How the Fed is continually re-evaluating/reinventing itself to remain an effective, efficient organization.

I. Thank-you very much for this opportunity to speak to you tonight. There's certainly a lot to talk about with an organization as large and complex as the Federal Reserve System. As you might know, our responsibilities are quite varied.

A. Supervise and regulate banks and bank holding companies.

B. Provide financial services to depository institutions and the U.S. government. Compete with the private sector in selling a number of services.

C. Most importantly, Fed formulates monetary policy.
   1. Five-state region. Head office here in Chicago. A branch in Detroit, and offices in Des Moines, Milwaukee, and Indianapolis. Also a new facility in Peoria.

D. Interesting time for the Fed.
   1. Many changes in the environment in which we operate.
   2. We're facing increasing public scrutiny.
   3. A lot of questions about our regional structure and whether it's still appropriate.
II. History of the Federal Reserve System important to understand the regional structure.

A. Set up by Congress in 1913.

B. Unusual among central banks in its decentralized, regional design.
   1. Mixture of public and private attributes.
   2. Interesting note: Some European central banks are trying to establish a structure and a process we've been fine-tuning for decades.

C. Two previous experiments in central banking.
   1. 1791 - 1811 and 1816 - 1836.
   2. Neither one made it past its original 20-year charter.
   3. In each case, the central bank was doomed by a very deep and typically American suspicion of concentrated power.
   4. Americans didn't feel confident giving government unchecked power to issue notes.
   5. But at the same time, many did not think that private parties should control the money supply.
      a. We went 77 years without a central bank.
   6. Fast forward to the early 1900s. U.S. was behind the times, as many other industrial countries already had central banks. A major bank panic prompted a re-examination of whether we needed a central bank. Thought to be a good idea. Big question was how to structure it.
      a. On one side were those who favored a centralized institution with a strong private-sector orientation — preferably located in New York.
      b. On the other side were those who wanted a regional structure dominated by the government.
      c. Organization that resulted was a compromise, an intricately structured balance between the public and the private, the central and the decentralized.
      d. To achieve this balance, President Woodrow Wilson and Congress created a system of 12 regional banks and a coordinating board of governors in Washington, D.C.
      e. Board would be appointed by the president and confirmed by the Senate.
      f. Presidents appointed by each Reserve Bank’s board of directors, consisting of leading private citizens from the region, with the approval of the Federal Reserve Board.
      g. The regional Reserve Banks would have a mix of public and private features — but they would be spread throughout the country.
h. Key word — compromise (public/private and central/decentralized).

i. It's a set-up that can be a bit quirky and unwieldy at times.

   (1) Two reserve banks in Missouri, but just one in California — for entire western section of U.S. And none in Florida.

j. But on the whole, system has worked well.

III. The decentralized structure has important advantages. It means that national policy is based on the best information from beyond the Beltway — at the grass-roots, regional level. And because we need to understand regional trends, we have undertaken a number of important regional initiatives.

A. Our ongoing study of the Midwest economy a good example. In keeping with our responsibility to study the regional economy for monetary policy input.

1. Midwest received a wake-up call in the 1980s.

2. Dramatic turnaround, and it remains strong.

   a. U.R. in each of our states below national average.
   b. Average 1 percentage point below national average.
   c. 1982 — U.R. was 3 percentage points above national average.

3. But we can't be complacent. It's important to look at public policy options that will help the region to be strong in the future.

4. That prompted our year-long study of the Midwest's turnaround.

5. So that policymakers are better able to position region for continued success. We need to know what happened, and why it happened.

6. Since FRB is a regional institution, we're uniquely positioned to study this region and communicate information to regional policy makers.

7. And through these efforts, information flows back to us — and helps us do a better job in our national monetary policy role.

8. Comprehensive, year-long study. Six workshops so far. For example, Global Linkages to the Midwest Economy; Designing State and Local Fiscal Policy; Labor Force and Education Policy; Midwest Metropolitan Areas: Performance & Policy.
9. We’re also working with an advisory group [copy of brochure].
   a. Governors of 5 states are honorary members
      (1) Each has representative on advisory committee.
   b. Six university presidents.
   c. Business organizations.
   d. Labor organizations.
   e. Not-for-profit organizations.


