



Federal Reserve Bank
Of Cleveland

The Federal Reserve System is responsible for formulating and implementing U.S. monetary policy. It also supervises banks and bank holding companies, and provides financial services to depository institutions and to the federal government.

The Federal Reserve Bank of Cleveland is one of 12 regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., comprise the Federal Reserve System.

The Federal Reserve Bank of Cleveland, its two branches in Cincinnati and Pittsburgh, and its Regional Check Processing Center in Columbus serve the Fourth Federal Reserve District. The Fourth District includes Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

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This essay presents this Bank's views about the importance of central-bank independence, accountability, and candor for achieving important national economic goals. The views expressed in this essay are not necessarily shared by the other Federal Reserve Banks or by the Board of Governors of the Federal Reserve System.

The President's Foreword

The Federal Reserve's independence has once again come under review. Legislation was introduced in Congress last year that would increase political influence over the nation's central bank. In the months ahead, such initiatives will evoke questions by elected officials about monetary policy and the Federal Reserve's independence.

This year's annual report essay argues that an independent central bank is crucial in order for any nation to maintain price stability and, ultimately, economic growth. In addition, increased central bank candor about its goals and methods would enhance the effectiveness of monetary policy and would provide greater accountability for its actions to the public and Congress.

Our own history and the histories of many other nations tell us that economic policies that are politically appealing in the short run often can lead to inflation in the long run. Clearly, elected leaders have a far more likely conflict between short- and long-term goals in monetary policymaking than does an independent central bank.

The year ahead seems likely to pose significant challenges for the Federal Reserve. As 1989 drew to a close, there was discernible evidence of slowing in the pace of the economic expansion. Whether the slowing is but a pause in an otherwise healthy expansion or is the precursor of a more severe slowing is, of course, unknown.

Nevertheless, our experience in the 1970s should remind us that trying to prolong the expansion at the cost of more inflation is a mistake. There is no trade-off between inflation and expansion because ultimately inflation causes recession, and inflation results in less-than-optimum economic performance. Maximum production and output can be achieved only when inflation is eliminated.

The Fourth District is guided in performing its central bank functions and in providing financial services by our 25 directors, to whom we extend our deepest appreciation. We are especially grateful to Daniel M. Galbreath, president of John W. Galbreath & Co., Columbus, Ohio, who resigned from the Cleveland board earlier this year due to other commitments. We also appreciate the contributions of our retiring Branch chairmen: Owen B. Butler (retired chairman of the board of The Procter & Gamble Company), chairman of the Cincinnati board; and James E. Haas (president and chief operating officer of National Intergroup, Inc.), chairman of the Pittsburgh board. Their leadership has been valuable and will be missed.

Special thanks go to those who have completed their terms of service on our Branch boards: Robert M. Duncan (president of the First National Bank of Louisa), who served on our Cincinnati Branch board; and Thomas G. Dove (chairman of the Executive Committee and chief executive officer of Wheeling Dollar Bank) and Karl M. von der Heyden (formerly senior vice

...AN INDEPENDENT CENTRAL BANK

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president-finance and chief financial officer of H.J. Heinz Company, currently executive vice president and chief financial officer of R.J.R. Nabisco, Inc.), who served on our Pittsburgh Branch board.

Our directors represent a variety of banking and business interests from throughout the District. Their dedicated service and guidance is valued, as is that of Thomas H. O'Brien (chairman, president, and chief executive officer of PNC Financial Corp), who is currently representing the Fourth Federal Reserve District on the Federal Advisory Council and is currently president of the council. The contributions made by members of the 1989 Small Bank and Small Business Advisory Councils are also very much appreciated.

Finally, I wish to extend my personal gratitude to the officers and staff of the Bank, whose energy, creativity, and commitment made 1989 a successful year.

Sincerely,

W. Lee Hoskins

President

March 8, 1990

Central Bank Independence

This essay argues that it is in the national interest for the Federal Reserve, as well as for all central banks, to be independent within government. We believe that independence is necessary for a central bank to pursue policies that foster long-term economic growth.

It is our view that maintaining a stable price level should be the Federal Reserve's primary objective. Given the long-run relationship between money and inflation, and the Federal Reserve's unique ability to determine monetary policy, this objective may in fact be the only one it can directly and consistently achieve.

Furthermore, we believe that the Federal Reserve is responsible for pursuing policies derived from public consensus, with candor, commitment, and accountability.

DISPERSED THE CENTRAL BANK'S

POWER AMONG



THE FEDERAL RESERVE'S

THIRTEEN ENTITIES — THE TWELVE REGIONAL

RESERVE BANKS AND

THE BOARD OF GOVERNORS

IN WASHINGTON, D.C.



**Foundation
For Independence**

The history of our nation is rich with episodes testifying to a pervasive wariness of executive-branch control of money and credit. One of the reasons our Constitution gives the power to coin money to the Congress, rather than to the President, is that the Founding Fathers were aware of the tendency of sovereigns to debase the currency.¹

The United States did not have even a semblance of a government central bank for 97 of its first 137 years of independence. The First Bank of the United States (1791-1811) and the Second Bank of the United States (1816-1836) account for the other 40 years. Both banks were essentially independent of the executive branch. Moreover, the fact that neither bank's 20-year charter was renewed illustrates the suspicion of any centralized control of money and credit.

FLEXIBLE DESIGN. In designing the Federal Reserve System in 1913, Congress was careful to assure, to the extent possible, the central bank's independence from the turbulent and shifting political pressures that could influence its operation. That sense of independence has been incorporated into the Federal Reserve in several ways.

First, Congress granted the Federal Reserve self-financing authority. Instead of Congress appropriating

money to operate the central bank, the Federal Reserve uses revenues from its own operations to pay its bills, and contributes its excess earnings to the Treasury.² The appropriations process would not be a potential tool for influencing Federal Reserve policy.

