Observations on the Centennial of the Federal Reserve System

The Philadelphia Fed Policy Forum

Philadelphia, PA

December 6, 2013

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President and CEO
Federal Reserve Bank of Philadelphia

FEDERAL RESERVE BANK
OF PHILADELPHIA

The views expressed today are my own and not necessarily
those of the Federal Reserve System or the FOMC.

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"The History of Central Banking in the United States"

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Highlights:

- President Charles Plosser welcomes participants to the 2013 Philadelphia Fed Policy Forum with some thoughts about the 100th anniversary of the Federal Reserve System.
- He notes that our central bank's decentralized structure has evolved and that the balance of power has shifted over time in response to economic events and legislation.
- He argues that trust and credibility are essential features for a successful central bank. In the spirit of the work by Nobel Prize-winning economist Douglass North, Plosser believes we should seek ways to ensure that these qualities are embodied in the institution itself.
- He stresses that a central bank can never be completely independent, nor should it be. In a democracy, independence should come with constraints and limits on the central bank's authority and scope of activities. The power to print money is a significant one, and central banks should be limited in how they can use that power.

Good morning and welcome to the Federal Reserve Bank of Philadelphia as we begin the 2013 Policy Forum. It is a pleasure to see so many familiar faces and to welcome those who are attending our forum for the first time.

This is our 10th Policy Forum, and as you can see from the program, this is a special occasion. The Federal Reserve will officially begin its centennial year on December 23rd. On that date in 1913, President Woodrow Wilson signed into law the act that created the Federal Reserve System. The 12 Reserve Banks officially opened their doors on November 16, 1914. In achieving this milestone, it seems appropriate to take a step back, reflect on our central bank's history, and seek a better understanding of its successes and its failures.

One of our objectives today is to highlight specific historical episodes to see how they have influenced or shaped the evolution of the institution itself. Like the Nobel Prize-winning economist Douglass North, I think institutions matter. In particular, I believe the institutional structure of the central bank matters. The central bank's goals and objectives, its policy framework, and its governance structure all play a part in its performance.

Given the historical perspective we want to take, what better place to begin than here in Philadelphia, the birthplace of our nation, both politically and economically. And we can start by looking at the earliest attempts to create a central bank for the United States.

The first institution was the brainchild of our first Treasury secretary, Alexander Hamilton. His efforts led to the creation of the First Bank of the United States, which was awarded a 20-year charter by Congress in 1791. Although the First Bank's charter was not renewed, the War of 1812 and the ensuing inflation and economic turmoil convinced Congress to establish the Second Bank of the United States, which operated from 1816 to 1836. However, it too did not win a renewed charter, with President Andrew Jackson leading the opponents in a heated political debate. I believe that both these institutions failed because they were unsuccessful in overcoming the public's mistrust of centralized power and special interests. Indeed, without public confidence in these institutions, they were doomed.

Like many of our nation's earliest institutions, the vestiges of both the First and Second Banks are located just a few blocks from where we now sit. The First Bank is located near Third and Chestnut streets, and the Second Bank is directly across the street from the hotel where some of you are staying, near Fourth and Chestnut streets.

After the first two attempts, it took nearly 80 years before Congress tried again to establish a central bank. The outcome was a new central bank with a governance structure designed to decentralize authority and promote public confidence — a decentralized central bank. This structure helped overcome political and public opposition that stemmed from fears that a central bank would be dominated either by political interests in Washington or by financial interests in New York. Yet even this structure, which has now lasted a century, has evolved, and the balance of power has shifted over time in response to economic events and legislation.

I believe that the fundamental concept of a decentralized central bank has great merit, in part, because it helps to preserve the independence and maintain the public trust in the institution. Independence is essential if a central bank is to play its fundamental role in preserving the purchasing power of a fiat currency. History is replete with examples of governments using the power to print money as a substitute for making tough fiscal choices, and the results were disastrous.

But, of course, a central bank can never be completely independent, nor should it be. In a democracy, independence should come with constraints and limits on the central bank's authority and scope of activities. The power to print money is a significant one, and central banks should be limited in how they can use that power. Such constraints can help build public trust and instill credibility in the institution. For me, trust and credibility are essential features for a successful central bank. In the spirit of Douglass North's work, I believe we should seek ways to ensure that these qualities are embodied in the institution itself.

Our program today will be a fascinating one. We have a distinguished array of economic historians, monetary policy experts, and former policymakers. The goal is to review the history of the central banking experience in the United States, beginning with the Second Bank. We have organized the sessions to focus on critical economic and legislative events that have shaped our central bank. We are particularly pleased to have former Chairman Alan Greenspan and former Vice Chair Don Kohn to close our program. This will undoubtedly be a lively and thought-provoking day. And I hope you will find it as instructive and fascinating as I will.

As I already mentioned, Philadelphia has a rich history in the political and economic founding of our country. Before we begin, I would like to recognize one guest in the audience. In our first session, we will hear about the legacy of the Second Bank of the United States. Many of you know that the president of the Second Bank was Nicholas Biddle. We are pleased to have with us today the great-great-great-granddaughter — I think that is the right number of greats — of

Nicholas Biddle, Cordelia Frances Biddle. Cordelia is actually my neighbor. She is an author and actress who is fascinated with history, particularly the history of Philadelphia. She has done research in our library here at the Philadelphia Fed while writing a book on another of her ancestors, the financier and founder of Drexel University, Anthony Drexel. Cordelia, thank you for joining us today.

And thank all of you for coming. Let's get the program started.