

The San Francisco Fed and the West

A Century of Reinvention

An Essay by President and CEO John C. Williams and Senior Editor Sam Zuckerman



Federal Reserve Bank of San Francisco
2013 Annual Report



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It was 100 years ago that the Federal Reserve Bank of San Francisco first opened its doors. That really isn't very long in the scheme of things, hardly more than a typical human lifetime. Yet, in those years, the economy, population, environment, and culture of the San Francisco Fed's western-state region have been utterly transformed.

As we mark the centennial of the founding of the Federal Reserve System and the San Francisco Fed, it is an opportune time to reflect on those changes. The evolution of our region has been remarkable. In the second decade of the 20th century, the seven western states then served by the San Francisco Fed were a thinly populated and underdeveloped territory on the American periphery, barely past their status as the American frontier. One hundred years later, the 12th Federal Reserve District has grown from 6% to 21% of the nation's population and become a global leader in such cutting-edge industries as digital technology, biotechnology, and renewable energy. And the rest of the world avidly follows cultural trends that first emerge here.

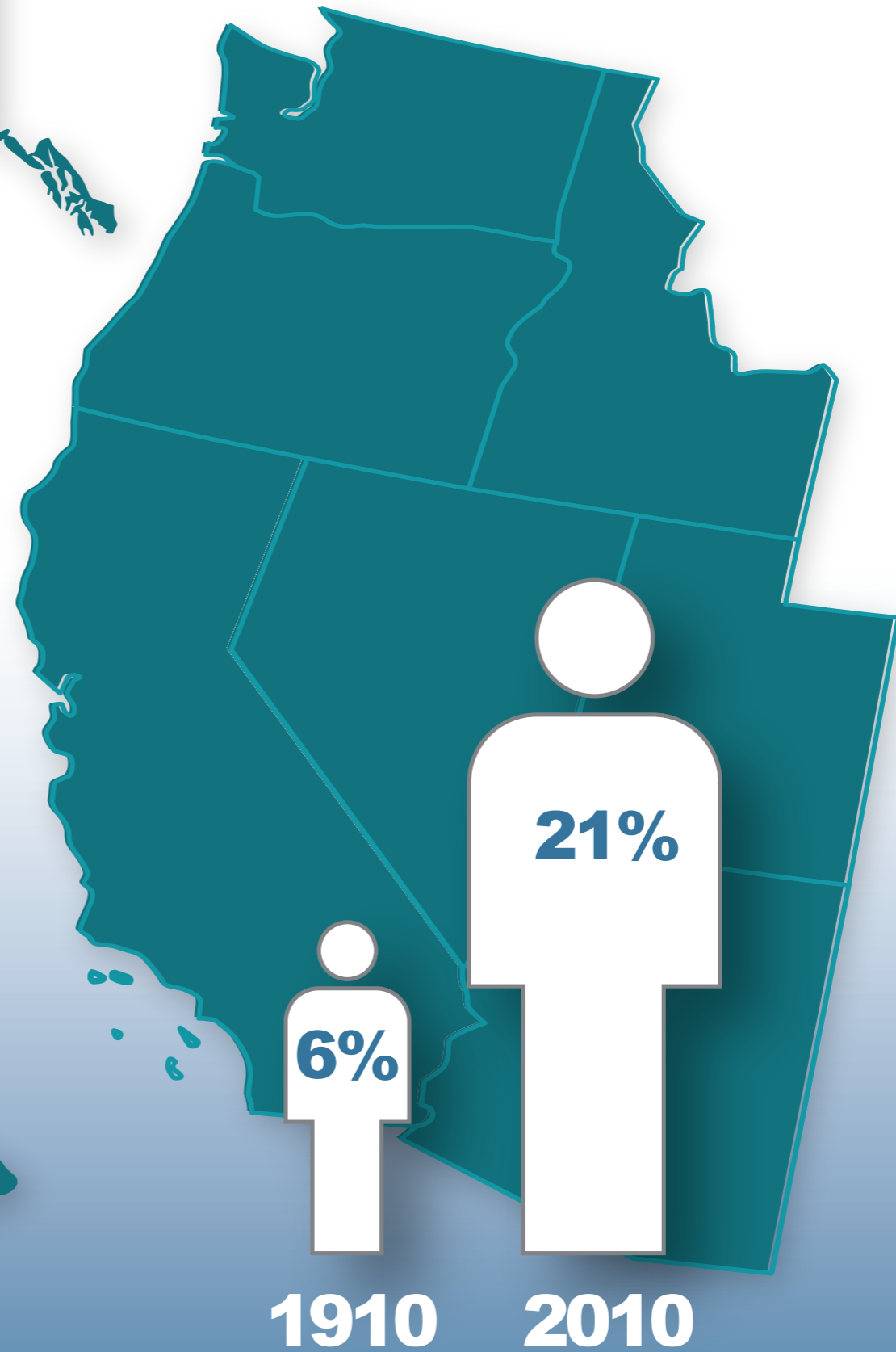
In the past 100 years, the San Francisco Fed too has been remade, along with the entire Federal Reserve System. In 1914, when the San Francisco Fed started in rented offices with a staff of 21, it was largely a creature of the banking industry. Its main jobs were to supply currency, clear checks, and provide credit to banks in its territory. Now, as a unit of our nation's central banking system, we have a voice in setting U.S. monetary policy, and we watch over the safety and soundness of a range of financial institutions. Our territory has expanded beyond the Arctic Circle and across the Pacific to include Alaska, Hawaii, Guam, and the Mariana Islands.

