



Bringing the Exhibit to Life in the Classroom

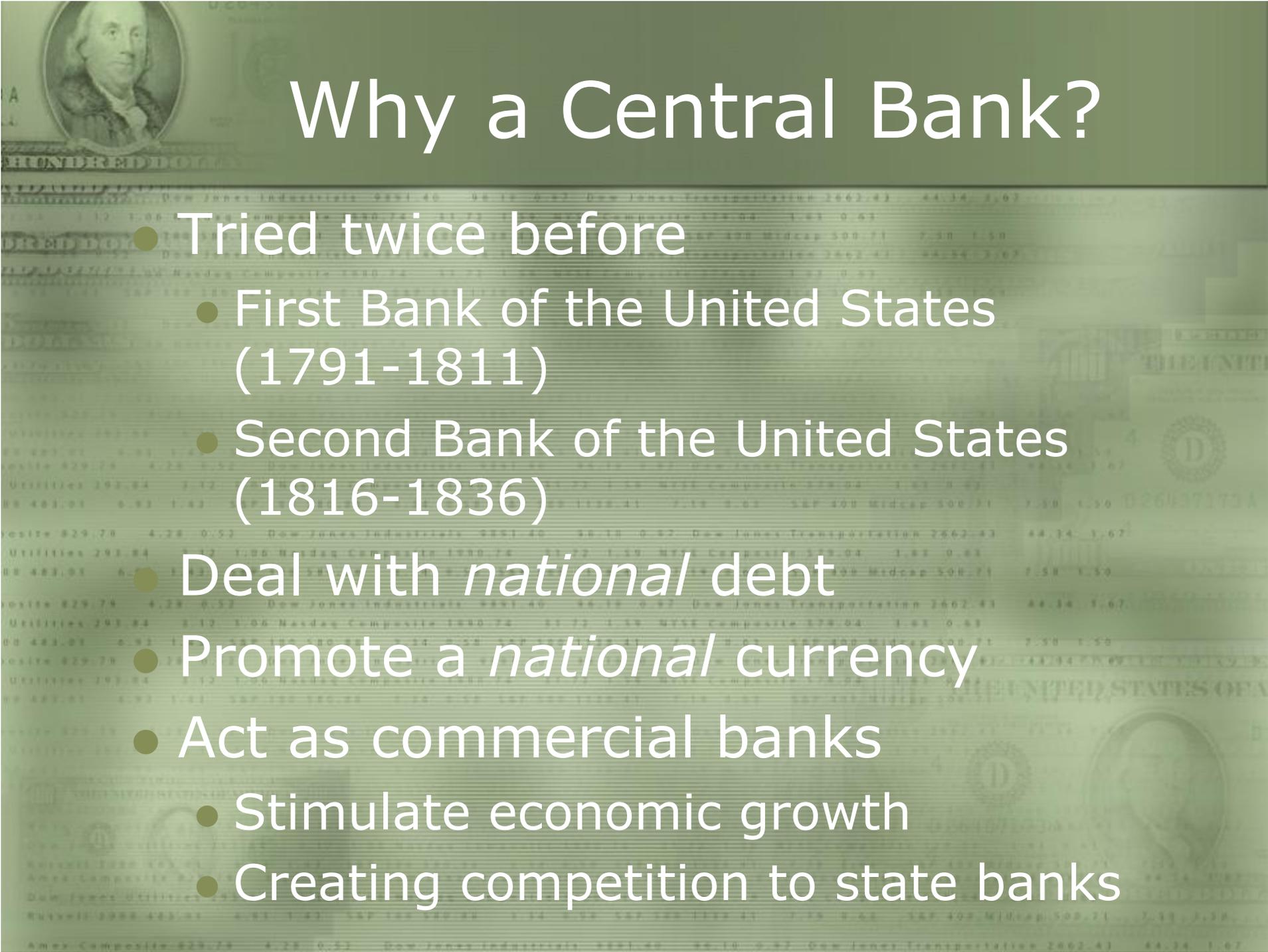
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Federal Reserve Bank of Dallas Economic Summit

Themes

- Need for a Central Bank
- Centralized or decentralized
- Functions
- Success & Failures
- 100 years later – we are still debating if the Fed should exist



Why a Central Bank?

