

KNOW YOUR CHICAGO
GRAHAM SCHOOL OF GENERAL STUDIES
AT THE UNIVERSITY OF CHICAGO

Chicago, Illinois
September 8, 1999

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The Federal Reserve and Community Development: Fostering Neighborhood Partnerships

I. Introduction (2 minutes)

- A. I am particularly delighted to be her today because Know Your Chicago is a city institution. It's been around for more than fifty years. And judging from the crowd today, it has some very popular programs.
 - 1. The Federal Reserve Bank of Chicago has also been around a long time. But I am not sure we are as well known as Know Your Chicago. In fact you might say that we are one of Chicago's best kept secrets.
 - 2. It worries us sometimes that most Chicagoans know so little about an institution that has such a large impact on their lives.
- B. Indeed, most Chicagoans don't know that the Federal Reserve isn't just one bank, but rather of system of *regional banks*.
- C. Three weeks ago in newspapers across U.S., headlines heralded the latest news from the Federal Reserve. "Fed Hikes Interest Rates", and "Fed Hike May Be It for Year". That sort of thing.
 - 1. Reading through such articles, you do tend to get the impression of this process beginning and ending in Washington, D.C. The reality is that the very heart and soul of the Fed is its regional core.

2. That regional core—and in particular, the Federal Reserve’s Chicago connection—is what I’d like to discuss today.
- D. I’m going to give special attention to the Chicago Fed’s ongoing efforts in community development. Because, these efforts help illustrate the value of having a system of regional banks, and not just one central bank.
 - E. Over the last ten years, we’ve come to realize that we have an obligation to better inform the public about the workings of the economy and the Fed.
 - So, I hope you’ll visit us on October 5 and 6 as part of this program and tell others about what you learn today and in October, and in doing so help us make the workings of the Fed as transparent as possible.

II. Y2K (3 minutes)

- A. Let me begin by saying a few words about Fed involvement in Y2K preparations. Obviously, given our role as the nation’s central bank, we are focussing considerable attention on Y2K.
 1. *First of all, I’d like to reassure you that there is no truth to the rumor that the Fed is stockpiling slide rules, sundials, and adding machines.*
 2. In fact, we’re confident that the century date change will come and go with a minimum of disruption.
 3. As a nation, we have worked together to meet important challenges in the past. We believe that the public will keep the year 2000 rollover in perspective, realizing it is one more challenge we will meet.
- B. At the Fed we are addressing Y2K at all levels. Nationally, the Fed has three main areas of responsibility.
 1. First, we’re a service provider: we provide financial services such as check processing and electronic payments to commercial banks and the U.S. government.
 2. Second, we are a bank regulator: we supervise and regulate state member banks and bank holding companies and branches of foreign banks.
 3. Last, but not of least importance, we formulate national monetary policy. We are committed to doing all we can to safeguard the operations of the U.S. financial system. That’s why Y2K is so important to the Federal Reserve System.
- C. We’ve already made significant progress in preparing for the rollover; all of our most important systems are ready for Y2K and are already being used on a daily basis.

1. As a financial service provider, we're confident there will be no disruption in our ability to meet the needs of our customers — be they commercial banks or the U.S. government.
 2. And we're confident that the banking system will be ready too. Regulators have already examined every bank twice to check for Y2K readiness and we've found that 99% of banks are making satisfactory progress.
- D. There is an old saying that a person surprised is already half-beaten. We have certainly taken this to heart, and we have no intention of being surprised by anything Y2K has to offer. But sound preparation is only part of the battle. We must also encourage the public not to over-react.
1. There has been concern that popular misconceptions about Y2K could lead some people to withdraw unusually large sums of money from their bank accounts.
 2. For this reason the Federal Reserve is making available more than enough cash to cover any unusually large demands.
 3. However, I'd like to remind everyone that there is no safer place for your money than where it is, Y2K or not.
 4. Although you may want to have enough cash on hand for the long holiday weekend, remember that credit and debit cards, as well as checks, are expected to work over the New Year's holiday as they would at any other time of the year.
 5. In short, we are confident that the Federal Reserve and the financial system will be fully prepared for the century rollover.

III. The Role of the Fed (5 minutes)

- A. Now let's get back to the role of the Fed. The Federal Reserve System that you and I take for granted is only 85 years old. America did without a viable Central Bank for most of its first 150 years.
1. It's not that the U.S. economy didn't need a Central Bank.
 2. It's not that commercial banks didn't need supervision.
 3. It's not that the price of bread didn't occasionally surge beyond affordability.
 4. It did. The need was there.
 5. One author writes that at the period between the first and second central banks in the early 1800s, "any place where there was a church, a tavern, or a blacksmith shop was

deemed a suitable spot for setting up a bank. With banks multiplying so rapidly, inflated currency and speculation in bank stocks naturally followed.” [put book down]

- C. By the end of that century, bank runs abounded.
 - 1. In 1893, on just *one* summer day, well over 500 banks suspended operations nation-wide.
 - 2. Bank failures here in Chicago, although not as numerous as those in New York, were notable for their size and impact.
 - 3. The word “bank run” sanitizes how devastating these failures were to individuals who lost their life savings.