The story of how a region on the edge of America became strong and vibrant is a tale of economic reinvention—not just once, but twice. It offers important lessons on what it has taken to successfully navigate the economic changes of the past century and the qualities that will be essential in the years ahead.

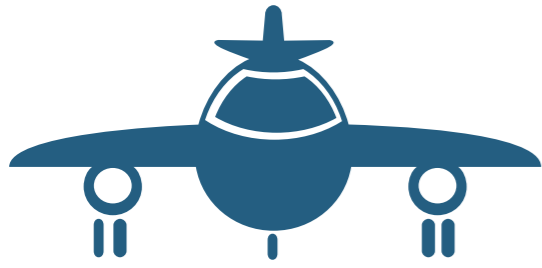
Of course, we were blessed with an enviable array of resources. In a District that stretched from the deserts of the Southwest to the rainforests of the Northwest, and from the Great Salt Lake to the Pacific, there were ores to be mined, timber to be harvested, oil for the taking, and rich soil for growing crops. But there was something else as well, something

12th District's Share of U.S. Population

In the past 100 years, the 12th District has grown from a thinly populated territory on the American periphery to a vibrant region that is an economic and multicultural epicenter for the nation and the world.



Source: Decennial Census
*Alaska and Hawaii included in the 12th District starting in 1960



In the 1950s, the San Francisco Fed's territory accounted for 40% of U.S. aircraft production. Los Angeles and Seattle, the headquarters of Boeing, had become world centers of aircraft design and manufacturing.

that allowed us to take full advantage of this abundance—the spirit of the frontier, where everything was new, opportunity abounded, and people came from far away to seek their fortunes. It was the boldness of our entrepreneurs and workers that allowed our western states to thrive.

As we matured and the frontier was settled in, we took steps to preserve our economic dynamism by channeling resources into education. We built world-class public and private universities that became hubs of innovation. We ensured our people would have the skills and intellectual tools needed to succeed in a competitive world. The frontier may be largely tamed, but the frontier spirit of our entrepreneurs endures, and our workers are among the most skilled anywhere. We still attract hard-working, adventurous people from far and wide. This concentration of knowledge and talent gives us a significant edge. It's vital that we do what is necessary to preserve it.