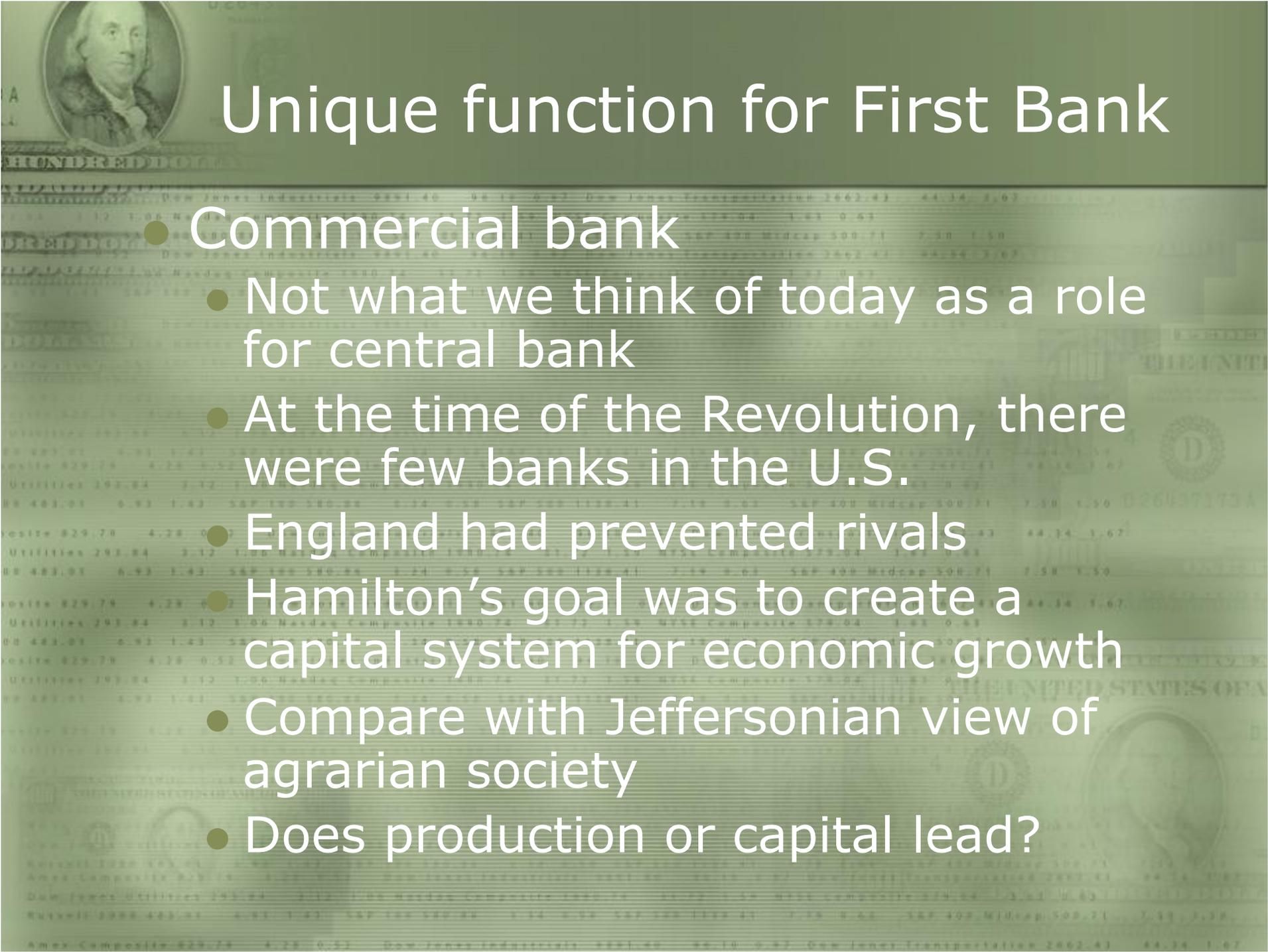
- Tried twice before
 - First Bank of the United States (1791-1811)
 - Second Bank of the United States (1816-1836)
- Deal with *national* debt
- Promote a *national* currency
- Act as commercial banks
 - Stimulate economic growth
 - Creating competition to state banks

