

# The Problem of Federal Reserve Governance: Law, Politics, and History

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*The Federal Reserve, Financial Regulation and the Administrative State*

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## *Abstract*

The US Federal Reserve System (Fed) is famous for its organizational complexity. Overlooked in debates about the costs and benefits of this complexity for the Fed's legitimacy, independence, and accountability is the congressional vision of what the Fed should be. The central bank is governed by a highly accountable seven-person Board of Governors to manage the rest of the system. Time and experience have eroded this authority as a matter of practice but not as a matter of law. The Fed governors are supposed to supervise the system, a legal aspiration that has increasingly been enervated by institutional drift. Using empirical and historical tools, this paper discusses the erosion of the Board of Governors over the Fed's century-long history, including the substantial reduction in real compensation for the governors, their diminished participation in Federal Open Market Committee (FOMC) meetings, and the increased vacancies that recently have been driven by the political process. To address these problems, the paper suggests reforms across three divides: cultural, regulatory, and legislative. Remedies include changing norms of FOMC meeting participation to place nonvoting members of the FOMC as "observers"; clarifying the role of the Fed's Board of Governors in supervising the Federal Reserve Banks, particularly with respect to the presidential search process; increasing attention to vacancies and promoting bipartisan interest in credible candidates; and increasing governor salaries to match those of their colleagues at the 12 Federal Reserve Banks, consistent with legislative intent from 1913.

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## I. Introduction

While most of the post-2008 legislative debates on reforming finance were about the functions of government and the functions of finance, some of the most enduring reform proposals have to do with central bank governance. These latter proposals focus on two key questions: Who should control the levers of power within central banks, and how should these individuals or organizations be selected? The 2008 crisis brought wholesale reforms to some jurisdictions, such as at the Bank of England,<sup>2</sup> but central bank governance elsewhere remained untouched. In Europe, for example, the governance structure of the European Central Bank is fixed by treaty, not statute. Changes to its governance, although some have sought them, are not easy to accomplish and have not occurred.<sup>3</sup>

The experience of postcrisis central banking in the United States lies in the middle, but it is closer to the European than the British example. The Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) focused on altering the powers of financial regulatory institutions, but it also wrought some important governance changes through the creation of the Financial Stability Oversight Council and the Consumer Financial Protection Bureau. Given how much of that authority resided, formally and informally, within the Federal Reserve (Fed) before 2008, these changes are appropriately labeled changes in central bank governance.

But at the core of the central banking experience, Dodd-Frank left the Fed alone. Besides creating a new vice chair for supervision and altering the roles of the boards of directors of the quasi-private Federal Reserve Banks,<sup>4</sup> the governance of the Federal Reserve System still exists

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<sup>2</sup> Salib and Skinner (2019).

<sup>3</sup> See Zilioli and Riso (2018).

<sup>4</sup> See 12 U.S.C. § 242 (on the creation of the vice chairman for supervision) and 12 U.S.C. § 341 (on changes to the appointment process of the presidents of the Federal Reserve Banks).

mostly as it did after its last wholesale reform during Franklin Roosevelt’s administration in 1935: it is governed by two committees, the Board of Governors and the Federal Open Market Committee (FOMC).

The changes in 2020—to the world and to the Fed—have highlighted the importance of central bank accountability. In response to the Covid-19 pandemic, politicians first turned to the Fed to run the economic policy response and now turn on the Fed, pushing it to do more or less than they have done.<sup>5</sup> Meanwhile, Fed Chair Jerome Powell has launched a monetary overhaul that resulted in a new intellectual framework for monetary policy that is also subject to praise and criticism.<sup>6</sup> In both cases, the Fed found itself making important value judgments about the past, present, and future.

Making value judgments is unavoidable. With those judgments, however, comes the need for accountability, which the Board of Governors is supposed to provide. But there is a significant difference between the central bank as Congress designed it and the Fed as it exists in the real world. In particular, the Board of Governors,<sup>7</sup> tasked by Congress to supervise the Fed, has atrophied, the consequence of institutional change that can and should be reversed.<sup>8</sup>

This failure of reform has triggered protests from scholars and practitioners and counterprotests from Fed insiders. At the heart of this debate is whether the system created in 1913 and significantly altered in 1935 still makes sense for the post-2008 era. That system

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<sup>5</sup> See Jeanna Smialek & Alan Rappeport, “Federal Reserve’s Emergency Loan Programs at Center of Political Fight,” *New York Times*, November 9, 2020.

<sup>6</sup> Jerome H. Powell, “New Economic Challenges and the Fed’s Monetary Policy Review,” Speech at economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 27, 2020.

<sup>7</sup> I refer to the Board of Governors and the governors themselves mostly interchangeably unless discussing specific individuals, recognizing that the institution of the Board is heavily influenced by its composition. I also use the term “governor” to apply, as appropriately for the historical context before 1935, to the Board of Governors or to the heads of the Federal Reserve Banks. When used in the latter instance, I refer to the governors by name and to the institution they led.

<sup>8</sup> For more on this dynamic, see Conti-Brown and Johnson (2013).

devolves power within the central bank to the politically accountable Board of Governors and the 12 quasi-private Federal Reserve Banks that are scattered unevenly throughout the United States. Advocates for reform argue that “the Federal Reserve’s governance structure is outdated and inadequate for ensuring the public interest”<sup>9</sup> and that “the structure we have inherited through historical contingencies and institutional evolution is simply not up to the task we have placed before it.”<sup>10</sup> The reform proposals range from making the Fed a “fully public institution”<sup>11</sup> to changing the Federal Reserve Banks to branch offices within the system<sup>12</sup> to giving the president and Congress more control over the Federal Reserve Banks.<sup>13</sup> The Fed’s defenders view this curious system as essential “to ensure that power over the nation’s monetary policy and financial system is not concentrated in a few hands, whether in Washington or in high finance or in any single group or constituency.”<sup>14</sup>

Arguments about reforming the Federal Reserve Banks and their role within the system are important and should continue. This paper, however, focuses on the other side of the debate by looking at the Fed’s Board of Governors, the legal linchpin of the system and the mechanism through which the public exercises even tangential oversight of the Fed. Although both the governors and the Reserve Bank presidents each (sometimes) share the vote on the FOMC, which is the Fed’s monetary policy committee, there are key differences. The legal status of their respective positions, the way they participate in FOMC meetings, and their compensation are all very different. The amount of time the governors and the bank presidents serve and whether they have past experience within the Fed also differ markedly. The end result is that the governors are

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<sup>9</sup> Haedtler, Levin, and Wilson (2016).

<sup>10</sup> Conti-Brown (2015b).

<sup>11</sup> Haedtler, Levin, and Wilson (2016).

<sup>12</sup> Conti-Brown (2015b).

<sup>13</sup> Fisher (2016).

<sup>14</sup> Powell (2017).

less well equipped to perform their statutory mission of supervising the Fed and providing the key mechanism for democratic accountability that Congress designed for them.

To be clear, the Fed was not designed to be fully democratic. Other proposals debated at the time of the Fed's reformation in 1935 would have made it so, but Congress did not take up that charge.<sup>15</sup> The Board of Governors, like the Federal Reserve Board before it, was designed to be a democratically accountable balance to the private bankers who participated in the key governance of the Fed. It is that balance that Congress envisioned for the governors, and that balance no longer functions as it should.

In this paper, I describe the path of the Board of Governors through history, going back to the two legislative foundings of the Fed (in 1913 and 1935) and continuing through much more recent experience. I use unique data to describe the participation rates in FOMC meetings—separating Fed governors, voting Reserve Bank presidents, and nonvoting Reserve Bank presidents—and conclude that Reserve Bank presidents have become more vocal in these meetings (regardless of voting status) while governors have become less so, even when controlling for the increased vacancies at the Board. I also look at two indicia of ideological diversity across the governors and Reserve Bank presidents: the length of tenure and whether the FOMC members previously worked within the Fed before their appointments. In both cases, the Reserve Bank presidents serve for longer periods of time and are more likely to be Fed insiders. Finally, I chart the compensation paths for these two roles and, for the first time, show that despite the governors' substantial lead on salary at the outset of the Fed, the quasi-private

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<sup>15</sup> The loudest voices for more radical reform were from Father Charles Coughlin and Senator Huey Long. Coughlin in particular envisioned the “abolition of the Federal Reserve Banking system” and the “establishment of a Government-owned Central Bank” that would function as a “financial democracy” led by central bankers elected from each state (Brinkley 1983, 112).

Reserve Bank presidents have far outstripped the governors in wage growth: the presidents' wages are rising even higher than inflation.

This paper also describes another major role that Congress delegated to the Board of Governors that is almost always ignored in these debates: the Board is meant to supervise the Fed. I describe the recent experience of the Federal Reserve Bank of Richmond and its former president, Jeffrey Lacker, to illustrate the problem with opacity on this front.

Building on this history, data, and recent experience, this paper offers a path forward to give the Board of Governors a fighting chance at fulfilling its legislative role. These proposals are organized by the level of legal formality required to instigate them, from changes in culture to changes in the FOMC's internal regulations to changes in legislation. These proposed changes include a cultural shift on behalf of presidents and senators from both parties to emphasize vacancy reduction, a problem that affects much more of the administrative state than just the Fed. It includes changes to the speaking roles of nonvoting FOMC members, giving them "observer" status, as is the role of nonvoting members in other central banks. And it includes legislative changes to the governors' salaries and their ability to communicate with each other informally.

Part I of this paper recites the history of Fed governance, from its first legislative creation in 1913 and the reforms of 1935, through the rise of the imperial chair in the 1980s, to the 21st century and the consequences of Dodd-Frank on Fed governance. Throughout this history, congressional efforts have made the Board of Governors even more central to the administration of the system. In part II, I describe the eroding status of the governors as the principal mechanism for accountability and supervision within the Fed. I focus on the appointment of Federal Reserve Bank presidents and how a scandal at the Richmond Fed prompted the first

resignation of its kind in Fed history; the vacancies crisis at the Board of Governors, including why it is so acute and why there is hope for its resolution; the erosion of governor salaries at the Fed in contrast to the inflation-adjusted salaries at the Federal Reserve Banks; the problem of “groupthink” at the Fed and how Reserve Bank presidents and governors compare in several ways; and how Reserve Bank presidents—whether they have a vote on the FOMC or not—dominate FOMC meetings, at the governors’ expense. In each case, with the exception of the consolidation of supervision at the Board following the 2008 crisis, the governors have lost their stature within the system.<sup>16</sup>

Part III then discusses the changes to the way insiders and outsiders engage the governance of the Federal Reserve System along three dimensions: cultural, regulatory, and legislative. In each case, the aim is to match Congress’s intent to balance insulation from politics with the necessary demands of political and democratic accountability and legitimacy. The governors sit at the center of that balancing act. Time has pushed them too far in the wrong direction. This paper makes the case for pushing the balance back to a better equilibrium.

## II. A Brief History of the Governance of the US Federal Reserve System

The Fed, first legislatively organized in 1913 and then substantially reorganized in 1935, has a unique governance structure that divides the work of central banking among various committees that are in turn composed of individuals appointed by public and private processes. The meaning of these committees, and the division of these responsibilities, is the product of historicized

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<sup>16</sup> Despite my efforts at a mostly comprehensive assessment of the Fed governors’ role and status, there are conceivably other arguments that could be made about the expansion of the governors’ status vis-à-vis the Reserve Bank presidents. I select these variables to focus on the key questions about the roles of the governors in supervising the Fed and staying in place long enough to accomplish those tasks.



memory. That is, how Americans have come to think of the public-private, centrally decentralized structure of the Fed has evolved, sometimes substantially, over time.

#### A. In the Beginning

Debates about the structure of money and banking in the United States are older than the republic itself. Thomas Jefferson, then James Madison, and then most powerfully Andrew Jackson had rejected as unprincipled (and unconstitutional) the advent of central banking in the United States. Any effort in the post-Jacksonian age to reformulate central banking would run into that barrier. Even though the First and Second Banks of the United States remained broadly popular—it was, after all, a Jacksonian veto of comfortable congressional majorities that led to the failure to recharter the Second Bank—the influence in the popular imagination of Jacksonian democracy on central banking was profound. Any effort, then, to create such a system had to reckon with that fear of centralization.

