



PHOTOS BY BRITT LECKMAN

PRESIDENTS, GOVERNORS & THE FOMC:

Regional Bank leaders provide long-term stability

The Federal Reserve has taken numerous unprecedented steps over the past several months to calm the nation's financial turmoil. Among the most notable was the Federal Open Market Committee's mid-December cut of the fed funds rate to almost zero.

It was an historic move that raised several issues, many related to policy and what steps the Fed might take with no additional rate cuts possible. Aside from policy issues, it also raised important questions about the

FOMC and specifically the role of the regional Federal Reserve Bank presidents, who serve on the committee.

The FOMC issues directives to the Fed's open market desk to engage in trades that move interest rates toward the FOMC's prescribed target. With that target now set effectively at zero for what appears to be an extended period, the FOMC has essentially no further authority to take additional steps. Any additional actions outside of interest rate moves will have to instead be made solely by the Board

of Governors of the Federal Reserve System, political appointees who may or may not rely on the regional Bank presidents as advisors.

In its online blog “Real Time Economics” only days after the rate cut, *The Wall Street Journal* asked “Does Fed Policy Marginalize Regional Bank Presidents?”

Some might logically follow up with another question: “Does it matter?”

Structure, creation of the FOMC

The FOMC, created by the Banking Act of 1935, is designed to reflect the unique structure of the Federal Reserve. The seven members of the Federal Reserve Board of Governors hold voting positions on the FOMC. Meanwhile, each of the regional Federal Reserve Bank presidents attends each FOMC meeting and participates in the deliberations. However, only five Federal Reserve Bank presidents vote. Those slots are filled by the New York Fed president with the other four positions rotating among the presidents of the 11 other Reserve Banks on an established schedule.

Initially, there was not agreement about the structure. In debate about the creation of the FOMC, the initial proposal called for the creation of a committee of three governors and two Reserve Bank presidents. It is perhaps not surprising that the legislation was drafted primarily by Federal Reserve Board staff and done without consultation of the Reserve Banks.

Federal Reserve Chairman Marriner Eccles took things a step farther, testifying before a House committee that he favored an even lesser role for the Reserve Bank presidents. Eccles supported making the Board alone responsible for open market operations with a committee of five Reserve Bank presidents serving only in an advisory role.

The ensuing debate is discussed by Allan Meltzer in his book, “A History of the Federal Reserve Vol. 1.” In it, Meltzer notes the fact that the legislation was essentially authored

by Board staff which “raised concern about the shift in power that the bill proposed. Repeatedly Eccles was asked about the dangers of consolidating power over discount rates, reserve requirements, and open market operations in a single agency, appointed by the president and subject to political control. Congressmen expressed concern about the potential for inflation and the use of monetary expansion by the executive branch to influence elections. And the old issue of regional autonomy remained. Eccles responded that ‘monetary policy is a national matter, and it cannot be dealt with regionally without having such situations as we have had in the past.’”

Critics said that the legislation would effectively end the public-private compromise that had been at the Federal Reserve System’s core since its creation in 1913. After debating the issue with the powerful Sen. Carter Glass in front of Glass’ Senate subcommittee, Eccles finally relented on his contention about the FOMC and agreed to accept an American Bankers Association proposal that would include five Reserve Bank presidents in setting monetary policy. Although the final bill gave the Board of Governors increased power and influence in other areas of the Federal Reserve, among Glass’ key accomplishments was getting the Reserve Bank presidents a role in setting monetary policy.

The significance of that development has only grown over time. While the governors may have wanted to keep monetary policy solely within their realm of authority, the reality has been that the Reserve Bank presidents—and not the governors—have provided institutional stability to the FOMC. The governorships, meanwhile, seem to have become much more vulnerable to change than officials in 1935 would have expected.

The governors

The Board of Governors is considered a government agency. The governors are nominated by the president and confirmed

FOMC who's who?

The Federal Reserve's Federal Open Market Committee (FOMC) is made up of the Board of Governors, who are political appointees, and the 12 presidents of the regional Reserve Banks, who are appointed by their Reserve Bank's board to serve as the Bank's chief executive officer. The FOMC meets eight times a year to set monetary policy. The governors hold voting positions while five presidents vote on a rotating basis with the exception of the New York Reserve Bank president, who always votes. All members participate in deliberations.

