Interview with Bruce K. MacLaury

Interviewed by James E. Fogerty
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JEF: Today I am interviewing Bruce K. MacLaury, President of the Brookings Institution, former President of the Federal Reserve Bank of Minneapolis. The interview is taking place at the bank headquarters in Minneapolis, Minnesota.

I'd like to begin with a biographical snapshot of where you were born, where you went to school, that sort of thing, to put you in context.

BKM: All right. Well, that's easy and disarming. Born in Westchester County, New York. Went to schools there, and then Princeton and graduate school at Harvard in economics. Put in a couple of years in the army, 1954 to '56. After graduate school, my first introduction to the Federal Reserve System was in the summer between my two years of graduate work in economics when I had to put bread on the table, and the Federal Reserve Bank of Boston had a job offer. I spent the decade of the sixties at the Federal Reserve Bank in New York.

JEF: What was your position at the New York Fed then?

BKM: I started out in the research program. I was what was quaintly called still at that time--this would have been starting in 1958--the British Empire section. You can hardly imagine that.

JEF: It's great. [Laughter]

BKM: [Laughter]. And I was on the Canadian desk. One of the reasons that I'd gone to the New York Fed after graduate school was because they offered a dissertation program. They said if I came and behaved myself that they would give me six months' leave of absence with pay--that was the key, with pay--to write a dissertation. So I put in my year and a half, or two years of work on the Canadian desk and then was allowed to write a dissertation and combined that with my work on the Canadian desk. That is to say the dissertation, now gathering dust somewhere in the archives, was on the development of the Canadian money market, and that was a way of getting a little head start on financial markets generally.

So I started in the research department. Relatively quickly--by 1960 or so--my then-boss was a man by the name of Charles Coombs, vice president of what became the foreign operations department, and he took a couple of people to go into foreign operations as opposed to foreign research. The Federal Reserve at that point was getting back into the business of foreign exchange operations market intervention.
What was really fascinating was getting into a business for the Federal Reserve that they had not been in, I think, since the teens, or the twenties, perhaps. So it was a matter of negotiating mutual credit arrangements with other major central banks, so-called swap arrangements. The trips back and forth to Basel, Switzerland, where the Bank for International Settlements was located, that was very heady stuff for a young man and very interesting.

JEF: That all took place between 1958 and 1969?

BKM: Correct. There was one intervening year where a senior boss of mine in the research department, Robert Roosa, went into the Treasury Department as undersecretary for monetary affairs in the Kennedy administration, brought a couple of us down from New York to work with him briefly at the Treasury in the early sixties, in the Kennedy years, and then managed to arrange for me to be secunded through the State Department to the OECD for a year, 1961-'62, on the staff over there. But, otherwise, generally that period of time was spent at the Federal Reserve in New York.

JEF: But then in 1969 you went back to Washington.

BKM: Back to Washington, yes. This was again to the Treasury Department. They recycle folks like me, I guess, but we don't call ourselves retreads. I was recycled, anyway. And, in that case, working for Paul Volcker, who was the under secretary for monetary affairs. That was two years as deputy under secretary for monetary affairs, and it was again working on international financial issues and, to some extent, on debt management issues for the U.S. Treasury.

JEF: Looking back on it, do you think that sort of foretold your return to Washington eventually when you went to Brookings?

BKM: No. I certainly had no inkling of that at all at that stage of the game. Brookings was a name that I was aware of. But I can recall, being in government, Brookings was definitely seen as, if not the enemy, not necessarily a friendly critic. It was certainly a critic, and only later did I find that that was its functional role. It was designed to be a critic of whatever administration was trying to manage government to try to make things better. But, no, I had no inkling back when I was at the Treasury Department that I would come back yet a third time to Washington for a second career, so to speak, outside of government and finance, in a think tank.

JEF: It wasn't the sort of thing where you said, "Boy, this is the place to be. I'd love to be in Washington permanently," or anything like that?

BKM: No. Absolutely not. In fact, the opportunity to come out to the Federal Reserve in Minneapolis in 1971 was again something out of the blue, but something very welcome. I mean, I liked the Federal Reserve, everything I knew about it. It was part of my heritage by that time. And to be the chief executive officer of one of the regional banks was about the highest occupation that I could imagine at that stage of the game.
JEF: Was your appointment a surprise? At that time you were the youngest person who's ever headed a Federal Reserve Bank.

BKM: I guess. Yes, but as is evident, that's a fleeting glory, to be the youngest anything. It was heady. Atherton Bean, for example, from this community came down to my office at the Treasury Department, and we chatted. I don't remember whether Bruce Dayton was there, but two or three people from the then board of directors of the Federal Reserve came for interviews. And I remember I was invited out, under only very thin cover, to give a talk, I think, about foreign exchange operations to the board of directors as a trial run to see whether I had two heads or could put two words together.

I'll put this on the record. We really had not lived outside the East Coast prior to 1971. And so the opportunity to come out to this part of the world was entirely new for us. She remembers very well to this day my description of Minneapolis as a jewel in the Midwest, and we found that to be true. It was, in many ways, propaganda and wish at the time I said it, but it became true for us.

JEF: Well, that's an interesting segue, because I was going to ask you about the move. Obviously you had not lived outside the East Coast, and here you were plunked down in the plains or near them, in the middle of what is the largest, most sprawling of the Federal Reserve districts.

BKM: Yes. It also then was, in terms of the balance sheet of the bank, probably the smallest of the Federal Reserve banks. But Hugh Galusha, my predecessor, who died in office, had built up the reputation of this bank well before I came to it by playing an innovative role. Even in the late sixties during the riots in cities across the United States, race riots and Vietnam War riots, the bank was seen as a neutral ground, a voice in the community that was not taking sides. One of the things that attracted me to Minneapolis was the openness of the community, the willingness of the community to listen to foreigners, so to speak, who came in from outside the community. The Federal Reserve, through Galusha's efforts and otherwise, became a voice in the community and a facilitator within the community in many different areas which had very little to do with the Federal Reserve's functional role as the central bank office in the Ninth District. That is to say it went beyond relationships with the financial community, which is not so unusual, to small efforts to foster economic development on Indian reservations, for example, or the dealings with the University of Minnesota. There were just any number of opportunities for someone who came into the chair at the head of the Federal Reserve in Minneapolis, which had been created by Hugh Galusha.

There was--let me interrupt myself to say--something called the Baconian dialogues. I don't know whether that has come across your screen or not.

JEF: No, it hasn't.

BKM: That was, again, the brainchild of Hugh Galusha. It began a number of years before I came to this bank. In fact, I participated in one of the week-long sessions, I guess it was, or long
weekends, of the so-called Baconian dialogues. Throughout the Ninth District he invited leaders from all sorts of areas--farmers, ranchers, manufacturers, bankers, academics, all walks of life--and brought together maybe thirty, thirty-five people, as I would recall, for a period of days together off in the wilderness. Hugh began, and I continued, a tradition for a number of years of bringing in speakers from around the country to have really a long discussion. It was a way of building a constituency--this was its indirect effect; it was not its purpose. But it built a constituency for the Federal Reserve throughout the whole of the district among leaders of the district in a way that served the bank and the community, I think, very, very well.

JEF: That's interesting. Did Galusha feel, did you continue to feel--you must have--that the bank needed a constituency? Can you describe your thoughts on that?