Trust

- Reliance on the integrity, strength, ability, surety, etc., of a person or thing; confidence.
- A central bank has to gain the trust of the economic users
 - Hard to gain trust – easy to lose trust
 - Provide stability
- Clearly defined role for the central bank
 - Needed but hard to achieve

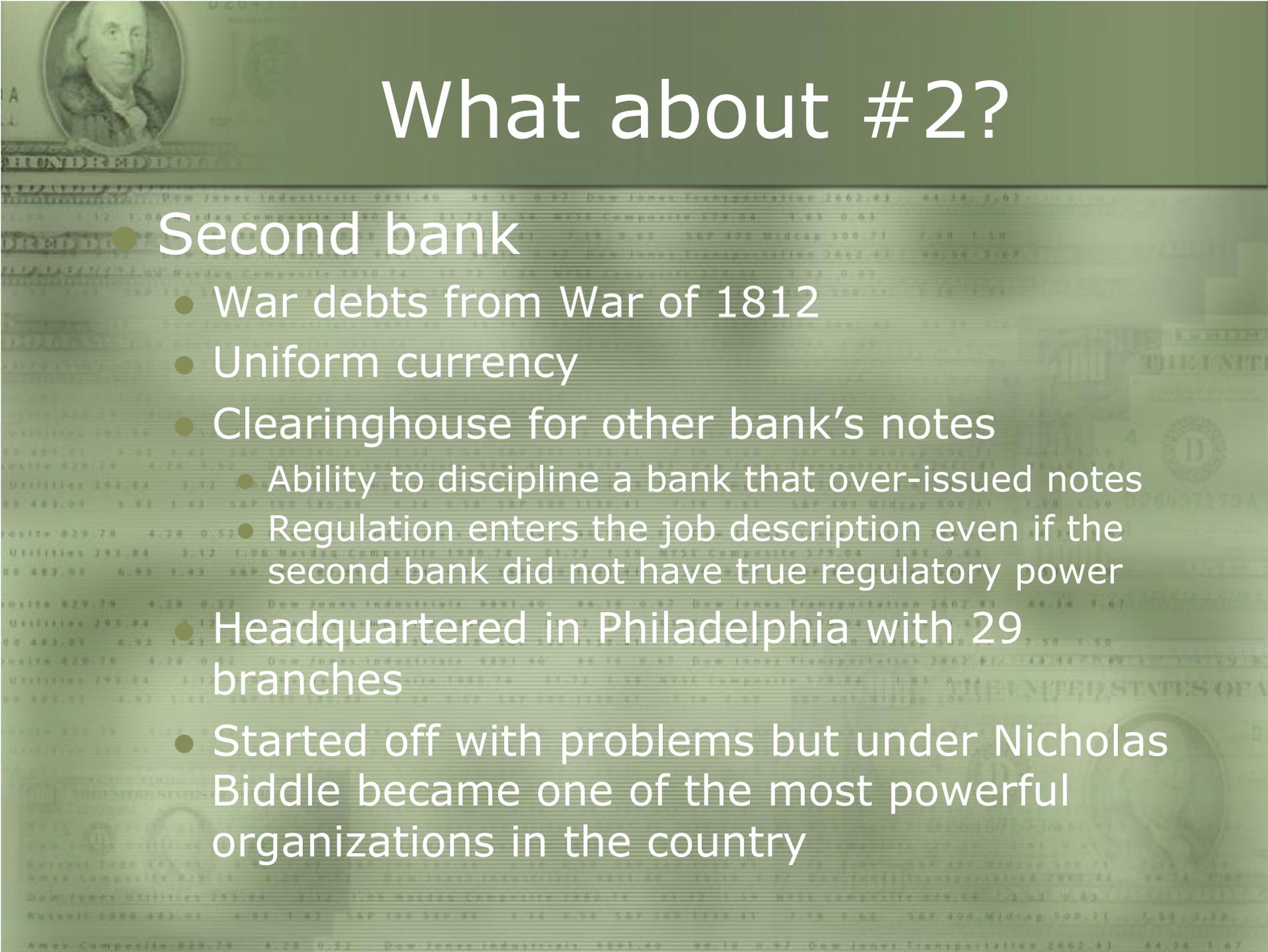
What is the role?