Second, Congress dispersed the central bank's power among the Federal Reserve's thirteen entities — the twelve regional Reserve Banks and the Board of Governors in Washington, D.C. The seven governors on the Board must be chosen so that, at any time, there is no more than one governor from any one District. This dispersion of power makes it difficult — perhaps impossible — for specific geographic areas or special interest groups to unduly influence Federal Reserve policies.

Third, Congress incorporated a blend of public and private elements into the Federal Reserve's structure. Commercial banks hold all the stock of the Reserve Banks, entitling them to elect six of the nine directors on the board of directors of each Reserve Bank. The other three directors on each board are appointed by the Board of Governors.

However, banking interests are not a dominant force on Federal Reserve Bank boards, since three of the six directors elected by bankers and all three of the directors appointed by the Board of Governors must *not* be bankers. In addition, the chairman and vice chairman of each Federal Reserve Bank board must be chosen from among the nonbanker group of directors appointed by the Board.

Fourth, Congress directed that U.S. monetary policy be decided by majority vote in the Federal Reserve's policymaking Federal Open Market Committee (FOMC). Voting privileges in the FOMC are held by the seven members of the Federal Reserve's Board of Governors, by the president of the Federal Reserve Bank of New York, and by a rotating group of four of the other eleven Reserve Bank presidents.³

Reserve Bank presidents are appointed by the boards of directors of the Reserve Banks, subject to the

approval of the Federal Reserve's Board of Governors. Federal Reserve governors are nominated by the President and confirmed by the Senate, a method of appointment intended to make the Board more sensitive to political concerns. However, their long terms — 14 years — and the fact that they cannot be reappointed after serving a full term, removes them to a significant degree from the pressures of the political process.

CONTINUING REINFORCEMENT. Through the years, Congress has affirmed its intention that the Federal Reserve should be independent. For example, the original Federal Reserve Act of 1913 created ex officio positions for the Secretary of the Treasury and the Comptroller of the Currency on the Board of Governors. But with the passage of the Banking Act of 1935, Congress removed these positions in recognition of the desirability of having the Federal Reserve's FOMC and Board of Governors be even more independent of the administration.⁴

Nor did Congress object when, in 1951, the Federal Reserve reasserted its independence from the Treasury. In what is now known as The Accord, the Federal Reserve and the Treasury affirmed the central bank's freedom to conduct an independent monetary policy. They agreed to abandon the wartime practice of pegging interest rates on Treasury debt issues at a low level for the convenience of the Treasury's borrowing activity.⁵

...CURRENT LAW REQUIRES THE

FEDERAL RESERVE TO PROMOTE MAXIMUM

EMPLOYMENT, STABLE PRICES AND

MODERATE LONG-TERM INTEREST RATES.

COOPERATE, COORDINATE, AND BE HELD ACCOUNTABLE.

Framework For Achieving Goals

Although Congress has given the Federal Reserve a substantial degree of independence, that independence does not mean freedom from responsibility to cooperate, coordinate, and be held accountable. Congress can, at any time, change the Federal Reserve if it believes that the central bank is not acting in the nation's long-run best interest.

Beyond what was specified in the original Federal Reserve Act of 1913, Congress has adopted various pieces of legislation that spell out the goals of the Federal Reserve, without indicating specifically what methods should be used to achieve these goals.

EMPLOYMENT ACT OF 1946. The Employment Act of 1946 requires the government to pursue "maximum employment, production, and purchasing power."⁶ This law was enacted when, at the end of World War II, Congress and the President were concerned that sharp reductions in government purchases of military equipment and the discharge of millions of military personnel might cause unemployment to rise to the levels experienced in the 1930s.⁷

Responsibility for achieving the goals of the Employment Act of 1946 was not assigned specifically to the Federal Reserve System or to any other agency of government. Rather,

the act was an expression of goals to be pursued by all agencies of the government to the extent that their usual operations and powers enabled them to do so.

HUMPHREY-HAWKINS

ACT. Amending the Employment Act of 1946 is the Full Employment and Balanced Growth Act of 1978, also known as the Humphrey-Hawkins Act. The Humphrey-Hawkins Act requires the government to pursue several national goals, including "...full employment and production, increased real income, balanced growth, a balanced federal budget, adequate productivity growth...an improved trade balance...and reasonable price stability."⁸

Like the original Employment Act of 1946, the Humphrey-Hawkins Act establishes general goals for all agencies of government rather than specific assignments for each one. However, the Humphrey-Hawkins Act is more specific in that it requires the President to establish economic goals consistent with eventually achieving total and adult unemployment rates of 4 percent and 3 percent, respectively.

It also establishes procedures to help coordinate the policies of the various agencies of government to achieve those goals. For example, the Federal Reserve is required to report its monetary policy plans to Congress semiannually, and to comment on the relationship of those plans to the President's goals.⁹

FEDERAL RESERVE

REFORM ACT OF 1977. In contrast to those laws, the Federal Reserve Act, as amended, assigns some specific goals to the Federal Reserve. The Federal Reserve Reform Act of 1977 amended the Federal Reserve Act of 1913 so that it now requires the Federal Reserve "...to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."¹⁰ However, it is the Federal Reserve's responsibility to decide how best to pursue those goals.