The Progressive Era framers of the Fed did indeed walk that Jacksonian line, building a system that they would somewhat implausibly deny was, in fact, a central bank.<sup>17</sup> So it was that Andrew Jackson loomed large over the 1913 debates about “the currency question,” as it was called, even as other key theorists of central banking—Walter Bagehot, for example—were nowhere to be found.<sup>18</sup>

The 1913 legislation created a central banking system that the world had not seen before. It was built on two sets of compromises, between centralized and decentralized authority and between private and public control.<sup>19</sup> The debate about how centralized central banking should be was one of the most heated of the 1908–1912 currency debates, with Republicans favoring a

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<sup>17</sup> Lowenstein (2015).

<sup>18</sup> A search through all legislative history materials for the Federal Reserve Act records no mention of Bagehot.

<sup>19</sup> See Mehrling (2002); Conti-Brown (2016).

centralized private association under the control of New York, with limited participation from other parts of the country. Democrats, reflecting the Jacksonian hold on the party that would continue for decades, preferred a significantly decentralized system whereby local and regional interests would control the system, with New York functioning as but one voice among many.<sup>20</sup>

The question of public versus private control was much less central to these legislative debates, at least until the inauguration of Woodrow Wilson as president in March 1913. Wilson injected a question of public control that was anathema to the practice of central banking the world over, as members of the National Monetary Commission—a congressional agency tasked with investigating the banking systems of the world after the 1907 Panic<sup>21</sup>—well knew. Even so, for those outside the finance world—as Wilson certainly was—the idea of self-regulation did not compute. In a famous exchange, a group of bankers assembled in the White House to lobby against Wilson’s preference for a public oversight board for the new reserve system. Wilson balked: “Will one of you gentlemen tell me in which civilized country of the earth there are important government boards of control on which private interests are represented?”<sup>22</sup> It is not recorded why the bankers did not give the obvious answer that almost all central banks were organized in precisely this way.

#### B. The Wilsonian Compromise

This compromise is at the heart of modern failures of Fed governance. Wilson’s lack of familiarity with the institutional arrangements of global central banking did not hold back the

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<sup>20</sup> Lowenstein (2015). Some conspiracist accounts of the Fed’s origins focus on the fateful trip to Jekyll Island, where Senator Nelson Aldrich and several banker advisers traveled in secret to discuss what they had learned from the National Monetary Commission’s efforts to study the “currency question” in comparative detail. What became the National Reserve Association emerged largely from that meeting, and much of it was included in the Federal Reserve Act. Fixation on a single meeting, however, overlooks how much of the Fed’s final structure emerged not from Jekyll Island but from the final negotiations dominated almost exclusively by the Democrats. See Conti-Brown (2016).

<sup>21</sup> See Aldrich-Vreeland Act of 1908, Pub. L. No. 60–169, 35 Stat. 546.

<sup>22</sup> Glass (1927, 112–16).

legislative momentum (and significant Democratic approval) of what now emerged as the Fed. As it was finally passed, the act created three key organizations (or, better, organizational types). The Federal Reserve Board would be located in Washington, DC, with members appointed by the president and confirmed by the Senate. Two of these political appointees would serve ex officio: the Secretary of the Treasury (as the chair of the Federal Reserve Board) and the Comptroller of the Currency. Five others would be appointed exclusively to the Board.<sup>23</sup> In addition, there would be “eight to twelve Federal reserve banks” that would, in effect, be small central banks spread unevenly throughout the United States.<sup>24</sup> Finally, and relatedly, each Reserve Bank would be “supervised” by a private board of directors selected to give the collective banks a supermajority influence over the affairs of each individual Reserve Bank.<sup>25</sup>

The passage of the Federal Reserve Act was regarded as a triumph in legislative engineering, a key contribution by the Wilson administration that was mentioned repeatedly as a major accomplishment in his obituaries.<sup>26</sup> But it was not an exercise in legislative clarity. It did indeed create a “system,” but not one with a clearly organized structure that located responsibility for that system. The legislation made clear that the Reserve Banks and the Federal Reserve Board would share much of their decision-making authority. However, legislatively

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<sup>23</sup> From 1922 to 1935, the Federal Reserve Board consisted of eight members: two ex officio and six appointed.

<sup>24</sup> For a fascinating, original, and empirical account of how the Reserve Bank cities were selected, see Binder & Spindel, 61-82 (2017)

<sup>25</sup> It is more historically accurate to say that the Federal Reserve Act created five key organizations, not three. The other two not mentioned have since receded in importance: the Reserve Bank Organizing Committee (RBOC) and the Federal Advisory Council (FAC). The RBOC was cochaired by the Secretaries of Treasury and Agriculture and selected, after extensive hearings, the cities in which the Reserve Banks would be located. The FAC is an organization of private bankers (still in existence) whose authority once rivaled the Federal Reserve Board in the public imagination but essentially atrophied to nothing. For more on the RBOC, see Binder and Spindel (2013).

<sup>26</sup> “New Yorkers Honor Wilson’s Life Work” (1924).

shared power is not a recipe for practical clarity. As Allan Meltzer has written, “Tension between the Board and the reserve banks began before the System opened for business.”<sup>27</sup>

The result was that the Fed’s early leadership experience was driven by personality, with conflicts between and among some of the Reserve Bank governors and members of the Federal Reserve Board. Such leadership as there was within the system was probably exercised by the governor of the Federal Reserve Bank of New York, Benjamin Strong. But this authority has been exaggerated largely because of Strong’s influence in New York and abroad. In fact, many of the Reserve Bank governors viewed themselves as independent, including indeed from the Treasury Department. In one tense and ironic instance of this independence, in 1922, Andrew Mellon, Treasury secretary under President Warren G. Harding and chairman of the Federal Reserve System, pleaded with the governors of the Federal Reserve Banks to sell their holdings of US debt—which Mellon was trying to liquidate—just so that they could maintain profitability. “I should regard it as particularly unfortunate if incidental questions of expenses and dividends were to be permitted to control on questions of major policy,” Mellon said. Most banks agreed, but the Chicago bank regarded this interference as inconsistent with the regional character of the Fed.<sup>28</sup> This posture toward Fed independence so that the Reserve Banks could monetize the public debt against political wishes is, of course, the opposite of what one would expect. Such were the strange incentives created by the original Fed.

### C.     Compensating the Central Bankers

Any status difference of the Reserve Bank governors and the governor of the Federal Reserve Board—the sometimes de facto head of that body, despite the Secretary of the Treasury’s de jure role as Fed chair—was not obvious at the founding of the Fed, at least in terms of the

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<sup>27</sup> Meltzer (2003, 75).

<sup>28</sup> Meltzer, 143–45.

compensation structure for officials within the system. By statute, the members of the Board were paid \$12,000—which in 2019 dollars is \$312,000. The boards of directors, with the approval of the Federal Reserve Board, would approve the salaries of the remaining members. On average, the Reserve Bank governors in 1914, the first year of operation, were paid a little less than \$16,000 (see table 1). Excluding the governor of the Federal Reserve Bank of New York, who earned \$30,000, the average was \$14,500.

**Table 1. Salary Information for the Federal Reserve**

**Board and the Reserve Banks**

<b>Position</b>	<b>Salary</b>
Federal Reserve Board	\$15,000
Boston	\$15,000
New York	\$30,000
Philadelphia	\$20,000
Cleveland	\$16,000
Richmond	\$10,000
Atlanta	\$9,000
Chicago	\$20,000
St. Louis	\$20,000
Minneapolis	\$15,000
Kansas City	\$7,500
Dallas	\$12,000
San Francisco	\$15,000

Source: Federal Reserve Board, *First Annual Report of the Federal Reserve Board for the Period Ending December 31 1914*, 1914.

However, within only a few years, differences in these salaries began to diverge. This divergence, in turn, created some public controversy. In 1921, the Federal Reserve Board voted to substantially increase the salary of Benjamin Strong, the governor of the Federal Reserve System. The US Senate in turn issued a “resolution of inquiry,” accusing the Board of being

“guilty of an amazing waste of public money in increase of salaries to officers and employes [*sic*] of the New York Federal Reserve Bank.” The resolution also instructed the Board to explain itself.<sup>29</sup> The salary upgrade, the Board wrote back, was necessary “in order to retain the services of officers who are constantly being tempted with outside offers at high salaries,” since their salaries “were 69 per cent less than those paid similar employes [*sic*] by banks which are members of the Federal Reserve system.”<sup>30</sup> The Board won the day: New York got its payday.

Congress, though, still held the salary strings of the Board itself and did nothing to keep pace either with inflation or with the attractive offers for similar work outside the Federal Reserve Board—including, indeed, the Federal Reserve Banks themselves.

In 1930, Roy Young, the Governor of the Federal Reserve Board, responded to these pressures in a personal way: he resigned his position and immediately took over the governorship of the Federal Reserve Bank of Boston. “Like many other able men before him,” the *Washington Post* reported at the time, “Mr. Young explained that he was compelled to leave the Government service in order to earn more money.”<sup>31</sup> Young’s first sentence in his resignation letter to President Herbert Hoover was clear: “For some time it has been necessary for me to consider accepting a more remunerative position.”<sup>32</sup> President Hoover, to whom Young’s letter was addressed, wrote that his reasons—salary—“are sufficiently compelling to forbid my insisting that you remain, much as I am tempted to do so.”<sup>33</sup>

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<sup>29</sup> “Federal Reserve Defends Salaries” (1921).

<sup>30</sup> “Federal Reserve Defends Salaries.”

<sup>31</sup> “Gov. Young Resigns Reserve Board Job” (1930).

<sup>32</sup> Roy Young to Herbert Hoover, August 26, 1930, Public Papers of Herbert Hoover, 355–56.

<sup>33</sup> Herbert Hoover to Roy Young, August 27, 1930, Public Papers of Herbert Hoover, 354–55.

This was the second time Boston had poached the Federal Reserve Board's governor with a more attractive job offer. Young's penultimate predecessor at the Board was William Harding. His immediate predecessor at the Boston Fed was also William Harding.

This dynamic did not go unnoticed by the Reserve Bank Governors. George W. Norris, Governor of the Federal Reserve Bank of Philadelphia from 1920-1936, spoke derisively of the Federal Reserve Board in his often overlooked (and often illuminating) memoir of private and public-sector work in Philadelphia in the Gilded Age and Progressive Era. He also spoke somewhat unsparingly of the individual members of the Board: Charles Hamlin was "not brilliant"; Adolph Miller "had a copious vocabulary and the didactic manner" of the professor he was once. George R. James, "an unusual character, prone to interpret all trends in terms of his store business in Memphis." And these were the ones he cared to mention. "Upon some of the later members it is kinder to make no comments."<sup>34</sup>

Why such poor central bankers on the Federal Reserve Board, when Norris praised so much his fellow Governors? Petty institutional competition isn't adequate, since the other eleven Governors were also in many ways Norris's competition. Norris provides his own answers, including the poor salary. "The fact is that positions on the Board unfortunately had an attraction for second- or third-rate men, while first-rate men were generally unwilling to make the financial sacrifice, and the loss of home ties and associations necessarily involved in acceptance of membership. It is within my personal knowledge that one member was appointed only after six prior choices had declined."<sup>35</sup>

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<sup>34</sup> Norris (1937, 202-203).

<sup>35</sup> *Ibid.* page 204.

#### D. Abolishing the Wilsonian Compromise

This federalist system of central banking was mostly, but not completely, abolished by legislative reform efforts that followed the election of Franklin Roosevelt in 1932. The reform of the Fed did not initially figure prominently in Roosevelt's legislative agenda. While the Glass-Steagall Act, legislation passed in 1932 and 1933, made some key alterations to the practices of monetary policy at the Fed, it mostly formalized the existing institutional infrastructure for monetary and regulatory policy decisions. The 1933 act created the FOMC, tasked explicitly with engaging in open market operations under the supervision of the Federal Reserve Board. But this early FOMC mostly placed congressional imprimatur on an existing understanding of shared monetary responsibility among the 12 Reserve Banks, even though the members of the Federal Reserve Board could attend FOMC meetings at their discretion.<sup>36</sup> In that first formulation, the Federal Reserve Board played no formal role beyond giving approval to decisions made by the Federal Reserve Banks.<sup>37</sup>

As part of the so-called Second New Deal, Congress passed at Roosevelt's urging the Banking Act of 1935. The 1935 act was part of a suite of much more prominent, controversial, and highly debated legislation, including the Social Security Act and the Wagner Act (which created the National Labor Relations Board and fundamentally altered the union-management relationship). The Banking Act was the brainchild of Marriner Eccles, who became the governor of the Federal Reserve Board shortly before the act's passage so that he could better advocate for its reforms.

