

Reflections on 40 Years at the Central Bank

Remarks by
Esther L. George
President and Chief Executive Officer
Federal Reserve Bank of Kansas City

January 18, 2023
The Exchequer Club of Washington, D.C.
Washington, D.C.

The views expressed by the author are her own and do not necessarily reflect those of the Federal Reserve System, its governors, officers, or representatives.

Thank you for the invitation to speak today.

In a few days, I will be stepping down from my post as president of the Kansas City Fed, having reached mandatory retirement, concluding a Fed career of more than 40 years. It has been an honor to serve the nation's central bank and to represent a region that includes all or part of seven states: Missouri, Kansas, Nebraska, Oklahoma, Colorado, Wyoming and New Mexico. There is much to appreciate about working for the Federal Reserve, certainly including its dedicated workforce. These talented people who say yes to working at the Federal Reserve on behalf of the public feel the weight of the institution's mission and its impact on every American. And, during times of crisis, they are prepared to step up in extraordinary ways.

Because the Federal Reserve's actions affect people's financial and economic situations, it is often in the headlines, including criticism, scrutiny and second guessing. One point of criticism has been the Fed's structure, with 12 independent regional district banks complementing the Board of Governors in Washington. Some view the Fed's decentralized structure as an outdated, reflecting a time when transportation and technology were far less developed. Others argue accountability would be enhanced by altering the authorities of the regional Reserve Banks in favor of more central authority with the Federal Reserve Board. Current ideas about changing the Fed include reducing the number of regional Reserve Banks from 12 to 5, making Fed presidents political appointees, and requiring congressional access to Reserve Bank records, including confidential supervisory information and sensitive personnel information. The tug-of-war, targeting reform of the central bank's regional structure, governance, and authority, is not a new one. It has been in play since the Federal Reserve's founding.

In my comments this afternoon, I'll talk about the Federal Reserve from the perspective of a career central banker in the nation's heartland, focusing on issues related to policy deliberations, community banking, and the nation's payment systems. Through this lens, I've witnessed the ways the Federal Reserve's structure has figured prominently in securing the public's trust as it carries out its mandated objectives.

Trust and Confidence

One of the most unique and important aspects of the Federal Reserve's decentralized structure is the participation of the American public in the ongoing operations of the 12 Reserve

Banks. The Tenth Federal Reserve District extends from the plains of the Midwest to the Rocky Mountains. Energy, agriculture, transportation and logistics are dominant economic drivers. You can drive hours through parts of the Tenth District and never see an office tower. (I apologize for bragging, but I love our wide-open spaces.)

By virtue of its design as part of a federated system, the public is able to engage directly with the Kansas City Fed and its branch offices by serving on our boards of directors and advisory groups. The governance of the regional Reserve Banks involves individuals from each District who oversee the Banks' operations and provide economic insights that inform monetary policy deliberations.

Our boardrooms are places where a labor leader and manufacturer; banker and non-profit executive; tribal leader and energy CEO, sit side by side. For a Fed policymaker, these discussions are obviously valuable. Not only do our directors provide fiduciary oversight and important insights on economic and financial conditions, but they create a level of engagement and understanding that would not otherwise exist. These are thoughtful discussions that may encompass topics ranging from the nuances of monetary policy to how economic conditions may be affecting nonprofit donations or certain segments of the workforce. My colleagues and I often reference what we've learned from these interactions as part of FOMC deliberations or in our speeches where they can provide important real-world examples of the economy.

A few weeks ago, I attended year-end board meetings at each of our Kansas City District offices. During those meetings, we also recognized the directors who were concluding their terms of Fed service. At these meetings in Kansas City, Denver, Oklahoma City and Omaha, I listened to these individuals describe their experiences of being invited inside our organization to govern and to offer their insights and advice. Over the course of their terms, they've learned what we do, and why. They know that we check politics at the door and that our motive is to listen and learn, so that we can understand and do our work on behalf of the public we serve. Very often, they tell us that this service has introduced them to people and perspectives that they would otherwise not have experienced. For me, these were strong reminders of the central bank's deep connections with a variety of Americans.

The structure of the Fed was no accident.

