability as the watchwords, to an early glimpse of the go-go 1980s.

For those of us intimately involved in trying to resolve this situation, the process was long and arduous. I remember personally going to meet with the board of directors of one of the banks involved to deliver the final message that their bank was to be closed--that there was nothing more that they or we could do to save it. I remember our gathering all of the Federal banking regulators and state of Tennessee regulators in the inner sanctum of our Fed office in Atlanta--working through the day, through the night, and into the next day to find a way to shut down all the banks involved without creating a public panic and an old-fashioned bank run. I remember the tension and our holding our collective breath as we were unable to find a buyer for one of the banks that had to be closed, knowing that bank would not open its doors for business on Monday morning. That had not happened in a while.

Along the way, we did things that, for the most part, had not been done for 50 years. For one thing, we had to close access to the discount window. And this situation taught me another lesson. Insolvent banks can stay afloat for a long time if they adopt a strategy of moving their assets from one affiliate to another, to stay one step ahead of the scrutiny of examiners. The lesson we learned in 1982 has proven to be relevant today. In the 1990s we have seen it applied to the Fed's supervision of international banks. We look at the organization as a whole. Our focus begins at the top--the organization in the home country--and works its way down to the affiliate in the U.S.

The third hard lesson I have learned over my career is simply this: The Federal Reserve, just like any other private or public entity, has got to change with the times. You all probably have your own list of the most formal and conservative companies that you have visited, and the Fed may well be among those. I never thought I'd see Federal Reserve employees coming to work in plaid shirts and khaki slacks. Now even we have casual day every so often. Although I managed the technology divisions of the Atlanta Fed earlier in my career, I never really thought I'd see the day when almost every CEO, including me, would have a P.C. on his desk, but now we do. I've had to change and so has the Fed. These shifts were necessary because they reflect the dramatic changes in technology and the way we work.

Change has occurred on a more substantive level too. I have spent almost half of my career with the Atlanta Fed in our Bank offices in New Orleans and Miami.

Those were, in many ways, my favorite assignments. They gave me the chance to get to know the bankers and develop strong and personal working relationships with them. Ironically, much of my work in recent years has revolved around helping to make the Fed more like the increasingly national banking corporations that are part of the industry we serve, often times dealing with key executives of the large, nationwide banking organizations in their corporate headquarters, rather than with their local executives. Although this is the way many large banks want us to work with them, we also remain committed to working with regional and community bankers at the local level just as we always have.

The Fed has been applying this lesson for several years. Following the lead of most large banks and other large organizations, we have consolidated our 12 mainframe automation functions that used to be duplicated in each of the Reserve Banks. We now have one shared Federal Reserve System staff for coordinating automation strategy and three shared-data processing sites. This kind of consolidation is continuing in other operational areas. For instance, we used to process savings bonds at all of our head offices and branches--37 in all. We now process them at only 5 locations. We are also acting more strategically. Last year we redefined our Fed product offices for each of the three major payments businesses--retail, wholesale, plus cash and fiscal agency services--to set strategic directions at the national level and respond more quickly to new developments.

A fourth lesson I have learned is that people with integrity make all the difference. You would all have your own example of personal integrity, but I have seen this lesson at work both on a personal and a professional level at the Fed. I will never forget the time in 1982 when we experienced the tragic death of a senior Federal Reserve Bank of Atlanta bank examiner. This man was a graduate of the Citadel, a national bank examiner for 10 years, a bank president in Florida, and finally as a Federal Reserve examiner, back to the work that was his first love. A number of us had been in Washington, D.C., discussing the options for dealing with the closing of a bank in Florida. After a series of meetings, we were scheduled to fly back to Atlanta one bitter snowy afternoon. At the last minute, I changed to a later flight. Little did I know that the plane I had been scheduled to fly on would crash into the Potomac River soon after taking off from National Airport. My colleague, senior bank examiner Arland Williams, was on the plane that went down. You may remember the story. He was the heroic person who lost his life that day helping other passengers and crew members on the plane to safety. There are lots of testimonials to Arland, including a beautiful framed testimonial that hangs in our Bank Supervision office in Atlanta, but perhaps the most telling is that his daughter now works at the Atlanta Fed in our Research Library.