The Banking Act of 1935 fundamentally altered the Wilsonian compromise that had created the federalist system of central banking in America—George Norris, the Philadelphia

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<sup>36</sup> Banking Act of 1933, section 8.

<sup>37</sup> Banking Act of 1933, section 8.



Fed Governor and memoirist mentioned above, referred to the Act as the Federal Reserve Board's "abolition."<sup>38</sup> The Banking Act also created a form of central banking that would quickly spread throughout the world and remain essentially unchallenged throughout the 20th century. The two parameters of compromise from the Wilsonian Democrats in 1913—centralization versus decentralization, public versus private control—became more clearly resolved in 1935. Now the Fed was a centralized public institution, although it still retained some echoes of the decentralized private system that Democrats had created in 1913.

It was also much more bureaucratic than political. Congress removed the ex officio members of the Federal Reserve Board and renamed the body the Board of Governors of the Federal Reserve System, the term "governor" being associated with central bankers; the former Reserve Bank governors were now renamed "presidents." Seven governors, appointed by the US president and confirmed by the Senate, would serve dual roles as members of this new governing body and as permanent members of the FOMC. The FOMC, itself just two years old, was thus substantially changed in composition. Instead of an FOMC consisting exclusively of private Reserve Banks, the new FOMC would be led by the governors, with five of the 12 Reserve Bank presidents rotating. Because the president of the Federal Reserve Bank of New York succeeded in pushing himself into a more permanent practical rotation at the expense of his alternate, the president of the Federal Reserve Bank of Boston, Congress made the New York Fed a permanent member of the FOMC in 1942.<sup>39</sup>

#### E. Board vs. Banks, Continued

The Banking Act of 1935 reformulated the Wilsonian compromise, but it did end, once and for all, the power struggles between the Federal Reserve Board and Reserve Banks. Just as was the

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<sup>38</sup> Norris (1937, 203).

<sup>39</sup> Act of July 7, 1942, 56 Stat. 647.

case before the 1935 act's passage, personnel still mattered enormously in setting the stage for the Fed's policy priorities. The role of the Reserve Bank presidents in creating the Fed-Treasury Accord of 1951 is well documented.<sup>40</sup> But that joint Reserve Bank-Board victory did not resolve the debate on where the power center lay within the Fed. It took another four years—20 years after the passage of the Banking Act of 1935—before that question was settled essentially once and for all.

The early 1950s pitted Allan Sproul, called “Mr. Federal Reserve” when he retired,<sup>41</sup> against William McChesney Martin Jr., the former Treasury official who had negotiated the détente with the Fed from the Treasury perspective before becoming President Harry Truman's pick to lead the Fed just a month later. There were two fronts for this battle, both dealing with the operations of monetary policy. First, the New York Fed prized its position as the implementer of the FOMC directives, including its freedom to alter those directives as needed in the times between FOMC meetings. During a long process, described contemporaneously as “civil but relentless,”<sup>42</sup> Martin built enough support for his more DC-centric view to abolish the Executive Committee of the FOMC—a primary mechanism for empowering the New York Fed—and otherwise displaced New York (and Sproul) as the leading front of monetary policy within the system.<sup>43</sup>

#### F. The Rise of the “Imperial Chair”

After the 1950s, a new threat to the legislative design of the Board as the supervisor of the Federal Reserve System arose, this time from within: the Fed evolved to become much more “chair-centric,” starting first with Arthur Burns (1970–1978) and accelerating under the

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<sup>40</sup> See Meltzer (2003), Hetzel (2001), Conti-Brown (2016), Binder & Spindel (2017).

<sup>41</sup> Banks (1956).

<sup>42</sup> Clifford (1965, quoting contemporary news sources).

<sup>43</sup> Bremner (2004, 100–117).

influential tenures of Paul Volcker (1979–1987) and Alan Greenspan (1987–2006). The rise of the imperial chairs coincided with the Fed’s own expanded role as the “only game in town” to combat the political crisis posed by the Great Inflation.<sup>44</sup> That period, which scholars date from 1965 to 1982, produced a political crisis that became the forefront of presidential attention during four successive administrations, beginning in earnest under President Richard Nixon.<sup>45</sup> But until 1979, the Fed played very little role in these debates. Perhaps most infamously, the most important monetary policy decision of the second half of the 20th century—the closure of the gold window in 1971, made permanent in 1973—was a political decision made by Nixon and his Treasury over the vehement protests of the Fed.<sup>46</sup>

President Jimmy Carter’s appointment of Paul Volcker in the summer of 1979 changed all of this, as Volcker launched—with some transparency—a monetary experiment in October of that year to target monetary aggregates rather than interest rates. The decision was and is largely hailed as primarily responsible for breaking inflation’s back.<sup>47</sup>

The rise of the Volcker Fed also gave way to an era of the imperial Fed chair. Volcker became a dominant figure not only on Capitol Hill—where Fed chairs had long been a fixture—but in the popular imagination as well. The elevation of his status was not, initially, flattering. The FOMC’s monetary policy did indeed secure much higher nominal interest rates—the one-year Treasury rates went from an already high 10.5 percent in July 1979 to 19.1 percent in June 1981, before settling to a relatively modest 6.6 percent when Volcker retired in 1987—with a predictable and predicted recession in both 1980 and 1981–1982. An “impeach Volcker”

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<sup>44</sup> The phrase “only game in town” with respect to the Fed’s link to inflation dates at least to future Treasury Secretary Donald Regan’s defense of the Volcker Fed in a *New York Times* piece written in December 1980. (Weisman 2016). For a more modern and critical version of this argument, see El-Erian (2016).

<sup>45</sup> For two good treatments of the role of inflation in politics, see Samuelson (2008) and Jacobs (2016).

<sup>46</sup> For Arthur Burns’s irrelevance to the closure of the gold window, see Wells (1998) and Silber (2012).

<sup>47</sup> Many have used this phrase, or one like it, to describe Volcker’s influence, including Senator William Proxmire. See Silber (2012).

movement arose, not only on the fringe of society but within Congress. Volcker had “legalized usury beyond any kind of conscionable limit,” Texas Democrat Henry Gonzalez said in a congressional hearing in 1981.<sup>48</sup> Gonzalez would eventually introduce a bill of impeachment against Volcker, although there was no real threat that Congress would act on it.<sup>49</sup>

But by the time of Volcker’s resignation in 1987, the story was different. On hearing the news, Chuck Schumer, then a member of the House of Representatives, said that President Ronald Reagan “should have been on his hands and knees begging Mr. Volcker to stay.”<sup>50</sup> The dollar fell immediately, causing trading to be suspended in Paris. Politicians called for Volcker to receive the Nobel Peace Prize. Former critics (such as Democratic Senator William Proxmire) credited Volcker with breaking “the back of inflation.” Even common citizens—those who had once flooded his mail with caustic diatribes—now sent encomia to the great guardian of the dollar.<sup>51</sup>

Alan Greenspan was not a household name when he was nominated to succeed the monetary giant. He was not politically anonymous, though. He had been an economic adviser to Richard Nixon and indeed may have played a role in that administration had he not insisted on a cabinet appointment—Secretary of the Treasury was his first choice—far beyond his years or reputation. He had later become the chair of the Council of Economic Advisers under President Gerald Ford and then served as the cochair of the influential National Commission on Social Security in 1983. He had been on the short list to succeed Volcker in 1983, when Reagan openly floated the idea of nominating someone else for the role of Fed chair. In the summer of 1987, he

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<sup>48</sup> US House of Representatives (1981, 211–12).

<sup>49</sup> Congressional Record, 98th Congress, 1st Sess., January 6, 1983, 143.

<sup>50</sup> Seib and Hume (1987).

<sup>51</sup> Silber (2012, 260–65).

won a prize he had long desired, standing with Reagan and Volcker when the announcement of one resignation and one appointment occurred the same day.<sup>52</sup>

Within a few years, and through a bruising relationship with the administration of President George H. W. Bush, Greenspan had become “the Maestro,” a central banker most associated with excellence, brilliance, and control—and not just on Capitol Hill. When Bill Clinton wanted to win public confidence that he was a “New Democrat,” serious about fiscal responsibility, he sought and received the support of Alan Greenspan (who sat next to First Lady Hillary Clinton at the president’s first address to Congress.)<sup>53</sup>

When Greenspan retired after nearly two decades at the Fed’s helm, as had been the case with Volcker, the praise was unrestrained. CNBC broadcast live as a young artist painted Greenspan’s portrait as part of the artist’s “Good-bye Greenspan” tour—an example of what Greenspan’s biographer called a “blur of adulation” that included receipt of the Presidential Medal of Freedom and the “Freedom of the City of London, an honor that conferred an ancient privilege to drive sheep across London Bridge.”<sup>54</sup> Even an erstwhile competitor, former Fed vice chair Alan Blinder, joined a coauthor in saying of Greenspan that “he has a legitimate claim to being the greatest central banker who ever lived.”<sup>55</sup> President George W. Bush was quite right when he said, at a farewell party, that “Alan Greenspan is perhaps the only central banker ever to achieve rock-star status.”<sup>56</sup>

Greenspan’s rise was remarkable, and likely more than any other central banker before or since, he was responsible for the Fed’s penetration into public discourse. But the problem with

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<sup>52</sup> For more on Greenspan’s long-standing interest in the Fed chair, see Mallaby (2016).

<sup>53</sup> Conti-Brown (2016).

<sup>54</sup> Mallaby (2016, 647–48).

<sup>55</sup> Blinder and Reis (2005, 3).

<sup>56</sup> Wessel (2009, 50).

this kind of fixation at the top was what it did at the legal center of power for the Fed—that is, at the Board of Governors. The Fed’s committee governance—an unwavering aspect of its design, altered only by expansion since the Fed’s legislative creation in 1913—was mostly forgotten by the public. Greenspan pushed for that control, at the expense of the Fed’s governors. They took notice. In 1996, “a tremor shook the Federal Reserve Board’s headquarters” as four Fed governors—including then governor Janet Yellen—met with Greenspan to demand better treatment.<sup>57</sup> The governors did not have a problem with Fed policy but with their inability to participate fully in that policy, “including discussions with the Treasury Department and research on international financial issues.” As one departing senior staffer put it, “He never had an interest in becoming [a governor]; it would have reduced his influence over the Fed’s policies if he did.”<sup>58</sup>

Greenspan knew this was true. In congressional testimony following the report of tumult at the Fed, Greenspan said that “all of the authority of the Federal Reserve Board is within the board members. I, as chief executive officer, have one statutory authority: I run the meetings.”<sup>59</sup>

This was the essential state of affairs at the Fed as of the financial crisis of 2008. The Fed chair dominated headlines, a reality that the new chair, Ben Bernanke, did not think was healthy. Bernanke “wanted to avoid the cult that had attached to Greenspan, the perception that the chairman *is* the Fed.” Bernanke “wanted to elevate the stature of the institution instead,” to make the Fed “more like the Supreme Court and less like a royal court where the king was surrounded by retainers.”<sup>60</sup> Fed governors, despite Congress’s intent, had evolved away from the center, and Bernanke wanted to change that.

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<sup>57</sup> Berry (1996).

<sup>58</sup> Berry (1996).

<sup>59</sup> Berry (1996).

<sup>60</sup> Wessel (2009, 66–67).

## G. The Fed's Governance after 2008

The legislative response to the 2008 financial crisis sought initially to deemphasize the Fed generally by removing consumer financial protection from its portfolio and by removing financial stability—not squarely in its portfolio before—and creating a new entity, the Financial Stability Oversight Council. These proposals, though their status and institutional design shifted during the legislative debates, emerged from the completed legislative project intact. The Fed had lost both battles, though it barely contested the first.

Senator Chris Dodd also initiated another effort to trim the Fed's sails by removing it from the business of bank supervision more generally. After a long and public debate with Bernanke on this front,<sup>61</sup> and after President Barack Obama's administration intervened in support of some retention of the supervisory role,<sup>62</sup> the Fed's Board of Governors and Dodd reached a compromise: The Fed would retain its supervision of the largest bank holding companies but lose supervision of the smaller banks. The Reserve Banks—those housed with staffing most of the supervision for these smaller banks—would lose the most from the compromise. As the *New York Times* reported in March 2010, members of the Senate Banking Committee and the Fed had “reached a tentative consensus on a plan that would strip the Federal Reserve of regulatory powers over all but the very largest banks, those with more than \$100 billion in assets.”<sup>63</sup> The move would have reduced the Fed's supervisory authority from over 5,000 financial institutions to just 23. This was the version of the bill reported out of the Senate Banking Committee.