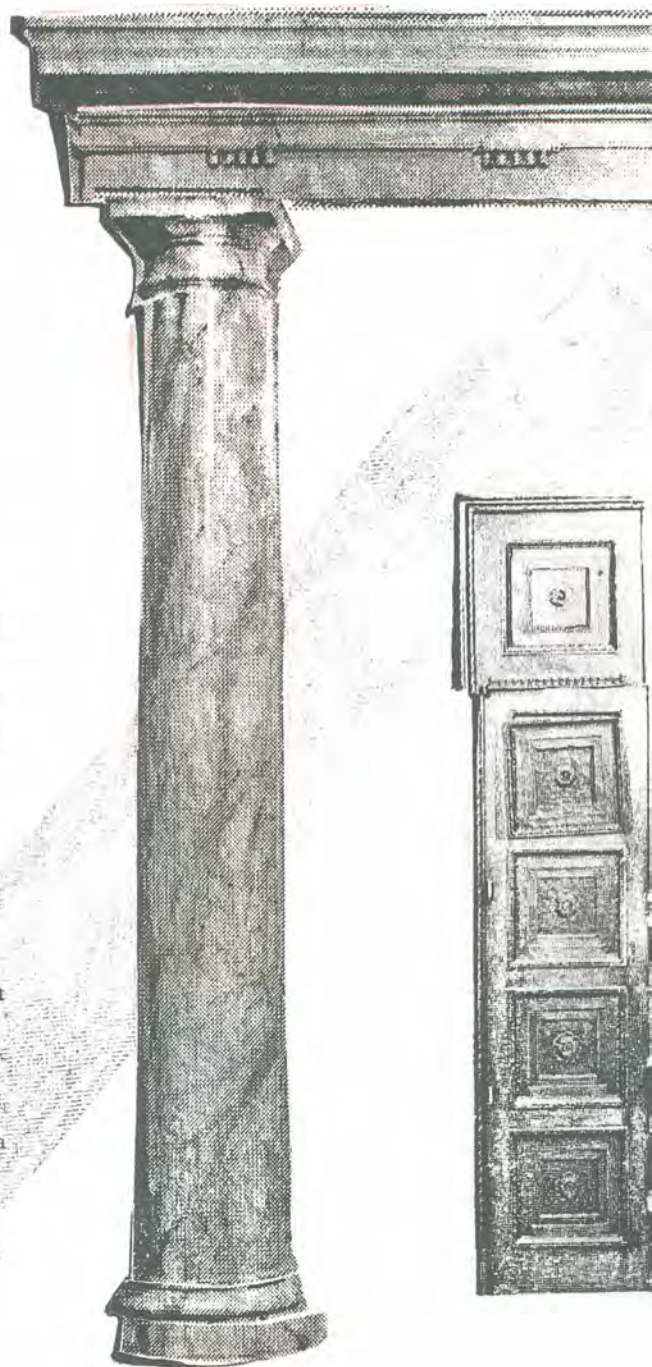
RESPONDING TO MULTIPLE GOALS. The multiplicity of goals established by Congress permits the Federal Reserve to choose which goal it emphasizes at any moment, rather than committing it to a particular goal.¹¹ This type of discretion

increases the likelihood that political and special-interest groups could try to influence the Federal Reserve to pursue the policy that is currently important to that group.¹²

In this respect, the Federal Reserve's situation is different from that of West Germany's central bank, which is also independent. More than one goal is specified by law for that bank, but German law states that the goal of price stability is to be given highest priority whenever another goal might conflict with maintaining price stability.¹³ That is a major reason why Germany's price level rose by only 212 percent between 1950 and 1988, while the U.S. price level rose by 391 percent.

CHARTING A COURSE.

Since current law requires the Federal Reserve to promote maximum employment, stable prices, and





moderate long-term interest rates, the Federal Reserve must choose a viable strategy to accomplish this mission. Two approaches seem plausible.

One approach would be for the central bank to try to achieve a balance among its three Congressionally mandated objectives. The Federal Reserve could use its own judgment about what balance among the objectives to pursue, and could change that balance from time to time depending on its view of how the economy works and what course is broadly acceptable to the public.

In essence, this is the practice that the Federal Reserve has followed. It has strived to balance desirable economic conditions such as full employment, economic growth, and low long-term interest rates with low rates of inflation.

But the major drawback to this approach is its feasibility. To strike a balance among the mandated goals requires that they be reliably linked to one another. Furthermore, monetary policy would need to be capable of influencing simultaneously all three economic dimensions in the desired directions and quantities.

Both economic theory and actual experience indicate that fine-tuning the economy through monetary policy is fraught with peril.

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While monetary policy is capable of influencing the economy in the short to intermediate run, over longer periods of time, monetary policy can only affect the rate of inflation. The rate of inflation, in turn, affects all dimensions of economic performance, including employment and interest rates. Maximum production and employment and low interest rates can be achieved only at low inflation rates.

By its very nature, a balancing act among complex economic goals causes substantial confusion about the Federal Reserve's intentions. Such confusion could be avoided to a large degree if Congress or the Federal Reserve assigned priorities to the goals, or if the Federal Reserve publicly explained the balance it was seeking among its goals, and promptly notified the public of any policy changes.

THE MONEY-INFLATION LINK. A more promising approach, at least for the long run, is to select one objective — the only one that the Federal Reserve can influence directly. This approach builds on the long-run relationship between money and inflation.

Using this approach, the Federal Reserve would seek to maintain a stable price level over time. Price stability could be defined as an inflation rate that averages zero over time and has only small and offsetting deviations from zero, or as an inflation rate so small that it does not affect economic decisions. An economy with price stability would experience changes in individual prices, but decisions about the future could be made without concern for persistent, long-run inflation.

Choosing between these two alternative methods of pursuing the Federal Reserve's goals — that is, balancing several goals or focusing on price stability — requires a thorough understanding of how the economy operates and how monetary policy affects the economy. Many aspects of these economic linkages are poorly understood, leading to spirited debates about how the Federal Reserve should conduct its business.

Most participants in this debate are likely to concede that only a central bank can produce price stability, that much of the movement in long-term interest rates can be traced to changes in expected inflation, and that employment and income growth over time depends essentially on developments in technology, efficiency, and labor-force growth. Consequently, the real issue in the debate concerns the trade-off between the short-run costs and the long-run benefits of pursuing price stability.

