Transcript

Fed Talk: Why Cleveland? The Story Behind the Fed's Regional Structure—and Why It Matters Today

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Presentation

Speaker

Owen F. Humpage, economist emeritus, Federal Reserve Bank of Cleveland

Moderator

Chuck Soder, senior media relations specialist, Federal Reserve Bank of Cleveland

Chuck Soder:

Hello, hello, hello, and good afternoon everyone. Thank you for joining us for today's *Fed Talk*, which by the way, is being recorded. My name is **Chuck Soder**, senior media relations specialist here at the Federal Reserve Bank. And I'm also on the team that puts together the *Fed Talk* Speaker Series, where we dive into all sorts of issues connected to the economy, ranging from inflation to the job market, to financial literacy. And all of those episodes are available at clevelandfed.org/fedtalk.

Now, I'm really excited to kick off today's conversation. Why Cleveland? The Story Behind the Fed's Regional Structure and Why it Matters Today. But before we jump in, a few quick housekeeping things. If you're joining us virtually, if Zoom crashes, the meeting drops, just use the dial-in information from your invitation to rejoin by phone. And your mic and camera are disabled, but we want your questions. So submit them using the Q&A feature in Zoom. And if you're in person, we've got paper and pens at your table. Please write your questions down and one of my colleagues will be around to pick them up. We'll get to as many as we can. And one last housekeeping item, the most important one, the views shared today by myself and by my fellow speaker, they are our views and not necessarily the views of the Cleveland Fed or the Federal Reserve system. Okay.

In just a moment, you will hear from **Owen Humpage**, economist emeritus here at the Cleveland Fed. He's going to talk about why there even is a Cleveland Fed and a Dallas Fed and a San Francisco Fed. But first, let me set the scene. If you attended our last *Fed Talk*, you may remember Owen describing how the financial system worked in the 1800s before the Fed was created.

In short, back then there were two big problems. One, there were a lot of bank runs. And two, a related issue, there were times when there just wasn't enough cash to go around, be it during recessions, or even at other times. Even during the harvest, farmers would pay loads and loads of farm workers, and that would put banks in a tight spot. So the Fed was the solution to those two problems.

However, why does the map look like this? Why are there 12 quasi-independent reserve banks across the nation instead of one big bank in Washington DC or New York? And how come our district headquarters is in Cleveland instead of somewhere else in that light blue area that we call the Fourth District? Well, that's why Owen is here. Owen, come on up.

Owen Humpage:

Thanks. Not sure you'll be happy at the end. So the Federal Reserve, as Chuck implied, has a unique structure for a central bank. It has a headquarter in Washington and then it has 12 semi-independent districts with the district headquarters. And you're sitting in the headquarters of the Fourth Federal Reserve District.

Now, the Fed was originally established to stave off banking panics. And during the last half of the 1800s, the United States had more banking panics than any other well-developed country. Under the idea, the member banks, banks that joined the Federal Reserve, would take their reserves and pool their reserves in the Federal Reserve Bank in their district. Now, reserves, I mean money they have backing their deposits.

And then when a crisis, a banking crisis hit, the Federal Reserve then was to loan out these reserves to each individual bank. When they loaned out the reserves, the money stock would increase. With a bigger money stock, they could settle the demands of their depositors for cash, and ideally without having to cut back on their loans because that would just make the crisis much worse.

And then the idea was to do this on a regional basis so that differences in the districts could be accommodated with the local Federal Reserve Bank. So when they paid back those loans they took out from the Federal Reserve Bank, the money supply would contract, and then the money would grow again according to the gold standard, which we were on. So over long term, the growth in money and the inflation rate in the United States was determined by the gold standard over long periods of time.

There was virtually no major disagreements about the way they were going to do that, but there were huge disagreements about the structure of the Fed, the governance structure of the Federal Reserve system. The banks in New York and in the East Coast wanted a structure that was highly centralized and they wanted it centralized and they wanted to say how it worked. They wanted to be the government of the governing structure of the Federal Reserve system that way. They would allow a few regional banks, but those banks were to be branches of the central authority so that bankers could run the whole show.

The banks in New York were sympathetic to the banks on the East Coast, especially the banks in New York, but they didn't quite 100% trust the banks in New York because they thought New York was starting to do risky types of loans, loans that were not consistent with the traditional loans of a commercial bank. The progressives at the time for sure, and these could be progressives in the Democratic party, progressives in the Republican party, they wanted a heavy investment of government in whatever central bank we had because they didn't trust the bankers to always act in the public interest.

And then the last group was a group we call the interior or country banks. This refers to those small banks scattered all over the nation, not so much in large urban areas. These banks did not want a centralized Federal Reserve system because they worried that a centralized Federal Reserve system wouldn't pay attention to their individual needs and the individual ways they had traditionally carried on banking.