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<sup>61</sup> Bernanke (2010b).

<sup>62</sup> Oral history of Amy Friend, February 7, 2018, on file with the author.

<sup>63</sup> Chan (2010).

At this point, the presidents of the Federal Reserve Banks stepped in, launching a full-scale effort to walk back the compromise supported by the Fed's Board of Governors. Lobbying seems the appropriate label, but neither the Reserve Bank presidents nor the senators characterized it this way. "They've done a good job of educating without lobbying," is the way Senator Claire McCaskill put it. "A lot of members of Congress were not as informed as they should have been about what the Federal Reserve is and how it works."<sup>64</sup>

However one describes their efforts, they succeeded spectacularly. The amendment to Dodd-Frank, sponsored by Kay Bailey Hutchison, a conservative Republican from Texas, and Amy Klobuchar, a progressive Democrat from Minnesota, restored the Fed's full supervisory authority. Their common connection: they both hail from states with a Federal Reserve Bank. The amendment passed 90–9, with one abstention. The Reserve Banks had, once again, protected a key part of their status within the system.

## ***H. Conclusion***

As the foregoing history suggests, the practice of Fed governance has been in a state of near-constant reinvention. The balance between the Reserve Banks and the Fed's Board of Governors has not always been obvious, nor has the balance between the Fed chair and the Fed's two committees. And while the complete independence of the Reserve Banks was not abolished in this passage of time, the legal status of the Reserve Banks is significantly different now from what it was in 1913. The Reserve Banks' continued policy relevance, even beyond their legal status, may be a testament to their political acumen—as seen in the Klobuchar-Hutchison amendment—but the questions remain: Is the Fed we have the same Fed that Congress designed? Have the Fed governors exercised their powers such that they remain the

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<sup>64</sup> Lanman and Torres (2010).



leaders of the Fed? This paper argues that the answer to both questions is no. Part II will explain some of the reasons why.

### III. The Governors and the Presidents: Data and Evidence on Key Parameters

The Fed's Board of Governors can be analyzed through the ways that the Fed governors do and do not maintain their status as the power center of the Fed. I will focus on five dynamics. First, there is the role the Fed governors play in supervising the Reserve Banks, both with respect to bank supervision and with respect to the selection of the Reserve Bank presidents. The latter authority is particularly opaque, leading to failures in accountability for the misbehavior of Reserve Bank presidents when it occurs.

Second, I analyze the increased vacancies at the Fed's Board of Governors—vacancies that have indeed risen significantly during the last 12 years. But rather than these vacancies being an instance of Washington as usual, there is space—indeed, there is some evidence—that both parties can consider a truce and restore senatorial comity to future Fed appointments.

Third, I look at the extraordinary erosion in the salaries of the Fed governors, in particular as compared to the presidents of the Federal Reserve Banks. The current salary for Fed governors is just under \$200,000 per year, a princely sum by most Americans' standards (where, in 2017, the median household income was \$62,000, according to the US Census Bureau). But it is significantly less than the average salary for Federal Reserve Bank presidents (which in 2019 is over \$406,000). As mentioned previously, this disparity has been a problem for Fed governance since at least 1922. It remains so today.

Fourth, I analyze the phenomenon of “groupthink” at the Fed, a topic of increased interest in academic and public circles alike. The Reserve Bank presidents are ostensibly meant to bring intellectual diversity to the Fed by living outside of Washington. In fact, their longer tenures relative to the Fed governors and their much higher likelihood to come from inside the Fed may exacerbate groupthink rather than remedy it.

And finally, I analyze participation in FOMC meetings through 2013 (the last year for which detailed transcripts are available).<sup>65</sup> Even controlling for the dramatic increase in vacancies at the Board of Governors, there is a secular trend at the FOMC for Fed governors to participate much less and for presidents—including nonvoting presidents—to participate much more.

#### A. Supervision of Federal Reserve Banks

The 1935 design of the Federal Open Market Committee unquestionably leaves the voting Reserve Bank presidents and the Fed governors as colleagues on the most important of their duties. But the statute also leaves in place a significant oversight role for the Board in two aspects of the Reserve Banks’ key operations: bank supervision and the selection of the Reserve Bank presidents. In the first instance, there is progress toward the assertion of supremacy for the more accountable Board of Governors; in the second, there is mostly confusion.

##### *I. The Reserve Bank Presidential Process*

As mentioned previously, Fed governance was a much debated part of the legislative process in 1913. But the act spent no time at all describing how the Federal Reserve Banks’ chief

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<sup>65</sup> I first analyze this phenomenon with a smaller dataset in Conti-Brown (2018).

officers would be selected, beyond giving that power to their boards of directors.<sup>66</sup>

Immediately, the directors of the newly established Federal Reserve Banks selected “governors” to lead them, even though the statute made no mention of such a position (focusing instead on “chairmen” of the Federal Reserve Banks and “Federal Reserve agents”—the only mention of a “governor” was for the Federal Reserve Board).

Congress formalized the process of selecting a leader of the Federal Reserve Banks in the Banking Act of 1935, as part of the Fed’s reformulation. In that statute, in addition to changing the name of the position from governor to president, Congress identified the officer as “the chief executive officer of the bank . . . appointed by the board of directors, with the approval of the Board of Governors of the Federal Reserve System.” This basic appointment process stayed in place until Congress modified it in 2010 with Dodd-Frank. After that modification, the Federal Reserve Bank president, still the chief executive officer of the bank, is “appointed by the Class B and Class C directors of the bank,” still with the approval of the Board of Governors. Class A directors—those bankers selected by the member banks—were removed from formal voting on the presidential search process, while Class B directors (nonbankers selected by bankers) and Class C directors (members of the public selected by the Board of Governors) retained their roles in presidential selection.

Whether Class A directors *participate* in the selection of Reserve Bank presidents is another matter: the process is so wrapped in secrecy that one cannot be certain of the consequences of this legislative change. Despite the relative durability of this process, and despite (or even because of) the simplicity of the legal instruction, the public knows very little about the exact structure of the Reserve Bank appointment process. Is the “approval of the Board

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<sup>66</sup> Federal Reserve Act of 1913, 12 U.S.C. § 226, sec. 4 (fifth) (2012).

of Governors” a veto, as the language suggests? If so, how often is that veto exercised? Or is the “approval” more preemptive, giving the Board more control over the process? In other words, here again the Fed Board and the Reserve Banks participate together in shared governance, but the contours of that partnership are unknown.

There are historical reasons to suggest that the balance is not static. When Paul Volcker was chosen as president of the Federal Reserve Bank of New York, for example, he was first called by then Fed chair Arthur Burns. “I need you with me on the FOMC,” Burns said, in offering the position.<sup>67</sup>

Three decades later, Timothy Geithner—then an official with the International Monetary Fund—described a more collaborative effort during his appointment. The first contact was from the New York Fed’s chair, Pete Peterson. But Geithner explained that this support came through Larry Summers and Robert Rubin, who suggested his name (and had no formal connection to the New York Fed). Alan Greenspan also gave his support.<sup>68</sup> That was enough.

The lack of clarity on who is responsible for these appointments can lead to a failure of accountability. But in some cases, the results may well be better than could occur through a more transparent process. For example, in November 2015, the Federal Reserve Bank of Minneapolis (with the approval of the Board of Governors) announced that its new president would be Neel Kashkari. The process was completely shrouded in secrecy—there was no public record, anywhere, that Kashkari was even considered for the position. Perhaps for good reason. Kashkari’s profile was unlikely to find much sympathy in a more politicized environment. He is a Republican whose last star turn had been as the Republican candidate for governor of California, losing badly to Democrat Jerry Brown. Before that, he had been a Goldman Sachs

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<sup>67</sup> Silber (2012, 127).

<sup>68</sup> Geithner (2014, 76).

banker who worked in the Bush and Obama Treasury Departments leading the Troubled Asset Relief Program, the politically toxic “bailout” program passed by Congress in October 2008. Kashkari, in other words, had no political constituency to support him to such a senior position in government. Moreover, he had no obvious connection to Minnesota—he is from Ohio (in the Cleveland Fed’s district) and attended college in Illinois (in the Chicago Fed’s district). In other words, had the presidential appointment process had more public input, it is very unlikely that this non-Minnesotan, too Republican for the Democrats and too closely associated with a “bailout” for the Republicans, could have succeeded.

In the three years since his appointment, Kashkari has been one of the most independent and interesting voices in financial and monetary policy debates. He has consistently argued on behalf of more rigorous efforts at bank regulation, especially with respect to capital regulation, than his colleagues at the Board, going as far as to advocate for breaking up the largest banks.<sup>69</sup> He has also been a voice of protest against the FOMC’s rate normalization process, one that the Fed itself abandoned much earlier than it had previously signaled, taking his dissents not only to the FOMC but to the editorial pages of the *Wall Street Journal*.<sup>70</sup> Whether or not one agrees with Kashkari, it is clear that his voice is unusual in these halls.

But even in this case, it is appropriate to ask whether such value-laden questions as these deserve a little more accountability in understanding their origin. Kashkari occupies one of the most important positions in public policy. Should the public have been able to participate, at all, in his selection?

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<sup>69</sup> Appelbaum (2016).

<sup>70</sup> Kashkari (2018) and Kashkari (2019).

## 2. *The Richmond Fiasco*

If Kashkari represents the positive side of the current process for yielding genuine intellectual diversity, which is unlikely to have come from a more transparent process, a governance fiasco in Richmond illustrates the real cost to Fed governance of this much opacity. Jeffrey Lacker became the president of the Federal Reserve Bank of Richmond in 2004 and was a reliable monetary hawk during much of that period, often critical of the Fed's monetary consensus toward low interest rates and quantitative easing. In 2012, Lacker spoke to a private-market analyst and disclosed information about the Fed's decision to dramatically enlarge its balance sheet by buying \$45 billion of Treasury debt per month. The next day, the analyst reported the information to investors, along with other inside information. When the minutes of the Fed's September meeting were disclosed the next day, it was immediately assumed that the analyst had obtained insider information from the Fed. When the Fed's own lawyers launched an investigation immediately after the breach, Lacker did not disclose his conversation with the analyst. But when the Department of Justice launched its own investigation three years later, in 2015, Lacker admitted the conversation.

In 2016, the Fed—meaning the Federal Reserve Bank of Richmond's board of directors and the Fed's Board of Governors, although as usual the public knows little of the exact balance of views between them—reappointed Lacker to another five-year term.

Lacker's resignation in 2017 is unprecedented in Fed history. Never before has a member of the FOMC resigned in a scandal. What is more scandalous than the illicit disclosure of market-moving information, though, is that Lacker was reappointed even after disclosing to investigators. Shortly after the resignation, Daniel Tarullo, an outgoing Fed governor, responded to the scandal by affirming that the Fed took appropriate steps. "What's most important is that

when there are problems seen, when there are potential problems with the rules we've established for the confidentiality of FOMC information, that the responsible parts of the Fed, whether it's the Reserve Bank board or the Board itself, take action to show that those are important rules," Tarullo said. "I think that is what has happened."<sup>71</sup>

It is difficult to be sure that Tarullo's view is correct. For it to be so, Lacker must have kept secret during his reappointment process in 2016—from both the Richmond board and the Board of Governors—that he had already disclosed the breach of the FOMC's regulations to investigators. Whether or not this is true, it seems that the vetting process for Reserve Bank reappointment is deeply flawed. Either the Fed Board and the Richmond board of directors did not have highly relevant information on the candidate, in which case the process is not well informed, or they did have that information and decided to reappoint Lacker regardless of the scandal.

Lacker's situation represents a case where greater transparency in the vetting might have gone a long way to uncovering problems already five years old by the time they were eventually disclosed.

## B. The Politics of Fed Vacancies

Meanwhile, the politics of Fed governance continued to deteriorate in ways that meant more vacancies, more of the time, at the Fed's Board of Governors. As mentioned, a key part of the 1935 change to the Federal Reserve Act was an FOMC with a majority of members selected through a politically accountable process. The 7-to-5-majority structure on the FOMC was an important part of its structure in the Banking Act of 1935: it was the compromise that preserved the Reserve Banks' existence on this policy body without giving them dominance.