- First Bank
 - Pay off war debts
 - Issue currency notes
 - Main office in Philadelphia with 8 branches in major cities
 - Coastal branches
 - And...



Unique function for First Bank

- Commercial bank
 - Not what we think of today as a role for central bank
 - At the time of the Revolution, there were few banks in the U.S.
 - England had prevented rivals
 - Hamilton's goal was to create a capital system for economic growth
 - Compare with Jeffersonian view of agrarian society
 - Does production or capital lead?



What about #2?

- Second bank

- War debts from War of 1812
- Uniform currency
- Clearinghouse for other bank's notes
 - Ability to discipline a bank that over-issued notes
 - Regulation enters the job description even if the second bank did not have true regulatory power
- Headquartered in Philadelphia with 29 branches
- Started off with problems but under Nicholas Biddle became one of the most powerful organizations in the country

Role of Power

- President Andrew Jackson was suspicious of the central bank
 - What if there was corruption?
 - How does the country control it?
 - Who controls it?
 - Wall Street vs. Main Street
 - Who has the power?
 - Competition to local banks

Panic

- 70+ years before the willingness to have a central bank
- Panics of 1873, 1893, and 1907
- Is it a willingness or a need to trust a central bank?
 - Need – I will overlook shortcomings
 - Willingness – You need to prove it to me
- Banker or populist controlled?
 - First two were banker controlled