So the Federal Reserve Act that Wilson signed into law on December 23rd, 1913 was a compromise of this structure. So the structure of the Fed is a compromise of all those ideas. The Federal Reserve Act created the Reserve Bank Organization Committee. And this committee was told that they could establish no fewer than eight reserve districts in the country and no more than 12 districts in the country.

So the Reserve Organization Committee consisted of the secretary of the treasury, whose picture you can see there, the secretary of agriculture, and the comptroller of currency. So these guys set out on an 18 city tour of the United States pretty quickly. And right before when they were leaving, the secretary of the treasury asked the treasury to send out a ballot to the 7,500 national banks that existed throughout the United States at the time. And on this ballot, he asked them to list their first, second, and

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third choice of a district headquarter city. Now when they did that, they had no idea what the districts would look like. So they were just picking their best city.

And the organization committee also hired a guy, H. Parker Willis, who was an economist, and had a lot to do with passing the Federal Reserve Act. Willis was supposed to gather the information from the organization committee, and then he was supposed to give them a set of options for setting up the Federal Reserve system. So what Willis did was he drew five maps, one each for eight districts, nine districts, 10, and so on. And you can see a couple of them up on there right now.

So what the committee was doing, trying to set up the Federal Reserve, was a very daunting task. Not only did he have to draw the outlines, but he at the same time had to pick a reserve headquarter city. And so they were interrelated. So the Federal Reserve Act dictated that they were set up to set up these reserve districts for the convenience and customary course of business. That says a lot, kind of says nothing.

So what it basically means is this, and I'll use an example. Suppose your bank's in Erie. If the banks in Erie, and their customers, both their depositors and the businesses that borrowed from them, have close connections to Pittsburgh, then they should be lumped in with Pittsburgh in a district. On the other hand, if they have close connections to Buffalo, they should be lumped in with Buffalo in a district. Or if they have close connections with both of these, then they all should be put together in a single district.

The second criteria though was a little more important from my view. The districts had to be independent. Or another way to think about it, they had to be equal in authority. Now to do this, and I'll explain a little more why, to do this, each Federal Reserve bank had to have $4 million in capital before it could start. At least four million, they could have more, any bank that wanted to be a member of that district had to subscribe to that capital an amount equal to 6% of their own capital. So what this means is that the districts had to be big enough in order to gather to have potential capital of $67 million. And that alone explains why some of the districts out west are huge because they don't have many banks, and the districts on the east are rather small.

The other thing works towards the same process. The banks had to be, this independence idea kind of worked like this. All the banks in the district had to have enough reserves pooled in the district headquarter to meet a financial crisis in that district. Now, the Federal Reserve Act allowed one district bank headquarter to borrow from another district headquarter. But if that went on continually, that kind of destroyed the district nature of the weaker district.

And what they were afraid of was some districts would start to dominate the weaker districts. The stronger districts would dominate the weaker districts. And for that very reason, what they did was they worried mostly about New York dominating the whole thing. So they established a Boston branch district, even though a lot of businesses and banks in Boston had very close relationships with New York. So they established that one to limit the domination of New York. And they did the same thing for Chicago banks. They started the Minneapolis district in order to kind of prevent Chicago for dominating things. So that's what I mean by sort of equal. They didn't want unequal districts.

So the next thing they had to do, or they did simultaneously, was pick a district headquarter. 37 cities applied to be district headquarters for as much as 12 districts. So they knew right away they were in trouble, people would be upset. And when they announced the 12 districts, a lot of people accused them of politics. Now the lists vary of the banks that were accused of being set up by politics, but it includes Atlanta, Cleveland, Dallas, Kansas City, and Richmond generally.

And here's sort of the argument. So Richmond was chosen, not because it was a good city, but because President Wilson was born in Virginia. The guy that was the comptroller of the currency and also on the reserve bank organization committee was a major banker in Richmond. And also a guy named Glass who basically wrote a draft of the Federal Reserve Act, he was the congressman for Virginia, the Richmond District.

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And for this Kansas City one, this is the one I always wonder about. It's not really about Kansas City. It was about Missouri having two headquarter cities, St. Louis and Kansas City. You look on a map, you only had to move it a couple of miles over a river and it would've been in Kansas. So the argument here is that the secretary of agriculture who was on the organization committee had been a president of a big university in St. Louis. And the other thing was the powerful speaker of the House of Representatives was from Missouri. And then also it was a major Democratic state.

