MESSAGE FROM MANAGEMENT

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First Vice President and
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The Federal Reserve System has been the subject of much controversy. We hear that the central bank did too much, or too little, during the financial crisis and that we should be doing more, or less, to promote economic growth and low inflation.

The Fed is no stranger to controversy. Since our founding almost 100 years ago, we have tried our best to serve the public. We have not always gotten it right, and we have learned many lessons, although scholars continue to debate both the causes of economic events and the efficacy of actions taken by the Fed and others. Let's look at some examples of lessons learned since our founding and at our key roles today.

Prior to our founding, the country did not have a centrally managed currency, and it experienced periods of financial panic. In 1913, the Federal Reserve Act established the Fed as a national clearinghouse to help resolve these issues. The debate about the central bank had hinged largely on the extent to which authority would be vested in the powerful money centers or dispersed throughout the nation. The Federal Reserve System—which includes 12 independent regional Reserve Banks and a federal agency, the Board of Governors—represents a compromise between those alternative views. From its start, the Fed has balanced the sometimes competing interests of different parts of the country and different parts of the banking system. The importance of staying close to Main Street, even as we address national economic issues, is an enduring lesson.

Since our founding, the economy has been through good times and bad. The Roaring Twenties was a time of great prosperity. Then, during the early years of the Great Depression, gross domestic product declined 30 percent, and unemployment rose to 25 percent. One-third of all banks failed. During this period, the Fed's interest rate policy fluctuated, but the Fed's actions were insufficient to prevent a collapse of the money supply and prices. Along with other factors, this policy error contributed to the depth and duration of the depression. This was a lesson learned—provide accommodative monetary policy in times of severe economic stress and falling prices.

During World War II, the U.S. Treasury pressed the Fed to cap interest rates to help finance government debt. This created inflationary pressure. Through this experience, we learned the importance of keeping monetary policy independent from fiscal policy. In 1951, the Fed and the Treasury reached an accord, which gave the Fed independence to set interest rates in pursuit of economic stability.

In the mid-1960s and 1970s, inflation began to rise, and policymakers did not respond effectively. During this period, called the Great Inflation, inflation spiked into double digits. Beginning in 1979, the Federal Open Market Committee (FOMC) increased interest rates to bring inflation back under control, causing a sharp recession in the early 1980s. This lesson was clear—do not let inflation creep out of control.

From 1985 to 2007, we enjoyed a long period of generally favorable economic performance called the Great Moderation. Improved monetary policy contributed to this prosperous period, which came to an abrupt end with the latest financial crisis. The causes of the crisis and the severe recession that followed remain a matter of debate. Certainly imprudent risk taking by many financial institutions and imperfect oversight by the Fed and other regulators played a role. So too did the incentives created by a large and ambiguously defined federal financial safety net.

Let's turn now from history to look briefly at the Federal Reserve today and to think about the implications of the lessons learned. The mission of the Federal Reserve System is to ensure the stability, integrity, and efficiency of the nation's monetary, financial, and payments systems. We accomplish this through our monetary policy, supervision and regulation, and payments roles.

In our monetary policy role, during the most recent recession, the FOMC established and continues to pursue a highly accommodative monetary policy while remaining vigilant about inflation. Our decentralized structure provides us with a deep and broad understanding of the economy and with the political independence needed to make decisions in the long-run interest of the public.

The Federal Reserve's focus on supervision and regulation ensures that financial institutions follow safe and sound practices and that they identify and mitigate risk. Many community and regional banks remain weak, so Reserve Banks have increased the frequency and depth of examinations. The Board of Governors and the Reserve Banks also have strengthened their oversight of the largest financial institutions. We are performing stress tests that assess how prepared they are for adverse financial and economic scenarios. We also are implementing enhanced capital standards and resolution plans.

The Federal Reserve System began as a system of clearinghouses for payments between banks, and continues in that role today. In 2011, we transferred more than $4 trillion per day on average in electronic payments, checks, and currency and coin. We also acted as the fiscal agent of the U.S. Treasury. These services underpin the day-to-day economic activities of consumers and businesses.

The community outreach activities of the Reserve Banks and the Board of Governors are integral to all three of our roles. Recently, our local outreach has focused on issues such as housing foreclosures, small business lending, workforce development, and nonprofit capacity building. The economy works best with a well-informed public, so we focus also on economic education and financial literacy.

Central banking depends both on science and judgment. There is no simple, single formula for optimal economic policy. So perhaps we should not be surprised by the level of controversy about the Federal Reserve, or even proposals to "end the Fed." Our roles and policies have evolved as we have learned from our history, but our founders created a structure that has withstood the test of time and that brings a mix of independent regional and national views to the policy table. In 2013, the Federal Reserve System will commemorate its centennial, and our dedicated people are ready to carry our public service mission into the next century. Ultimately, the public will judge how effectively we fulfill our responsibilities as a central bank.

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