BKM: Yes. There are many aspects to a regional Federal Reserve bank, and interestingly, to me at least, the twelve different district banks played their roles very differently in different communities. They are allowed to play their roles. There are differing constraints upon different Federal Reserve banks in the various communities which they serve. I think that no matter what district one is talking about, the role includes explaining to the interested public what monetary policy is, what it is all about, giving it a rationale in the community, being a spokesperson for macroeconomic policy--not to use jargon--in the community. And it's a two-way street. Funneling back to Washington and to the monetary policy-making process the views of people in the district, particularly those who happen to be the directors at any particular point in time of the bank itself, but a much broader constituency as well. It's a two-way communications post, if you will, an outpost for the Federal Reserve System, which pays big dividends in many ways. For one thing, it gives, I think, a greater reality to the formulation of monetary policy in Washington, which otherwise could be quite academic.

Beyond that, the central bank's role in the economy is an anomalous one. It has great power, but it is not a democratically organized institution. I, as president of the Federal Reserve bank, am not appointed by the Congress. I am not approved by the Senate. The process, I won't bother you with. You probably know. But it's very nuanced. But we are not democratically elected, and we are not responsible in that way to the electorate. Therefore, all the more reason that we have to spend as much time as we can explaining the rationale for that separation, if you will.

JEF: You particularly mentioned people like small town bankers and businesspeople across this big district. Did you find them receptive to those efforts like that?

BKM: Speaking to many communities within the district was one of the remarkable aspects of my stay here. It seems to me it had that reputation before I came, and I found it to be true. That doesn't mean that everybody believed everything that was said by the august president of the Federal Reserve. Monetary policy, again, especially when there is a need to restrain credit, does not have a very happy effect upon communities or upon ranchers or anybody else who sees the price of credit going up. That is a negative impact upon his business, and he doesn't like it. He can perhaps be persuaded there is a need for it in a larger sense for the nation, but its first impact is negative on him and his business.
I think another sidelight on that might well be that Minnesota in particular, but the Ninth District more generally, was a home of the small town bank. That is to say, small, independent—that's the key word, independent—bankers. Not large networks. And the independent bankers were not the greatest fans of the Federal Reserve System. They saw the Federal Reserve System as a monster that tried to infringe upon their right to an independent way of business in their communities. So there was definitely a tension, if it's fair to say, within that constituency about the role of the Federal Reserve in society. So there was a willingness to listen, an openness, a friendship that was accorded, but not necessarily similar views.

JEF: I would like to get back to that point in a couple of minutes from a slightly different angle. But before we leave Hugh Galusha, did you know him before you came here?

BKM: Yes. He had invited me to, as I say, participate in one of the sessions of these Baconian dialogues. That was one of the ways that I had gotten to know him. But also during that period of my career in the 1960s, when I was working on the foreign exchange operations of the New York Federal Reserve Bank, I was attending the so-called Open Market Committee meetings in Washington. Therefore, throughout that period of time, I, as a junior staff person sitting behind the desk, not at the desk, was nevertheless privileged to get to know all of the people who were the heads of the Federal Reserve banks and the governors.

JEF: By all accounts he was a man of immense charisma.

BKM: Yes.

JEF: A Montanan, I believe, by birth.

BKM: Yes. Right.

JEF: And obviously understood the district. Did you find it easier to take over from someone like that because of the presence he had established or difficult because of the presence he had established?

BKM: I supposed that's one of those questions that gets answered both ways. The answer is both. I felt they were very large shoes to fill, that there was a great love for Hugh Galusha in the district. He was a native son. He had been a principal in an accounting firm, as I recall. He was very active in the National Park Service and a supporter of national parks and conservation, well before that became popular. And so there was a great love and affection for him and in the innovative role that he played.

The other side of that issue is that, as I said before, he had established a platform, a believability, a credibility, on the part of the Federal Reserve in this district which continued for the office which I came then to fill. And so there was a momentum behind my arrival on the scene which stood me in very good stead as I went forward.
JEF: When you arrived, you mentioned a couple of people who were on the board--Atherton Bean and Bruce Dayton and others. Are there others that come to your mind who, in fact, were on the board that hired you?

BKM: Well, Steve [Stephen F.] Keating, I think, was here. I should have gone back to look at the whole list.

JEF: That's all right. I just wanted a couple. Did you sense from them, from the majority of the board, that they wanted Galusha's policies, such as they were, continued?

BKM: Again, we have to distinguish policies from policies, because it is true that the Federal Reserve directors, the directors of a Federal Reserve bank, can have an influence on monetary policy, but it is very, very indirect. And, therefore, it was not a matter of continuing policies with respect to how this district ought to vote its vote in the Open Market Committee meetings. I never felt under any pressure to continue the monetary policy role of the Federal Reserve. But, in a different sense to be innovative, to be open, to be a leader in the community, to go beyond the narrow mandate of what a Federal Reserve bank is chartered to do. It was very clear that that was one of the missions that the directors of this bank felt needed to be carried forward.

JEF: Did you begin to travel quite a bit when you came out here then?

BKM: Around the district? Yes, though always with the feeling that there was never as much as should be, but I think that would always be the case. But I saw my role and tried to fulfill it by being in the various states of the district, on trips to make speeches at Rotary Clubs and any other constituencies that I could find that would listen. That was part of the responsibility and a very enjoyable one.

JEF: Did you have any reflections when you saw eastern Montana for the first time? I know it awed me, and I grew up in the Midwest.

BKM: Well, I can answer not directly, but indirectly. It's not so much eastern Montana. I can tell you that a friend had said that the Big Sky State was over-awing--if there's such a word--that the vastness of it was overwhelming to the human spirit. That was a reaction. I did not happen to have that reaction. I would still say that Glacier Park and Flathead Lake are a part of my heritage. One of the finest trips that I remember with my family--I had two young sons at that period of time--was to Flathead Lake and Flathead Lake Lodge and Big Sky, the ranch, the resort, and skiing that part of the world. To visit the branch in Helena was never a chore; it was always fun, desirable. And, as you know, the Helena branch has its own board of directors. To go out and meet with them--I don't remember whether it was twice a year or something of the sort--was always something I looked forward to.

JEF: The Helena branch recently acquired a handsome new building, too.
BKM: Absolutely. I've not been in it, but I've seen the plans and the pictures. Yes. Again, I remember very well the old building that, even in my day, we had tried to get updated. It was a futile chore, which I'm glad my successor has succeeded in doing something about.

JEF: Speaking of buildings, one of the things that you inherited from Hugh Galusha was the building in which we are sitting right now, which was then on the planning boards under construction.

BKM: Yes. It was a hole in the ground when I arrived in 1971. The plans were all set and Gunnar Birkerts, the architect, was well along his way overseeing the construction, and the construction went forward. I don't remember exactly the date for the move-in, but it was 1973, as I recall, and that was a banner day. The great planning efforts that Tom Gainer, who just popped his head in the room here, was very much involved in planning even back then, as I recall. We had all the manholes taped down, and we were going to move on an unspecified date the assets in the vaults from one building, which was not very far away, to this building, with police escorts and all the rest. So it was exciting. It lifted the spirits.

This building that we are sitting in was, I think, the first of a generation of new Federal Reserve banks. The old buildings had survived; they had fulfilled their functions for something like fifty years, from the twenties to the seventies, and they were beginning to wear out. They were beginning to become outdated. Again, Hugh Galusha was somebody who had seen that, had lobbied for it. It was very difficult, I think, in lobbying the board of governors, because this was not just one more building, this was an edifice that deserved respect and standing in the community. Whether the taxpayers should pay for that kind of a statement was a controversial issue. He had fought those battles, and it was my responsibility to make sure that we moved in smoothly and made the best use of it.