- D. In 1906, the Chicago Tribune described this scene outside a Milwaukee Avenue State Bank, where crowds extended three blocks long, and, I quote, “Men and women knelt and prayed in the street that their gold might be returned to them ... others were robbed as they came smiling from the safety deposit vaults.”

- E. The lack of financial stability throughout most of the 1800s, and the early 1900s hurt the economy.
 - 1. The business cycle accelerated and decelerated erratically like a windmill in a dust storm.
 - 2. By 1908 Andrew Carnegie would characterize American banking as “the worst in the civilized world.” If our disastrous economy of the day was what Carnegie would call “civilized”, I’d hate to think what he’d have called “uncivilized”.

- F. And yet, despite the need for greater financial stability, the U.S. government, shut down the first two central banks in the late 1700s and early 1800s.
 - 1. President Andrew Jackson explained, “Such a concentration of power in the hands of a few men [has proven] irresponsible to the people.”
 - 2. For our first 138 years, Americans voters had a clear message: even financial disaster is better than a monopoly of power over money.

- G. It wasn’t until 1914 that the third and final incarnation of the U.S. central bank, the Federal Reserve, opened its doors . Today the Federal Reserve is one of the most trusted government institutions in America.
 - 1. In fact, the Fed is seen as so key to the quality of life we now enjoy that it is hard for you and I to imagine America without a Federal Reserve. *Its like Chicago without Studs Terkel.*

- H. What changed between 1836, when the second U.S. Central bank closed its doors, and 1914, when operations began at the current Federal Reserve?
 - 1. Did Americans become more trusting of centralized authority?

2. I personally doubt it.
- I. No, the change that allowed the Federal Reserve to flourish was a fundamental rethinking of the very definition of the term “central bank.”
 1. A central bank for the United States would have to be more than a bankers’ bank, but an institution mandated to serve the economic interests of all Americans.
 2. Only when the central banking system was redesigned to represent more fully our large and diverse economy, did the American people warm to the notion.
 - J. Today’s Federal Reserve is therefore a juggling act, balancing the financial needs of each and every American: be they consumers, factory workers, bankers, small town businessmen, or retirees who can’t afford to see inflation wipe out the value of their pensions.
 - K. So I’d like to spend some time clarifying how the Fed balances so many constituencies and commitments.

IV. Fed Structure and Functions (9 minutes):

- A. The challenge for the designers of the Fed was to create a central bank that would be *both* the child of elected government *and* protector of the long-term financial interests of the economy.
 1. A purely government-controlled Central Bank could subject monetary policy to the whims of politics.
 2. Or as the House Ways and Means Committee said in 1839, “the temptation to supply the Federal Treasury by the easy process of [currency], rather than resorting to the unpopular process of internal taxation, would be too fascinating to resist.”
 3. On the other hand, a central bank that was overly dominated by the private sector could be seen by the public as potentially corruptible.
- B. The resulting Fed we have today is, like many successful American institutions, a system of checks and balances.
- C. First, the Fed is a balance of public and private control, serving as a link between the public *governmental* sector on one hand, and the private *banking* sector on the other.
- D. Second, the Fed also balances centralized and regional control.
 1. Thus the Fed is made up of a Board of Governors in Washington, but also twelve *regional* banks, including the Chicago Fed.
 2. Here in Chicago we serve a five-state area consisting of most of Indiana, Illinois, Michigan, Wisconsin, and all of Iowa.

3. We have a head office on LaSalle Street as well as district offices in Detroit, Des Moines, Indianapolis, Peoria, and Milwaukee.
- E. Our regional structure helps us monitor local concerns throughout the country. And this in turn, ensures that we live up to the overall mission of the Federal Reserve, which is, quite simply, to foster a safe and sound financial system and a healthy, growing economy for the entire nation.
1. As part of this effort, we receive regular input from bankers, business executives, labor unions, academics, community groups and others.
 2. At the Chicago Fed, for example, I travel throughout the Midwest to get a first-hand view of what's happening in the region.
- F. Although the Fed constantly balances public vs. private authority, there is no doubt that we are accountable to Congress and the American people.
1. The seven members of the board of Governors are appointed by the President and approved by Senate for 14-year terms.
 2. The Fed reports directly to Congress twice a year regarding policy objectives. And Fed officials regularly testify before Congress on matters pertaining to banking and the economy.
- G. And yet the Fed is insulated from short-term political pressures. We pride ourselves on being non-political and non-partisan.
1. We cover our own expenses through interest earned from our monetary policy operations and fees charged from our check processing and other services we sell to banks.
 2. We do not receive congressional appropriations.
- H. You may be surprised to learn that the regional banks operate like a private company in many ways.
1. For example, neither I nor my staff are government employees. We are not civil servants. Just like the businesses on LaSalle Street we have costs and revenues, and we're constantly working on greater efficiency and better customer service.
 2. And we have a Board of Directors consisting of nine representatives from our district that performs functions similar to that of a Board of Directors of a private firm, though they also become directly involved in helping formulate monetary policy.
 3. Many people believe that I am appointed by the President, but it is the Board of Directors of the Chicago Fed that selected me, with the approval of the Board of Governors in Washington.
- I. Perhaps it is the setting of monetary policy that best demonstrates the system of checks and balances at work.