For Cleveland, the claim was Newton D. Baker, who was the mayor of Cleveland in 1912, was a good friend of President Wilson. In fact, he campaigned vigorously for Wilson, and he would eventually become Wilson's secretary of war in 1916. So those are the arguments for those cities. I don't have really good ones for Atlanta and Dallas, but you can ask later.

Well, now economists, being the nerds they are, actually tried to figure out, predict the districts using statistical methods. And what all these studies show is the key thing, the thing that describes the district's district headquarters, the key thing is that ballot those bankers took way back in the beginning. All of the district headquarters ranked very high on the bankers' list, which means the bankers basically picked the headquarters. They were happy with them.

There was one exception, can you guess? Cleveland. Cleveland had less votes on that ballot than either Cincinnati or Pittsburgh. And of course, Pittsburgh went wild. So here's why Cleveland was chosen over Pittsburgh and Cincinnati. First, Cleveland was the last city on that 18 city tour, and they may have had information about the questions typically being asked, but they kind of guessed what they were and they prepared answers very carefully for that.

The second thing was the organization committee viewed banking in Pittsburgh as being kind of dominated by a few banks, mainly Mellon Bank, whereas they viewed banking in Cleveland as being more competitive. The other thing was Pittsburgh had had a number of national bank failures before 1914. Cleveland had none. The second reason they chose Cleveland over Pittsburgh and Cincinnati was Cleveland's industrial base was more diversified than the industrial base in Pittsburgh. Pittsburgh's mainly related to steel and iron. Now that meant that the loans of the banks in Cleveland were more diversified.

Now this goes along with that old adage, don't keep all your eggs in one basket. So if the loans are diversified, the banks are going to be safer. If the banks are safer, the depositors are going to be safer. The last reason is that growth in Cleveland looked much better than growth in Pittsburgh and also Cincinnati. The thing that tipped Cleveland above Cincinnati was it was a major port on Lake Erie, and it had all the commerce coming in and going out of our port at the time.

So I have three minutes to get to the sad part of this story. So the Federal Reserve that was formed, the Federal Reserve was a compromise. It was supposed to lend out money in emergency situations. Even before the banks got going in 1914, war broke out in Europe, countries went off the gold standard. Try as they might in the '20s, they could not get back on the gold standard. That meant that money in the United States was fiat, and it meant that the Federal Reserve's obligation then became, not just making emergency loans, but conducting monetary policy.

The other problem that appeared almost overnight was the Federal Reserve Act, good as it was, did not pinpoint who was specifically in charge. Was it the Treasury? The treasury secretary and the comptrollers of the currency sat on the Federal Reserve Board. Was it the Federal Reserve Board itself, or was it the district banks? So during the war, the Treasury basically took over the Federal Reserve system, encouraging them to lower their lending rates and also to make preferential loans to banks selling bonds. They wanted to make bonds easy to buy.

In 1919 though, after that was over, they were still pushing the district banks around and the district banks got upset. District banks were in charge of monetary policy now, and the inflation rate was really high. So they got through that. But then because they were conducting monetary policy, the lending mechanism was not as important as open market operations, that is buying government bonds and

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injecting reserves into the banking system. So the district banks kind of coordinated their efforts in doing that. Well, then the board said, “No, no, we're in charge.” And then again, arguments between the district banks and the boards grew.

Then making it all the more worse was the Great Depression of the '30s. And even the district banks were disagreeing. Chicago might disagree with Cleveland, and so on. So in 1933 and in 1935, Congress changed the act a little bit. First of all, they separated the Federal Reserve from the Treasury. The second thing they did was they made the Board of Governors the guys with the most power. That's where power centralized. And then the district banks went on to perform their own operations. So I've come in with eight seconds left. So thanks.

Chuck Soder:

Okay. Thank you, Owen. And now that we have some historical perspective, I'm going to cover what the Fed does today and what we do right here in our district, which means I've got to cover the five functions of the Federal Reserve system. And we're going to start with the big one, one that you guys might be familiar with, monetary policy. Raise your hands if you've ever read a story in the news about the Fed making an interest rate decision. Okay, almost everybody. That's monetary policy. Monetary policy is a fancy way to say what a central bank does to influence the amount of money flowing through the economy.

Congress has given the Fed two monetary policy goals. On one hand, we pursue price stability. And on the other, maximum sustainable employment. We've got to keep these two goals in balance. And to pursue those goals, the Fed mainly relies on one single tool. It manages one single interest rate called the federal funds rate.

What is the federal funds rate? Well, that's the rate that banks, if banks borrow money from each other overnight, they pay interest. The rate they pay is the federal funds rate. That one tiny rate has a ripple effect throughout the economy on mortgages, car loans, business loans, credit cards, and from there, it grows.