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CAN ONLY AFFECT THE RATE OF INFLATION...(WHICH) AFFECTS

...ECONOMIC PERFORMANCE.

Price Stability And Independence

Why is price stability — that is, the elimination of any upward trend in the general level of prices — an important goal, and why does a central bank need independence to pursue it?

Without price stability, an economy becomes vulnerable to inflation, and inflation is costly in several ways. First, inflation hampers efficiency by reducing the clarity of price signals. When a price or wage rises during an inflation, it is often unclear how much, if any, of the increase is a relative increase, and how much merely reflects the rise in the general price level.

This lack of clarity reduces the efficiency with which decisions can be made by households about occupations, employment, and consumption; and by firms about output levels, equipment-labor ratios, and materials inputs to their production processes. Uncertainty about future rates of inflation adds to investment risk and increases the risk premiums in interest rates, reducing investment and shifting it toward shorter-lived capital goods.

Second, in the United States, inflation interacts with the tax code to discourage saving and investment. Interest earned on financial assets is taxed in full, even though part of the interest income is merely an inflation premium. Investment is discouraged

because business profits are overstated, and therefore overtaxed, because the tax code allows depreciation only with respect to the purchase price of capital equipment, rather than its current replacement cost.

Third, unanticipated inflation redistributes wealth and earned income. Wealth is shifted from lenders to borrowers, or more specifically, from net monetary creditors to net monetary debtors, including the government, by reducing the purchasing power of the funds being used for repayment.

Real earned income is shifted from people with inflexible wage contracts to those who are able to raise their wages or prices faster than the rate of inflation. These redistributions are unjust because they are not legislated in a democratic process by representatives of the people.

...INFLATION

HAMPERS EFFICIENCY...

DISCOURAGE(S) SAVING

AND INVESTMENT...

REDISTRIBUTES WEALTH...

(AND) ENGENDERS

SOCIALLY WASTEFUL

ACTIVITY.

Fourth, inflation engenders socially wasteful but personally necessary activity to hedge against and to profit from inflation's redistribution of wealth. Households hedge against inflation by buying houses, land, buildings, and nonproductive assets such as gold, for which they otherwise would have no need. During hyperinflations, households even hoard foodstuffs and other basic commodities.

Firms increase inventories as an inflation hedge. Analysts sell forecasts to help people know how much inflation to expect, consultants sell advice on methods of hedging against the inflation, and financial institutions develop financial instruments to be used as inflation hedges.

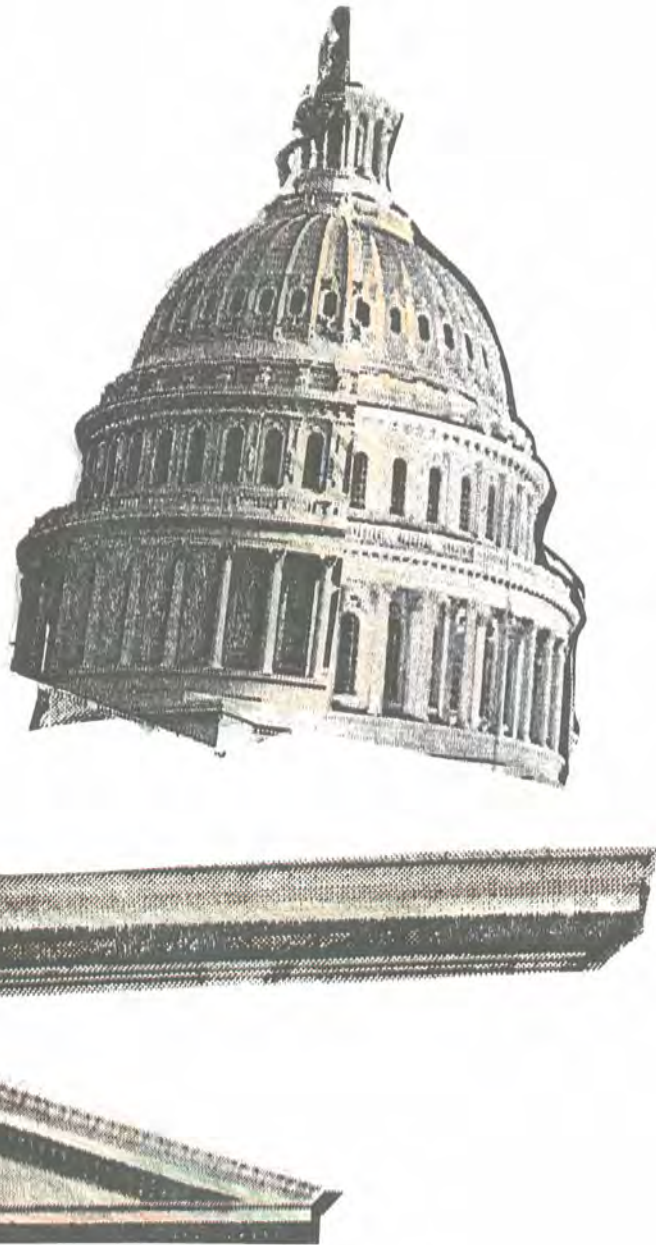
Although these activities are sensible for the firms and people who engage in them, they are socially wasteful because they merely alter the pattern of inflation's redistribution of wealth, rather than adding *to* that wealth.

PRICE STABILITY. If the aggregate price level is predictably stable, lenders do not need compensation for the inflation they expect between the times the loans are made and repaid. With price stability, the inflation premium would become nearly zero, in contrast to the 4 to 5 percent built into current rates. Reducing the size of the premium for expected inflation is, in fact, the only method that the Federal Reserve has for achieving lasting reductions in long-term interest rates.



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By pursuing a policy of price stability, the Federal Reserve would have the maximum possible impact on employment. Businesses would be able to plan with some certainty and without the concern that inflation could adversely affect their plans.