1. The setting of interest rates is the single most influential act of the Fed and is performed by the members of the FOMC, the Federal Open Market Committee.
 2. I say the FOMC is “balanced” because it is made up of both all of the 12 regional bank presidents and 7 Governors appointed by the president. Alan Greenspan chairs this committee.
 3. At any given time only 5 of the regional bank presidents can vote. This means that interest rates are always set by a body that shares power between both government appointees and non-government, with the government appointees having a majority.
- J. In short, the Fed’s structure is complex, but it works.
1. And regional set up helps insulate us from political pressure and obtain input from a variety of sources.
- K. A good indicator that the Fed is a system that works is our current economic success.
1. The lower inflation we’ve achieved in the past decade has provided the foundation for the strong real growth and low unemployment that are a hallmark of the current expansion.
 2. We’re now in the longest peacetime expansion in our history. There is no denying it: nationally and here in the Midwest, these are the best of times.
- L. And yet juxtaposed against the extraordinary nature of this expansion, there are still some people who are not yet full participants in the burgeoning economy.
1. The best way that monetary policy can help most Americans is to create a low inflation environment conducive to growth.
 2. Sustainable growth is the best way to ensure that the benefits of our national affluence reach every corner of American society.
 3. A rising tide truly raises all boats. That assumes of course that some boats aren’t tied down, or kept out of the harbor all together.
 4. Removing barriers is one of the greatest challenges facing us as a nation.
 5. So it is important that we develop initiatives that will bring more Americans into the increasingly prosperous mainstream.
- N. Since the early 1970s the pace of real income growth has slowed and income inequality has increased.
1. In fact, those in the bottom of the income distribution saw virtually no growth in their income after inflation for over two decades, while the top 20 percent have experienced strong increases.
 2. And the problem is not easily solved.

- O. Although this expansion is the second longest in U.S. history, not until a few years ago did we see the widening income gap begin to narrow.
- P. The reasons for this trend are a subject of debate among economists. But it's clear that urban economic development efforts can help. As always the solutions lie in lessons learned from past mistakes.
1. I worked at HUD back in the 1970s and that experience led me to believe that government initiatives need to include private sector involvement in order to be effective.
 2. The high rise public housing projects for families is an example of one of our worst government policies. It tore apart neighborhoods and concentrated people with problems in one place, multiplying their problems.
 3. Hopefully, we have learned from these mistakes and in the future public-only approaches that do not take into account market forces will be minimized.
- Q. As a regional institution with a mixture of public and private features, the Chicago Fed is in a unique position to facilitate public-private partnerships in the Midwest.
- We've championed a number of new partnership initiatives that allow us to share our expertise with many Midwestern governmental and private sector growth and development organizations.
- R. Many of the Fed's activities in this area are related to its responsibilities for the Community Reinvestment Act or CRA.
- As you may know, CRA was passed by congress to help ensure that financial institutions meet the credit needs of their communities, particularly low-and moderate-income neighborhoods.
- S. One project of which the Chicago Fed is particularly proud is the Mortgage Credit Access Partnership.
1. We launched MCAP in 1996 with six other partners from both the public and the private sectors.
 2. The goal of MCAP is to ensure fair treatment for all homebuyers in the Chicago area, regardless of where they choose to live, their race, ethnicity, or gender.
- T. Some 100 organizations participate in MCAP and the partnership has made home-lending more equitable and consistent across the Chicagoland area.
- For example, MCAP has introduced an explicit non-discrimination provision to the Illinois Appraiser License law.
- U. MCAP is making a real difference in the Chicago neighborhoods that need it most. Neighborhoods with high rates of foreclosure quickly become half abandoned.

1. As you might guess, lower income minority communities are the worst hit.
2. Rather than simply pointing fingers and suggesting what others might do, two non-profit MCAP participants created the Foreclosure Intervention Program.
3. They then partnered with the City of Chicago, HUD, and seven financial institutions.
4. The program has already prevented 100 foreclosures. That's 100 families that would have been ripped from their homes needlessly. And 100 homes full of light on otherwise silent streets.

V. Conclusion (1 minute)

- A. In conclusion, I'd like to thank you for scheduling a tour of the Federal Reserve Bank of Chicago this year, and for your interest in our community development efforts. You will hear more about this on October 5 and 6.
 1. You know, the poet and activist Georgia Douglas Johnson, once said, "Your world is as big as you make it." It seems to me that this could be the motto of Know Your Chicago.
 2. One of our city's greatest attributes is its small town feel. Another is its remarkable diversity, of people and communities, yes, but also of opportunity. Chicago is a world of opportunity, city-size.
 3. Know Your Chicago is dedicated to exploring those opportunities. By celebrating every nook and cranny of Chicago life over the years, you've made Chicago a bigger and better city.
 4. I hope that after learning more about the Federal Reserve Bank of Chicago, you'll feel the same could be said about us.