So just to give you an example, let's say the economy, a hypothetical situation, let's say the economy's not doing so well, people are losing jobs. In a situation like that, the Fed might lower the federal funds rate, goal being make it easier to borrow money, maybe encourage more spending, and hopefully create jobs, which sounds pretty good. Lower rates, more jobs, more money. I mean, I would like more money. You guys would probably like to have more money, right? Well, yeah, it sounds good.

But I'd like to keep in mind something one of my favorite philosophers once said from the late 1900s, he had a very insightful theory on this topic. His pen name was Notorious B.I.G. He wrote a treatise titled Mo Money, Mo Problems. If you have too many dollars chasing too few goods, prices go up. And if prices go up across the economy, we call that inflation. A little bit isn't so bad. The Fed aims for 2% inflation because wages typically keep up if inflation's at a low level. But if inflation gets too high in that situation, the Fed is going to be more likely to raise the federal funds rate.

Because if inflation gets too high, even if wages are going up, it's going to hurt people on fixed incomes. It's going to be tough for wages to keep up because most people's wages only change once a year. It's going to be hard on people who save money, and it's going to make planning for the future tough. If you're trying to save for your kids' college education, and price levels are going up too fast, you don't want to get caught not having saved enough.

So luckily the Fed has a lot of expertise on inflation, especially here in Cleveland. We are the home for the Center for Inflation Research, which does a lot of really awesome high level serious research on inflation, but it also does a lot of stuff for regular folks, like most of us here. If you want to know what stagflation is, if you want to know what hyperinflation is, or shrinkflation is, you could Google Center for Inflation Research, or just poke around on our website, look for the inflation tab and you'll find it.

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So we'll come back to monetary policy in a bit, but we got to hit the other core functions of the Federal Reserve. Number two, we got bank supervision. Our bank examiners just in this district supervise more than 200 financial institutions to ensure they operate in a safe and sound manner, and follow all laws and regulations. And these folks have their boots on the ground throughout the district. It makes me think, so I'm a proud, annoyingly proud native of Wapakoneta, Ohio. Who's heard of Wapakoneta, Ohio? Raise your hands. Yes. And I have some cousins in nearby Minster, and one of my cousins, I don't know if she still works for a bank over there, but when she learned I worked for the Fed, she was like, “Oh, I want to hear all about it.” Because she knew the Cleveland Fed specifically because of the bank examiner that would regularly show up in her office. Okay.

The flip side of bank supervision, I think of it as the flip side of bank supervision, is financial stability. Our supervision team, they look at single banks. The financial stability team at the Fed, they're watching out for risks that could threaten the system as a whole, be they from a big bank that gets into trouble, from the stock market, from new and unfamiliar financial products.

A lot of this work was inspired by the Global Financial Crisis back in 2008, which I know my former boss, Mark Dodosh, remembers very well. We were working at a newspaper here in town and had to cover it. So a lot of those lessons were learned during that time period, which is one thing I like about working for the Fed. If things go wrong, we study the heck out of it and figure out what to do next. Okay.

Fourth function, we are the bank for banks. This is not a secret. We have billions of dollars in cash in this building. I do not lay claim to any of it, aside from what's in my wallet. This is why you went through metal detectors coming in here. We do not print the cash. The Bureau of Engraving and Printing does that, but we do, when banks need more, we take the orders, we order more of it from them, and we distribute it to those banks.

And take a look in your wallet. Pull out a dollar bill from your wallet right now, if you've got one in your pocket. If you look on the left hand side of that bill, I was going to hold one up as a prop, but I didn't bring my wallet. If you look on the left hand side of that bill, you're going to see a letter and a number. And depending on the design of the bill, it might be in a different spot. But the left hand side, if you see a D4, that is a bill issued by the Federal Reserve Bank of Cleveland. Wave it around if you have a D4 bill in your hand. Yes, we got a winner. A few more of you certainly D4 bills in your pockets, but you didn't want to get them out for me. I'm a little offended there.

Anyway, so we distribute it to the banks, but if they have too much, they send it back to us. And when they do, we track it meticulously. We take it in huge stacks, pump it through these big machines that, literally, I mean, they are going through dollar bills so fast. They can go through about 780,000 bills in one shift. The machines are looking for bills that are worn out. They're looking for bills that have markings all over them. Those get shredded. They're also looking for counterfeit bills. And I was told on a cash tour recently that, yeah, every week they might find a few counterfeit bills. And those get analyzed by somebody who's certified here on our team. And if they think it's counterfeit, they ship it to the Secret Service for investigation.