JEF: It must be difficult, nonetheless, to carry out the construction of a building which you had no hand in planning. Did you find that to be true, or were there so many staff members who had been involved in it that you didn't feel that?

BKM: Well, I certainly never felt that way at all. That's an alien thought to me. The magnificence of the plans and the structure, I mean, it was no chore to catch the spirit that had been the guiding spirit of its design. So I think the only thing that I would regret is that it was not my conception. I would have been proud to have been the conceiving spirit of the building rather than simply the first operator. So there was nothing negative about kind of stepping into somebody else's shoes. If it had been a building with which I could not have identified, I think that would have been much tougher, if I thought mistakes had been made. But we had no idea about the problems that would subsequently befall the building when I was involved with it.

JEF: That's interesting. The institution I work for has just built a huge building in St. Paul, and people do personalize these things, you know, and look at it and say, "Oh, if I had been doing it, I wish this had been there, or I would have done this."
BKM: I certainly had none of those feelings. One of the other privileges that came along with the mandate of move-in was to acquire some art with which to decorate the walls in the plaza. One of the great joys of my life, frankly, was doing that. Dentists, I'm told, go out on Wednesday afternoons and play golf or do something else. I spent at least a year or so Wednesday afternoons, not every one, traveling around to art galleries with guidance from the [Minneapolis] Institute of Art and the museums, looking at galleries for art within the district. It was an education and a great honor, really, to be able to put some stamp on the nature of the building and its decor. I, again, inherited this, but it was great fun to carry through the statuary that exists on the plaza. The artists had been selected.

JEF: That's interesting. Then you were able to bring into the building artwork from people across the whole district.

BKM: Again, different Reserve banks subsequently were building their own buildings and had different conceptions as to how they felt the building should make a statement for the district. There were still enough details in terms of the plaza, the waterfall in the plaza, the symbolism of the waterfall in the plaza, and the statuary, that I felt, at least, that there was some part of me that could be reflected within the building, even though the whole concept was not my own.

JEF: Interesting. Let me return to something that you talked about just a bit ago, and that was the fact that in the Midwest, Minnesota particularly, independent bankers have flourished. But it's also true that the Twin Cities are the home to two very large bank holding companies that had grown larger. Did you find a tension there between having to deal inevitably with the big banks that owned a lot of others and had huge assets and the small bankers across the district?

BKM: Well, clearly they had different agendas on bank structure issues, but the idea that not all banking institutions had to be members of the Federal Reserve System gave a fair amount of leeway. On the one hand, the complexity of the bank supervision system of the United States is a real problem and has proven to be a problem and still is a problem. Nevertheless, it minimized to some extent the otherwise institutionalized frictions that would have arisen if everybody had been forced into one basket, so to speak. So that the independent bankers could have state charters and be responsible to state supervisors as opposed to the FDIC or the controller of the currency.

The freedom of choice is, I guess, the bottom line of the banks themselves with the freedom to either be members of the Federal Reserve, or to choose a state charter. That allowed for a good deal of flexibility. Therefore, the tensions that existed did not flare up. It's not one of my memories that I had to keep peace or was offending through the Federal Reserve one constituency as opposed to another. I think the American Bankers Association, the trade association, had a tougher time dealing that kind of an issue than the Federal Reserve as such.

JEF: Was there any attempt at that time--banking regulations, of course, changed in the ensuing fifteen years--on the part of what are now Norwest Corporation or First Bank System to grow, to change banking regulations, to lobby so that they could buy more banks and become larger?
BKM: I'm trying to remember. Yes, but it was not a major issue that I recall. The supervisory role of a regional bank is as minister for Washington rather than as independent devisor of the rules. That is an awkward way of saying that the rules on bank supervision and regulation are really formulated in Washington and within the Federal Reserve System by the board of governors. The implementation of those rules comes through the regional Federal Reserve banks. But it is well understood that if the bank holding companies wish to petition to acquire one bank or another, yes, they have to come through the regional bank and the dossier becomes very thick, and I think that they chafed, certainly, under the degree of bureaucracy that was required for all of these applications. That was always a bone of contention. But they understood our role in the region, and that they really had to make their case in Washington, not here. So that reduced friction to some extent.

JEF: You, as a regional president, never felt that the independent bankers somehow sort of expected you to, well, if not champion their cause but to serve their interests?

BKM: Protect them in some sense? No, I'm afraid that they would have seen the Federal Reserve as the enemy. They didn't expect us really to be their protectors. Their protectors were the state supervisors and the Conference of State Bank Supervisors. And if not the enemy, the Federal Reserve was always suspect because the national banks by law had to be members. They were the big banks in practice, and, therefore, I don't think the independent banks would identify with the Federal Reserve.

JEF: Would you discuss research priorities and projects at the time you were president?

BKM: I think during my era, the St. Louis Federal Reserve was known as the monetarist bank within the Federal Reserve firmament. To my knowledge, the Minneapolis Fed did not have a standout reputation prior to my arrival in its research role. John Kareken, who is still a professor at the University of Minnesota, was an economic advisor to me at the time.

During the time that I was here, Tom Sergeant and Neal Wallace were people from the University of Minnesota who were playing a role in our research department at the Minneapolis bank, were working with macroeconomic models and, at the time, became concerned that macroeconomic models were not sufficiently stable to be good predictors of the course of the economy for reasons that became known as the rational expectations school of economics. If you are examining a system, the system changes because you are examining it. And in the monetary context, the world knows that the Federal Reserve is trying to follow a particular course with respect to inflation, and the public will take into account the Federal Reserve's efforts and frustrate them. Therefore, macroeconomic models do not exhibit stability that you would like to think they would have in predicting that if the Federal Reserve takes such and such an action, it will have this effect on the state of the economy four quarters, six quarters hence.

It was that thought process that was beginning to be used while I was here. I thought it was a very interesting development and, in fact, a frustrating development, because it undermined the whole rational for Federal Reserve monetary policy. I mean, taken to its extreme, it would mean that
monetary policy was impotent, that it could not do anything, that it would be second-guessed from the very instant of its move and, therefore, could not have any effect upon the real economy. It could have an effect upon the money values of the economy, but not on real employment and economy activity. So it was a very threatening concept to anybody associated with the Federal Reserve System. And Milton Friedman, from a very different perspective, the monetarist perspective, had likewise for a long time popularized the view that the Federal Reserve is in business only to create jobs for central bankers. This was a new nail in the coffin of central bankers, if I could put it that way.

I thought it was a very interesting set of ideas, and I tried to encourage the research department at that time to work on these ideas, but I never saw those ideas of rational expectation, as determining how I should vote or work within the deliberations of the Open Market Committee.

Now, I think one of my successors, Mark Willes, who came in as president after I left, was very intrigued with this line of reasoning within the research department at the Federal Reserve in Minneapolis and made it more of an official policy line of this bank, a symbol, if you will, of this bank within the Federal Reserve System. So there became a voice for the rational expectation school coming out of Minneapolis. That grew out of work that was going on here while I was here, but I thought that it was a very interesting intellectual exercise, not a direct policy-related exercise while I was here.

**JEF:** When you went to Open Market Committee meetings, how much preparation did the research staff give you? I understand, in talking with previous presidents, some wanted more, some wanted less.

**BKM:** Yes. I felt that it was absolutely essential that I have good briefing materials, and I can't remember now whether we spent a half a day. But I would not go to Washington without feeling that I had been very well briefed by my research staff. One of my directors—directors, that is to say, of the board of directors—told me that it was a very expensive research operation to have a million dollars, which I think was the cost of the research department at that time, spent for the education of one individual, namely, the president of the regional bank. I know he had tongue-in-cheek, but, nevertheless, there was a small knife as well.