In another heroic situation, staff members at our Fed Branch in Miami put themselves on the line when Hurricane Andrew devastated areas around Miami in 1992. Despite the severe weather that was on the way, they showed up at the branch--some with their families and pets--to help meet the anticipated demand for currency. As it turned out, the local economy reverted almost exclusively to cash in the days immediately after the hurricane, and our staff's efforts were critical to the city's quick recovery. Our employees worked without power, using flashlights in the vault, and still managed to pay out five times the amount of cash normally paid out the Monday after the hurricane hit. In the midst of all the destruction and turmoil, they remained energized by their sense of social mission. People with such dedication are the heart and soul of the Atlanta Fed, indeed of the Federal Reserve System. I am convinced that this kind of commitment is a major reason why we are a respected institution in a time when many public organizations are regarded with cynicism. There are also some examples in my mind of corporate integrity that help define the relationships between the Fed and those it supervises, and I will come back to those in a moment.

Where Does the Fed Need to Go?

What do these lessons of the past imply for the challenges of today and tomorrow? I don't have simple formulas or answers to address the many new issues and new developments we face together. But I think these examples offer some ideas about how the Fed needs to evolve in order to continue playing an effective public policy role. At the same time, these lessons also suggest some things we need to preserve. Let me first look at the areas where I think we need to change.

The first area where things need to continue to evolve is our approach to monetary policy. As the structure and workings of the economy change, we need to continue to search for new ways to think about appropriate policy and how it is to be implemented. Nowhere is this more obvious than when reflecting on the System's experience with focusing on the money supply as a guide to policy. This approach appeared to be a good model for a while, but more recent experience has shown us how things change. One of the new phenomena we are seeing is a fundamental difference in price-setting behavior in the present business expansion. Despite the good growth we've been having, we simply aren't seeing the wage and price pressures that we've seen at this stage in past business cycles. Business people tell me that their ability to pass along price increases is very, very difficult this time. I believe that our more favorable experience with inflation in recent years and the Fed's demonstrated commitment to move toward price stability are big factors behind this shift in behavior. But to truly understand and respond to this shift, it seems to me that we have to continue exploring new tools and new models that can give us a better picture of our national economy and how monetary policy can best be used to contribute to sustainable, non-inflationary growth.

I also believe there is room to rethink the long-term objective for monetary policy. (And we have to work on communicating it in a way that the world can understand--and believe.) Proposals have been made recently to redefine the Federal Reserve's policy objectives with a greater emphasis on price stability, and relieve the System of its parallel responsibility for focusing on employment and output growth. These proposals deserve careful consideration and public debate. Don't misunderstand me--I'm not suggesting that there is only one answer to monetary policy questions. However, I would like to see us get to a point where people have absolute faith in our commitment to price stability. The more this credibility is firmly entrenched, the more freedom we will actually have to make countercyclical policy moves.

Aside from monetary policy, more change needs to come in the area of bank supervision and regulation. At the broadest level, the Fed must make a material contribution to the debate of appropriate public policy that will guide the evolution of our financial services industry. In particular, we must help to lead the thinking on what a sound financial services industry for the United States in the next century will look like. One way to begin is at the narrowest level--rethinking the definition of the "local banking market." For example, we might take a new look at the competitive factors we should use when evaluating mergers and acquisitions. Many new competitors are offering services comparable to those offered by banks. Yet these suppliers are not considered in contemporary antitrust analysis. We need to examine how this can best be done and still facilitate a truly competitive environment for banking customers.

I also hear banks complaining about the specialization going on in bank exams, with 15 teams coming out to look at different areas of an organization. (I am exaggerating here, but I'm sure it can feel this bad at times.) We must find ways to conduct a more general, integrated approach to bank exams, an approach that looks at the whole picture and not just the pieces, an approach that acknowledges that the bank's management is responsible for its safe and sound operation. This shift goes beyond the organizational structure of banks. For example, risk management is an area where examiners must be sure that a financial service institution is doing a prudent job managing not only credit risk but also interest-rate risk and other risks that are associated with new products and services.

In the payments area, I'd like to see us get back to more of the leadership role we once had, but to do that in partnership with financial service companies. The industry does not need us to tell people how to do their business. Nonetheless, it is a unique time in the evolution of the payments system. The structure of the financial services industry is changing radically. Applicable technology is virtually exploding before us. In the process, we are seeing profound changes in the infrastructure through which all of us--as businesses and as individuals--make payments. And lots of people from outside the industry, who neither understand nor feel responsibility for the integrity of the payments system, want a piece of the action.