An economy with a stable price level is more efficient and more likely to grow, because confusing price signals and disincentives for saving and investment are reduced. Price stability promotes fairness because it eliminates unlegislated redistribution of wealth and income caused by inflation. The resources once used for hedging against inflation's redistributions can be freed for other uses.

A criticism of using a stable price level as the Federal Reserve's primary goal is that the Federal Reserve would not be directly attempting to achieve a balance among inflation, employment, and growth. That criticism is invalid because monetary policy cannot bring about lasting increases in employment or economic growth, except by providing a stable price environment.

SUPPORT FOR INDEPENDENCE. How important is political independence for central banks as they pursue price stability? Substantial evidence indicates a link between central-bank independence and the ability to achieve price stability.

Assessments of the degree of independence of the central banks of several major nations and their corresponding rates of inflation in recent decades indicate that countries whose central banks have a greater degree of independence have experienced lower rates of inflation.¹⁴

IF THE UNITED STATES IS TO ACHIEVE PRICE STABILITY

The wisdom of having an independent Federal Reserve is supported by U.S. experience. The Federal Reserve's independence, which is greater than that of all but a few of the central banks of the world, has resulted in the United States having had less inflation than most other countries.

From 1950 to 1988, consumer prices rose by 391 percent in the United States, while they were rising by a weighted average of 511 percent in industrialized nations (including the United States) and by about 32,000 percent in developing nations.

This evidence leads naturally to the conclusion that independence is a necessary condition for the Federal Reserve to successfully pursue price stability, or even to seek a balance among employment, stable prices, and long-term interest rates, if that should be the desired course of action.

Moreover, it appears that the degree of independence is an important determinant of avoiding inflation, even when other sociopolitical factors that might explain differences in national inflation rates are considered. For example, even taking into account other possible causes of inflationary pressure, the degree of central-bank independence appears to have an important effect on a nation's price stability.¹⁵

The Goal Of Monetary Policy

If the United States is to achieve price stability and enjoy its benefits, the nation's central bank must have price stability as its monetary policy goal.

The Federal Reserve's control of money creation gives it the power to control the price level over time. No other agency of our government can do that. Furthermore, while monetary policy may affect employment or interest rates for short periods of time, the lasting effect on employment or interest rates results only through control of inflation.

Therefore, if this nation is to enjoy the benefits of price stability and, at the same time, to have maximum employment, output, and the other benefits of free markets,

(HAS A) LASTING EFFECT ON EMPLOYMENT OR INTEREST RATES ONLY THROUGH CONTROL OF INFLATION.

the Federal Reserve must pursue price stability.

A PUBLIC COMMITMENT.

It is our view that the Federal Reserve should commit itself to the goal of price stability.¹⁶

Announcement of such a commitment would serve three purposes. First, establishing a specific goal would enhance the ability of Congress to hold the Federal Reserve accountable for achieving the goal. Central-bank accountability is appropriate in a democracy and, in fact, Congress has the ultimate authority to change the Federal Reserve's goal.

Second, a commitment to price stability would enhance the Federal Reserve's freedom from political pressures as it pursued that goal. The absence of any prioritization of the legally mandated goals creates circumstances in which various parties are likely to try to influence the Federal Reserve to emphasize one or another of those goals.

A public commitment to price stability would reduce the effectiveness of political pressure to deviate from that goal. Thus, a distinction can be made between a central bank that is accountable for long-run performance and a central bank that can be influenced by government officials who might be pursuing

short-run goals that might be incompatible with long-term performance.

Third, the Federal Reserve's public commitment to price stability would foster the expectation of price stability in the economy. Price and wage decisions that are consistent with price stability would be encouraged, thereby making price stability easier to achieve and maintain.

IMPLEMENTING PRICE

STABILITY. Commitment to price stability requires more than just saying that price stability is the goal the Federal Reserve will pursue. To be useful and effective, the commitment must include some important details. Because the United States has not had a long-term policy of price stability, the Federal Reserve will need to implement such a strategy gradually. The initial step would be to establish and announce a specific timetable for reducing inflation and eventually eliminating it.

The Federal Reserve should then announce and explain the actions it will take to achieve its specified trajectory for the inflation rate. Whenever decisions are made about the money growth or the interest rates that the Federal Reserve is seeking in order to follow its timetable, those decisions should be announced immediately.¹⁷