A point I'd like to make in this context is that the briefing was as much a matter of strategizing. The regional banks and the regional bank presidents had materials sent from the board of governors in advance of our trip to Washington that we would then study, and the research department, in effect, would critique them. They would not only give their own points of view, but also critique the points of view coming out of Washington, so to speak. So I was armed in two different ways. One, with the views about the state of the economy, the prospects of the economy, and what monetary policy might or might not do about it from the ideas of the research department, but also a critique of the ideas that were going to be coming out of the staff of the board of governors in Washington. I emphasize that because I think both were important. They were not necessarily symmetrical. Although one might like to think that it's a very rarified discussion of monetary policy around the Open Market Committee, it was really a policy committee, in my days, for open discussion and
there were negotiating tactics. Some presidents would come with a written brief of a couple of pages and read their statement into the record, and that would be their contribution to the discussion. If the discussion took a course that was not consonant with the brief that had been prepared for them, they would be at sea, to speak frankly. That was not my way of operating. I think it was not an effective way of operating.

But there were tactics that could be employed, because Arthur Burns, the chairman while I was president, chairman of the Federal Reserve, had a very different way of chairing the Open Market Committee meetings than had his predecessor, Bill Martin. Bill Martin was much less structured, waited until the end, until everybody else had had his say around the table, and then at the end Chairman Martin would say, "Well, I think we have a consensus to do this." Never, in fact, stating his views. Arthur Burns was far more directed in how he tried to run the committee. And, therefore, in response to that, I think the presidents, and certainly I'm speaking for myself, would have to game the Open Market Committee strategy as well. Whether one used the materials that came from Washington and referred to the raw numbers that came out of those as a way of making a point, that was fair tactics. Even though I would not necessarily believe the raw figures that I was quoting, they were an opportunity to make a point in the discussion that I felt deserved to be made.

This is a long-winded response to your question about how the briefing went, but I felt I needed to be fairly well steeped, not only in what my people thought about the economy, but also issues that I could use that were likely to be coming at me, us, while I was in Washington.

JEF: It's an interesting comment on the dynamics of the committee as well, of course.

BKM: Right.

JEF: In what way, at the time you were president of Minneapolis bank, did the presidents of all the regional banks represent points of view specifically coming out of their regions? In other words, people in Montana, North Dakota, South Dakota probably felt certain downturns or upturns in the economy more so than people in Mississippi or somewhere else.

BKM: Yes. Yes. Well, there was then, and there still is, I guess it's called, the beige book. There were different books designated at the time by their colors—the green book, which had econometric models; the red book, which had monetary figures; and the beige book was a compilation of information from the twelve districts of the country about business conditions in those various districts. I guess I would say that in my day, the differences among the regions were interesting, but not determinative, if I can put it that way. Sometimes one got different effects in different regions, and the agricultural regions would be feeling something different from the manufacturing regions, and New York, as kind of the lead money market bank of the system, would have a different set of concerns.

My sense was that the regional differences in economic conditions played less of a role than the deliberations about how the national economy was going. That was really the factor. I think this was different in my day than it would have been twenty or thirty years before, because by the
sevenites, it was a national market. Even today we can talk about bicoastal effects, the fact that the conditions on the East and West Coast are different from the economic conditions in the center of the country. I think that that's more true today in some ways than it was in the mid-seventies that I remember something about.

So my shorter answer is that I don't think that regional economic conditions played that large a role. Different presidents would speak. If there was something peculiar to their region, they would enter that in the record, so to speak, to let their colleagues know. But, by and large, that was not where the major focus of attention was.

**JEF:** After all, as president of the bank, you're the CEO of a major operation with a great deal of influence. What were some of the management issues you would say if you had those that come your mind, that you faced as CEO of the bank? You moved into a new building. Did that lead to any restructuring in the bank, for instance, of workload? Did it lead to an expansion in staff?

**BKM:** Yes. Good question. I guess my response is that organizational questions did not take a great deal of time. I've got to say that the first vice president, in my case, first Maury Strothman and then Clem [Clement] Van Nice, were chief operating officers, and they had the major responsibilities for the operations of the bank as an organization. And, yes, there were organizational questions that came up, but they were not the major ones that caused a great deal of concern for moving into the bank, getting organized and getting settled in. "Are we going to eliminate this department or are we going to downsize this one?" was not a major issue. Dealing with increasing check volumes was a major issue. How were we going to gear up technologically to deal with increases in volume was an issue. There was a very effectively established structure within the bank, chaired by the first vice president or chief operating officer, so that the president's role was really monetary policy and being spokesperson for the Federal Reserve and funnel for the Federal Reserve from the community back to Washington. I saw those as the major roles.

Now, that was true during my time. There have been major issues since my time. It was just beginning to develop that the Federal Reserve was no longer going to have a monopoly on money funds transferred or on check clearing or on a lot of these other services. We had not been totally a monopoly when I was here, but the whole issue of pricing of services and competing with other networks was just beginning to come on stream, and that has made a whole world of difference to the way of operating. In that sense, operating issues would have come very much to the top of the building and to the CEO in a way that did not happen to during my tenure.

**JEF:** Tell me what you think, if you would, of the increasing pressure to be profitable, however profitable is defined within the Federal Reserve System. Do you have any reflections on that?

**BKM:** Yes. I think it's fair enough game. I think we were always conscious of playing this middle role in a community. We were not quite government. We didn't want to think of ourselves as being part of "the bureaucracy" or the government. There was an **esprit de corps**, I think, within the Federal Reserve, which I hope and believe still exists. That was separate from "a government agency." And yet there was no question at any point in time that we were serving the public.
interest. I always thought the idealness, if there is such a word, of my job halfway between the public sector and the private sector, was that it had both the advantages and some of the disadvantages of both sectors. In other words, my salary was not going to be as high as somebody who was running a network of banks and making high profits. I mean, there was psychic income in feeling that I was in public service and doing something useful, and that was worth a lot to me personally.

So, again, it's a rather elliptical way of getting at your question about whether we should be out competing with the private sector. Many of the functions that we perform can be as effectively performed in the private sector, and we ought to have to compete. The Federal Reserve—I still say "we"—ought to compete on equivalent grounds. And I realize that within that phrase, "on equivalent grounds," has been a whole chapter of history in itself.

**JEF:** But you see no particular difficulty in that or constraints that puts upon the Federal Reserve that are unfair to it, in fact, by expecting it to, within the confines of government, perform something which really is a private sector role?

**BKM:** But there are very different kinds of roles. I think that the bank supervision and regulation function is something that cannot be privatized. On the other hand, processing of currency and coin is not something that a Federal Reserve bank has to, in the grand order of things, do. There are other ways of handling that. So there are different functional roles that a central bank plays. Central banks around the world play different kinds of functional roles, and there's no God-given mandate that, let's say, check processing or electronic funds transfer has to come through the Federal Reserve.

There has long been this question, even with respect to bank examinations, as to whether or not the monetary authority, which is the Federal Reserve, needs at the same time to have a role in bank supervision and regulation, or whether, as in some other countries, that functional role of bank supervision and regulation can be handled by the treasury or by some separate government organization. The argument is, on the part of the Federal Reserve, and I share this, that bank supervision should not leave. It could be truncated, it could be narrowed, but should not depart from the Federal Reserve. The Fed, in order to carry out its monetary policy functions, needs to understand the innovations and mentality and operations of major banks in society, and can only have that feel of the pulse, if you will, by being inside their operation.