Congress had already established two central banks that were unable to secure the public's trust, and their charters were not renewed. What went wrong? The First and Second

Banks of the United States were isolated in what was then the national power center of Philadelphia, and with governance structures that did not reflect the system of checks and balances found in other important national institutions. Congress was keenly aware of these apparent shortcomings as it considered a third attempt to form a central bank. This time, the design moved away from a highly centralized institution with concentrated authority in favor of a decentralized system that would share authority across the nation.¹

The Federal Reserve System reflects a blended structure of public oversight by the Federal Reserve Board of Governors over 12 quasi-privately chartered regional Reserve Banks. These regional Reserve Banks and their affiliated branches have the obligation and the opportunity to meaningfully engage with the American public within each of their designated Districts.

When creating the first central bank of the United States, Alexander Hamilton was particularly concerned that a more politically controlled bank would prove to be an enticing tool for manipulation by interests who would favor short-term political gain over long-term national stability.² Decades later, the Federal Reserve's governance and structure proved effective as the FOMC under the leadership of Chair Paul Volcker responded to high inflation. It is hard to imagine a scenario where a more politically controlled central bank would have been willing to take the very difficult and painful measures that ultimately proved necessary to restore economic and price stability for the nation.³ Today, the U.S. is again experiencing high inflation and the Federal Reserve is aggressively tightening monetary policy. And, once again, the benefits of central bank independence are apparent.

The Fed's system of checks and balances includes the FOMC structure that has been in place since the mid-1930s. Only five Reserve Bank presidents are voting members of the FOMC at any one time, leaving the seven publicly appointed Fed Governors in a majority position. This arrangement promotes a diversity of views and healthy debate about policy options. In fact, an observer wouldn't be able to tell the difference between voters and nonvoters in any of the discussions because everyone participates equally in the meeting until the vote is taken.

¹ Todd, Timothy. [*The Balance of Power: The Political Fight for an Independent Central Bank, 1790-Present*](#). Federal Reserve Bank of Kansas City. 2009.

² For more on this see: Chernow, Ron. *Alexander Hamilton*. New York: Penguin Press, 2004.

³ For another example of the intersection of the Fed policy and political pressure see: Todd, Timothy. [*Under Pressure: Politics and the Federal Reserve During the 1990-1991 Recession*](#). Federal Reserve Bank of Kansas City. 2011.

Just as monetary policy deliberations reflect the value of a decentralized central bank, the regional structure plays a key role in the Federal Reserve’s bank supervision and payments work.

Community Banking

The characteristics of the financial system have changed significantly over the past 40 years. Banking consolidation and concentration has resulted in a handful of Globally Systemically Important Banks—referred to as GSIBs; a small number of mid-sized banks; and, fewer, although still thousands of, small banks.⁴ Another notable change in the landscape is that nonbank financial services providers have increasingly captured a large share of the retail banking business.

There are no GSIBs headquartered in the Tenth Federal Reserve District. Instead, there are hundreds of regional and community banks. Across the region, households, small businesses and agricultural producers rely heavily on local banking firms to supply credit and deposit services. The business models, economic conditions and banking needs of a farmer in rural Kansas or Nebraska differ significantly from those of a hotel owner in Jackson, Wyoming, a real estate developer in Denver, an entrepreneur in New Mexico, a nonprofit in Missouri or an oilfield services company in Oklahoma City.

As a supervisor of these banks, the Federal Reserve’s understanding of these unique customer needs and local economic conditions benefits enormously from its regional structure and engagement. Regional Reserve Banks also work closely with state banking regulators to fulfill supervisory mandates.

Community bankers serve on regional Reserve Bank boards and advisory councils to inform our understanding of local economies, the financial services landscape, and concerns of consumers and communities across the country. Through this engagement, we also gain insights to the challenges facing these institutions as they provide access to credit in their communities.

Much as the profiles and business models of banks differ, so do the risks presented to the financial system. Too often, our banking regulations have lacked the nuance to fully account for the differences in risk posed by small and regional banks compared to their larger peers and non-

⁴ Hanauer, Matt. Brent Lytle, Chris Summer and Stephanie Ziadeh. “[Community Banks’ Ongoing Role in the U.S. Economy](#).” *Economic Review*. Second Quarter 2021. Federal Reserve Bank of Kansas City. pp. 37-81

bank financial services providers. As a result, the compliance costs and burden affecting small banks can be outsized relative to the benefits to financial stability and fair access to credit.

