There is a quote about history that is sometimes attributed to Oklahoma’s Will Rogers and more frequently to Missouri’s Mark Twain. Although the wording may vary depending on the source, the quote in general is that “history may not repeat itself, but it sure does rhyme a lot.”

Although the current financial crisis has its own unique aspects, Rogers or Twain would note that there are certainly elements that rhyme with what occurred in the past. After an economic expansion without precedent in United States history, the nation has found itself in a period of financial turmoil caused by a confluence of factors. Among them: rampant speculation and the apparent manipulation of finance by some. Because the nation’s largest financial institutions are so tightly intertwined, our entire system has become extremely vulnerable. Moreover, as the financial crisis worsened, a loss of confidence turned the financial crisis into an economic recession.

Although the events I’ve described certainly sound familiar to us today, I am specifically talking about the Panic of 1907, one of 13 panics that the nation endured over a 100-year span concluding in 1914. Understandably, during the 1907 crisis, much public anger was directed at Wall Street, where many believed high-risk behavior had placed the entire nation’s financial fortunes at risk, and at Washington, where strong regulations might have curbed this behavior.

...Since our nation’s founding, the same key issues have been at the center of any debate about a central bank: its structure and governance.

The events of 1907 had an important and lasting impact on the United States. After the panic, lawmakers recognized that the United States needed a central bank, and they began the process that led to the passage of the Federal Reserve Act in 1913 and the opening of the Federal Reserve a year later. Similarly, important changes came after the Great Depression. Within the Federal Reserve, lawmakers created the Federal Open Market Committee and established the structure of today’s FOMC.

Another direct result was the creation of the Federal Deposit Insurance Corporation to insure bank deposit accounts.

Recently, the Federal Reserve Bank of Kansas City staff compiled a report summarizing the Fed’s political history for our board of directors that provides an important perspective on the reasoning behind the Fed’s structure. I am very pleased to tell you that the report, “The Balance of Power: The Political Fight for an Independent Central Bank, 1790-Present,” is now available on the Kansas City Fed’s website. I believe it will be of interest to anyone concerned about the evolution of financial power in our country as well as
those interested in the Federal Reserve, central banking and the financial crisis.

Among the more notable findings in this report is that since our nation's founding, the same key issues have been at the center of any debate about a central bank: its structure and governance. Not surprisingly, both played an important role in creating the makeup the Federal Reserve has today.

Congress gave the Federal Reserve a blended structure reflecting checks and balances to distribute responsibility broadly through the United States in the form of regional Federal Reserve Banks. As I noted, these Banks are under the direction of local boards of directors that provide an important balance to the Fed's Board of Governors, all seven of whom are political appointees. In the report, you can learn about various attempts to make the structure less independent and, in effect, more political.

For example, in the 1930s, Sen. Carter Glass, an author of the Federal Reserve Act in 1913, had to step in when then-Fed Chairman Marriner Eccles attempted to remove the Reserve Bank presidents' votes on the FOMC, thus placing all of the Fed's key responsibilities under the sole control of the Board. On a different front, former Fed Chairman Paul Volcker, a former Reserve Bank president as well, spent much of his tenure resisting some politicians, both in the administration and in the capitol, who wanted total authority over the Federal Reserve in order to force the Fed to lower interest rates. Mr. Volcker and the FOMC, meanwhile, knew that in order to reduce rampant inflation, interest rates would have to remain higher than anyone would want.

Now, in the months ahead, much may be debated about the Federal Reserve including its structure. I hope that careful consideration is given to any proposal before it is implemented.

The Fed's structure is one that carefully balances interests and keeps power in check. As I told the Congressional Joint Economic Committee in testimony earlier this year, it would be a sad irony if the outcome of a crisis initiated on Wall Street was to result in Wall Street gaining power at the expense of other parts of the country.

Although I'm not as poetic as Rogers or Twain, as proud citizens of our nation's heartland, I think they both might agree.

THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY


Directors often question the nature of the role and relationships between the political elements of the Federal Reserve and its independence. This volume was created to help Federal Reserve Bank directors, who are responsible for the governance of their Districts and the guardianship of the Federal Reserve System.

Read “The Balance of Power” online at KansasCityFed.org.