But that question of what functional role the Federal Reserve needs to play, as I say, is not God-given and needs to be argued on its own merits from one place to another, from one functional issue to another. And, therefore, I don't say that the Federal Reserve is unfair in competing with the private sector, but nor is it unfair that the Federal Reserve in some of its functional areas should have to compete with the private sector.

**JEF:** That's interesting, because clearly when you look at the system, it has functions among the regulatory ones which clearly are not revenue-producing and other functions which produce revenue. To an outsider like myself, you know, if one were to strip away the revenue-producing
functions, it would compromise the justification that this system ought to generate a certain amount of revenue.

**BKM:** I think that, again, you have to make distinctions, because this gets very much to the core of the central bank independence. If the Federal Reserve were dependent upon the Congress for appropriations to carry out its central bank roles, its independence definitely would be compromised, from my point of view. Therefore, I say it is absolutely essential, with the benefit of hindsight now of many years, that the Federal Reserve have its own independent sources of revenue and not be dependent upon appropriations from the Congress. But now the Federal Reserve has a portfolio of government securities that is huge, and the interest income from that portfolio of securities which arise from open market operations, open market purchases, more than assures any sort of revenue stream that it needs for this independence role and, in fact, it gives back, so to speak, to the treasury those revenues from its portfolio of government securities which it does not require for its operating costs.

In that sense, it is very important to the independence of the Fed that it have a source of independent revenue, but that is more than taken care as in the current institutional structure by its portfolio of securities. It does not need any other revenue-producing sources to fill that function. Now, there might be other functions that I've forgotten about that would justify or require other independent sources of revenue, but they don't come readily to mind.

**JEF:** So some of those could be stripped away without compromising the system.

**BKM:** That's right. That would be my sense.

**JEF:** Were there any things that came up during your tenure as president that you think of, changes in the system, changes in the bank, the way things were funded? Did revenue continue to rise? Were you able to add people as you needed them? Was there downsizing? Downsizing, of course, is a word that's become current since that time.

**BKM:** Right. No, there was always the annual fight with the board of governors about regional bank budgets. And so there would be constraints and we would be stopped from doing this, that, or the other thing, which we felt was very important to do. But this is just part of the bureaucratic jockeying. I think, of any kind of branch office with head office, so to speak.

One of the issues that stands out in my mind during my tenure was not in that realm, but rather in the realm of monetary policy itself. There was one particular vote in 1972 where I felt--it was after price and wage controls had been implemented by the Nixon administration. There was a big question about whether monetary policy wasn't being too easy, too forthcoming, in order to keep interest rates down low so that they would not become subject to the kinds of controls that were being imposed upon other prices. After all, interest is a price.

Arthur Burns had a very difficult row to hoe in this respect, because he was not only chairman of the Federal Reserve, but he was also the chairman--I can't remember whether it was the Interest and
Dividends Committee, but there was a commission that oversaw interest and dividend payments during that period of time. And he did not in any sense wish to have caps put on interest rates, and I shared that point of view. That would have been disastrous. But he felt that we--we, the Federal Reserve--needed to follow an easier policy, a more forthcoming policy than I felt was desirable for the state of the economy. So it came to a vote. He felt very strongly about this, and a vote against the chairman is not something one does lightly. I felt very strongly, at that time, that it was important to take a stand, even at the risk of having interest rates rise more than would be politically desirable at that time and, therefore, voted against the proposal that the chairman was putting before us. That was one of the formative, maybe, badges of courage, if I can put it that way, of my career. There aren't that many opportunities that come along that way.

**JEF:** Your interest and expertise is in international economics. Were there international events that you felt affected the Federal Reserve System, the U.S. economy, etc.? How global was the economic village, if you will, at that time?

**BKM:** While I was president here, the international financial system, the Breton Woods System, as we had known it before, was coming apart. In 1971, I can remember, very shortly after I arrived here in Minneapolis, the United States felt that it could no longer sustain the gold standard and decided to unpeg the dollar from $35-an-ounce gold. So that was the beginning of the coming-apart of the Breton Woods system, and that coming-apart was ratified in 1973 when many of the major countries went on floating exchange rates because they could no longer sustain the linkages among their economies with fixed exchange rates.

So there was a lot happening in the international financial arena during the time that I was president here at the Minneapolis Fed. The fact is that international issues were an explicit part of the deliberations of the Federal Reserve during those years. To my recollection, I can't remember an occasion in which monetary policy decisions during that period of 1971 to '76 were changed in a way that would have been to what I would call the detriment of the United States in favor of the larger global system.

The United States was the dominant economy, even though it was less dominant than it had been before. We called the tune. General [Charles] De Gaulle did not like that in the sixties. He had threatened and, in fact, turned in dollars for gold and made himself very unpopular with the Treasury and the Federal Reserve for doing so. But we were still able to make the rest of the world take dollar IOUs; that's what it came down to. I guess you could rationalize this by saying that to keep the American economy on an even keel as best we could understand what that meant, was more important for the world economy than to try and nuance monetary policy in the United States to serve a broader, what would now be called a G-7, decision.

**JEF:** Less international sensitivity, in fact, than there is today.

**BKM:** Yes. Absolutely.

**JEF:** Less linkage.
BKM: Absolutely so.

JEF: What was, if you could characterize briefly, the economic climate? What was the economic climate in the Ninth Region particularly at that time between 1971 and 1977? How would you characterize it? Was it good times? Not-so-good times?

BKM: I think there were tough times in terms of agricultural land prices. I'm trying to remember now, but there had been a substantial run-up in agricultural land prices, which then, as I recall, during the first half of the seventies were going back down again, and that was very tough on the agricultural part of this region. So it was not good times, good economic times, for the agricultural interests of the Ninth District. The question then became, should that have been a determinative or major influence on a vote by the president of the Ninth Federal Reserve District in the central monetary policy-making institution, the Open Market Committee?

For better or for worse, I felt that that was a factor which I had to be aware of, sensitive to, but could not be a major voice in how I chose to vote, because my vote really was how I felt the national economy was moving. It was a matter of expressing awareness, concern, but monetary policy is a very blunt instrument--"blunt" is maybe not the right word, but aggregative; that is to say, very broad instrument. It is not refined. Many people would argue, and in some countries it is the case, that monetary policy ought to be targeted at particular industries or industry groups. My feeling was very much the opposite, that we had a Farm Credit Administration specifically set up to try to ameliorate conditions or deal with conditions in the agricultural sector, that it was very well to have subsidies from the taxpayer to the agricultural sector if that's what the voters wanted through the Congress, but that that was the way to handle sectoral interests or concerns, not through broad monetary policy.

JEF: You mentioned something earlier that interests me. You mentioned Indian reservations, particularly in efforts to bring industry to them and to improve economic conditions. This was in the pre-casino gambling era.

BKM: That's right.

JEF: Tell me a little bit about that, if you can.

BKM: Jim Hammill, who was then the head of our public affairs, public information, had a particular interest--I don't know for what reason--in economic development in the region. Certainly it did not take very much to see that economic conditions on reservations, even at that time, were very depressed. The question was whether there was anything at all that an organization like the Federal Reserve, whose charter did not in any way mandate it or even permit it, to take a role in promoting economic development on reservations. What we ended up trying to do were a few conferences only. The concern was very much here, although there was very little that a central bank could do about them. So I mentioned it because it was a source of concern. It was a matter of a number of conferences that we tried to organize. But in terms of its impact upon the ground, it
was a source of frustration to me--I know to me, but I'm sure to the intended recipients as well. And I continued to see it, as I left, as one of the most difficult, intractable, if I could put it that way, intractable regional issues in which I had not made any dents at all in the end.

