

## The Federal Reserve System's Unique Structure Is a Strength

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Examining the Structure of the Federal Reserve System

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Chairman Lucas, Ranking Member Vargas, and members of the Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity, thank you for the opportunity to discuss the topic “Examining the Structure of the Federal Reserve System.”

As the name suggests, the Federal Reserve System's structure divides power between central and regional authorities and between public and private interests. As a former Reserve Bank president, I am confident that such a system is the more effective (though not perfect) framework for assuring diversity of views and achieving better policy outcomes for a nation as complex and diverse as the United States. This structure insulates the institution from short-term political influence while also keeping it accountable for its actions to the Congress and public it serves. To argue that such a structure is inefficient, as some do, fails to appreciate its value.

The nation's regional differences are illustrated in a variety of ways, both simple and complex. For example, some years ago, I spoke with a senior policy official from another region of the country who was making his first visit to the Midwest. During the conversation, he quite sincerely noted how impressed he was that the city we were visiting had such a “full” skyline. This reminds me of a quip once shared with me: “Provincialism is not unique to the provinces.”

On a more substantive level, one need only look at the differences in average home prices, labor markets, services, and manufacturing activities among regions to appreciate how economically diverse the nation is, and how these differences magnify during a financial crisis. Having sat at the policy table, I am confident the different Reserve Bank voices made for better decisions than would have otherwise been achieved. The fact is that we may be one nation, but we are a nation with large variances in regional perceptions, biases, and economies. We are sometimes “The Not-So United States.”

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The founders of the Federal Reserve were clearly addressing these differences when they created our decentralized system in 1913. Even then, decades before today's high-speed technology, there was no physical necessity for separately chartered Reserve Banks with separate boards of directors. By then, however, the United States had already experimented with two monolithic central banks, and lessons had been learned. The First Bank of the United States was established in 1791, and like today's Federal Reserve System, it was controversial. Some protested its constitutionality. Many were fearful of its centralized framework and its unmatched influence. When it came time for Congress to renew the Bank's charter in 1811, the Bank's critics were able to stop it.

The idea of a central bank returned in 1816. The War of 1812 had thrown American finance into chaos. Given that experience, a second Bank of the United States was established, again with a 20-year charter. It, too, was controversial and feared for its size and influence. Eventually, Andrew Jackson vetoed the renewal of its charter, bringing an end to central banking in the United States for the next eight decades. Regional distrust of the nation's first two central banks in no small way contributed to their demise.

Fast forward to the early 20th century, as the United States became a growing economic force, and many among the elite of the banking industry were convinced the US needed a "central bank." The topic again was controversial, and among the issues was whether the United States would have a highly centralized institution, or whether it would be best to create a new system—a decentralized system that would share authority across the nation. In his memoirs, Paul Warburg, one of the Federal Reserve's principal architects, noted that "the debate regarding the structure of the central bank went on for some time, but in the end, a system of centralized reserves and decentralized banking power was chosen."

The Congressional founders understood that to provide for a more durable institution, they needed a structure that shared responsibilities and power across the country. Each of the 12 Reserve Banks has a board of directors drawn from the region in which it is located. These directors provide not only oversight of the Reserve Banks but also information regarding their industries and communities. Through them, the Federal Reserve has roots that run deep within our communities, which enable it to garner broad public knowledge and support and to function far more effectively than if it were located only on Wall Street or the nation's lobbying center. The regional banks that complement the Board of Governors help keep the System from becoming insulated from Main Street America.

The decentralized structure and these principles are as important today as they were in 1913, perhaps more so. The System of Reserve Banks has performed well across the nation during crises, including the banking crisis of the 1980s, the tragedy of 9/11, the global financial crisis (GFC), and the COVID-19 pandemic. During the GFC, for example, while the Board of Governors and Federal Reserve Bank of New York were correctly focused on assuring liquidity for some of the largest banks, insurance companies, and broker-dealers, other Reserve Banks in the South, Midwest, and West were, just as importantly, paying attention to large regional banks and financial institutions that, in the heat of the moment, were not at the top of the center's concern list; nevertheless, had those institutions failed for lack of liquidity, the consequences would have devastated their local economies.

Obviously, many things have changed over the past 100 years. We have experienced exceptional changes in banking technology and products, and some banks have grown both in national and international scope. With such change, it is appropriate to periodically review the Federal Reserve's

structure and how efficiently it operates. On balance, however, the fundamentals that drove the United States toward a decentralized system should remain a central factor defining its structure. While bank consolidation is occurring, there remain thousands of regional and community banks, credit unions, and emerging fintech banks, and communities that will be affected by the Federal Reserve's monetary policy and payments decisions, and they will not all be affected in the same way.

Also, as a former CEO, I can say that I worked daily with experienced Reserve Bank directors, CEOs, and COOs constantly reviewing System-wide operations, upgrading payments, information technology, and human resource systems, and consolidating operations when needed.

Another concern sometimes raised is whether the Federal Reserve's decentralized structure creates too many voices speaking about FOMC policy, thereby creating confusion for markets and the public. This concern, however, gives too little credit to the value of debate and transparency in policymaking, or to the benefits of including regional, independent voices in the policy discussions that affect every American citizen.

The structure of the Federal Reserve System and the role of the Reserve Banks acknowledge the nation's federal structure, and, in doing so, represents the public's interests far better than a single monolithic institution removed from Main Street and more easily influenced by political or narrow financial interests, as history has shown. Robert Bremner, in his biography of Chairman William McChesney Martin Jr., refers to a quote that describes the Federal Reserve System as "America's greatest contribution to the science of government." While this may be hyperbole, I am confident that, judging from history, its structure has served the nation well; looking to the future, it is designed to last.