The Reinvention of the 12th District Economy

This is where we came from: one hundred years ago, the economies of the seven states of the 12th District were based almost wholly on what could be wrested from the land. As the San Francisco Fed's first Annual Report noted in 1915: "This district is enormously rich in natural resources and surpasses in variety of products." In 1909, 49% of the nation's gold, 67% of its silver, 57% of its copper, and 61% of its lead were produced in the District. California was the leading oil producer. Washington and Oregon were essentially lumber camps, with that industry representing 60% of economic activity in those states. Utah was synonymous with copper, and Idaho with potatoes. Except for its mines and a few scattered ranches, Nevada was sparsely populated, with a little more than 80,000 inhabitants. Arizona had been admitted to the union just two years before. San Francisco was still recovering from a catastrophic earthquake and fire. Los Angeles had only in the previous decade secured the water it needed to grow. And, even as we supplied the nation with the output from our farms, mines, forests, and oil fields, we didn't manufacture much of anything. In 1909, the value of 12th District manufactured products equaled only one-third of the output of New York City's factories.

Our profile changed dramatically as we went through our first reinvention, a shift that culminated in the decades after World War II. Cheap hydroelectric power, a concentration of engineering know-how, and the burgeoning growth of Western markets fueled a nascent factory network, turning our region into a manufacturing powerhouse. The region's largest state, California, led the way, starting with food processing and oil refining, and then expanding into a broad range of light and heavy manufacturing. As economic historian Paul Rhode has written: "What had been an unimportant industrial location in 1900 became the nation's number one manufacturing state by 1977."

Major 12th District Industries

A Century of Reinvention

1920



OIL/GAS

Food and Consumer Products



Forest and Paper Products



Mining



1955



AEROSPACE

Oil/Gas

Forest and Paper Products



Food and Consumer Products



Mining



Retail Grocery



2013

5



COMPUTER HARDWARE

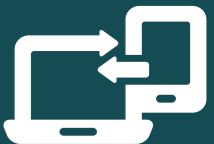


SPECIALTY STORES



Software Programming

Communications Equipment



Broadcasting Cable TV



Mining



Electronic Instruments Controls



Footwear



Fashion Stores



Money Center Banks



Semiconductors



Oil/Gas

Biotechnology Drugs



Airline Services



Advertising



Electric Utilities



Entertainment Media



Personal Household Products



Retail Grocery



Truck Manufacturers



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The companies that are building successful businesses by extending Internet technology into retailing, transportation, entertainment, and social networking are largely based in our District.

Aircraft production is a notable example of the rise of manufacturing in our District. Southern California's balmy climate, which permitted aircraft to be parked outside and tested year-round, first attracted the industry before World War II. An expanding industrial cluster soon emerged as technical expertise and support industries sprang up. In 1933, aircraft manufacturing employed 1,000 workers in Southern California. By 1943, that number had risen to 280,000, according to researcher Rosa Maria Moller. In the 1950s, the San Francisco Fed's territory accounted for 40% of U.S. aircraft production. Los Angeles and Seattle, the headquarters of Boeing, had become world centers of aircraft design and manufacturing.

After World War II, electronics manufacturing became increasingly important, a trend that gathered steam when Silicon Valley became the global capital for information technology. In the final decade of the 20th century, as the Cold War came to a close, aerospace declined in the District. Electronics picked up some of the slack, with Seattle, Portland, Boise, San Diego, and Phoenix growing as producers of high-tech equipment.

The aerospace and electronics industries benefitted from and reinforced our District's position as a scientific and technological leader. Thanks to the presence of some of the world's leading research universities, our District produced more than its share of scientists and engineers. After World War II, as demand for advanced weapons systems heated up, District states accounted for close to half of all U.S. research and development spending, and almost one in four new jobs for physicists completing their doctorates.

This laid the groundwork for our second reinvention—a shift to a service and knowledge-based economy. As the forces of globalism have swept the world in recent decades, manufacturing has migrated to the developing world. Production in sectors such as aviation and information technology has dwindled in our District. At the same time, we have cemented our status as a center of research, engineering, and design in those sectors. And our location on the Pacific Rim connects us through trade with the emerging industrial and technological powers of Asia.

The rise of the Internet, with its astonishing capacity to disrupt and reshape just about every area of life, has added new momentum to our latest reinvention. Thanks to our existing tech-sector base, the presence of leading research institutions, a concentration of venture capital, and a culture of innovation, we were exceptionally well positioned to take advantage of this revolutionary technology. As a result, the companies that are building successful businesses by extending Internet technology into retailing, transportation, entertainment, and social networking are largely based in our District.