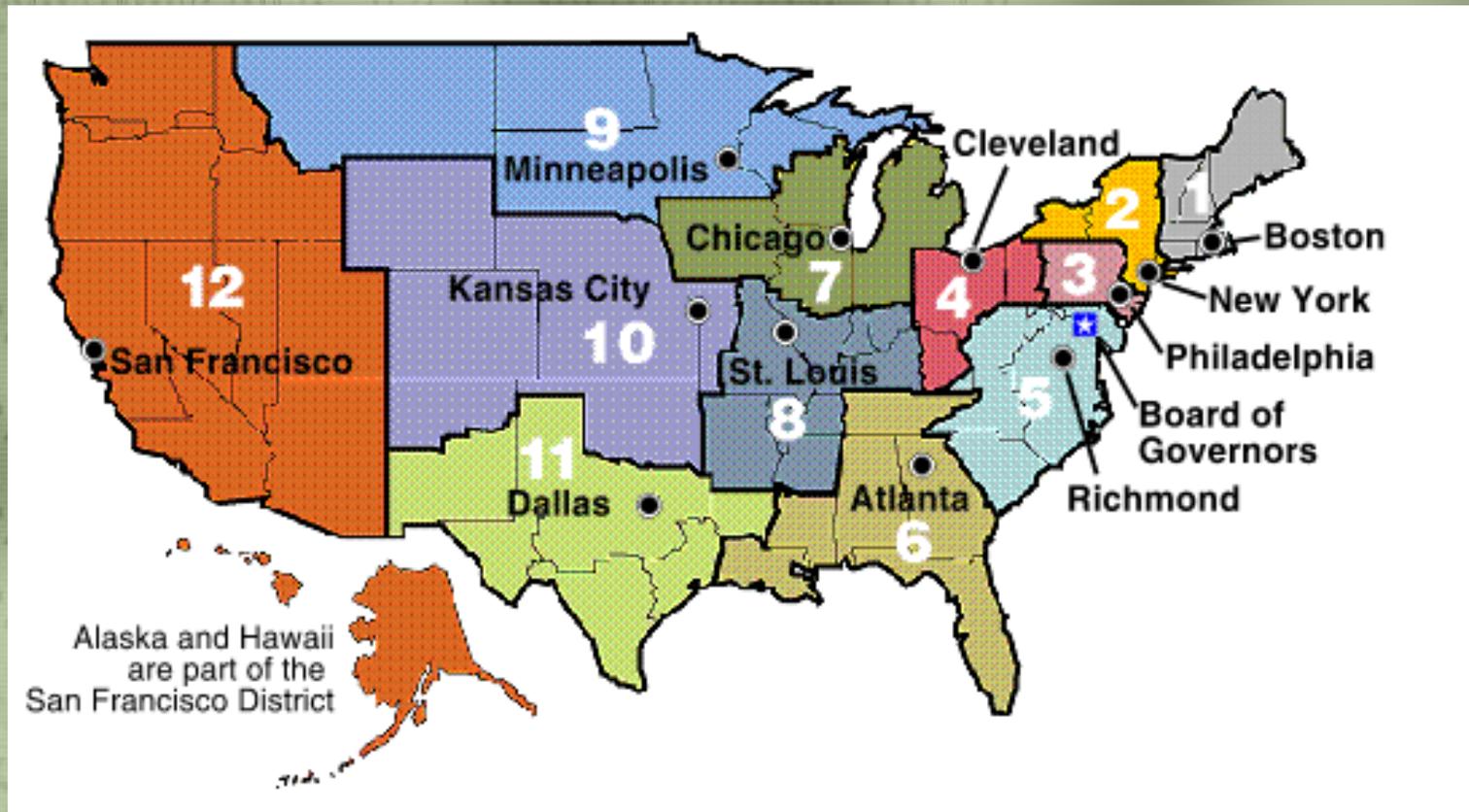
Decentralized Nature

- The Federal Reserve is decentralized
 - New York and Philadelphia cannot concentrate power
- No commercial bank function
 - Not competing with local banks
- Profits given to Treasury
- Authority over payment systems
 - Fungibility
- Monetary policy

Board of Governors

- No president can appoint more than four
- Remove political pressure
- Allow the Fed to have a long-term focus