11. Many interesting issues emerging so far.
   a. Manufacturing employment — 1977-83 — we lost 3 percentage points of our share of national manufacturing employment.
      (1) Since 1983, we gained 2 percentage points of national manufacturing employment.
   b. Manufacturing industries e.g., steel and autos
      (i) reconcentrated in Midwest.
   c. Rural areas
      (i) increased manufacturing employment.
      (ii) increased agricultural output.
   d. Tight labor markets
      (i) Led to acceleration of population growth led by in-migration to region.
      (ii) Most pronounced in rural areas.
      (iii) 1980-90 population in rural counties declined by 2.2 percent.
      (iv) 1990-present — population increased and wiped out losses.
   e. Chicagoland
      (i) Midwest’s population continued to drift to metropolitan areas.
      (ii) Transforming from manufacturing center to service center.
         (a) Business services.
         (b) Trade.
         (c) Travel.
         (d) Financial Services.

B. We are all aware of some external factors that have benefitted the Midwest. For example:

1. Declining energy prices.
2. Cuts in defense spending (defense spending concentrated on coasts).

3. Declining dollar.

C. These external factors do not completely explain the turnaround in Midwest's mainstay manufacturing industries.

1. They are more of a return to normalcy than a guiding external hand.

2. Even in decades prior to energy shocks, federal spending, and exchange rate shocks, the Midwest's share of manufacturing has been steadily declining.

D. Key to Midwest success, I believe, is the fact that the Midwest's industries have changed HOW they conduct their businesses.

1. Midwest has not dramatically changed in lines of business.
   a. More concentrated than nation in its mainstay industries — durable manufacturing and agriculture.

2. Region changed way it does business — its
   a. Organization.
   b. Mode of Operation.
   c. Technology.

3. Implementation of best manufacturing practices. For example:
   a. Lean manufacturing, just in time.
   b. Each industry has found ways to be competitive.

E. We can be thankful for this improvement, but we can't be complacent.

1. No natural advantages.

2. No external trends that will sustain the region.

F. Nothing lasts forever.

1. Technology is a moving target.
   Other regions of U.S. and world will come back just as Midwest has.

G. We need to look at these policies that can keep prosperity going.

H. Another regional initiative being led by the Chicago Fed is the Mortgage Credit Access Partnership. In keeping with the Fed's responsibility to ensure fair access to credit.

1. MCAP is aimed at achieving fair access to mortgage credit and housing in the Chicagoland area.
2. It's a partnership among many players. Voluntary effort.

3. Key is bringing together the broad spectrum of participants involved in the home-buying process.

4. These are people actually involved in the process, developing practical strategies.

5. We have over 100 organizations represented. These include lenders, realtors, appraisers, insurers, community groups, government agencies, secondary market makers, and credit rating agencies.

6. Not looking to simply hold meetings.

7. Our goal is to develop recommendations for meaningful change.

8. To eliminate any policy or practice that creates the potential for, or actually results in, unfair treatment in the home-buying process.

   Unique opportunity to make meaningful changes in the Chicago area. At workshop in September, participants decided on four topics they saw as most important in Chicagoland area.

   a. Divided into work groups to address issues in these four areas

      (i) FHA-insured lending;

      (ii) Credit reporting/credit scoring;

      (iii) Appraisal process;

      (iv) Education of both consumer and industry participants.

   b. Work groups will each analyze issues and will report back to partners in the first half of next year their recommendations for changes in policies and practices.

   c. Unique opportunity to make meaningful improvements in the homebuying process within greater Chicagoland and to help ensure fair treatment for all.

I. Also along the lines of fair access to credit, we recently published the results of an important study on how people borrow money in the Hispanic community of Little Village on the Southwest Side. [Rob Townsend, University of Chicago — his study supported by MacArthur Foundation, among others]

   1. Study found that family and friends are frequently more important than banks as a source of loans for both individuals and small business owners in Little Village.