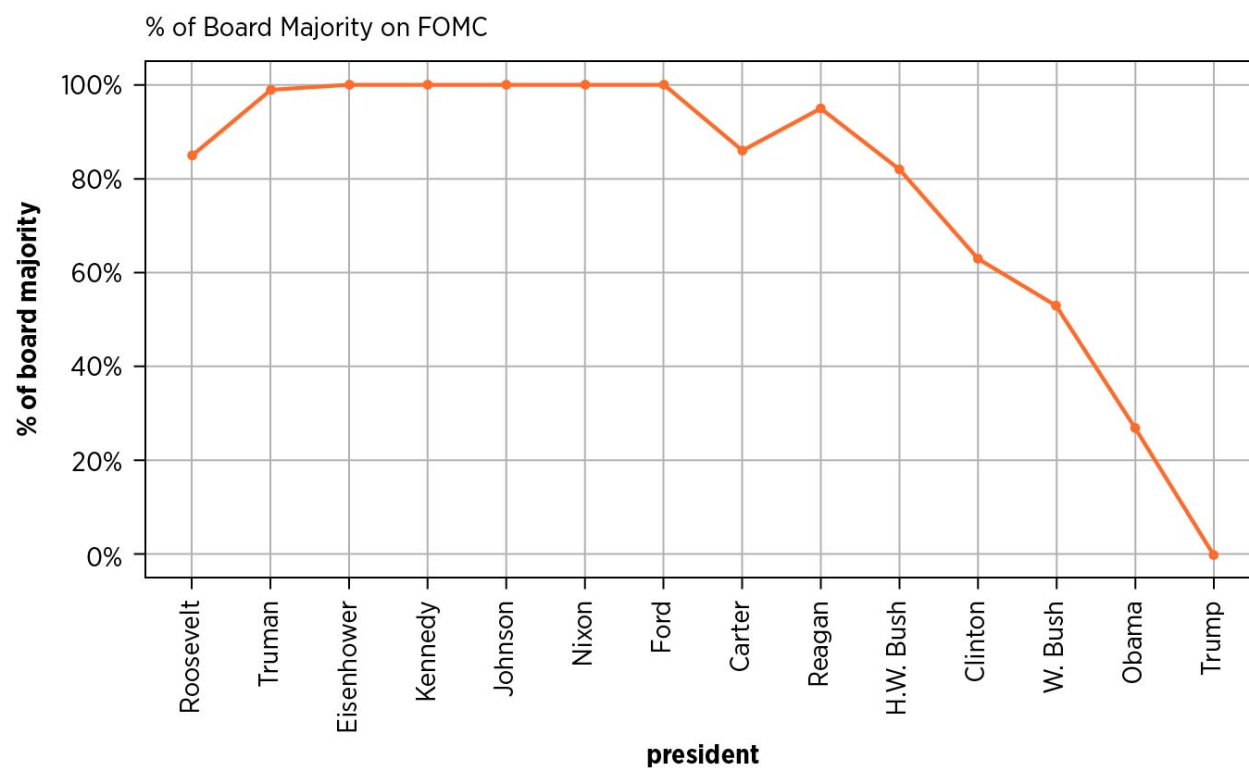
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<sup>71</sup> Timiraos (2017).

And for decades, that process worked smoothly. Figure 1 illustrates the percentage of time, during each presidential administration, that the Board of Governors maintained this majority.



**Figure 1. Board of Governors Majority on the Federal Open Market Committee, 1935–2019**



Source: To compute vacancies, I compiled start dates and retirement dates for each Fed governor since 1935, using data from the Board of Governors of the Federal Reserve System.

After some delay in setting up the new Board of Governors in the 1930s, presidents from Harry Truman to George W. Bush maintained that majority status more than half the time. Under Barack Obama, that number dropped to below 30 percent. Donald Trump has not yet seen a Board of Governors with a majority on the FOMC.

What has led to this collapse at the Board of Governors? Three groups bear the blame. The first is the governors themselves. The idea of a 14-year term was always something of an illusion, but the tenure of the Fed governors has been well below the statutory term for a long time, since at least the 1950s.

Presidents Obama and Trump bear some of the blame. They simply did not (or, in Trump's case, do not) make nominations a priority, even though both presidents for long stretches enjoyed party majorities in the Senate without the filibuster.

But there is a deeper history.<sup>72</sup> In 2008, near the unpopular end of the George W. Bush administration, the president nominated three people to fill Fed vacancies: community banker Elizabeth Duke, banker Larry Klane, and incumbent Fed governor and University of Chicago professor Randall Kroszner. Only Duke was confirmed, “in an apparent bid [by Democrats] to keep the positions open for the next president to fill.”<sup>73</sup> It worked. Barack Obama was elected in 2008, and Democrats strengthened their Senate majority. For the first time in Fed history, there were three simultaneous vacancies.

Obama began filling them, first with Daniel Tarullo in 2009, then in 2010 with Sarah Bloom Raskin (a former banking commissioner in Maryland and Senate staffer), Janet Yellen as the first (and, so far, only) female Fed vice chair, and MIT professor Peter Diamond.<sup>74</sup> Given the symbolic importance of Yellen's appointment (and her unquestioned qualifications, given her status as a two-time member of the FOMC), and given Raskin's support from the Senate, Republicans—especially Alabama Republican Richard Shelby—focused their ire on Peter Diamond.

Their first argument—that Diamond was not qualified for the post because his primary focus as an economist was as a labor economist—was absurd. Labor markets are central to the understanding of appropriate monetary policy. And by coincidence, Diamond won the Nobel Prize in economics while his nomination was pending.

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<sup>72</sup> *Wall Street Journal* reporter Josh Zumbrun has described much of this history on Twitter. See Zumbrun (2017).

<sup>73</sup> Ferraro (2008).

<sup>74</sup> Ferraro (2008).

When this criticism failed, Shelby focused on a once-important part of the Federal Reserve Act that had essentially fallen into desuetude. The act requires that members of the Board of Governors each hail from different Federal Reserve districts.<sup>75</sup> In 1930, this issue became a major news story as Hoover's first choice for the governorship of the Federal Reserve Board, Eugene Meyer, was from New York, but so was the incumbent vice governor, Edmund Platt. To secure the appointment of Meyer, Platt resigned.<sup>76</sup> This issue came up again in 1951, when Truman wanted to appoint a loyalist at the Fed as part of the Fed-Treasury Accord, but his first choice was from the Seventh Federal Reserve District (Chicago), and a Chicago seat was already in place. So it was that William McChesney Martin became Fed chair.<sup>77</sup>

But this tradition has fallen by the wayside. Ben Bernanke, for example, was appointed as a member of the Board of Governors from the Sixth Federal Reserve District (Atlanta). Bernanke was raised in South Carolina, located in the Fifth Federal Reserve District (Richmond). He spent most of his career in the Third Federal Reserve District (Philadelphia). His only plausible connection to Atlanta was that he was born just over the South Carolina border in Augusta, Georgia.<sup>78</sup>

Even so, Senator Shelby used this legal tool to exact his revenge for Senator Dodd's earlier obstructions. President Obama nominated Diamond three times, to no avail. Diamond won the Nobel Prize, withdrew from the process, and wrote an op-ed, "When a Nobel Prize Isn't Enough," to decry the partisanship of the process.<sup>79</sup>

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<sup>75</sup> 12 U.S.C. § 241.

<sup>76</sup> "Meyer to Get Post; Platt Will Resign" (1930).

<sup>77</sup> Bremner (2004, 81).

<sup>78</sup> Bernanke (2015).

<sup>79</sup> Diamond (2011).

President Obama and Senate Democrats decided to avoid the gridlock by pairing appointments for remaining vacancies and including a Republican (originally Richard Clarida, now the Fed's vice chair) and a Democrat (Harvard economist Jeremy Stein). Clarida withdrew, and the Obama administration looked for a palatable Republican alternative. They settled on Jerome Powell, a mostly obscure figure who had stood up to fellow Republicans for their hostility to the Obama administration's fiscal policies.<sup>80</sup>

Vacancies in the Obama administration continued to rise, but they mostly went unaddressed after one final push to keep the Fed minimally staffed at five governors. When Donald Trump won the 2016 election, the Fed's vacancies continued at a critical pace. Trump picked Republican moderates in Randal Quarles, Richard Clarida, and Michelle Bowman, along with Nellie Liang (a former Fed staffer) and Marvin Goodfriend (also a former Fed economist). The Senate confirmed all but the last two. Goodfriend's testimony before the Senate Banking Committee was not well received, and Liang withdrew in the face of Republican hostility.

In July 2018, President Trump departed from a 30-year norm of presidential noncomment on Fed policy to express his dissatisfaction with the Fed's monetary policies.<sup>81</sup> This pressure has continued to the present. At the same time, he abandoned his more conventional picks for the Board of Governors and announced that he intended to nominate Herman Cain—a failed Republican presidential candidate—and Stephen Moore—a partisan economic commentator and former Trump campaign adviser—as his preferences for the remaining two vacancies. The public engaged in a thorough vetting of both candidates, revealing significant questions of judgment, views about monetary policy, and alleged scandals that ranged from tax evasion (Moore) to sexual harassment (Cain). Both withdrew from consideration, with Cain citing the paltry salary

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<sup>80</sup> Timiraos and Harrison (2017).

<sup>81</sup> For a timeline of Trump's comments, see Condon (2019).

for members of the Board of Governors and Moore citing an abusive and partisan process.<sup>82</sup> But in both cases, the path to nomination was essentially blocked by members of the president's own party. "I would like to see nominees that are economists first and not partisans. I think it's important that the Fed be a nonpartisan entity," Senator Mitt Romney (R-Utah) said. "The key is that someone is outside of the political world and is an economic leader not a partisan leader."<sup>83</sup> Others expressed similar views about Moore, although his controversial history may have mattered more.<sup>84</sup>

This history of the fights over Fed vacancies is important because it illustrates a few important realities about the Fed appointment process. First, the tit-for-tat strategies—most obvious in 2008 and a few years later with Peter Diamond—are all relatively recent. Although there are indeed secular trends involving vacancies in other parts of government, Fed acrimony is much more recent.

Second, the Cain and Moore appointments show that enough Republicans still view the Fed as appropriately nonpartisan. This does not mean, of course, that politics will be irrelevant. But it does mean that the lines of political appropriateness in Fed appointments still matter to many people on Capitol Hill. This suggests a promising path for reform.

### C. Salaries

Herman Cain is not the first potential central banker to complain about Fed salaries. Part I explained how the deterioration of the salaries for members of the Federal Reserve Board led to curious outcomes that drained the Board of its potential strength. That deterioration has only accelerated—dramatically—in the decades since. Using original data obtained from the Fed's

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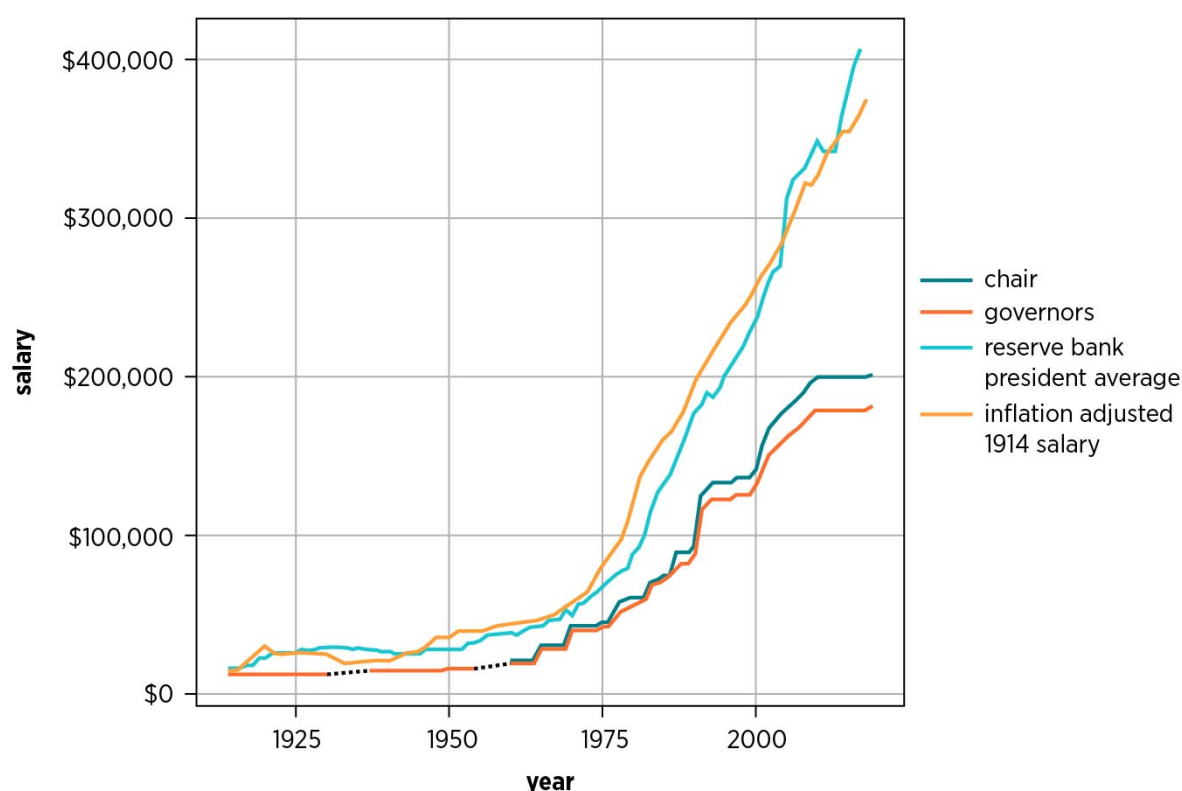
<sup>82</sup> See Kiernan (2019) for more on Cain's potential candidacy; see also Moore (2019).

