

Leadership, Progress
and the
Federal Reserve System

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I am pleased to be here this evening and to have the privilege of addressing this group of Federal Reserve System leaders. Given recent events and your performance under enormous stress, I have to ask myself: “Do you really need a speech tonight on leadership?”

Your mettle as leader has just been tested. Your understanding of and commitment to a vision of the Federal Reserve System as the world’s financial leader has just been tested. During this terrible crisis your commitment to duty and your success demonstrate to all what leadership really is.

The Federal Reserve System assumed risks, physical and financial, that few other organizations were able or prepared to accept for the financial world. That is leadership shown in the chaos of crisis. That is courage and leadership shown under the most trying of circumstances. Without hesitation, I am proud to say not just that I am an American, but also that I work for the Federal Reserve. We should be proud.

Perhaps our performance through this trial is the best definition and example of leadership one can give. Perhaps nothing more need be said. But, this crisis will pass and we will need to come back to the matter of leadership and the requirements of leadership under more normal

circumstances. And that is what I have been asked to address here this evening.

What makes this program unique is not just that it is about leadership but that it is about leadership and the Federal Reserve System. This is important because I am convinced that we have issues that are, indeed, unique to the Federal Reserve. What are the challenges confronting this organization? Why do I say they are unique? Why will it take skilled leadership to navigate through the issues and to define a vision for people to believe in and adopt? What is expected of you and of me?

The most demanding long-term issue confronting the Federal Reserve, in my opinion, is the task of defining a vision that appreciates and respects our role as the central bank of the United States, that understands and respects our decentralized structure, and then balances the objectives served by this structure with the need to be an efficient, hard-driving organization.

Both sets of objectives are legitimate and represent forces in which the too great a neglect of one for the other will most certainly undermine the Federal Reserve's long-run viability as an independent, effective central bank. At times, they conflict and unsettle relationships among the twelve banks, Federal Reserve Information Technology (FRIT), and the Board of Governors. Always, the objectives and the strains around them should be on our minds. In the end, they require that we define and constantly attend to a vision that recognizes their dual primacy within the Federal Reserve System.

In an effort to put substance around this push for a balanced vision, I want to provide you some historical and operational background information, admittedly as seen through my eyes and in the context of my biases. Still, they are worth considering. I will not resolve a single issue here this evening. I will not propose a vision. My goal is to encourage you to accept the notion that as leaders it is our duty to sort through the issues most cautiously and with a good degree of humility. We must then define a vision that will keep this great institution moving forward for decades to come.

There is in the Federal Reserve a long tradition of local autonomy and innovation and performance that has made it one of the most successful and admired institutions in the world. Part of the reason for this success is the ability to adapt to the world as it changes, and yet remain aligned with our fundamental missions.

Efficiency

Today, the rapid changes and operational advantages facilitated by technology are forcing the Federal Reserve to focus on harvesting these advantages for itself. This has led to an enormous focus on the matter of operational scale and cost containment. With technology, especially communication technology, requiring enormous capital investments in equipment and software, the need to capture economies of scale is real and unavoidable. With this is also the goal of improving operational control. From nearly every perspective, the drive toward cost reduction is

unrelenting, and I sense either enthusiastic support or resigned acceptance of this need from nearly every part of the Federal Reserve System.

Indeed, the drive for scale has led the System to revamp its organizational structure, increasingly moving authority from the Reserve Banks to steering committees such as the Financial Services Policy Committee (FSPC), Information Technology Oversight Committee (ITOC) or the Supervision Committee. Also, as a consequence of these trends, we now rely much more on a “matrix” management structure to run the Federal Reserve System.

There are important instances that demonstrate the benefits realized from both the change in operations and the change in management. The benefits being harvested from FRIT are an example. As the Federal Reserve Banks have outsourced mainframe operations to FRIT, important and measurable cost reductions have occurred. As we have learned from this experience, we are beginning to explore other areas to capture similar improvements and cost savings. These include, for example, process-oriented functions such as Human Resources Information Systems (HRIS) and GroupWare.

Although these consolidations have their own set of operational issues, it is hard to dispute that -- on balance -- we have benefited from them. In each case, the ability to license software and to purchase hardware on a large scale has resulted in savings. In other words, on a Systemwide basis we have been able to reduce costs and deliver a high-quality product.