So anyway, cash is not the only form of payment or financial service we deal with here. A huge amount of digital payments touch Fed systems at some point. ACH transfers, wire transfers, not all of them, but a huge amount of them. And especially government payments. The Fed is the bank for the US government, so that kind of makes sense. And the Cleveland Fed in particular does a lot related to government payments. Our Treasury services team has developed a lot of apps related to those transactions.

More crowd participation. Raise your hand if you've ever paid a student loan. All right, a lot of you. And raise your hand if you own a passport. All right, a bunch of you there too. Most likely those transactions when you paid for those things, that touched a system developed here in Cleveland. Okay. And you guys don't get to see the... You get to see the old vault on your tour, at least those here in person, but you won't get to see the new vault.

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So I have to show you this picture. This guy's name is Johnny Cash. He is, they have a complicated name for it, but I call them robotic forklifts. And they are fully automated. I don't recommend you stand in front of them, but if you get near it, it will sense you and go around you on its way to a very large cash warehouse.

All right, fifth and final function, consumer protection and community development. By law, banks are required to meet the credit needs of all communities where they do business, and that includes lower income communities. Our supervision team makes sure that they do. But beyond that, we also do a lot of community development research on topics like housing, workforce development, and small business. And raise your hand if you own a small business, even if it's like a tiny little consulting firm.

Okay, well you guys who do, I want you to go to fedsmallbusiness.org right now because we here in Cleveland manage the National Small Business Credit Survey for the Federal Reserve. It's one of the most important sources of information in the nation about how small businesses are doing, what challenges they're facing, and their financial needs. So please, please, please participate. That's one of the many ways that people in our district can help inform us.

Okay, let's zoom out for a minute. All right. I showed you this map earlier. There are 12 dots, all of them reserve banks with their own president. The star in Washington, that is the Board of Governors. They are led by seven governors, appointed by the president, and confirmed by the Senate. And forgive me for quoting Captain Planet here, with those seven governors and 12 reserve bank presidents, with their powers combined, you get the Federal Open Market Committee. This is the group that sets interest rate policy.

Every Reserve Bank president shares their views on the economy and the insights they learn from their regions when they go to these meetings, which are every six to eight weeks. And that includes our president, Beth Hammack. She participates in those interest rate decisions. So she has got to be really well informed. Luckily our research department has her back. They study the national economy and the regional economy, and then they brief her about it before every meeting. The hard data, the research, that stuff is all critical. Beth says that frequently, but she also realizes that they come out with a lag and they don't always capture everything.

So how do we fill that gap? How do we really know what's happening on the ground? Well, the Cleveland Fed has eyes and ears all over this district. We get intel from surveys. We get intel from our board of directors. We've got advisory councils in every major city throughout the district and some midsize cities. And then President Hammack in particular is very big on getting out into the district, hearing from local leaders, and even employees themselves. She likes to do round tables with workers.

And not only that, it's not just her getting out into the district. We have an external engagement department. I'm a member of that. Several members of that department, they go out into the field as well, keeping their ears close to the ground. And I'm going to give you one example of that before I finish my portion here.

As I told you, I'm a native of Wapakoneta, which is in Auglaize County, which is right next to Mercer County, a very, very big farming community over there. And this story really hits me kind of close. The head regional executive at our Cincinnati office, Julianne Dunn, travels up through Western Ohio and down through Eastern Kentucky. And I think it was like a year and a half, two years ago. Yeah, we'd all been hearing about bird flu as being a big problem. But she traveled to Mercer County and Auglaize County, where I'm from, and she had a meeting, and literally every single person she talked to at that meeting mentioned bird flu. And that set off alarm bells for her. She's like, “I've got to make sure all of my colleagues know how big of a deal this is.”

And so she immediately sent out a dispatch to all her counterparts across the system, and I think they had a round table discussion about it because bird flu was killing millions of chickens at the time. How's that going to affect the price of chicken and eggs? How's that going to affect some of these communities that rely on these areas? So I tell that story because I think it's important to understand

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when the Fed makes decisions, they're informed, yes, by the latest inflation and employment data, but they're also informed by people like yourselves all across the district. And so to sum it up, if I could say we do three things, we try to keep employment up, inflation down, and keep the financial system stable and effective. Thank you.

Oh, I still got the microphone on. Great. Okay. So we will be taking questions very shortly. So if you're online, use the Q&A feature in Zoom to submit your questions. Here in the room, you might have some questions on your mind already. Feel free to start writing them down. But I'm going to get us started with a question for Owen because I know he has a lot of historical knowledge that I don't have. And I know that he's done a little bit of work on this topic.

The regional banks, from what I understand, they've played an important role over the years in terms of injecting creative ideas into the system, as being a source of diversity of thought because ideas are coming from different types of places, that sort of thing. I know you've read up on that topic from papers you've done in the past. To what degree is that the case and might you have an example?