<sup>83</sup> Everett (2019).

<sup>84</sup> Timiraos (2019).

annual reports (for the Reserve Bank salaries) and from a successful Freedom of Information Act (FOIA) request to the Board of Governors (for the Fed governors and Fed chairs), I was able to track just how much the salary for a governorship has deteriorated over time. Figure 2 shows the salaries of the various members of the Federal Reserve System—the Fed chair, Fed governors, and Federal Reserve Bank presidents—against the Bureau of Labor Statistics data on the Consumer Price Index..

**Figure 2. Salaries at the Fed: Chair, Governors, Presidents, Inflation, 1914–Present**



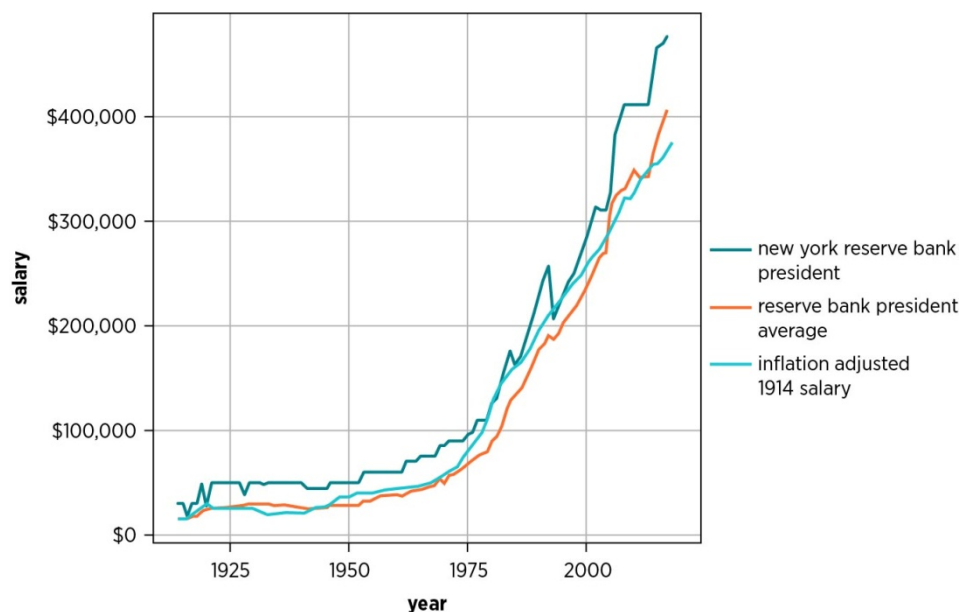
Sources: Annual Reports of the Federal Reserve System, 1914–2018, were used for salary data on the Federal Reserve Banks. I acknowledge with gratitude the staff at the Fed’s FOIA office for their help in securing the salary data on the governors. They lacked data from 1955 to 1964, shown here extrapolated with a dotted line.

The results are remarkable. Not only have the presidents of the Reserve Banks kept pace with inflation, they have outpaced it. But the Fed chair and governors lag far behind.

From the beginning, the authority to set the salaries for the members of the Federal Reserve Board (later, the Board of Governors) rested with Congress; for the officers of the Federal Reserve Banks, including the presidents, the local boards of directors made those determinations. Salary problems under Congress’s control are not unique to the Fed. But they are present.

It is worth examining, though, whether the Federal Reserve Bank of New York—paid exactly double the salary of the members of the Federal Reserve Board in 1914—is an outlier, pushing the Reserve Bank average far beyond the Board. Figure 3 illustrates the salary growth for the president of the New York Fed.

**Figure 3. Salaries at the Federal Reserve Bank of New York and Other Reserve Banks, against Inflation, 1914–2019**

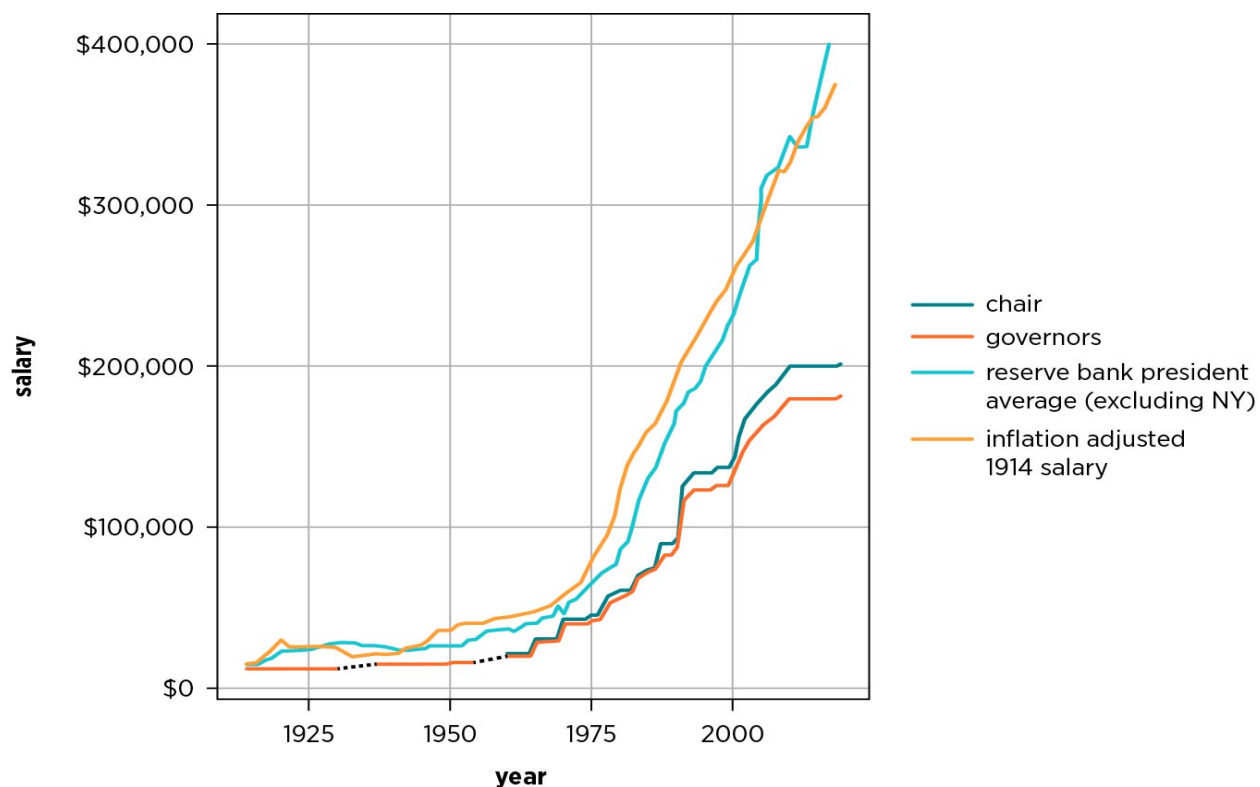


Sources: Annual Reports of the Federal Reserve System, 1914–2018, were used for salary data on the Federal Reserve Banks; salary data on the governors came from an FOIA request to the Board of Governors.

Figure 3 does indeed show that the New York Fed's salary growth is higher, and more jagged, than that of the other Reserve Banks. But even when New York is removed from the analysis (as in figure 4), the results are essentially unaffected.



**Figure 4. Salaries at the Federal Reserve System: Chair, Governors, Reserve Banks (excluding New York), against Inflation, 1914–Present**



Sources: Annual Reports of the Federal Reserve System, 1914–2018, were used for salary data on the Federal Reserve Banks; salary data on the governors came from an FOIA request to the Board of Governors, with data from 1955 to 1964 extrapolated with a dotted line.

Once New York is excluded, it is clear that inflation adjustments play more of a role for the Reserve Banks—until roughly 2005, after which the Reserve Banks grow at a much higher rate.

The deterioration of salaries within the Federal Reserve System presents a serious problem for Fed independence and Fed accountability. It places barriers in front of public service for the Board that do not exist in the same way for the Reserve Banks. The answer is not to decrease the salaries of the Reserve Bank presidents but to increase the salaries of the members of the Board of Governors.

#### D. Groupthink at the Fed: Insider Status and Length of Tenure

A key issue that has gained more prominence since 2008 has been the extent to which central bankers suffer from “groupthink” or “monoculture,” synonymous terms that refer to ideological, methodological, and intellectual homogeneity.<sup>85</sup> The Fed’s governance structure is meant to mitigate that tendency. The theory is that the president of, say, the Federal Reserve Bank of Kansas City will simply see the world differently from a Fed governor, in part because the Fed governor is expected to be a creature of politics and the Kansas City Fed president is a creature of his or her community.

There are good reasons to expect, however, that the practice does not match the theory. Some have argued that one of the most important distinctions to assess in central bankers is whether they are, in fact, former Fed staffers. Since 1990, almost 70 percent of Federal Reserve Bank presidents were hired directly from within the Fed.<sup>86</sup> Since 1981, that number is roughly the same (although here, I code for any previous Fed experience). That is 25 percentage points higher than the same figure for the Board of Governors, as shown in table 2.

**Table 2. Insider Status at the Federal Reserve System, 1981–2019**

	<b>Percent Insiders</b>	<b>Percent Outsiders</b>
Reserve Bank President	69.1%	30.9%
Governor	44.7%	55.3%

Sources: Publicly available information in historical news accounts. Using data from public sources, I coded each Reserve Bank president and governor as having (or not having) previous work experience at the Fed.

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<sup>85</sup> See Fligstein, Brundage, and Schultz (2017); Riles (2018); Siegel (2019).

<sup>86</sup> Klein and Weiss (2015).

It is of course possible to have diverse views within a single organization, and many of the Reserve Bank presidents with previous Fed experience do not agree with each other. But the difference in experience here points *toward* the Board of Governors, not away from it.

The track record on other kinds of diversity also suggests that the process for selecting Federal Reserve Bank presidents is deeply broken. The Federal Reserve Banks broke the white-black color line almost 10 years after the United States elected Barack Obama as the first African American president, when Raphael Bostic became the first African American president of a Federal Reserve Bank (Bostic was appointed president of the Atlanta Fed in 2017). That is 50 years after the same line was broken at the Board of Governors, when Andrew Brimmer became the first African American on the Fed’s Board of Governors. While there have been improvements in recent years, and while the Board is no exemplar of race and gender diversity, the Reserve Banks lag behind.<sup>87</sup>

Finally, the Reserve Bank presidents and Fed governors differ in another important respect: how long they stay in their position. Table 3 breaks down tenure by Reserve Bank president and governor and by quartile. Figure 5 does the same, graphically.