... IT APPEARS THAT

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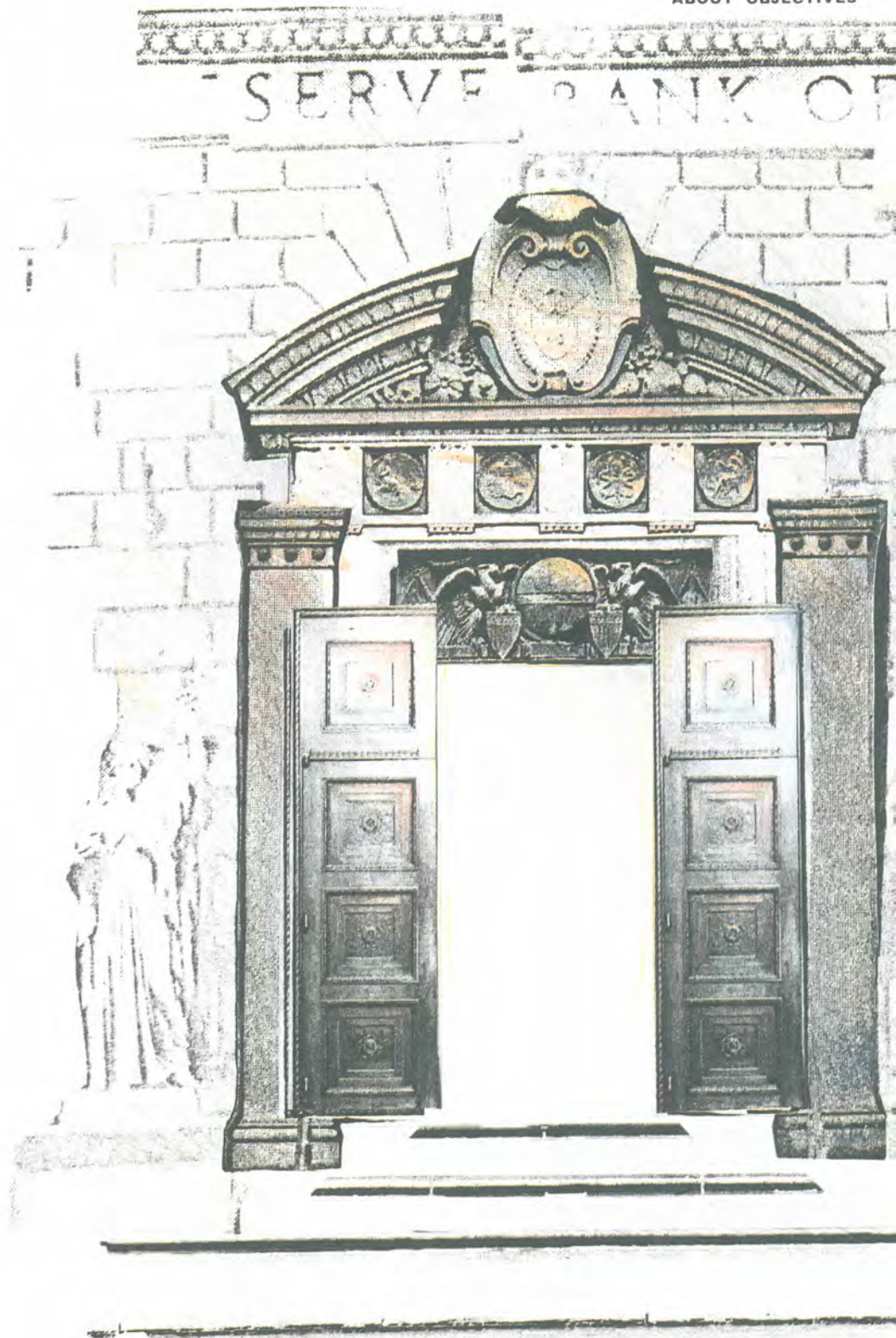
While we believe that decisions should be announced immediately, we think that the details of discussions in FOMC meetings should not be released because to do so could inhibit discussion in those meetings.

Finally, if the inflation rate deviates from the announced timetable, the Federal Reserve should explain why the deviation has occurred, and announce and explain the actions being taken to get back on track.

Federal Reserve independence, and candor about objectives and timetables, would interact to aid the Federal Reserve's pursuit of price stability in several ways. Independence in determining monetary policy is necessary if the Federal Reserve is to have credibility when it announces how it will conduct monetary policy. Candor in announcing its goals and methods will only enhance Federal Reserve credibility, which will facilitate achieving price stability.

FEDERAL RESERVE INDEPENDENCE,

ABOUT OBJECTIVES



AND CANDOR

AND TIMETABLES, WOULD INTERACT TO AID THE FEDERAL RESERVE'S

PURSUIT OF PRICE STABILITY.

Conclusions

There is much to recommend the continued independence of the Federal Reserve System. Clearly, the authors of the Constitution intended, as one aspect of the separation of powers, that the executive branch of government should not have the power to coin money. And it is clear that Congress, in its design of the central bank, intended that the Federal Reserve should have substantial independence from both the executive and the legislative branches in conducting its operations.

Expert opinion here and abroad has, through the years, urged that the executive branch of government in any nation should not have the power to create money and credit. Moreover, empirical evidence indicates that those nations whose central banks have greater independence also have less inflation than other nations.

Inflation interferes with a nation's pursuit of other economic goals such as full employment, economic growth, and low interest rates, while price stability supports the pursuit of those goals.

The Federal Reserve's independence has served this nation well. While U.S. price-level experience has not been as good as it should have been, it has certainly been much better than those nations whose central banks are controlled by their executive branches of government. Our nation's prospects for greater price-level stability, and thus the opportunity for greater overall long-run prosperity, will be enhanced if the Federal Reserve's independence is maintained and its commitment to price stability is strengthened and made more explicit.

Footnotes

1. See Lawrence Gipson, *The Coming of the Revolution: 1763-1775* (Harper and Row, 1954), pp. 40-54. Another reason was to keep the states from having the power to coin money. See Edward Meade Earle, ed., *The Federalist*, nos. 42 and 44 (Madison, 1788), (Modern Library, 1937), pp. 275-76 and 289-91.

2. In 1988, the Federal Reserve System had \$17.55 billion of net income after expenses. From that net income, \$17.36 billion was contributed to the U.S. Treasury. See *75th Annual Report 1988*, Board of Governors of the Federal Reserve System, p. 216.

3. The voting records of Federal Reserve Bank presidents and governors in the FOMC are quite different, which supports the notion that the structure of the Federal Reserve provides representation of different views of what is best for the nation. When voting at FOMC meetings during the last quarter century, presidents have been twice as likely as governors to dissent from the FOMC's majority in favor of a tighter monetary policy, while governors have been five times as likely as presidents to dissent from the majority in favor of an easier monetary policy.

4. See Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States 1867-1960*, (Princeton University Press for the National Bureau of Economic Research, 1963), pp. 445-46, footnote 25.

5. *Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1951* (Government Printing Office, 1951), p. 271.

6. Employment Act of 1946, Section 2, as recorded in the *United States Code: Congressional Service, Laws of 79th Congress, Second Session* (West Publishing Company), p. 20.