We have another core strength that helps us prosper in a post-industrial economy—our skill at entertaining people in their moments of leisure. One might say that Hollywood was the West's original knowledge-based industry. Tourism has grown explosively in recent decades, and our region is a major destination. Low-cost air travel has made Hawaii accessible

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San Francisco Banking Center, Circa 1920

Image Courtesy of the Library of Congress,
Prints and Photographs Division

San Francisco didn't get to be the headquarters of the 12th Federal Reserve District without a fight. Seattle, Portland, and Los Angeles each vied for the privilege. But, San Francisco, the financial center of the West since the Gold Rush, was the logical choice.

to millions. And no one who saw Las Vegas as a dusty railroad junction a century ago could possibly have imagined what it has become today.

In all these areas, the spirit of the frontier is still alive. Our ability to stay on the leading edge of emerging economic trends reflects our history, the diversity of our people, and our informal culture. Many of the people who migrated to the West came to get away from more rigid societies. As author Neal Gabler wrote in a portrait of Hollywood's founding studio executives, "unlike in the East, the social structure was primitive and permeable ... new and unformed, ... there was no real aristocracy in place."

Scholars such as Paul Rhode and AnnaLee Saxenian argue that, in some parts of the West, business culture is different than it is elsewhere. It's not clear whether Casual Friday was invented here, but it might as well have been. Throughout much of our region, informality, a rapid pace of innovation, diversity, and tolerance are woven into the fabric of the way we do business.

As we recognize our strengths, it is also important to acknowledge our challenges. Millions of people in the West have not benefited from the economic changes of recent decades. The rise of new economic sectors has created enormous wealth. But global shifts in manufacturing have made well-paying, middle-class jobs harder to find, while low-wage workers struggle to make ends meet. Ongoing pressures in public finance jeopardize our investments in education and our future as a leader in an increasingly knowledge-based global economy. The great system of public education we built is threatened and even at state colleges and universities, costs are moving out of reach for many students.

It may also be that the optimism and willingness to take risks that serve us so well also make us prone to destructive booms and busts. That may explain why large swaths of our District—including Arizona, Nevada, and large parts of California—were hit so hard by the housing crash of the past decade. We must take a hard look at both our strengths and our weaknesses, and work to ensure that our nine states are not only more prosperous, but also that this prosperity is shared.

The Federal Reserve Bank of San Francisco over 100 Years

Just as the economy has changed radically over the past century, so has the San Francisco Fed. That transformation reflects the vastly increased scale and complexity of the nation's economy and financial system, and the expanded policymaking and regulatory roles of the Federal Reserve.

Congress created the Federal Reserve and authorized Reserve Banks in strategic locations around the country because the absence of a central bank made the nation's financial system inefficient and vulnerable to crises—a danger demonstrated

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San Francisco Fed Headquarters
315 Battery Street
1918 – 1923

Image courtesy of the
 San Francisco Fed Archives

Originally, the San Francisco Fed and the other Reserve Banks were given great operating latitude, in keeping with the decentralized system set up by Congress. Their main functions were settling transactions between financial institutions, lending money to banks, and managing the availability of credit in their Districts.

graphically when financier J.P. Morgan had to personally intervene to stem the Panic of 1907. But Americans had a long-standing suspicion of a single powerful monetary authority. In the 19th century, the two previous U.S. central banks had been shuttered. So, in 1913, Congress created a central banking system with a notably decentralized structure. It consisted of a government Federal Reserve Board in Washington, D.C., and 12 Reserve Banks that were unique public/private hybrids.

San Francisco didn't get to be the headquarters of the 12th Federal Reserve District without a fight. Seattle, Portland, and Los Angeles each vied for the privilege. But, San Francisco, the financial center of the West since the Gold Rush, was the logical choice. A U.S. mint and the West's largest securities market, then called the San Francisco Stock and Bond Exchange, were located here. And the city had far and away the largest banks and the most bank capital in the seven-state region. The decision to locate the 12th District Reserve Bank in San Francisco was announced in April 1914, and the San Francisco Fed started business on November 16 of that year.