Owen Humpage:

I've lived it.

Chuck Soder:

Really?

Owen Humpage:

Yes. So as I explained, originally the districts were to kind of let money take issue with the particular things that go on in various regions, the economic things. But now the nation is more unified and interest rates are the same across the country. They used to be different in different regions.

So the reserve banks then sort of have a different function nowadays. One of those functions is to have a research staff that does all sorts of things. But often the research staff in one bank will disagree with the research bank staff in a different bank. Now, if this was a unified system with just one Board of Governors, no district banks, it would be really hard politically, within the structure of the organization, to disagree with the idea that's prominent among all the rest. But with district banks and their independence, that doesn't happen.

So here's my example. When I was at this bank, I started in 1973. Shortly after that, the Federal Reserve started buying and selling foreign exchange in the foreign exchange market in order to influence exchange rates. At this bank, and at Richmond, and to a little bit in Minneapolis, we couldn't figure out how this worked, given the way the Fed did it. And so we started doing empirical research and we started showing up at FOMC meetings complaining about it, our president would.

And the idea, basically we showed them that it didn't work very often the way they thought it did. And the other thing that we argued was that it interfered with monetary policy. Now they would divorce any effect the intervention had on money at the time, but we argued that people didn't understand that. And so they didn't know what we were doing. Generally, if we were tightening monetary policy, the dollar appreciated, but if people wanted to keep the dollar low, what would they do? They would put more reserves in the banking system to lower the dollar. This didn't work.

And eventually we convinced enough people at the FOMC to stop intervening, and we haven't intervened since the mid... Well, they did a couple in the early 2000s. The last intervention you may have read about was strictly by the Treasury. We didn't participate in that as far as I know. So that's an example of why the district banks are important.

Chuck Soder:

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And this type of thing, you don't have to go into lots of examples, but this type of thing has recurred-

Owen Humpage:

Yes. You'll often see-

Chuck Soder:

... multiple times.

Owen Humpage:

... that a president, they'll vote to change the federal funds rate one way or the other, and some of the presidents will dissent from that vote because they didn't think it was proper. So yes.

Chuck Soder:

Gotcha. Gotcha. So I imagine we have some questions in the audience. First, I'm going to go to an online question. **Emily**, maybe we could start there.

Emily Kalina:

We can. We have a question online for Owen. It says, “If you were to remake the Fed system today, how would you remake it? How would you change the districts?”

Owen Humpage:

So I thought about that because it came up the last time I was talking. I wouldn't. Here's why. So the Federal Reserve was established under the gold standard where we needed to lend money occasionally to banks having a crisis. But now we're not on the gold standard. So the Fed has to conduct monetary policy, right? Then it's good to conduct monetary policy where you have a bunch of reserve banks that may disagree and you can have a discussion about that.

The other reason I wouldn't bother to change the district is we don't need to. I mean, we still address differences in the agricultural sections of the country, the industrial sections of the country. We investigate that, and get that information to make our policy decisions, but monetary policy now affects the whole district. You don't...

Chuck Soder:

Whether they draw the line a little bit this way or a little bit that way is not quite as-

Owen Humpage:

Yeah, whether they put the line a little bit. Doesn't matter really.

Chuck Soder:

Gotcha. Cool. And did we get any from the room? We get a lot from the room? Hopefully we got a lot from the room. Oh yes, we did.

Emily:

Okay. Here's the first one from the room. In no particular order, they were just collected. How has the dramatic growth in electronic payments and the decline in the use of cash affected the velocity of money and the Fed's ability to control the money supply?

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Chuck Soder:

You know-

Owen Humpage:

Go ahead.

Chuck Soder:

And I should note that Owen is not a current, Owen is a retiree who maintains a title here at the Fed, right? Is that how you say it?

Owen Humpage:

Yes.

Chuck Soder:

Yes. So when it comes to how things are going in the current economy, and I'm not an economist at all, when it comes to how things are going in the current economy, we may have some limitations, but maybe there's a historical aspect to that question that you feel comfortable with.

Owen Humpage:

First of all, I don't know what it does to the velocity of money. My guess is it, let's see, it could... No, I don't think it would affect velocity very much. The other thing is I do know a number of central banks across the globe are thinking about issues of electronic money. The Swedes are, I know that. I think the Germans are. The Federal Reserve may have it somewhere going on, just looking at it. As far as central banks are concerned, one of the major issues is this. If a central bank was to make... Well, I'll just leave it at that. They are investigating this. They look at everything all the time to make sure they're up to date on this, and some central banks are looking into it seriously.

Chuck Soder:

Gotcha. Thank you, Owen. Back to **Emily**.