   2. Limited role of formal financial sector in part due to community's lack of interest — but still some unmet credit needs in community.

   3. Therefore, researchers speculated that loan instruments being offered are not attractive — too inflexible.

      a. Suggest that financial institutions might improve services by using or replicating informal community networks.
4. These findings useful to us as we work with financial institutions and neighborhood organizations interested in community development.
   a. We hope to get more information on why this is happening.
   b. We also hope to replicate this type of study in other Chicago ethnic communities.

IV. These initiatives are a couple of very specific examples of some benefits of our regional structure. As I mentioned, increased public scrutiny of how Fed operates. You have seen some recent press coverage questioning the structure of the Fed -and its responsiveness to a changing environment. The issue received some fairly prominent play in newspapers like USA, Today and The Wall Street Journal.

V. Stories raised some valid questions, but they failed to mention how we’re addressing those questions ourselves. Fed is in a special position because of our independence and because of our special role as a central bank. We have to take extra steps to make sure that we are well-run and carefully controlled. We cannot afford to have any financial irregularities.

A. Like so many other organizations today, we’re actively re-evaluating how we do things at the Fed. One way at the Chicago Fed is through Fresh Look.

B. It’s really a fundamental re-examination of how we operate and work with one another — and how we provide service to our customers. Our goal is simple: To become the recognized leader in the eyes of those we serve and within the Federal Reserve System.

C. Like other organizations, we felt we needed to respond to a changing environment. Though we’re a central bank — a public institution with a public purpose — we recognize that like a private firm we have customers, and we have competitors.

   1. We’re seeing new technologies, globalization and demands for innovative financial products.

   2. More competition and higher customer expectations.

   3. Bank consolidations are more frequent, and our competitors are getting stronger and stronger.

   4. Changes are needed to stay competitive.

   5. As a first step, we created a new vision for the organization. We developed long-term strategies to achieve the objectives in our vision. And we set in motion a process to create a new corporate culture.

D. Extensively surveyed employees. Found some good and bad things regarding our culture.

   1. We’re developing initiatives to change our culture in the areas of leadership… communications … empowerment… performance management… skill development… and customer focus.

   2. Changing the culture one of the most important, ambitious — and difficult — initiatives our bank has ever undertaken.
E. Created teams of people to take a hard look at how we provide services to one another and to our customers.

1. Team of people working full-time on how we can better provide service to our customers.

2. Team of people working full-time on how we can better provide support services to one another. Improving how we work with customers, and each other, is what Fresh Look is all about.

VI. We also have a number of strategic re-evaluations underway at the national level. Efforts to maintain a strong regional presence, but to do it efficiently.

A. I’m involved in a Federal Reserve System Strategic Planning Coordinating Group.

B. We’re also continuing efforts to organize and offer financial services on a national level more efficiently.

1. We’ve established national product offices to coordinate the distribution, pricing and quality control of financial services we sell, like check processing and electronic payments.
   a. Taking steps to provide seamless service to rationalize operations in today’s marketplace.

C. Also have consolidated our mainframe computer operations at three sites across the country.

1. To provide a more cost-effective — but still highly reliable — operation.

2. Consolidated processing of wire transfer, ACH, book entry, accounting and other services.

D. I’m also part of a group that’s looking at our basic infrastructure in relation to how we provide financial services.

1. System-wide, we have 12 head offices, 25 branch offices, and 12 regional check-processing sites.

2. As we re-examine the financial services we offer and as we consolidate operations, we are taking a close look at our infrastructure needs. A re-examination of the sites needed to provide financial services, how they will operate, and where they should be located.

VII. Conclusion

A. As you can see, a lot going on. All within the framework of a structure that’s a bit unorthodox — but it works well.

1. We are not a perfect organization.

B. The key point to remember is that the organization is evolving. The Fed is continually re-examining itself to make sure it remains an effective; efficient organization.

C. Now, I’ll be happy to answer any of your questions.