

Statement

**Subcommittee on Monetary Policy and Trade of the House Financial Services Committee
September 7, 2016**

**Jeffrey M. Lacker
President
Federal Reserve Bank of Richmond**

**Rayburn House Office Building
Washington, D.C.**

Good morning. I am honored to speak to the Subcommittee about the governance structure of the Fed's regional Reserve Banks.¹

To understand the Fed's structure, it is essential to understand the Fed's purpose. Prior to the founding of the Fed, the banking system was often unable to adjust the supply of monetary assets flexibly enough in response to the changing needs of commerce. The Fed was founded to "furnish an elastic currency," in the words of the preamble to the Federal Reserve Act. Clearinghouses – bank-owned cooperatives in larger cities – played an important role in how periodic crises were resolved before the Fed, including the issuance of currency substitutes, but were widely viewed as favoring the interests of large money center banks. Reserve Banks were modeled after the clearinghouses, but with note issue powers and universal eligibility for membership, the aim being to improve upon the role of the clearinghouses in a way that served broader public interests. A plan for a centralized institution was rejected out of concern about excessive Wall Street influence at the expense of diverse regional interests. Proposals for a government-controlled central bank were rejected as well for fear the federal government would use control of the money supply to resort to inflationary deficit financing. At the same time, a measure of public sector oversight was viewed as essential, consistent with Progressive Era thinking, so the Act included a Federal Reserve Board whose leaders were politically appointed.

Thus, the final Federal Reserve Act reflected a balance of competing considerations: a federated set of institutions to provide for representation of a diverse range of geographic and commercial interests, with a hybrid public-private governance structure to provide for public oversight but contain potential misuse of monetary authority.

The governance structure of the Federal Reserve is still effective, in my view, because the considerations the founders wrestled with are all still relevant today. The federated structure has benefited policymaking by ensuring that a diversity of perspectives on policy and economic conditions are brought to the table. Reserve Banks historically have shown intellectual leadership on topics that initially went against the grain of mainstream thinking but later became broadly accepted, and Reserve Bank presidents have a record of challenging conventional views. In addition, the federated structure has promoted broad regional engagement across the country, deepening the Fed's understanding of the diverse economic challenges facing American communities.

To be sure, our country's understanding of diversity has expanded since 1913. And it is in keeping with the spirit of our founding that the Federal Reserve has taken the importance of diversity seriously as we have sought to ensure broad representation of views in the formulation of monetary policy, including

those associated with disadvantaged communities. I believe our record in this regard, like that of many other organizations, shows a combination of substantial progress and areas where more can be done.

In addition to bringing diverse viewpoints to bear, the Fed's public-private governance helps our policymaking focus on its longer-term objectives. At times there is a temptation to provide excessive economic stimulus in the short run and leave the subsequent inflationary costs for future policymakers to deal with. Evidence from around the world, along with our own history, amply demonstrates that the temptation of short-sighted monetary policies is a bipartisan vulnerability, just as the Fed's founders feared. For central banks, this implies that meeting-to-meeting monetary policy decisions need to be insulated from short-term political pressures driven by electoral considerations.

But independence with regard to the choice of monetary policy instrument settings must be paired with strong accountability for the economic results of policymaking over time. Accountability rests on transparent communications, which help Congress and the public evaluate the Fed's performance against its mandate.

The Fed's public-private structure supports monetary policy independence by ensuring a measure of apolitical leadership. The Reserve Banks' autonomous balance sheets, protected appropriations status and independent capital stocks all play a role as well by limiting high-frequency interference that might diminish instrument independence.

The presence of bankers on Reserve Bank boards is said to represent a conflict of interest since Reserve Bank staff supervise banks. But strict rules limit bankers' roles; they simply have no avenue through which they can influence supervisory matters. Moreover, best practice for any board is to seek members with expertise relevant to the organization's activities. The Fed's large payment processing operations make the original rationale for having bankers serve on Reserve Bank boards still valid. In addition, bankers are particularly well-positioned to report on economic conditions in their footprints.

In conclusion, while some claim that the Federal Reserve's governance structure is a historical anachronism, the continued relevance of the trade-offs taken into account by the authors of the Federal Reserve Act argues for the continued utility of the finely balanced arrangements they crafted.

Thank you.

¹ My remarks reflect my own views and not those of my colleagues in the Federal Reserve System.