Members of the Federal Reserve Board of Governors



Ben Bernanke
Chairman



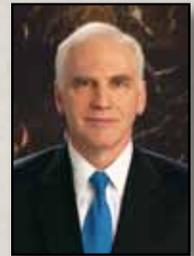
Donald Kohn
Vice Chairman



Kevin Warsh



Elizabeth Duke



Daniel Tarullo

Federal Reserve Bank Presidents



Eric Rosengren
Boston



William Dudley
New York



Charles Plosser
Philadelphia



Sandra Pianalto
Cleveland



Jeffrey Lacker
Richmond



Dennis Lockhart
Atlanta



Charles Evans
Chicago



James Bullard
St. Louis



Gary Stern
Minneapolis



Thomas Hoenig
Kansas City



Richard Fisher
Dallas



Janet Yellen
San Francisco

by the Senate. For the FOMC, the governors are expected to bring the government, or public, component to the Federal Reserve's unique blend of interests. With the expectation that they will have broader interests in accountability, the governors hold a 7-5 voting majority on the FOMC.

Of the five individuals currently serving as Federal Reserve governors, Vice Chairman Donald Kohn has the longest tenure at approximately 6.75 years. He is followed by Chairman Bernanke, with approximately 6.25 years of service spread over two appointments. Kevin Warsh has slightly more than three years of service. Elizabeth Duke was appointed in August, and Daniel Tarullo, who was appointed in January, is the most recent to join the Board.

Two governor positions remain unfilled. As it currently stands, there has not been an FOMC meeting with seven governors participating since March 2005. In the vast majority of meetings since that date, only five governors have taken part.

The regional bank presidents

The presidents of the regional Reserve Banks are the other component of the FOMC. The presidents are selected by the boards of directors at their respective Reserve Banks and confirmed by the Board of Governors of the Federal Reserve System.

Although the presidents were initially considered the "private" component of the FOMC's public-private structure, that description is no longer appropriate. Of the nine local directors who select the president, six are elected by bankers within the respective Federal Reserve District while three directors are appointed by the Board of Governors. There is very much a "public" component to the regional Bank president positions. Reserve Bank presidents participate in numerous public events and they gain significant insight on business and banking conditions through regular contacts with individuals from throughout their respective Districts.

Of the 12 Federal Reserve Bank presidents, nine have held their posts for less than five years, and three of those have been Bank presidents for less than two years. The two longest-serving FOMC members are Kansas City Fed President Tom Hoenig, with more than 17 years of experience, and Minneapolis Fed President Gary Stern, who has held that position for more than 24 years.

Historic perspective

The Federal Reserve governorships were created to provide stability to the nation's central bank in much the way that the justices serve the Supreme Court. Although governors do not have lifetime appointments, their terms are established in a way that is designed to greatly reduce the potential for political influence: Except in rare occasions, they may serve only one term, and, at 14 years, the term is designed to extend through multiple presidents. Ideally, even a two-term president would be able to appoint only four governors.

However, in practice, that has not been the case. At the time President George W. Bush left office, all five of the then-current Federal Reserve governors were his appointees. Two governor seats not filled by Bush were vacant, meaning that Bush could have, assuming Senate approval, appointed all seven positions to the Board of Governors.

That multiple appointments would be made by one president—especially a two-term president—is not at all unexpected or unique in Fed history. Virtually all Fed governors leave office well before the end of their term. The rules restricting the length of time a Federal Reserve governor can serve almost never come into consideration.

Looking at the 15 Fed governors appointed since former Chairman Alan Greenspan's appointment on Aug. 11, 1987, and excluding current governors, the average time spent in office was 5.6 years. Removing Greenspan's 18.5-year tenure from the equation lowers the average to 4.6 years per governor.

These relatively brief tenures in office are not a recent development. The 39 Fed



THE FEDERAL OPEN MARKET COMMITTEE (FOMC) forms monetary policy to promote economic growth, employment, stable prices, and sustainable trade, among other objectives. Meetings are held at the Marriner S. Eccles Federal Reserve Board building, pictured, in Washington, D.C.

governors appointed since 1965 averaged 5.8 years in office. Removing Greenspan's exceptionally long tenure cuts the average number to 5.5 years.

Prior to 1965, Governors generally served much longer in office, although even then a full term was a rarity. The 63 Governors serving between the creation of the FOMC in 1935 through Randall Kroszner's departure in January held office for an average of 7.9 years. The longest tenure as a governor belongs to M.S. Szymczak, who served from June 1933 through May 1961. Also notable is Paul Volcker's four years at the helm of the New York Fed before he became Fed chairman.