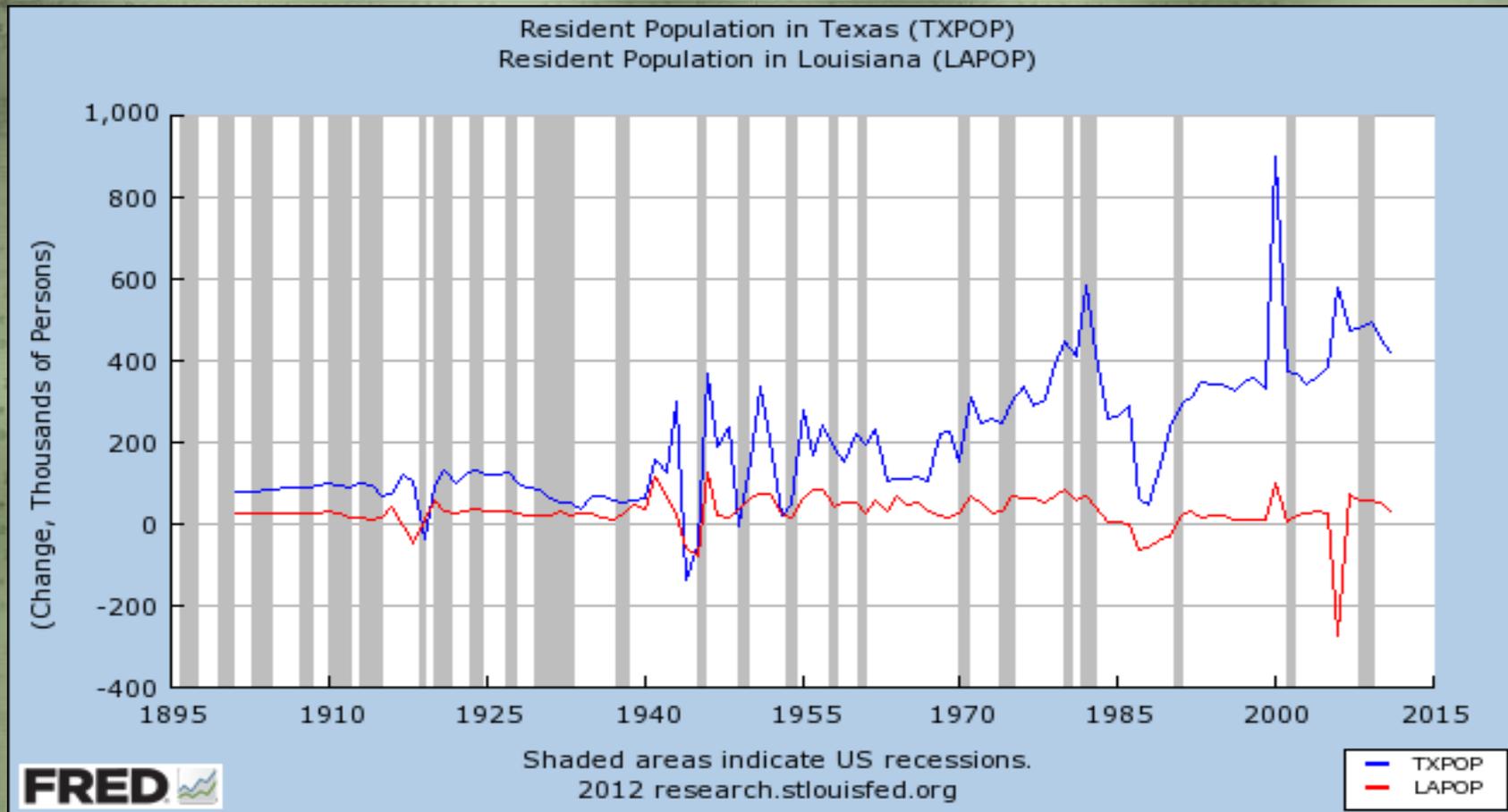
Twelve Districts



Why Dallas?

- Could have been Dallas or New Orleans
 - Houston?
 - Galveston?
- New Orleans is “old South”
- Dallas is “new Southwest”
- Need to appease Texas
- Texas first, city second

Where the people are (will be)



What should the districts be today?

- Add or re-divide?

- San Francisco

- Los Angeles

- Seattle

- Phoenix

- Removed?

- Cleveland

- Richmond



Is it easy to move an institution?

- Once it is created, it can be hard to change the logistics
 - Important for the first division to be forward-looking
- What institutions and/or institution locations should be changed in your community?
 - Why are they not moved?
 - Check clearing sites
 - Cleveland
 - Bureau of Consumer Financial Protection
 - Where are the offices?

Transactions Motive

- Currency and other forms of payments as a medium of exchange
 - Both parties must recognize and accept
- Trust
- To Counterfeit Is Death
- \$100 not accepted in many countries
 - Take extra \$50 bills

Trust in Currency

- Who holds the power regarding the creation of currency?
 - State banks or Federal government
 - Notice the focus on trust in a currency
- Illinois dollar worth less than Tennessee dollar, which is worth less than Philadelphia dollar (Free banking time)
 - 30,000 different currencies were in circulation

Cash

- Importance of no counterfeits
 - 0.18% of currency in Dallas is found counterfeit
 - Mostly \$5 and \$20 bills
- 2800 containers of cash in the Dallas Fed vault
- Why we redesign the currency
 - Franklin's leaves

Why still use cash?

- Anonymity
- Speed
- Convenience
- Safer?
- Travel
- Easier to manage a budget
 - For some people, when they see the cash disappear, they recognize that they are spending
 - Budget envelopes

Cash Expenditures

- Life-span shortest for \$5 and \$10 and then \$1
 - \$100 last 4x longer
- What are we buying with cash?
- Where are we buying with cash?