Emily:

Okay. We have another one from our online folks. This one says, “Do Fed reserve banks provide payment services to commercial banks in the respective regions? If so, how or what services, and how, if at all, have those services changed over time?”

Chuck Soder:

Well, I can talk a little bit about this topic. So I did a little bit on payments up here at the stage. And as I mentioned, the Fed has an ACH product, ACH automated clearinghouse. A lot of payroll is handled through ACH payments, and big bulk amounts all at once. The Fed has its own wire service product. We've even got a new product, a newer product came out a few years ago called FedNow, which is a truly instant payment product that is growing quite a bit. And one thing, I do know a little bit of history. Sometimes I like to act like I know a little bit of history.

Owen Humpage:

Me too.

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Chuck Soder:

Yeah. So the Fed ACH product is interesting because that was actually developed by the San Francisco Fed working with banks in their region back in, I don't know, '50s or '60s, or something like that. They all got together and said, “Okay, we think we can do something better here.” And so the first ACH technology was developed there by a regional bank with its regional banking partners. Does that sound accurate to you, Owen?

Owen Humpage:

I know very little about that topic.

Chuck Soder:

Okay. Thank you, Owen. Next up.

Emily:

That's okay. Okay. We'll go to one that is in the room. Why $4 million to start a district?

Owen Humpage:

Well, I don't know exactly why four million exactly. So I'm going to borrow something from my colleagues who wrote a paper on bank capital. So suppose you're going to buy a house. You have a house picked out, you go to the bank, you say you want a loan. The bank's going to say, “Well, you have to put 20% down of your own money.” So that's your equity in the house. If the house appreciates, your equity grows. If the house doesn't appreciate, if the price falls, you lose equity. But what that equity does, it's a buffer for the bank that loaned you the money that kind of gives them... They're not going to lose everything on this loan.

Bank capital works the same way. When people wanted to set up a Federal Reserve bank, they would go to the banking regulator, and he'd say, “Well, you have to put in some capital,” that is essentially the counterpart of equity. So the banks put in their money, and then that acted as a buffer for the lenders who are the depositors in the bank in case the bank gets in trouble. So that's the whole issue of bank capital. And the legislation required at least $4 million. And I've actually looked at this. Most of the banks had considerably more than $4 million in capital, at least in 1914, and the banks on the East had maybe much more, including Cleveland, actually. That's all I know.

Chuck Soder:

Cleveland was quite the financial center for the nation back then.

Owen Humpage:

Well-

Chuck Soder:

I don't know where we stood. I mean, obviously New York and Chicago were probably number one, number two.

Owen Humpage:

I actually think that Cleveland, in a debate about Cleveland, Cincinnati, and Pittsburgh, and this also applies to Atlanta and Dallas, which I didn't talk much about. It wasn't so much that they were financial hubs. They were regional financial hubs for sure, but it wasn't so sure that they were major financial

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hubs. But what was important to the organization committee was Cleveland, Dallas, and Atlanta have very good prospects for future growth, more so than a lot of other cities. For example, Atlanta and Dallas got it, but not New Orleans, not Mobile, not Charleston in South Carolina, because those were older cities, well established, but their growth prospects didn't look as good. And I think that's really why Cleveland got that position.

Chuck Soder:

It's hard for us to imagine that there was a time when Cleveland was the absolute big boom town, which the numbers show it was, but-

Owen Humpage:

So when I was a kid, it was the fifth largest city in the country.

Chuck Soder:

Emily, what you got for us?

Emily:

All right. We're going to go back to our online folks and here's the question. As we continue educating the public about the Federal Reserve system, how can we better communicate the historical reasons behind the selection of the 12 reserve bank cities while helping audiences understand why that regional structure remains relevant today?

Chuck Soder:

Well, I'm a communications person, so I guess I'll start with that. I suppose it's one reason why we had this conversation. A lot of people who live in this region know that we're here, but they may not realize why that matters to the district. And now what we can do to spread the word, when this is on the web, share the link with all your friends and family. That's probably the first thing.

But otherwise, I do think it's important that people realize that there are several people in this district whose job is to make sure we understand what you're going through, whether you're a business owner or whether we're just looking at the workforce in general. So we want people to know that we're your eyes and ears, and we want people to know that there are lots of ways you can actually help us with that quest.

One is fill out the Small Business Credit Survey. But we do lots of surveys. Really anybody who's a business owner, every few weeks, some of you may have heard of the Beige Book. That's a product we put out about two weeks before every FOMC meeting. And that is largely informed by a big survey we do very regularly. And for that, we've got to get to know the people in our district, get to know the businesses in our district. So I think there's a lot of benefits to people knowing about us, but maybe Owen has something else to say. If you guys have great ideas for how we could spread the word, of course, we'd love to hear them.