JEF: You tried. That's interesting. A brief question for you. You mentioned running the bank and the fact that you had a couple of highly capable first vice presidents who were COOs, if you will, for you. How would you describe yourself as a manager? Hands-on? How would you describe your management style?

BKM: Certainly not one who would volunteer to get down into detail. The role of the CEO of a regional bank, it seemed to me, was to make sure that the operations side of the bank were run as cost-effectively as one could, but that we were a statutory organization, that our mandate--it is not the kind of an organization where innovation, in terms of starting a new business, is encouraged or even permitted. There was not very much room for imagination in terms of starting new businesses, but there was room for doing what we were assigned to do--moving into the electronic age with respect to security custody. How to stay ahead technologically of the functions that were our responsibility was a major responsibility of the institution, and that I wanted to see that we were doing. But it was more to see that we were doing it well. It was more oversight in some sense, I guess I would describe it, more oversight and asking probing questions. I hope they were probing. I think some of the people who were here would attest to that.

In terms of personnel management, one of the advantages, I think, of this kind of an organization is that, especially in the Ninth District, it draws good people. One of the things that was very clear to me--just drawing upon the labor pool of the Ninth District or specifically the Twin Cities was a joy because of the competence of the people who were coming to work here. Therefore, it didn't take a lot of management to get good work effort out of the staff. It was a feeling of camaraderie, of esprit de corps, at least that was my sense of it. To foster that, to continue that, was a kind of a role. I tried to provide leadership, if you will, in maintaining esprit de corps and desire to do a good job and to make sure that, for example, the United Way campaign and other activities of that sort where we could play a community role were carried out. That's what I saw my role as being.

I contrast that to some extent with New York City and the Federal Reserve in New York where it's drawing on a very different and much more diverse community, even then, and management of personnel was a much tougher job. I didn't have a lot to do with that then, but it was a much tougher job. So for that reason as well, management was not a major concern, and I must say the talent within the bank made promotions easier. You were choosing among good people and, therefore, needed very little recruiting on the outside, which is always taking a gamble.

JEF: How would you characterize your relations with the bank employees generally as CEO? I mean, how did you communicate with them?

BKM: Informal. That is to say, I think first-name basis has been my style from beginning to end, and concern for the welfare of the staff is, I think, a characteristic that would be said of me, and it was genuine, is genuine. I did not do much conscious walking around on each floor to make sure
that I was seen so many times per month, but an open door in my office was definitely a policy, still is a policy. The last thing I would describe myself as would be an autocrat. I am not an autocrat. I'm, in that sense, a democrat. I want the ideas to percolate up. If you can have a vision of where you want to go and then have the implementation percolate up from the bottom and choose among good ideas, that would be my desire, and I hope that this carried out.

**JEF:** That's very clear. Within the Federal Reserve System at the time you were president, were there drives to centralize any functions? You look at the twelve banks and they all have research functions and they all have data departments and they all have this, that, and the other thing. There appears to be an increasing desire to at least centralize some things, automation being a clear example right now. Did you see the beginnings of those then or was that not as apparent?

**BKM:** It was not a major issue that I can recall. The word "federal" in Federal Reserve System was taken very seriously, and we had enough concerns that Congress was going to try to clip the wings of the Federal Reserve. I grew up in the era of Wright Patman from Texas, a congressman. The Federal Reserve was his favorite whipping boy, and he was not alone in this, although fortunately he did not have much support. But being able to mobilize the support of the regions on behalf of the independence of the Federal Reserve was one of the great strengths of having a federal system. People in the field and not just the directors of the banks, and not just the bankers of the district, but the leaders of the district would come to the defense of the independence of the Federal Reserve whenever that was threatened, as it was from time to time.

One of the issues that came along, I can't remember when, was the extent to which the General Accounting Office, the watchdog of the Congress, ought to audit the Federal Reserve System. Rightly or wrongly, the Federal Reserve System at that time saw that as a great potential threat to its independence, and there was a lot of negotiation as to, "All right. If the GAO is going to audit the Fed, what can it audit? What can it not audit?" The regions were important in influencing their congressmen to keep that kind of threat to the independence of the Fed at bay. Therefore, having too much centralized—this comes back to your point about centralization—is a risk, I think.

One of the strengths of the Federal Reserve System is that it is out there in the field, has loyalties, and is able to communicate at the grassroots level. That is one of the great strengths of the system. To centralize would diminish this. Clearly, some things in technology need coherence and I would say rules of supervision. Rules for the discount window. We haven't talked about the discount function. And from time to time I would get complaints from one or another of the banks saying, "Look, you're much tougher on administration of the discount window in the Ninth District than I understand the banks to be in the Seventh District or something else." Some sort of uniformity of administration of policies has to be part of the game, but the independence of the regions to the extent feasible is something I would still support. I still feel that strongly.

**JEF:** How much political contact did you have? You just mentioned the fact that the regions could be instrumental in dealing with congressmen and senators from across the country. How much political contact did you have? How much did you feel you should have?
BKM: Not much on any sort of a day-to-day basis. It was definitely to ward off a threat. In no sense were the regional banks encouraged to lobby. In fact, on the contrary. I'd say they were fairly well discouraged from trying to have independent contacts with congressman from their region. Now, some may have done that. I did not choose to. But it was very clear that the political defense of the Federal Reserve was in Washington. We could have had an awful lot of crossed wires if each of us was going to speak to our congressman other than with well-cleared mandate from the center. So although I spoke of mobilizing the area, this was a matter of marching orders—that's too strong—but a consensus from the center that we needed support on this kind of an issue and can you help us get it. In that case, it would not be the bank president dealing with the congressman. Rather, he would ask leaders within the district, if they were so minded, if they would be willing to contact their congressman. Much more could be said by the people who are dealing with the congressmen from the district than from the Federal Reserve presidents of district banks.

JEF: Did you ever have congressman coming to you on behalf of constituents where they felt that you, as the president of a Federal Reserve bank, all part of the larger system, could be helpful to them?

BKM: I think the honest answer is no. I did not have any of that feeling. What I remember about politicians strikes a chord, although it's not a direct response to your question. Then-Senator Hubert Humphrey was here on some occasions, and it was pretty clear to me that he was ambivalent about the concept of the Federal Reserve. He would say, "Yes, it should be independent. But . . ." And then the "but" became—I mean, he was, I think, a quintessential populist and he was a bit concerned about the independence of the Federal Reserve and whether it was not somehow representing the monied interests of the country and whether it was stepping on the toes of the small person in the district or the farmers or somebody else with whom he had great intimacy and sympathy. So definitely I had a feeling of ambivalence whenever he would show up. He didn't show up often, and was very friendly when he did. But I did not have any lobbying on behalf of a constituent by a congressman that I can recall.

JEF: Looking at the system and how it's changed since you left the presidency of the Federal Reserve Bank here in Minneapolis, do you have any comments you want to make on the changes in the system for the better, for the worse, increasing centralization, increasing politicalization?