Checks as Payments

- State banks created checks as a way to deal with regulation
 - Remember that regulation creates the incentive to develop something to get around the regulation

Check Clearing

- 45 locations in 2003
- Check 21 in 2003
 - Electronic collection
- One location since 2010
- How many jobs lost?
 - Technology impact
 - Outsourced – is it easier to lose your job to a machine or to another person in a different country?

Changes to Payments

- Float goes to the business
 - Mail float is gone
- Pay with smart phone instead of cash
 - Need the mom-and-pop shops to convert
 - Probably take a decrease in technology cost or a technology subsidy
- Security issue – trust
- Draft from our accounts
 - Cheaper for firm

Cash in a Crisis

- The Fed makes sure cash is available during a crisis
 - Y2K
 - 9-11
 - Katrina
- Keynes discussed the precautionary motive for money

Trust Revisited

- Credibility
 - Always focus on long-term goals
- Reputation
 - Clearly present actions
- Delegation
 - Central banker
 - Decentralized

Independence

- One of its most important features
 - Removes/reduces political pressure
- The Fed voraciously wants to maintain its independence
- Responsible to Congress
 - Humphrey-Hawkins testimony
 - Use as reputation builder
- The Fed earns a profit – does not cost the public an explicit outlay

Transparency

- If the public knows more, is Fed policy more effective?
- We act based on their words
 - Less pull on Stephen's extension cord
- Today, the information makes us more confident in the Fed's actions
 - Not favoring one group over another



Views of Independence

- Public interest view
 - Serve the public
- Bureaucratic behavior view
 - Maximizes its own welfare
- Generally, Fed policy never compromises its own independence
 - Bailouts – public interest or bureaucratic?
 - Revisit the banker vs. populist

Local Interests

- Beige book
 - Anecdotal evidence
 - Share the story of each district
 - Populist
- Eleven Fed banks rotate for four voting positions
 - Eleven banks have to respect the others so that when one bank does not have a vote, its interests are still heard
- Is the average American aware of this?
 - The bailouts linked the Fed to TBTF

Relationship with Treasury

- Act as the bank for Treasury
- Accord of 1951
 - Separates Fed and Treasury
 - Allows Fed to change interest rate for monetary policy and not for cheap borrowing costs for Treasury
- Fed is proud of this
 - Act in best interest of country not government

Panics

- J.P. Morgan \$25 million + Treasury's \$25 million + \$30 million from 12 friends
 - Public and private solution
- Warren Buffett provided funds to financial institutions in 2008
- Lender of Last Resort

Recent Bailouts

- Who had the funds?
 - Fed pumped \$3 trillion
- Fed made all the major banks borrow from the discount window to avoid a bank run
- Stigma problem
- August 23, 2007 – Citigroup, Bank of America, JP Morgan Chase, and Wachovia each borrowed \$500 million
 - Four largest banks

What if?

- Moral hazard
- What would have happened if there was no bailout?
- Second Bank of the U.S. became too large according to critics
- Citigroup and Bank of America?

Bagehot's Rule

- During a crisis, a central bank should lend to those banks that are sound (have collateral) but at a penalty rate
- Were the bailouts at a penalty rate?

Fed Marketing (Lack of)