7. *Economic Report of the President, January 1947*, (GPO, 1947), p. vii.

8. Full Employment and Balanced Growth Act of 1978, as recorded in the *United States Code: Congressional Service and Administrative News, Laws of 95th Congress, Second Session* (West Publishing Company).

9. *Economic Report of the President, January 1979*, (GPO, 1979), pp. 106-08.

10. Federal Reserve Reform Act of 1977, as recorded in the *United States Code: Congressional Service and Administrative News, Laws of 95th Congress, First Session* (West Publishing Company).

THE FEDERAL RESERVE'S INDEPENDENCE
HAS SERVED THIS NATION WELL.

11. "Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Domestic Monetary Policy of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, October 25, 1989," *Federal Reserve Bulletin*, vol. 75 (December 1989), p. 797.

12. See Robert L. Hetzel, "Central Banks' Independence in Historical Perspective," *Journal of Monetary Economics*, vol. 25, no. 1 (January 1990). Hetzel distinguishes between central banks that have independence with commitment to a particular goal, and independence with autonomy to choose a goal or goals. He argues that the latter type of independence tempts special interest groups to try to influence the central bank's choice of goal.

13. See Manfred Willms, "The Monetary Policy Decision Process in the Federal Republic of Germany," in Donald R. Hodgman, ed., *The Political Economy of Monetary Policy: National and International Aspects*, Conference Series no. 26 (Federal Reserve Bank of Boston, July 1983), p. 36.

14. See Alberto Alessina, "Macroeconomics and Politics," *Macroeconomics Annual* (The MIT Press for the National Bureau for Economic Research, 1988), pp. 38-43 and table 9. See also King Banaian, Leroy O. Laney, and Thomas D. Willett, "Central Bank Independence: An International Comparison," Federal Reserve Bank of Dallas, *Economic Review*, (March 1983), pp. 6-8.

15. Alessina, *Macroeconomics Annual*, p. 42; and Banaian and others, *Economic Review*, pp. 12-13.

16. Federal Reserve Chairman Alan Greenspan apparently agrees. See Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, "Monetary Policy Report to the Congress," *Federal Reserve Bulletin*, vol. 75 (August 1989), pp. 527-38: "...the fundamental objective of our policy... remains to maximize sustainable economic growth which in turn requires the achievement of price stability over time;" and "Any inflation that persists will hinder the economy's ability to perform at peak efficiency and to create jobs." See also Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, "Monetary Policy Report to the Congress," *Federal Reserve Bulletin*, vol. 75

(April 1989), p. 274: "Maximum sustainable economic growth over time is the Federal Reserve's ultimate objective. The primary role of monetary policy in the pursuit of this goal is to foster price stability."

17. For a detailed rebuttal of the argument that delayed release of the FOMC's decisions is necessary, see Marvin Goodfriend, "Monetary Mystique: Secrecy and Central Banking," *Journal of Monetary Economics* (January 1986), pp. 63-92. For a study showing that prompt release of the Federal Reserve's one-quarter-ahead money projections would improve the accuracy of the public's expectations of future money growth, see Michael Hutchison and John R. Judd, "Central Bank Secrecy and Money Surprises: International Evidence," Working Paper 89-02 (Federal Reserve Bank of San Francisco, June 1989).

STATEMENT OF CONDITION

	1989	1988
Assets		
Gold certificate account	\$ 661,000,000	\$ 655,000,000
Special drawing rights certificate account	508,000,000	314,000,000
Coin	35,198,010	25,463,147
Loans and securities:		
Loans to depository institutions	260,490,000	890,000,000
Federal agency obligations bought outright	375,348,521	402,430,203
U.S. government securities		
Bills	6,016,323,386	6,515,038,679
Notes	5,256,981,596	5,253,906,524
Bonds	1,772,647,794	1,728,921,594
Total U.S. government securities	13,045,952,776	13,497,866,797
Total loans and securities	13,681,791,297	14,790,297,000
Cash items in process of collection	311,132,941	243,970,219
Bank premises	33,636,690	31,674,850
Other assets	1,996,567,172	793,404,407
Interdistrict settlement account	1,213,581,514	(559,500,560)
Total Assets	\$ 18,440,907,624	\$ 16,294,309,063
Liabilities		
Federal Reserve notes	\$15,565,816,189	\$13,703,779,373
Deposits:		
Depository institutions	2,107,236,707	1,893,425,046
Foreign	8,100,000	8,250,000
Other deposits	62,171,052	13,993,166
Total deposits	2,177,507,759	1,915,668,212
Deferred availability cash items	287,754,553	266,000,247
Other liabilities	162,828,823	179,054,731
Total Liabilities	\$ 18,193,907,324	\$16,064,502,563
Capital accounts		
Capital paid in	\$ 123,500,150	\$ 114,903,250
Surplus	123,500,150	114,903,250
Total Capital Accounts	\$ 247,000,300	\$ 229,806,500
Total Liabilities and Capital Accounts	\$ 18,440,907,624	\$16,294,309,063

Comparative Financial
Statement

For years ended December 31

SELF-FINANCING AUTHORITY.