BKM: I think the times have been tough. I have the greatest respect and admiration for Paul Volcker. That's not just because I worked for him at Treasury. When he was chairman of the Federal Reserve, he had a very tough row to hoe, and I think he established during his chairmanship the independence of the Fed in very important ways. He was a great tactician, from my point of view. He espoused monetarism without believing in it himself. He's never said so in so many words, but that's my characterization of his policies during the period from 1978 to the mid-eighties. So in that respect, I think he was a tower of strength, not only for the country but for the Federal Reserve System during his tenure. I think [Chairman of the Board of Governors of the Federal Reserve System] Alan Greenspan has carried on. One tends to personalize the Federal Reserve always in terms of its chairman. He is the spokesperson, the ultimate spokesperson for the system, and I think neither of these men has done anything to undermine the credibility of the
Federal Reserve. They've both, in difficult economic times, played it out pretty well.

With respect to how the system operates, I have simply not stayed close enough to know if the regional banks are more or less independent than they were. I have not stayed close enough to give you a good answer to that question.

**JEF:** Fair enough on that. In 1977, you left the Federal Reserve Bank of Minneapolis. What precipitated your departure?

**BKM:** I remember quite well. It's interesting to me, at least, how individuals continue to play a role over time. Robert Roosa, who when I started with the Federal Reserve in New York, was the vice president for research at the New York Federal Reserve Bank (that was in 1958). In 1961, he became under secretary for monetary affairs at the Treasury and brought me and a couple of other people down to the Treasury to work for him. And then that same Robert Roosa, turned up again as chairman of the board of trustees of the Brookings Institution in 1976-'77 at the time when Kermit Gordon died in office. Robert Roosa was the one who was responsible for the search for a new president for the Brookings Institution. I hope I was not a fair-haired boy that he had on his list, but very clearly he, I'm sure, put my name in play as a potential candidate. I know from what others have told me that there was a long list for the presidency of Brookings.

First of all, I was very much intrigued by a piece called *Equality and Efficiency: The Big Tradeoff*. This was a book that is still one of the Brookings classics. It was written by Arthur Okun after he left the chairmanship of the Council of Economic Advisors and came to Brookings. It was a series of lectures about how, in a nation that so values equality in terms of its political institutions--that is to say the right to vote, one person, one vote, all of these democracy and egalitarianism in the political system with rights--how that can coexist with an economic system based upon free enterprise, the market, and devil-take-the-hindmost. So he put it this way--equality and efficiency. Equality in the public sector, efficiency in the private market sector, the big tradeoff. This was something that I was very impressed with. I had used it, in effect, as a text in a number of my speeches out here in the district.

So when a call came out of the blue from Bob Roosa to ask me whether I would be interested in this kind of an assignment at Brookings, I was aware of the Okun book and some other publications Brookings had done. And, frankly, I had spent my career up until that time in various aspects of the Federal Reserve System, had become a president of a regional bank, there was not very much more that lay ahead of me, so far as I could see, within the institutional structure of the Federal Reserve. Here was an opportunity that came along to continue my interest in public service and in public policy, but with a very different mandate. Now, how much of this is rationalization after the fact, you will be able to decide, not I. But I see it as a continuity, a thread that runs through a career.

What I've traded off, looking now in retrospect, is a feeling that there was a lever of power within the Federal Reserve where what I thought really could have some influence in the halls of governance. It is much more indirect with respect to Brookings Institution. There it is ideas. There are no levers. It is convincing those folks in government that here is a better way.
The other aspect that intrigued me was that monetary policy is monetary policy is monetary policy. There's a fairly narrow focus to the mandate of the Federal Reserve. Going back to Hugh Galusha, he had broadened that in a very major way to social problems within the district and many other aspects that were not really the mandate of the Federal Reserve. But that was his own self-creation, if you will, his initiative. The Brookings Institution is interested in public policy, by no means just in monetary policy, but in foreign policy, security policy, economic policy writ large in governmental institutions and how they work and how they do not work. I saw the opportunity as a role in an institution that would be lifelong learning in a much broader sphere than I had had the opportunity to be in up until that time.

I would add one other comment in this context. The tradeoff is leaving an institution where one did not have to worry where the money came from. Almost literally you could coin it in your basement, if you had to, within the Federal Reserve. In an institution like Brookings Institution one has to live by his wits. I was trading off wearing a hat to passing the hat, if you will. [Laughter]

JEF: [Laughter] An interesting idea. Looking from your perspective, from your vantage point, at the Brookings Institution, you're very interested in international monetary policy, etc. Are there things you think the Federal Reserve ought to do that perhaps other central banks do that it doesn't do? Are there things that the system perhaps could be performing if it were allowed to do so or if it indeed took the opportunity to do so?

BKM: Good question. I'm not so sure that I can say this about the Federal Reserve as such. Casting a slightly wider net, I do think that one of the problems of the savings and loan mess and the problems of banks in the real estate market and a lot of other financial disasters of the last decade, could have been mitigated or foreseen if we had had a more coherent federal regulatory and supervisory set of institutions. We have this nexus of state bank supervisors, the FDIC, the Controller of the Currency, the Federal Reserve, and I should mention also the Securities and Exchange Commission, all with pieces of the pie, responsible for different parts of the elephant, to mix metaphors, I think did lead to not everybody knowing what everybody else was doing. Now, there are all sorts of coordinating mechanisms, but they clearly did not work.

One of the things that the Bush administration put forward and made a little progress on was banking supervision reform. I think the Federal Reserve could have taken a larger role. This gets to be institutional turf, so it's not so easy to take the leadership role, because as soon as the Federal Reserve says, "Well, we think we ought to do a little more," you are definitely taking away parts of the pie for somebody else. But that's a role that coordination of the supervisory and regulatory function could perform. I think the Federal Reserve could have played a more constructive role and needs to still.

JEF: When you talk about banking supervision and regulation, do you see essentially the BCCI [Bank of Credit and Commerce International] thing as a blip that simply brings forward the notion that regulatory reform is needed or as a symptom of something much deeper and much broader?
BKM: I think that broadens bank supervision and regulation to the global arena, and I was thinking much more domestically when I made my previous comment. But you put your finger on, I think, a very important issue. It has been through the Bank for International Settlements, the BIS, that there is the so-called Cooke Committee that has tried to bring some coherence to bank capital requirements and risk adjusted capital requirements on a global basis, at least for major industrialized countries. A major step in the right direction, but in which there is still a long way to go. We have nothing comparable, or very little comparable, to what has been already achieved in the banking area with respect to comparable or coordinated supervision of national and international securities markets, and that's another major area that needs some coherent oversight, which is only beginning to come into play.

I would say that is another area where there has been and still is, to a considerable extent, a diametrically opposed philosophy of supervision between the Securities and Exchange Commission, on the one hand, and the banking regulators, as a group, on the other hand. That is to say, the SEC has, from its inception, overseen the protection of securities markets and investors--I'm oversimplifying, obviously--by providing the investor with enough information on which to make his or her own decisions. In the case of the Federal Reserve, it was protecting and managing; you don't want to make all the problems of the banks public, because you'll create a run on the banks if there's a loss of confidence in the banks. Therefore, behind the scenes, do what you can to get the banks out of trouble, but don't let the public know. This is a conflicting set of philosophies.

So now, today, there is a whole question of whether banks should be required by law to mark their securities portfolios to market on a daily basis. That would be adopting much more of the SEC philosophy and much less of the Federal Reserve's philosophy. This gets arcane, I'm sorry to say. But I think it's an area in which the Federal Reserve probably needs to give way some. For the future, we do have more sophisticated investors and depositors, and we can't protect them all through deposit insurance, which raises its own moral hazards as we have seen in the way the banks have been falling by the wayside, and how depositors, including big depositors, have been protected. We are moving away from that, but I think that that's an area in which there is still room for the Federal Reserve to play a more innovative role.