The processes of changing how we operate and how we manage ourselves, indeed, have benefited our “bottom line.” This is important. For like any organization, if we had failed to seek out better and more efficient ways to operate -- and as a result we needlessly waste resources -- we would be unable to compete in our priced services areas, and we would be legitimately subject to criticism from the public in our bank supervision and research functions. This is serious stuff -- not to be taken lightly.

But, are there other long-term implications to our changes in operations and management structure? We need to consider this as part of our analysis of real long-term costs. We must always remain aware that foremost we are a “Central Bank,” with more to serve than lower costs or market share. Efficiency is more than that. Most decisions involve a trade-off -- something given up for something gained. Efficiency, as important as it is, most certainly involves giving up something. What is it? How important is it? And what is the long-term implication of such a trade-off?

Structure

To get a better feel for this, we must know a little history and understand some of the background to our basic charter and mission.

In this regard, we need first to appreciate that the Federal Reserve System is not designed as it is by accident. It is not an anachronism. It was designed this way to preserve its existence.

We have had a run of good news about the Federal Reserve these past eight years or so, and we are feeling secure about our standing with the American people. But this has not always been the case, and it will not always be the case in the future. There is a small group of people that confidently believes that we are an illegal, corrosive institution that is undermining the strength and vitality of the U. S. economy.

There is a larger group of people that believes we are simply too powerful, have too much control over the economy, and need to be brought to rein. That was also the case in 1913 and was a major reason we were organized into twelve districts and twelve banks with separate charters. The goal in setting forth the Federal Reserve System was to diffuse power, to provide independent views from different parts of the country, and to build a network, which instills confidence within our communities across the country.

On that topic, Paul Warberg, one of the founders of the Federal Reserve wrote the following:

One of the striking points of strength of the Reserve System lies in its weakness. This paradox means that the strength of a system of regional banks consists in engendering in the minds of people a comfortable feeling of protection against the dangers of an autocratic central administration. In this respect the Reserve System is to be preferred to the threat which was provided by ...(my) United Reserve Bank proposal. There is no doubt that if enacted, it would have offered easier and more tempting targets for political attacks. This political superiority of the Reserve System cannot be too highly appraised, although it is, at the same time, the System's greatest weakness.

We are, in other words, without question, a product of the populist fears of “big” institutions. And those fears, while currently somewhat dormant, are as real today as they were nearly ninety years ago. And if for whatever reason we were to abandon our current structure, it would be short order until we would see the elimination of our regional directors, connections into the community, and our effectiveness in communicating with the broad populous of the United States. We, in my opinion, would compromise our ability to most effectively carry forward our mission.

For these reasons, I am of the opinion that to focus on efficiency without remembering why we are organized the way we are, is to undermine our long-term viability. It is just as critical to understand this fact as it is to understand the critical need to be as efficient as possible. To think of us as a Citigroup or a Bank of America is to miss the point of our very existence.

So, what is our duty in these circumstances? In my mind, it is to renew our vision and review our manner of operation to be certain that it respects the primacy of the System’s mission and balances efficient operations with the political reality that shapes and defines the purpose and environment within which we serve.

Leadership and Process

Finally, what about process in building this vision and this operational framework? I want to share six statements with you that I have found useful over the years. They are not mine to claim, but they are mine to share with you and I hope you find them helpful. They are worth reflecting on as you

engage in dialogue among yourselves and with others as you work over the next few days.

- First, effort is critical to the exercise of leadership. Your first duty is to work and serve.
- Second, leadership is not about asking, “what do you want?” It is about defining what the institution requires to be great.
- Third, defining these requirements should make us uncomfortable about where we are—but excited about where the institution is going.
- Fourth, leading cannot provide security in what we are doing today-but can outline a future that we can achieve with effort.
- Fifth, There is much to do, and you must choose to join together as leaders if this institution is to succeed.
- Last, I am not talking about management here tonight -- that will follow. I am talking about leadership. I am talking about defining our vision in such a way that we can best balance our dual priorities in this fast-changing world.

You have an opportunity to lead and make a difference. And in doing so you will keep this organization strong and prepare it for the next ten decades.