Finding the right calibration in today’s supervisory framework will be necessary to ensure that community banks do not bear a disproportionate regulatory burden and can remain competitive as they meet the credit needs of the communities they serve. As I’ve noted in other remarks, opportunities exist to further develop risk-focused approaches to supervision, to better tailor capital requirements, and to provide clearer guidance around innovation and alternative business models. These steps might better balance the costs of regulation with its benefits.

Unfortunately, I am not optimistic that the legislative aims of ending too big to fail will serve to bring more stability and prosperity to communities that depend on small banks. The nation’s largest banks continue to grow larger while holding less capital.⁵ At the same time, consolidation among smaller banks is likely to continue, as regulatory burden persists in a competitive landscape of unregulated providers offering a variety of banking services. These trends are not likely to be benign for small businesses and communities across the country.

The Payment System

Finally, the regional Reserve Banks have long played an important role in supporting the various ways Americans pay for goods and services. As Congress undertook the task of designing a central bank for the United States in 1913, it was clear that lawmakers intended for the new institution to assist in improving the performance of the nation’s payment system. The day before the Federal Reserve Act was signed, Representative Carter Glass of Virginia compared the flow of payments in the economy to “highways of commerce.” He used the metaphor to illustrate how the Federal Reserve, through a number of regional Reserve Banks located across the country would provide currency to fuel the economy and serve as the hub of a national clearing network for checks.⁶

Since then, the nation’s payments system has evolved dramatically. Electronic payments have flourished, and households and businesses have grown accustomed to paying for things using mobile phone apps, as well as credit and debit cards. While the marketplace responded

⁵ Pellerin, Sabrina. “Bank Capital Analysis Semiannual Update.” Federal Reserve Bank of Kansas City. Q2, 2022. https://www.kansascityfed.org/Banking/documents/9272/Bank_Capital_Analysis_Report_-_2Q_2022.pdf.

⁶ Medley, Bill. *Highways of Commerce: Central Banking and the U.S. Payments System*. Federal Reserve Bank of Kansas City. 2014.

with new ways to meet this customer demand, the “highways” on which these payments travel had not been updated, meaning it can take as much as a few days to get access to your money.

In 2019, the Federal Reserve’s Board of Governors approved the development of a new service to modernize the nation’s payment infrastructure. Known as FedNow, this service will enable payments to be made instantly and available anytime, including holidays and weekends. As they have historically, the regional Reserve Banks will operate the FedNow service, promoting the payment system’s accessibility, safety and efficiency. By making funds available immediately, consumers can pay utility bills and rent, split the tab at a restaurant or rent payments with roommates, and small business owners will be able to pay their suppliers. Immediate access to funds could be particularly important for those on fixed incomes or living paycheck to paycheck.

Importantly, the Federal Reserve’s role will ensure equitable access to banks of all sizes nationwide by operating a real-time service for faster payments alongside the existing private-sector system. Public commenters have noted the importance of safety in faster payments, highlighting the Federal Reserve's record of resiliency, especially during periods of stress. This new retail payment infrastructure will support competition, decrease market concentration, and provide a neutral platform for innovation.

Consistent with its public mission, the launch of the FedNow service later this year recognizes that everyone deserves the same ability to make and receive payments immediately and securely, and that every bank deserves the same opportunity to offer that service to its community. FedNow will give banks of every size in every community across the country the opportunity to provide real-time payments to their customers.⁷

Conclusion

Through the compromises and choices made in designing the Federal Reserve System, Congress created a durable and credible public institution. Alongside the Federal Reserve Board of Governors, comprised of public officials nominated by the president and confirmed by the Senate, regional Reserve Banks were distributed across a dozen geographic Districts to carry out

⁷ Brainard, Lael. “[Delivering Fast Payments for All](#).” Speech at the Federal Reserve Bank of Kansas City Town Hall, Kansas City, Mo. Aug. 5, 2019.

the System's operational functions, to be responsive to regional economic and financial conditions, and to participate in monetary policy deliberations.

Federal Reserve officials are asked to make decisions in the long-run best interest of the American public. Sometimes those decisions can be unpopular. As innovation and structural change reshape the economic landscape, all of us who work at the Fed understand that our policy decisions must take into consideration long-run public benefit and stability. Every decision and action must take into account potential unintended consequences. This is a powerful argument for central bank independence.

Across the regional Federal Reserve Bank offices that help policymakers traverse a vast geography, and in the meeting rooms at the Federal Reserve Board here in Washington, the American public has the opportunity to interact every day with the central bank in ways that can build trust.

And at the end of the day, trust really is our only product.