Owen Humpage:

I don't know. I just think institutions change over the years, and it's good to track the history of their changes. Personal experience, there were things, when I started here in 1973, it was the big inflation period, and we were doing things that, at that time, certain operations and stuff like that, they don't exactly do anymore the same way. But occasionally I'll get calls from people in the system and they'll want to know how something that they're doing today actually started. And they'll want to know how it evolved and changed. And they'll want to know, over the course of that evolution, how did people object

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to it and what was the counter arguments to the objections? So knowing the history of an institution can be very important, I think.

Chuck Soder:

And you, yourself, and some of your colleagues here at the Cleveland Fed over the years, I know you've done a lot of economic research, but you've also done research that's history related.

Owen Humpage:

Yes.

Chuck Soder:

And I know it's not just us here in Cleveland who do have researchers who have that historical perspective and will take a look back, not with the goal of learning some fun trivial thing from the past, but from learning lessons from the past. And I know the experience of the 1970s inflation. I've just heard tales that inflation was so bad in the '70s that researchers, not just at the Federal Reserve system, but around the world, studied some of these topics very closely and have learned those lessons. So a lot can be learned from the past.

Owen Humpage:

Yeah, we learned a lot of stuff. For example, for a while we were worried about people bartering. Businesses were bartering instead of using cash. Guy would come and paint your house. If you were a plumber, you'd come to his house and do the plumbing. No cash changed hands. How do you measure an economy that... So we experienced the great inflation, which a lot of people haven't.

Chuck Soder:

Right. I think we got a couple minutes, maybe one more question.

Emily:

Okay. This one is from the room. And so are either of you able to comment on the key differences between the British, Canadian, and US systems?

Owen Humpage:

They all conduct monetary policy. The Britains, I can tell you this, the Bank of England was one time controlled by the Treasury. In the late 1980s, they separated that. They conduct monetary policy. As far as I know, they're a centralized bank, a central bank. No regions or districts. Canada, the bank is independent of the Treasury. They conduct monetary policy, same way we do, same way the British do.

Chuck Soder:

Yeah, but they don't have the decentralized, neither of them would have that decentralized structure.

Owen Humpage:

I don't think Canada has the decentralized structure.

Speaker 5:

[inaudible 00:56:46].

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Owen Humpage:
Huh?

Speaker 5:
The current prime minister, Mark Carney, was the governor of the Bank of Canada.

Owen Humpage:
Yes.

Speaker 5:
And he was recruited by the British-

Owen Humpage:
Exactly.

Speaker 5:
Bank of England.

Chuck Soder:
So for the online audience, he was just mentioning that one of the governors from Bank of Canada was recruited by the British to leave the Bank of England.

Speaker 5:
Canada has probably not more than seven banks in the entire country.

Owen Humpage:
That's right.

Speaker 5:
But they're all big.

Owen Humpage:
Yes, they're big.

Speaker 5:
One of the probably.

Chuck Soder:
And so we do have to wrap up. We are at the very end of our timeline, but-

Speaker 5:
I'm from Canada. And one of the things we're proud of, Canada never.

Chuck Soder:

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Wow.

Owen Humpage:
If you want to see me after this, I'll tell you my biggest social faux pas involved the Bank of Canada.

Chuck Soder:
Oh boy. We're not going to get into that here, Owen. Okay, everyone.

Owen Humpage:
It's clean. It's clean.

Chuck Soder:
Okay. All right, everyone. Thank you so much. Owen, I really appreciate you being here.

Owen Humpage:
Thank you.

Chuck Soder:
Before we wrap up, before we wrap up, you got to know about a few things. We'd love to hear your thoughts. If you're online, there's going to be a survey link in the chat. And it'll also pop up on your browser after the program ends. And everybody's going to get an email afterward. So if you're in person, your survey link will be there. Please, please give us feedback. It helps us do things better.

Oh, this is really important here. **Emily**, I'm going to need your help. Next slide, please. You do not want to miss the next *Fed Talk*, January 13th. The head of our research department, Ed Knotek, is going to be giving his very popular annual economic outlook presentation. That's going to be purely virtual. So if you're at work, but you can take a late lunch break or something, please do register and tune in. Don't wait until then. Sign up right now. Scan the QR code on the screen.

And if you want to watch or listen to this again, the video and audio will be at clevelandfed.org/fedtalk. If you're a podcast person, we're on all the major podcast platforms. And thank you. Thank you all again for spending time with us and have a great rest of your day. And for those of you here in person, please see the guides over to our right, to my right, your left most likely, to get to your tour. Thank you.

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