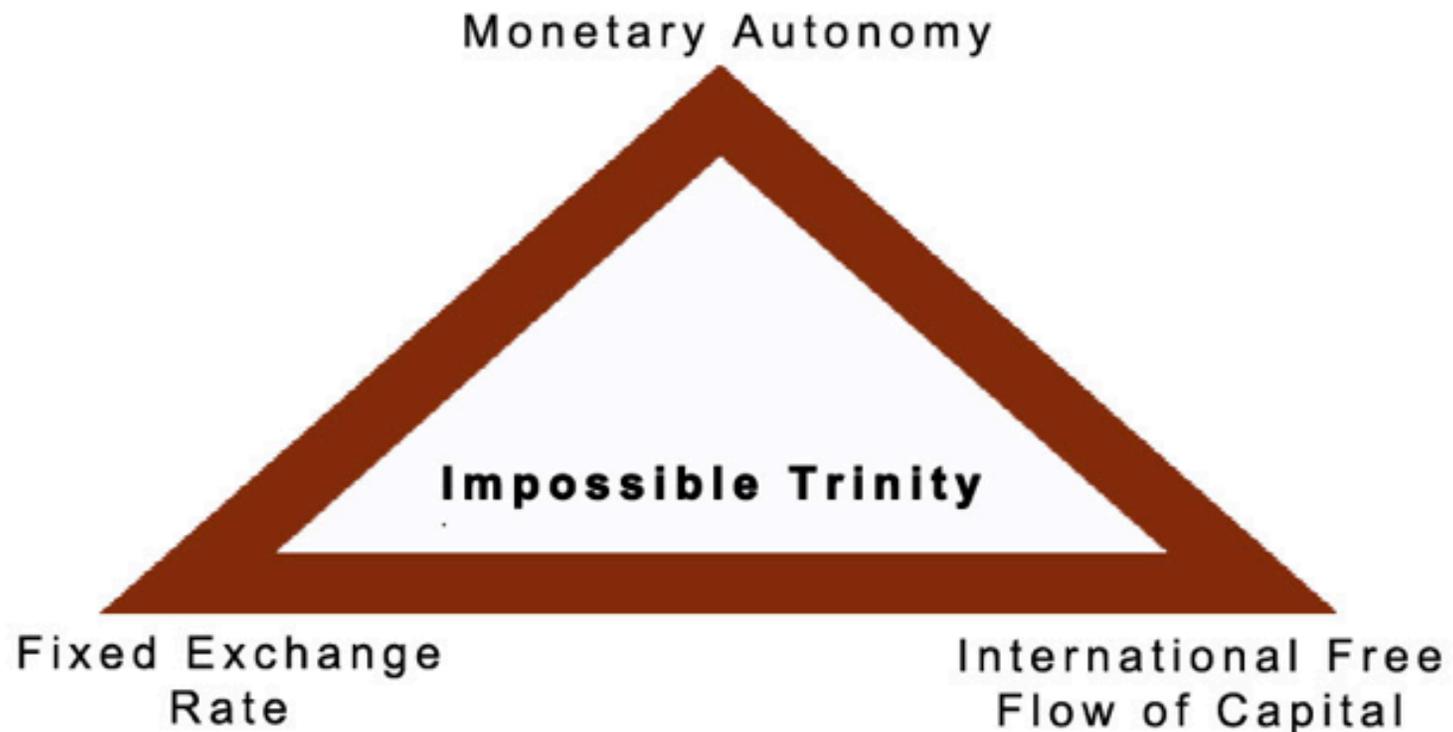
- Bank of America complains about buying Merrill Lynch but Fed does not counter in press that BAC was already looking to buy Merrill



Let's go to Kansas

- If the Fed loses credibility, to whom should we delegate the role of monetary policy?
- Gold Standard – impotent monetary policy because trying to maintain standard
- Impossible Trinity

Impossible Trinity



Greek Crisis

- Euro
 - Fixed exchange rate
- How much will the Germans pay to keep the euro?
- What happens with Spain and Italy, which are much larger than Greece?
- Is the European Central Bank credible?
 - Germans have the credibility

Regional Differences

- Let Greece fail?
- We let states fail
- We let cities fail
- Why are some more special than others?
- Regional importance

Regional Economy

- 11th District's economy is outward looking
 - Exports
 - Commodities
 - Keeps the jobs here
- Exhibit
 - M.L. Leddy's niche manufacturing of boots
 - Laguada.Low export service

Demographics

- We cannot ignore the demographic changes within the U.S.
 - Older
 - Social Security and Medicare are just beginning to feel the pressure
 - More varied backgrounds
 - More of a feeling of mistrust for financial institutions?
 - What are our shared experiences?

Fed's Future

- Does the Fed need to earn our trust all over again?
 - Were we spoiled by the 1980s and 1990s?
- What do we expect?
 - Would it be different if we could “see” the banks punished for the financial crisis?