JEF: From your vantage point, do you think the commercial banking system faces some or all of the same problems that S&Ls did?

BKM: No. No. By no means. I think that the thrift institutions, the S&Ls, were in some ways prisoners of a very different set of regulations under which they operated. They were also greatly disadvantaged by an outburst of double-digit inflation in this economy. Their balance sheets were grossly mismatched between the maturity of their assets long term, on the one hand, and the short-term nature of their liabilities, on the other. That mismatch in times of inflation was just a terrible burden for them. And then they were freed up and they got into a lot of trouble thereafter. There's a whole different scenario that applies to S&Ls than applies to banks. Clearly, we are going through a major real estate restructuring. There has been one already, and there will continue to be major consolidations.
What General De Gaulle said about France was, "Who can govern a nation with 500 cheeses?" I think that was his phrase. Well, who can govern a nation with 14,000 banks? If you were starting a system from scratch, I cannot imagine that the United States would have 14,000 banks. So there will continue to be consolidation and there will be losses to the deposit insurance system, but the deposit insurance system is largely funded by insurance premiums paid by the banking system itself. It has not been, by and large, a drain upon the taxpayer, and I think that will continue to be the case.

JEF: And you don't see the major money center banks facing liquidity problems on the scale of the S&Ls?

BKM: No, I do not.

JEF: Do you see on an international scale the will among the major nations to cooperate more in banking regulation?

BKM: In banking regulation, yes. We do have different structures, major differences in the structures of our financial institutions, even though the veneer of multinational banks means that they can operate in a whole range of markets under different rules. But I think that the challenge represented by the BCCI phenomenon was that there was no home base for BCCI. It played in the interstices of the international financial system and was responsible to nobody. I really think that that was, if not unique, very unusual and is a symptom of a problem. If any bank can become that large and get away with not being subject to anybody's regulation, that is a problem. But the bank regulators and bank supervisors are on to that, and my sense is that we are moving in the direction of coordination and cooperation and structural movement toward a common ground, though we'll never achieve a completely common ground. I don't think that's a major threat.

JEF: Going beyond regulation to one other question, what is your view of the common European currency which seems to occasionally come closer and then take two steps further away?

BKM: Yes. Well, moving two steps ahead and one step back has really characterized the Common Market from its inception in 1958. There have been periods of innovation and periods of pause and even periods, well, it's just saying the same thing a different way--retrogression. I don't think there's any doubt that the politicians and political leaders got out ahead of the people in Maastricht in December of 1991, and there is now a reaction against bureaucracy in Brussels. What has been known in the United States as states' rights, what is known--a terrible word--in Europe as subsidiarity. What was missing was a democratic process. They were not bringing along the people in Europe in this process.

The Germans are now spending billions of dollars a year to subsidize what was Eastern Germany. In those circumstances, they are obviously and for good reason looking inward rather than to, "How
can we get along with the rest of Europe?" Germany is suffering from inflation created by German unification, and that has put a whole new role for the deutschmark. We don't want to have the deutschmark become some part of a composite currency that is going to be subject to different kinds of inflationary powers processes. We've got enough inflation at home.

There are a whole host of political issues that have been dropped into the pot, if I can put it that way, since the "go" sign of Maastricht toward a common currency. That has derailed it for the time being. I hope, and I believe, that it is a temporary derailment and that it may become a common currency by the turn of the century. I still think that there will be, by the logic of it.

JEF: In spite of national sentiments which appear to make cooperation even more difficult.

BKM: Yes. This gets really to be very metaphysical, because if you have currencies as the twelve have had and now for the moment do not have because the European rate mechanism has broken down and fallen apart for the time being, the sentiment, in most cases, for wanting to put it back together again is still there. But a European monetary system that is linked together with more or less fixed exchange rates is tantamount to having a common currency. So long as there are fixed exchange rates that vary very little with respect to one another, you have in all but name a common currency.

So the question, is an old question. Can you bring along political integration and economic integration by acceding to a common currency, in effect locking arms and saying, "We are together as one, and, by god, the rest of the economic system is going to coalesce around that currency"? That's one point of view. Others take the opposite view, that is to say, "We have to harmonize our economic systems within our nation states, tax systems, and increase the mobility of people across national boundaries. All of these things have to be in place before we can link ourselves together in a common currency." That's an age-old argument. It's still being played out, and there is no one answer to that. Either side has a legitimate argument and depends upon the circumstances. But I continue to think that the logic of economic harmonization will prevail unless we fall apart into Yugoslavia's--and that's a whole other ball game.

JEF: That's interesting, because it has often seemed to me that currency is, at least in Europe, symbolism as much as anything else. I mean, the Queen's picture is on this. Julianna's picture is on that. And there is almost an emotional attachment to it which transcends logic.

BKM: There are two other ways of moving in the direction of a common currency, neither of which is espoused officially at the moment, but at least logically is possible. One is to have a parallel currency that you have in the ECU, European currency unit, and it could be given some sort of currency form. That is to say, there are already bonds denominated in ECUs, not in any particular currency. They are a basket of currencies. One could imagine ECU notes circulating in parallel with deutschmark notes and pounds and all the rest, and may the best man win, so to speak. In effect, you have two currencies, as some countries do already. I mean, dollars circulate in some countries parallel with domestic currencies, and can be used for transaction. That is one way of sneaking up on the problem of a common currency. A second way is to have what is called a
two-speed Europe, or multi-speed Europe, so that you have, let's say, Germany, France, and the Benelux forming its own inner core with a common currency. Then as others--Italy or Britain or Denmark or whatever--feel that they wish to join in this common currency and adhere to it, then let them join. So you can sneak up on the common currency in a way that need not be a big bang.

**JEF:** The parallel one makes a great deal of sense. I can see that.

**BKM:** Well, there are problems associated with it. Nobody likes to have his currency be the lesser. I mean, good money drives out bad. In other words, deutschmarks might never be phased out by ECUs, but lira might well be banished, and that hurts national pride, needless to say, in Italy. So there would be a lot of invidious comparisons made if one tried to sneak up on it that way. It's not a panacea.

**JEF:** Interesting. I wondered if there were parallels, and I see that there might well be some, between the logic in national currencies and the logic that always seems to be apparent in national airlines.

**BKM:** Yes.

**JEF:** Whether Sabena makes money or KLM makes money often seems less important to some people than--

**BKM:** That there be the flag.

**JEF:** Yes. A flag carrier.

**BKM:** Right.

**JEF:** I have really no more topics right now, Mr. MacLaury, for you. Is there anything that you think I ought to have asked you that I didn't?

**BKM:** That's the inevitable final question of any good interviewer, and you have been fantastic, too. Allow me to just think out loud. I don't think I have any final wisdom, except to say (perhaps this isn't wisdom, it's just reflection) that my regard for the Federal Reserve is something you can perhaps sense when I still speak of "we." Even after fifteen years away from the Federal Reserve, that says, I think, something about how I viewed the opportunity of being within that organization. I feel a great deal of loyalty, a feeling that I've never worked with and would not hope to work with a finer, more dedicated group of people. This sounds like propaganda, but it really is the way I feel.

Partisan politics are not what I'm about. If I'm about something, it is really a technocrat. I want to see good public policy and the nation served by good governance. That sounds very grandiose, but that's what turns me on, and partisan politics do not. Therefore, being part of an administration is not interesting to me. I'd say the Federal Reserve is the quintessential technocratic without being bureaucratic organization.
JEF: A beautiful summary. Thank you, Mr. MacLaury.