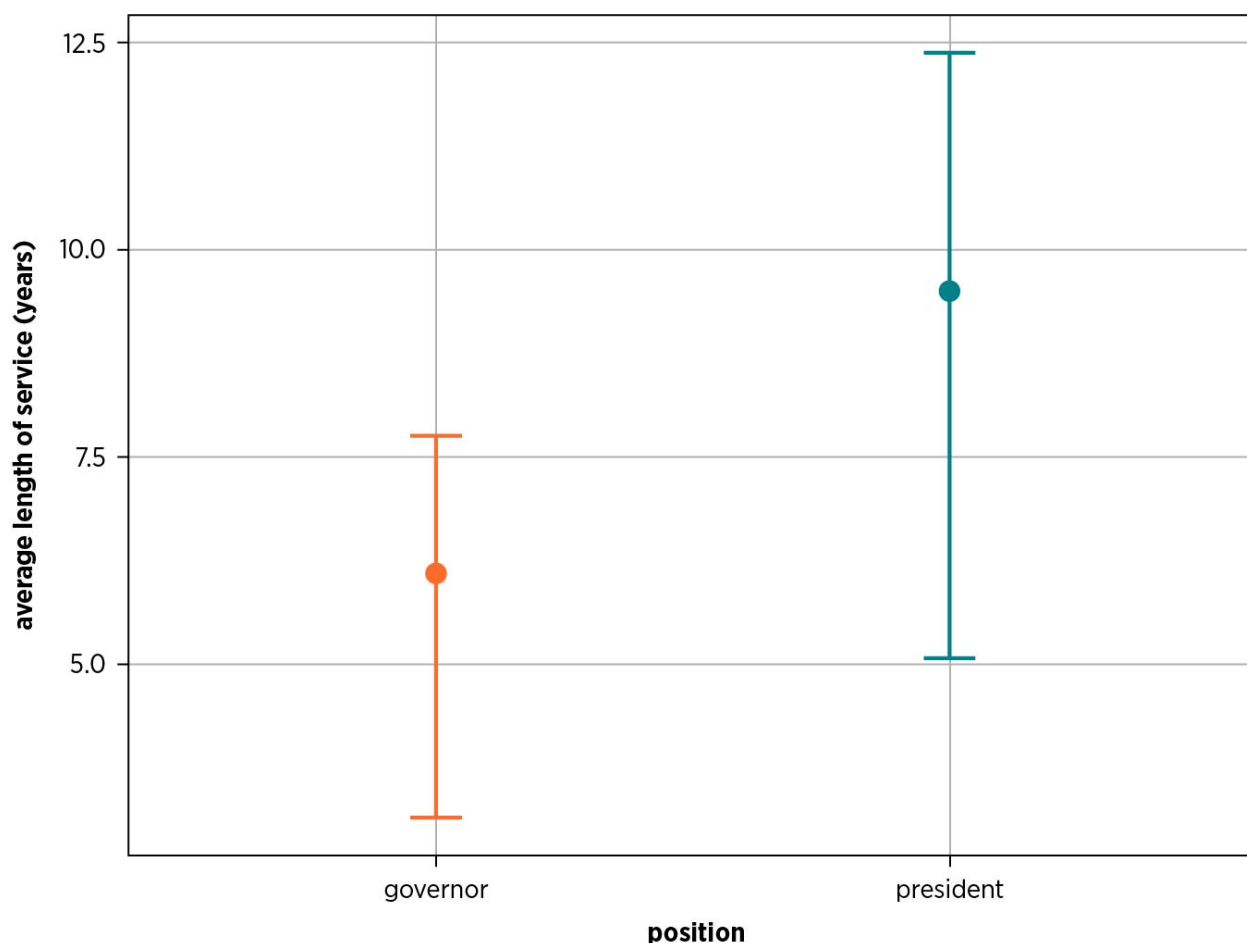
**Table 3. Length of Tenure (Years) of Reserve Bank Presidents and Governors, by Quartile (1981–Present)**

<b>Length of Tenure (Years)</b>			
	<b>First Quartile</b>	<b>Median</b>	<b>Third Quartile</b>
<b>Reserve Bank President</b>	5.07	10	12.37
<b>Governor</b>	3.14	5.18	7.75

Source: Publicly available historical news accounts.

<sup>87</sup> See Klein (2016).

**Figure 5. Length of Tenure (Years) of Reserve Bank Presidents and Governors, by Quartile (1981–Present)**



Source: Publicly available historical news accounts.

The differences again are remarkable, made more so because the terms for governors are in fact 14 years, whereas the terms for Reserve Bank presidents are five years, each set by statute (although a full 14-year term is not renewable for governors; the five-year terms for presidents can be renewed until a retirement age).

On the one hand, these data suggest that governors should not resign their posts with such frequency, a phenomenon that has increased in recent years. Longer tenure might make for better

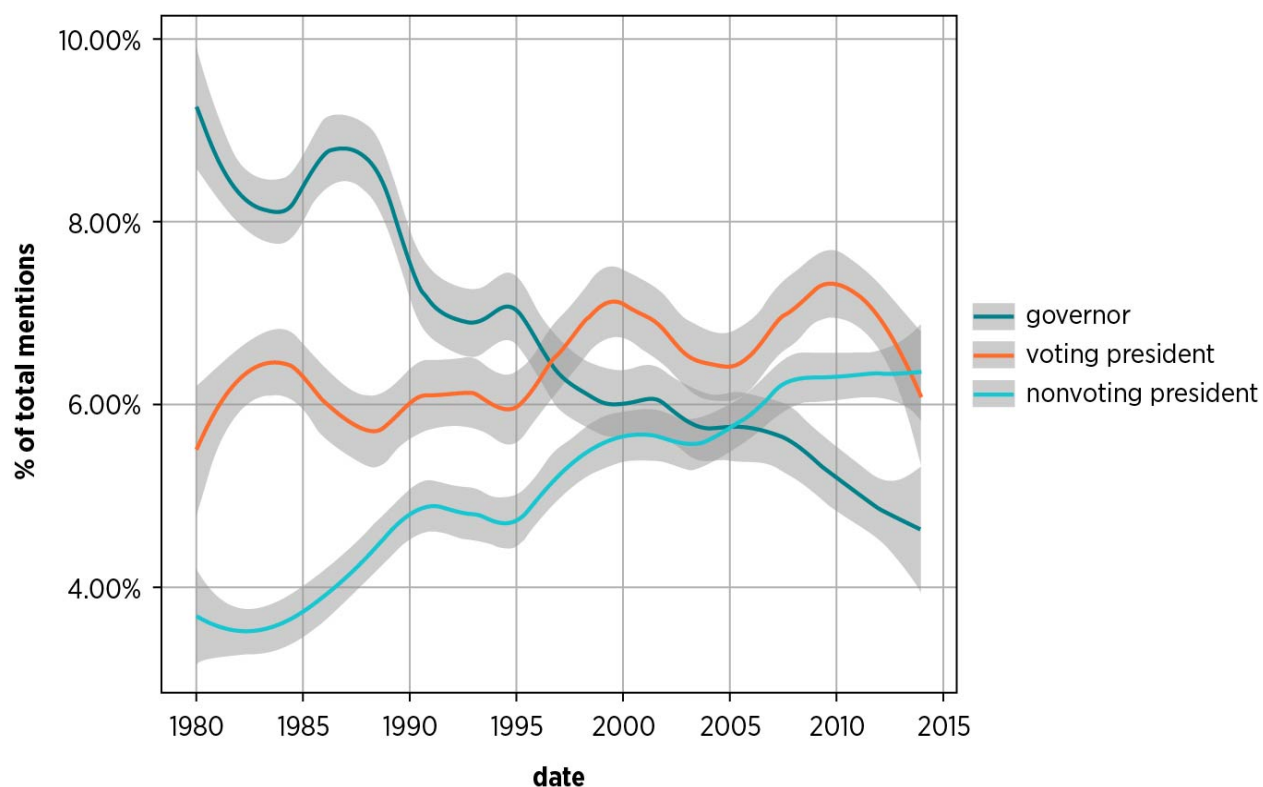
policy as policymakers learn their roles better. But the data could also suggest a lack of intellectual innovation as Reserve Bank presidents stay for longer and longer. Perhaps here, the willingness to stay planted at the Reserve Banks should be the sign of intellectual stagnation and the turnover at the Fed Board of Governors the sign of appropriate intellectual flexibility.

#### E. FOMC Participation

Many of these comparisons between Reserve Bank presidents and Fed governors depend on reducing their roles to an apples-to-apples comparison. That is, governors and Reserve Bank presidents do not have identical jobs. Governors spend more time on financial regulation; Reserve Bank presidents are the chief executive officers of a large enterprise. These differences may suggest some justification for different treatment, though not in obvious ways.

But as members of the FOMC, they do indeed serve a similar—even identical—function: to determine the nation’s monetary policy. The key mechanism for doing so is the meetings of the FOMC. Given traditions of consensus, even unanimity, these meetings are arguably more important than a simple vote. Thus, participation in FOMC meetings (see figure 6) is perhaps a useful proxy for prominence in that role.

**Figure 6. FOMC Meeting Participation by Voting Status, 1980–2013**



*Source: Transcripts of the Federal Open Market Committee.*

The x-axis in figure 6 represents time, from 1980 to 2013 (the dates for which the FOMC transcripts are available). The y-axis is taken from the average number of times each individual FOMC participant excluding chairs is mentioned by category (governor, voting president, nonvoting president), divided by the number of overall mentions per meeting, giving a participation percentage for each meeting. The graph shows trend lines with 95 percent confidence intervals.

The trend lines are unmistakable: governors participate far less, nonvoting Reserve Bank presidents far more. The reason may be driven by personalities. In the early 2000–2010 period, several Reserve Bank presidents—Jeffrey Lacker (Richmond) and Richard Fisher (Dallas)

among them—did not regard their voting status as a barrier to stout meeting participation.

Regardless, if the FOMC meeting is the forum for determining the appropriate contours of the Fed’s monetary policymaking space, and if participation is the mechanism for defining those contours, then there is no question that nonvoting Reserve Bank presidents occupy a prominent—and increasingly dominant—role in that process.

#### F. Conclusion

This part surveyed data on key aspects of the deterioration of the status and power of the Fed’s Board of Governors by looking at vacancies, diversity, salaries, and FOMC participation. Despite congressional intent to give the governors preeminent status within the system, practice has nudged the institution in a different direction.

### IV. III. Reform Proposals

What, then, can be done to restore the congressional vision of the Fed’s governance? I discuss here three kinds of reforms: cultural (especially with respect to vacancies), regulatory (especially with respect to how FOMC meetings are run and how the Board participates in Reserve Bank presidential appointments), and legislative (focusing on increasing Fed governors’ salaries and changing the structure of their appointments by shortening their terms to—counterintuitively—) extend them).

#### A. Culture

The problem of Board vacancies is a grave one and is in part indicative of broader trends in financial regulation and the administrative state generally.<sup>88</sup> But there are good arguments that

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<sup>88</sup> For more on vacancies among financial regulators, see Schardin and Sheth (2017). For vacancies in the administrative state generally, see O’Connell (2009) and (2017).

the Fed's vacancies are uniquely urgent and that the Senate and president already have the underlying culture of respect for the Fed that will allow for easy remedies to this crisis.

The problem is uniquely important to the Fed because the majority position of the Board of Governors at the FOMC is vital to its democratic legitimacy. The Reserve Banks were not removed from the monetary policymaking process in 1935, but they were placed in a minority-voting position. In most cases, the FOMC reaches decisions by broad—almost unanimous—consensus. But putting the nation's most important economic policies in the hands of individuals selected in secret does not enhance the Fed's legitimacy. Other agencies of government—in finance and beyond—do not have this same public-private mix and therefore do not necessarily need the same urgent attention to fixing it.

As explained in part II, the problem of Fed vacancies is a function of the president not giving sufficient attention to the matter and of a relatively recent spate of bad blood in the Senate. The two presidents most responsible for the vacancy crisis—Barack Obama and Donald Trump—did not (or, in Trump's case, do not) make these vacancies a priority. That should change, even if the Fed can function without those vacancies being filled. The burden for resolving those vacancies begins with the president and his advisers.

As seen in the earlier discussion of Moore and Cain as potential nominees, President Trump has shown more enthusiasm lately for filling Fed vacancies in 2019 than he did in 2017 or 2018. The failure to offer names that could clear thresholds of basic qualifications should not deter President Trump's advisers from continuing that process. The number of qualified Republicans whose views on monetary policy are sympathetic to the administration and who have not alienated the president through earlier antagonisms is not large, but it is certainly larger than two.



The real cultural change can and should occur in the Senate. It is not a stretch to view Senators Chris Dodd and Harry Reid as being partly responsible for the culture of delay-until-election in 2007 and 2008. The Republicans have amply responded in kind, leading eventually to the Democrats putting an unnecessary hold on Randal Quarles's appointment when Quarles was in fact already serving on the Fed's Board of Governors.