INCOME AND EXPENSES	1989	1988
Current Income		
Interest on loans	\$ 2,429,631	\$ 1,384,919
Interest on government securities	1,149,099,468	1,055,774,529
Earnings on foreign currency	56,068,247	16,607,328
Income from services	42,968,475	40,109,734
All other income	592,146	571,323
Total current income	\$ 1,251,157,967	\$ 1,114,447,833
Current operating expenses	66,379,062	65,237,787
Cost of earnings credits	11,691,875	11,043,526
Current Net Income	\$ 1,173,087,030	\$ 1,038,166,520
Profit and Loss		
Additions to current net income		
Profit on foreign exchange transactions	\$ 702,956	\$ 0
Profit on sales of government securities	68,403,659	1,369,885
All other additions	3,270	5,885
Total additions	\$ 69,109,885	\$ 1,375,770
Deductions from current net income		
Loss on foreign exchange transactions	\$ 0	\$ 28,098,147
All other deductions	1,190	108,533
Total deductions	\$ 1,190	\$ 28,206,680
Net additions or deductions	\$ 69,108,695	\$ 26,830,910
Assessments by Board of Governors		
Cost of Unreimbursable Treasury Services	\$ 3,338,604	\$ 1,924,431
Board of Governors expenditures	4,877,500	4,620,100
Federal Reserve currency costs	10,402,141	10,064,330
Total assessments by Board of Governors	18,618,245	16,608,861
Net Income Available for Distribution	\$ 1,223,577,480	\$ 994,726,749
Distribution of Net Income		
Dividends paid	\$ 7,054,527	\$ 6,811,391
Payments to U.S. Treasury (interest on Federal Reserve notes)	1,207,926,053	985,705,508
Transferred to surplus	8,596,900	2,209,850
Total distributed	\$ 1,223,577,480	\$ 994,726,749

**Federal Reserve
Bank of Cleveland
Directors**

As of December 31, 1989

Chairman & Federal Reserve Agent

CHARLES W. PARRY

Retired Chairman & Chief Executive Officer
Aluminum Company of America
Pittsburgh, Pennsylvania

Deputy Chairman

JOHN R. MILLER

Former President & Chief Operating Officer
Standard Oil Company of Ohio
Cleveland, Ohio

DANIEL M. GALBREATH

President, John W. Galbreath & Co.
Columbus, Ohio
(Resigned July 1, 1989)

VERNA K. GIBSON

President, The Limited Stores, Inc.
Columbus, Ohio

LABAN P. JACKSON, JR.

Chairman, Clearcreek Properties
Lexington, Kentucky

WILLIAM H. MAY

Chairman & President
First National Bank of Nelsonville
Nelsonville, Ohio

WILLIAM T. MCCONNELL

President, The Park National Bank
Newark, Ohio

DOUGLAS E. OLESEN

President and Chief Executive Officer
Battelle Memorial Institute
Columbus, Ohio
(Term began August 22, 1989)

ROBERT D. STOREY

Partner, Burke, Haber & Berick
Cleveland, Ohio

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Chairman & Chief Executive Officer
Huntington Bancshares Incorporated
Columbus, Ohio

President, Federal Advisory Council

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Chairman, President
& Chief Executive Officer
PNC Financial Corp
Pittsburgh, Pennsylvania

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Retired Chairman of the Board
The Procter & Gamble Company
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Louisa, Kentucky

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The Provident Bank
Cincinnati, Ohio

KATE IRELAND

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Frontier Nursing Service
Wendover, Kentucky

JERRY L. KIRBY

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President & Chief Executive Officer
Citizens Federal Savings & Loan Association
Dayton, Ohio

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Cincinnati Directors

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National Intergroup, Inc.
Pittsburgh, Pennsylvania
(Resigned September 20, 1989)

Chairman

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President & Chief Operating Officer
Allegheny Ludlum Corporation
Pittsburgh, Pennsylvania
(Term began October 5, 1989)

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Consolidated Natural Gas Company
Pittsburgh, Pennsylvania

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Chairman of the Executive Committee
& Chief Executive Officer
Wheeling Dollar Bank
Wheeling, West Virginia

STEPHEN C. HANSEN

President & Chief Executive Officer
Dollar Bank, FSB
Pittsburgh, Pennsylvania

JACK B. PIATT

Chairman, Millcraft Industries
Washington, Pennsylvania
(Term began November 3, 1989)

E. JAMES TRIMARCHI

President & Chief Executive Officer
First Commonwealth Financial Corporation
Indiana, Pennsylvania

KARL M. VON DER HEYDEN

Senior Vice President-Finance
& Chief Financial Officer
H.J. Heinz Company
Pittsburgh, Pennsylvania
(Resigned July 6, 1989)

MILTON A. WASHINGTON

President & Chief Executive Officer
Allegheny Housing Rehabilitation Corporation
Pittsburgh, Pennsylvania

**Federal Reserve
Bank of Cleveland**

Officers

As of March 1, 1990

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First Vice President

RANDOLPH G. COLEMAN
Senior Vice President

JOHN M. DAVIS
Senior Vice President & Director of Research

JOHN J. RITCHEY
Senior Vice President & General Counsel

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General Counsel

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Vice President & General Auditor

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Assistant Vice President & Economist

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Assistant Vice President & Economist

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President & Economist

JAMES B. THOMSON
Assistant Vice President & Economist

WALKER F. TODD
Assistant General Counsel
& Research Officer

HENRY P. TROLIO
Assistant Vice President

ROBERT E. WHITE
Assistant Vice President & Assistant
General Auditor

DARELL R. WITTRUP
Assistant Vice President

Cincinnati Branch

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Senior Vice President

ROSCOE E. HARRISON

Assistant Vice President

DAVID F. WEISBROD

Assistant Vice President

JERRY S. WILSON

Assistant Vice President

Pittsburgh Branch

HAROLD J. SWART

Senior Vice President

RAYMOND L. BRINKMAN

Assistant Vice President

LOIS A. RIBACK

Assistant Vice President

ROBERT B. SCHAUB

Assistant Vice President

Columbus Office

CHARLES F. WILLIAMS

Vice President

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This annual report was prepared by the Research Department and the Public Affairs and Bank Relations Department, Federal Reserve Bank of Cleveland. For additional copies of this report, contact the Public Affairs and Bank Relations Department, Federal Reserve Bank of Cleveland, P.O. Box 6587, Cleveland, OH 44101.

Design, Illustration and Principle Photography Nesnadny & Schwartz

Portrait Photography Mike Steinberg