Given these types of changes, we at the Fed have the unique opportunity to be a catalyst. "A catalyst for what?" you might ask. I think the answer is a catalyst for change in an industry that needs a more efficient, low-risk, accessible payments system. A seeming myriad of payment alternatives is unfolding, with smart cards and Internet banks and screen phones. It is imperative that this new payments system be safe for our customers to use. It is also essential that everyone have some sort of reasonable access to these new services. People using different systems should not have to worry about things like interconnectivity and standards and security. They should only know their payments are getting made accurately and on a timely basis.

To help make sure this happens, the Fed should be an industry catalyst and a leader, helping to resolve any number of problems that are cropping up. Sometimes we can do that by bringing parties together to resolve differences in standards. Sometimes, by setting sensible policy or regulation to govern payments processing. Sometimes, by helping with education and promotion. And sometimes, by being an efficient processor that can help set some industry norms and make sure there is broad availability of services. I'm thinking here of our focus on moving the check system into a more electronic world, with widespread truncation. Ironically, the more we push electronic payments, the more we undercut the check business that is so large a part of our Fed and industry operations. But there is no turning back, and there shouldn't be.

The Fed must also continue to change its own payments operations. Consolidation and standardization will be our mottoes for many services in the foreseeable future. We've got to follow these guideposts because they reflect changes in technology and in the industry.

All in all, I have highlighted some pretty significant changes for us at the Fed, and they cross all of the areas in which the Fed has responsibilities--monetary policy, bank supervision, and payments services. But some important things about the Fed don't need to change. In the monetary policy area, for instance, one thing we do quite well is gather grass-roots, regional information and bring this economic intelligence to bear on Fed policy discussions. I've been personally involved in this process since I served as a branch manager many years ago and more so in the past decade, serving as Bob Forrestal's backup at the FOMC. I can assure you that this perspective is one of the unique contributions the Fed presidents bring to the FOMC discussions. This role of the regional Reserve Banks--through their Boards of Directors and their contacts with other business and community leaders and bankers--should not change one iota.

Another important area we don't want to change is integrity. People have a right to look to the central bank to be even-handed, fair, and objective in everything we do. Integrity is at the heart of the monetary policy role. We must continue to do whatever is best for the country, regardless of who is in the White House, regardless of who is in Congress. We must do what is best for the country whether it's an election year or not. This principle is really at the core of why the Fed was structured some 80 years ago in its unique way. We've got to preserve what that structure created, namely a balance between public and private, a balance between a centralized focus and being in touch with the grass roots of the nation, a balance between independence and accountability.

Integrity is also the cornerstone of the relationship between any bank supervisor and the banks or bank holding companies it supervises. It's been interesting to me to think about the issue of bank regulation today versus 15 years ago. A classic breakdown in corporate integrity was clearly at the heart of the Tennessee bank debacle from the 1980s that I talked about earlier. And if you think about most of the significant failures in recent years, it's clear that a breakdown in integrity was at the root of many, if not most, of those problems too.

Finally, there is a personal dimension to integrity and public service. The Fed has been able to recruit very talented and dedicated people, even though the upside financial gains in a public policy organization like the Fed simply aren't there. A big reason is that people like to work in an environment where integrity is regarded as the very highest corporate value. Now more than ever the Fed has got to recruit and retain the best and the brightest if we are to meet the challenges that lie ahead. Thus, we've got to preserve this special emphasis on integrity.

Conclusion

In conclusion, I've learned some interesting and compelling lessons along the way in my many years with the Fed. Now, in my new role, I have the opportunity and the responsibility to help the Atlanta Fed and the Federal Reserve System as a whole change to better serve the evolving financial services industry. And I'm excited about that. I promise you I will stick my neck out and help to tackle some of the toughest changes. But at the same time, I am convinced that we shouldn't change those parts of the Fed that already work well and are proven over time to be right. In particular, we've got to be sure that our basic principles like integrity and independence do not get compromised. This is a fascinating and pivotal time for the financial services industry, for the nation's economy, and for us at the Fed, and I truly look forward to continuing to work with all of you in my new role.

CONTACTS

Jean Tate
404-498-8035