Originally, the San Francisco Fed and the other Reserve Banks were given great operating latitude, in keeping with the decentralized system set up by Congress. Their main functions were settling transactions between financial institutions, lending money to banks, and managing the availability of credit in their Districts. They also promoted use of Federal Reserve notes, the nation's new paper currency replacing paper money issued by private banks. That was a big deal in the West, which wasn't far from the days when debts were settled with gold dust. Distrust of paper currency ran deep and most people paid for goods and services with coins.

The wide autonomy granted the Reserve Banks created a problem: with each Reserve Bank managing credit in its own territory, it was possible to have 12 separate policies and significant differences in interest rates from District to District. Such a system proved unworkable. Within two decades of the Fed's creation, monetary policy—the setting of interest rates—shifted in several steps to the Federal Reserve Board and a newly created Federal Open Market Committee in Washington, D.C., to centralize policymaking.

As a result, the San Francisco Fed and other Reserve Banks no longer set monetary policy for their separate Districts. Instead, we take part in the process of setting policy at the national level. The 12 presidents of the Reserve Banks and the seven governors of the Federal Reserve Board sit on the Federal Open Market Committee. Except for the New York Fed president, who always votes on policy, the Reserve Bank presidents vote on a rotating basis.

The world of the San Francisco Fed in its early years was tightly woven with the West's banking industry. All nationally chartered banks had to become Fed members, meaning they owned shares of and kept accounts with their Reserve Bank. State-chartered banks could choose whether to become members. Within a few years, the San Francisco Fed established

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San Francisco Fed Headquarters
101 Market Street
1983 – Present

Image Courtesy of the
 San Francisco Fed Archives

The modern San Francisco Fed must contend with a banking industry and financial system that exchange information digitally, and operate with global reach and lightning speed.

branches in Seattle, Portland, Spokane (later consolidated with Seattle), Los Angeles, and Salt Lake City to work with the banks in those regions. The San Francisco Fed became the regulator of state-chartered member banks in the 12th District.

The banking industry in those days was a far cry from what it is today. It was rare for a bank to have a branch outside its home office. As a result, the nation was served by thousands of small banks. In 1915, the 12th District alone had 1,725 banks. But, thanks to a series of legal changes, branch banking began to take root. A visionary immigrant, A.P. Giannini, founder of San Francisco's Bank of Italy, renamed Bank of America, saw the potential of a branch network and set up offices throughout California, creating the model familiar to us now.

The financial system of a century ago was far simpler than it is today. There were no exotic financial instruments, no trading desks, no risk management offices. Payments were made with cash, checks, or by wire. Books were kept by hand. Credit cards and debit cards didn't exist. The number of banks in the 12th District has dropped to about 400, but those banks are orders of magnitude larger than those that were here when the Fed began.

The modern San Francisco Fed must contend with a banking industry and financial system that exchange information digitally, and operate with global reach and lightning speed. The San Francisco Fed still supervises small banks, but it also watches over institutions with hundreds of billions of dollars in assets and business lines that are light years removed from the deposit-taking and loan-making of the early 20th century banks.

The relationship of the San Francisco Fed with the rest of the Federal Reserve System has also changed. The System is much more centralized today and, as a result, the role of the Federal Reserve Board as our overseer has increased. Centralization has diminished the power of our board of directors and created more of an arms-length relationship with the banking industry than existed 100 years ago.

Meanwhile, each Reserve Bank performs specialized services for the Federal Reserve System as a whole. For example, the Atlanta Fed oversees electronic check processing and automated clearing house services, while the New York Fed runs the Fedwire funds transfer system. San Francisco is the Reserve Bank responsible for strategic direction of the System's cash operations. Our Cash Product Office develops and implements the Fed's overall currency strategy to make sure the economy's need for cash is always met. The San Francisco Fed is also a major developer of software for the System. In this, we benefit from the concentration of information technology innovators in our District.

Today the San Francisco Fed is part of a 21st century central banking system that has evolved far from its roots. The story of the San Francisco Fed is really the story of how the world has changed since 1914, and how we have evolved with it. The transformation over the past 100 years has been enormous, and it continues into our second century. As we change though, we must strive to keep the spirit of the West alive in us and work to remain a force for economic progress in our region.