It is time for a senatorial truce. And the Republicans have already offered the first olive branch by rejecting as unqualified—even before nomination—Stephen Moore and Herman Cain. It is plausible to argue that some Republicans rejected the candidates for reasons that had little to do with their lack of experience in monetary policy,<sup>89</sup> but other Republicans explicitly noted the need to preserve nonpartisanship at the Fed in reaching their conclusions.<sup>90</sup>

Democrats should respond in kind. If President Trump nominates qualified candidates who treat the process of Senate confirmation with appropriate respect, Democrats should move quickly to confirm them. The Republicans have done precisely this in confirming Quarles, Bowman, Clarida, and Powell. They should have done better with the president's nomination of independent Nellie Liang. And Democrats should support—and largely have supported—them in this effort.

When a future election places the White House, the Senate, or both in the hands of Democrats again, both parties should continue the new peace of 2019. Unqualified candidates of either party should be rejected. Candidates who refuse to engage seriously with their past relevant expertise before the Senate Banking Committee should also be rejected. Otherwise, commitments to the quality of the Board of Governors should mean that both parties support the process to ensure that the governors can fully staff their obligations in supervising the Fed.

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<sup>89</sup> Timiraos (2019).

<sup>90</sup> Everett (2019).

The public also has a role to play here. The politics of Fed governance are not often greeted with enthusiasm. When President Obama leaked that he was considering both Larry Summers and Janet Yellen as potential Fed chairs in the summer of 2013, a media frenzy unfolded that some decried as akin to a political campaign. George Will, the conservative *Washington Post* columnist, wrote that “the *campaigning* by several *constituencies* for and against what supposedly were the two leading *candidates*—Larry Summers and Janet Yellen—to replace Bernanke as chairman of the Federal Reserve” meant that the Fed “can no longer be considered separated from politics.”<sup>91</sup> Similarly, four years later, President Trump sponsored a process to choose the Fed chair that some decried as “a reality show” process, with deeply reported vacillations between and among very different candidates.<sup>92</sup> The critique was lodged yet again when Cain’s and Moore’s potential candidacies were vetted.<sup>93</sup>

Rather than being a defect of Fed governance, this kind of media attention was a signal contribution to US discourse on central banking and why those outside the insular world of central banking should care a great deal about these events. Of course, some people fixated on issues outside the immediate purview of the Fed—Larry Summers’s controversial tenure at Harvard, Janet Yellen’s height, or Stephen Moore’s Christmas cards, for example. This is inevitable. The public reads analyses of the most important and controversial issues facing central banks and central bankers at each juncture. The increased public attention on these appointments is a boon for Fed accountability, not an affront to its independence.

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<sup>91</sup> Will (2013).

<sup>92</sup> Da Costa (2017).

<sup>93</sup> Moore (2019).

## B. Regulation

Cultural change is hard to predict and impossible to manage. Fortunately, there are other changes that the Fed can direct more explicitly to improve some of the erosion to the status of the Fed's governors.

### *1. FOMC Participation*

The first opportunity for improvement is with the FOMC itself. As Adam Posen, a former member of the Bank of England's Monetary Policy Committee, has argued, the FOMC is just too big to be effective as a deliberative body.<sup>94</sup> This problem is especially acute given how much the nonvoting members of the FOMC are active participants in these debates. They should not be. They are not formal members of that committee when they lose their vote.

Under the Federal Reserve Act, the FOMC controls its own regulations.<sup>95</sup> The members of the FOMC—particularly when the Board has a majority—should consider changing those regulations such that nonvoting members of the FOMC are invited to attend only when making a specific presentation to that committee. Alternatively, the FOMC should—by regulation or norm—discourage active and spontaneous participation of alternate members of the FOMC. This will permit the governors to return to their past status as active participants in these meetings, a status that, as demonstrated in figure 4, has atrophied over the past many years.

Some might argue that such changes would undermine the public-private partnership of the FOMC by deemphasizing those Federal Reserve Bank presidents who rotate off the FOMC. But such an argument would badly misunderstand what Congress did when taking the FOMC away from the Reserve Banks in the first place, in 1935. The entire point of the committee is to

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<sup>94</sup> Beckworth (2018). Paul Tucker, former deputy governor of the Bank of England, agreed with Posen. See Beckworth (2019).

<sup>95</sup> 12 U.S.C. § 263(a).

give the publicly accountable Fed governors a majority on that body. With so much participation in those meetings, even a fully staffed Board will pale in numbers compared with the 12-person-strong Reserve Bank presidents. And given the vacancy crisis at the Board, and with very little break in continuity at the Reserve Banks, the gap only grows.

## 2. *Reserve Bank Presidential Appointment Process*

Former Fed staffer Andrew Levin has argued that the process of Reserve Bank selection “should be reformed so that each board of directors takes nominations from the public, publishes a list of all eligible nominees, and then engages in a selection process that involves genuine public participation through hearings and other forms of input and feedback.”<sup>96</sup> I agree. The changes that the Fed should pursue in reforming the presidential appointment process at the Reserve Banks need not be substantial legislative changes, although these have also been considered. Rather than fundamentally changing the legislative framework, the Board of Governors—not the FOMC—can offer much more clarity about the presidential appointment process, adding regulatory specificity to statutory ambiguity.

The Board, following criticisms of the opacity of the process that led to three major appointments to the Minneapolis, Philadelphia, and Dallas Reserve Banks, did indeed offer some clarity on this process.<sup>97</sup> This is a positive step for which the Fed should be congratulated. But the clarification still leaves substantial questions unanswered. The Board asserts correctly that the “process for selecting a Federal Reserve Bank president is set forth in the Federal Reserve Act.” This is minimally true, but only insofar as the Class B and Class C directors “appoint” the presidents “subject to the approval” of the Board of Governors. The additional clarity is useful:

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<sup>96</sup> Haedtler, Levin, and Wilson (2016).

<sup>97</sup> Federal Reserve Board (2016).

According to the Board, the Class B and C directors also form a search committee, hire a search firm, and consider candidates “both within and outside the Federal Reserve System” along a range of appropriate qualifications. The Fed governor who is chair of the Federal Reserve Bank Affairs Committee “meets regularly” with the relevant search committee until the search committee proposes finalists. The Board of Governors interviews finalists, the Class B and C directors appoint one of them, and the Board votes on its approval.

According to the Board’s descriptions, the phrases “shall be appointed by” the directors and “subject to the approval of the Board of Governors” mean an iterative process, rather than an appointment with consent. This interpretation may be appropriate, but there are a number of unanswered questions that the Fed should answer, including the following:

1. Do the Class A directors participate informally in this search process? Do they forward names to the committee? Are they briefed on progress?
2. The Board virtually never exercises a formal veto, and indeed, members of the Board almost never vote against an appointment. Does the Board exercise a veto at other parts of the process?

Perhaps more controversially, it is worth disclosing—as often occurs in searches for CEOs, university presidents, and the governors themselves—a short list of candidates under consideration. Some candidates may not welcome the public attention. But given the scrutiny to which Reserve Bank presidents are subject in the course of their work, such publicity-shy candidates are unlikely to be well suited to lead in such a high-profile role. Others might object to the embarrassment of not being selected. This is also not a strong argument for secrecy. Individuals from the private sector—including academia—are likely to benefit from their status as a near central banker. Fed insiders who feel passed over for a deserved promotion may be

misunderstanding the nature of central bank accountability. Despite the track record for promoting Fed insiders for these positions, the Federal Reserve Bank presidencies should not be viewed as “promotions” but as public service, including the privileges and responsibilities that public service demands.

### C. Legislation

Two of the problems discussed in this paper do not lend themselves well to resolution wholly within the Federal Reserve System: the erosion of governors’ salaries and the ways that resignations create awkward vacancies. These matters will require legislative fixes. Unlike other legislative proposals, though, they are relatively surgical, if still likely to be controversial.

#### *1. Salary Protection*

First, the governors’ salaries should be pegged either to inflation or, even better, to a running average of Reserve Bank salaries. Since the salaries of the governors are set by the same statutory process that structures compensation for all senior political appointees, Congress would have to remove the governors from that structure and make the salary trajectory *sui generis*.

Such compensation is appropriate when compared to the United States’ closest ally, the United Kingdom. Members of the UK Parliament earn £79,498, or \$105,000 in USD, compared to \$174,000 for members of the US Congress. The UK prime minister earn £150,00, or \$198,000, compared to \$400,000 for the US president. But the Governor of the Bank of England earns a base salary of \$611,000. The reason is simple: the precise work of central banking commands much larger salaries outside of official roles.

The United States has its own political traditions, of course, and legislative change here may well be a hard political bargain to strike. But if the governors are to have the prestige necessary to do the job Congress has placed before them, salary protection is an important part of that conversation. Incorporating at the very least inflation adjustments for those salaries will go a long way to ensuring that the governors can maintain the status that Congress designed for them.

## 2. *Extending Governors' De Facto Tenure by Reducing Their De Jure Terms*

The 14-year terms for the governors are among the longest in government, short of the lifetime tenure for federal judges and a 15-year term for the Comptroller General of the United States (who leads the Government Accountability Office). The number is not randomly drawn. A 14-year term is meant to insulate the Board from extensive political control from the president. If each governor served the full tenure, a US president would have to face the electorate after appointing just two of the seven governors. Even after two full terms a president would only, under those idealized circumstances, be able to appoint a bare majority of governors. To preserve the gaps, the otherwise nonrenewable 14-year terms would stay fixed such that those governors filling the stub terms of their resigned predecessors could still receive their own full 14-year term.

As I have argued elsewhere, reality has been far different.<sup>98</sup> It is the norm for US presidents to pick their central bankers roughly at a pace of one per year. The vacancy crisis has only exacerbated those tensions. In two years, President Trump has had a full seven vacancies.

A legislative solution would reject as quaint the notion that governors will serve for 14 years. Instead, it would be better for the governors to have shorter terms—say, 10 years or even 6—and to have no restrictions on when those terms begin or end. This would make the

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<sup>98</sup> Conti-Brown (2015a).

terms of service seem much less forbidding, encourage healthy turnover, and eliminate the problem of a sitting central banker beholden to the president for a term renewal that the Federal Reserve Act would otherwise forbid.

The latter point is not merely hypothetical. When Randal Quarles was nominated by President Trump as the vice chair for supervision, he was in fact nominated for three positions: as vice chair for supervision for a renewable four-year term; as governor, to fill an unexpired term that would end just three months later; and as governor for his own 14-year term.<sup>99</sup>

It is difficult to say why President Trump chose this curious structure, but some Democrats used it to render Quarles a lame duck after January 2018 for a period of several months. This meant, essentially, that Quarles served as a central banker at the pleasure of the president. Restructuring the governors' terms of service such that there is no such thing as an unexpired term would remove that harmful potential in the future.<sup>100</sup>

## V. Conclusion

In 2000, Washington chronicler Bob Woodward called the governors "C list" political celebrities who are anonymous politically and socially.<sup>101</sup> The 2008 financial crisis has probably made the job much more enticing, but other factors have limited the governors' ability to do their essential work, whatever the social standing of the position.

This paper has argued—from law, history, and new data—that the congressional vision of the Fed governed by a politically accountable Board of Governors has badly atrophied over the century of its existence (and especially in the past quarter century). This institutional drift does

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<sup>99</sup> Conti-Brown (2017).

<sup>100</sup> Another proposal advanced by House Republicans consistent with empowering the governors would be to give them access to staffing resources independent of the Fed chair. See Financial CHOICE Act, H.R. 10, 115th Cong. (June 12, 2017).

<sup>101</sup> Woodward (2000, 126).



not mean that the Fed is not still an effective central bank. It does mean, however, that it runs a democracy deficit that Congress had hoped to eliminate in the Fed's legislative design.<sup>102</sup>

Congress can reassert this vision itself by, for example, protecting the governors' salaries. But there is much the Fed can do to place the governors in their rightful place as supervisors of the Federal Reserve Banks and of the Fed itself. Whatever benefits come from the remnants of the decentralized, public-private system that Congress in 1913 passed but substantially revisited in 1935 need not be abolished. But the Fed is not powerless to permit more and better public engagement with its key processes through promoting the vital necessity of the Fed's governors. The governors' importance can be reemphasized in ways that will enhance the quality of the Board and the level of public engagement with central banking in ways that are vital for the Fed's continued legitimacy.

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<sup>102</sup> For more on related concepts, see Tucker (2018).

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