

Reflecting on 100 years of Checks and Balances

Later this year, the nation will mark the 100-year anniversary of the founding of the Federal Reserve System, which was established with the signing of the Federal Reserve Act on Dec. 23, 1913. As we reflect on the role the central bank has played during the past century, we should recall that the System traces its roots to the populist movement of the early 20th century. Additionally, the debate over how to structure the Federal Reserve involved key leaders who represented this part of the nation.

These populist roots are still relevant to monetary policy deliberations nearly 100 years later and help highlight the importance of my current responsibilities as Kansas City Fed president in bringing forward independent views to national deliberations in Washington, D.C.

Populist roots

At the end of the 19th century, it was clear that the nation's monetary system was not working to the economy's benefit, and it was especially ill-suited for farmers, laborers, merchants and wholesalers.

The nation's unstable financial system led to tremendous uncertainty about the value of money. This uncertainty was fueled by the constant threat of a possible financial crisis, which would hit the nation's banks every few years as part of a vicious cycle. In a time when there was no deposit insurance, we can appreciate why these crises were known as "panics," as depositors raced to their local banks hoping they would not be greeted by a closed teller window at the end of the line.

In Nebraska, where agriculture played such a key role in the economy, as it does today,

an attorney by the name of William Jennings Bryan gave a voice to farmers' concerns about the financial system and the problems surrounding the seasonal availability of credit. As a three-time presidential candidate, Bryan helped shape the national conversation about the financial problems experienced by those in the middle of the country. Bryan was a vocal critic of banks and the gold standard, and his famous "Cross of Gold" speech, given at the Democratic National Convention in 1896, cemented his historic reputation as a persuasive speaker and leader on these issues.

While Bryan and others who shared his concerns had ideas about how to reform the nation's monetary system and pushed for what they called an "elastic currency," no significant reform was attempted until after the Panic of 1907.

Much of what has been written about the 1907 panic centers on the activities of speculators in New York City who attempted to corner the copper market with disastrous results. From there, the story shifts to the role of New York financier J.P. Morgan in organizing a private-sector rescue of the nation's financial system.

Perhaps less well-known is the impact the panic had on the rest of the country, including the Midwest. As banks in New York seized up, the flow of money to the rest of the country



stopped. Within weeks, there was no currency available for businesses to pay workers, for merchants to pay their vendors or for borrowers to pay their debts.

Due to the shortage of currency in this part of the country, streetcar workers in the city of Omaha during the fall of 1907 were paid with the nickels customers used to pay their fares. In smaller cities, such as Hastings, Neb., Atchison, Kan., and Guthrie, Okla., informal coalitions of banks quickly organized and issued cashier's checks and other substitutes that circulated as cash throughout their community until the panic eased and U.S. currency began to flow

again. In many places, businesses were forced to close and employees were laid off because there was simply no way to pay wages.

It was clear that this growing nation needed a central bank. By 1912, some lawmakers presented a plan that would place responsibility for the nation's credit and money supply into a single, centralized board consisting of 46 directors who overwhelmingly represented the banking industry. Populists including Bryan, who by this time was serving as secretary of state under President Woodrow Wilson, criticized this approach as giving too much power to financial interests.



Kansas City Fed President Esther George spoke at a luncheon of community business leaders and then spoke with some of the attendees afterward on Sept. 6 in Omaha, Neb. The Omaha Branch of the Kansas City Fed organized the event.

Oklahoma Senator Robert Owen, a banker during the Panic of 1893, generally agreed with Bryan's concerns but recognized the need for a more balanced and representative approach to central banking. For more than a decade, Owen had proposed his own banking reform measures, and as chairman of the new Senate Banking Committee in 1913, he was in a position to introduce a bill that included both a central government board and a regional reserve system to represent differing regional economies and banking needs.

President Wilson and members of Congress debated these issues for months. By late 1913, lawmakers finally arrived at the compromise that created the Federal Reserve System and its structure of a central Board of Governors in Washington and 12 regional Reserve Banks located across the country.

The Federal Reserve reflects the tradition of checks and balances that characterize other important institutions in the United States. The Federal Reserve's designers recognized that the central bank would need a wide range of perspectives when deliberating policy that affects the availability of credit and money in the broader U.S. economy. The regional Reserve Banks provide a clear line of sight into how national policy affects Main Street.

While I consider the Federal Reserve's structure to be a success in terms of the founders' intent, I often read that "too many voices" and the "complex structure" of the Federal Reserve System are confusing to the public. To the contrary, it is important that this representative structure not be disregarded or diminished. This structure and its governance



provides for a diversity of views that are transparent to the public and are reflected in its deliberations about the U.S. economy and its decisions on monetary policy.

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The preceding was adapted from remarks delivered during a public address in Omaha, Neb.