Interestingly, Congress has twice extended the term of office for Federal Reserve governors, but the moves had little actual impact on how long the governors stayed in office. Terms were 10 years prior to the Banking Act of 1933, which extended them to 12. The Banking Act of 1935 instituted the current 14-year terms.

Of the 82 individuals who have held appointed positions as members of the Board of Governors since the Fed's beginning in 1914, only nine have served 14 years or more. Interestingly four of those nine had their initial appointment prior to the institution of 14-year terms.

The most recent governor to complete a full term was Greenspan, who finished an unexpired term before serving his own full 14-year term.

The tenures of the Reserve Bank presidents, meanwhile, have consistently been longer than those of the governors. Excluding those who held office on an interim basis and the current Federal Reserve Bank presidents, there have been 22 Federal Reserve Bank presidents serving from the time of Greenspan's 1987 appointment through the most recently retired leader at each Bank. Their average time in office is 11.6 years, or a little more than twice the tenure of the average governor.

The average since '87, however, could arguably be considered to actually be a little longer. Gary Stern, who became president of the Minneapolis Fed in March 1985, was in office when Greenspan became chairman and thus is not included in the tally because he is currently a Bank president. Including Stern, the average rises to 12.1 years. The figure also does not include Tom Hoenic, who has more than 17 years at the helm of the Kansas City Fed. Including both Stern and Hoenic raises the average to 12.3 years. Conversely, since Greenspan's appointment, the former long-time chairman is the only Fed governor who remained in office for more than nine years.

Going back further in Fed history to presidents serving at the time of the FOMC's creation in 1935 through the most recently retired president at each Bank shows that the 83 presidents, excluding interims and those who died in office, served an average of 10.5 years each.

The future

Relatively brief tenures on the FOMC will continue in the years to come.

Under mandatory retirement rules, Minneapolis Fed President Gary Stern will have to leave office before Nov. 3, 2009, and the Minneapolis Fed's Board of Directors will

select a replacement. Even if President Obama filled the current vacancies on the Board of Governors immediately, the 19-member FOMC in December 2009 will include only five members with more than five years of experience.

A breakdown:

- Five members with less than one year of experience including three governors and New York Fed President William Dudley, who is the permanent vice chairman of the FOMC;
- Another nine members with between one and five years of experience;
- Four members with five to eight years of experience;
- One member with 18 years of experience.

On average, they will have less than four years of experience. That is assuming none of the other current governors or presidents quit over the next year. Based on history, that seems unlikely. Taking away Hoenig, they will average a little more than three years of experience.

Looking further ahead to 2011 when Hoenig will face mandatory retirement, the longest-serving FOMC member will be San Francisco Fed President Janet Yellen, with 10 years of experience including her time as a Fed governor. After Yellen would come Cleveland Fed President Sandy Pianalto with just more than eight years of experience, followed by Fed Chairman Ben Bernanke and Vice Chairman Don Kohn with eight years each. Eleven members would still have less than five years of experience. Because of Hoenig's lengthy tenure, the average improves comparatively little over two years' time to 5.1 years of service, again assuming no one retires before that time, which, based on history, seems extremely unlikely.

Under the political influence?

The regional Bank presidents are clearly doing more than contributing their regional perspective to FOMC's policy deliberations. Aside from Greenspan, whose length of service is unlikely to be repeated, it has been the presidents who have brought the institutional stability to the FOMC. With their longer terms of service, they bring experience to the

table. And with the likelihood they will remain in office longer, some might argue they could also bring a greater regard for the long-term consequences of their actions, as they will still be involved in policy deliberations in the future.

The creators of the FOMC, like the framers of the Federal Reserve Act before them, recognized the importance of checks and balances in creating the body responsible for the nation's monetary policy. The primary concern of Sen. Glass, who was a key author of the Federal Reserve Act while a congressman two decades earlier, was the consolidation of power within the government. Monetary policy, Glass and others recognized, could not be solely in the hands of individuals who might be vulnerable to immediate political considerations and not as concerned about the long-term ramifications of their actions.

Although the 14-year terms of governors were designed to provide sufficient insulation, the number of years served by most governors has made them more like conventional political appointees than the Fed's creators ever intended. That does not mean they are politically vulnerable, only that the potential exists.

Media accounts, such as *The Wall Street Journal* blog, suggest that the regional Reserve Bank presidents have been marginalized in the current environment. It may be a few years, until the current crisis is well behind us, before it is clear how much it mattered.



BY TIM TODD, EDITOR

FURTHER RESOURCES

To learn more about the Federal Reserve System's FOMC, and to read minutes from its meetings, visit KansasCityFed.org/TEN.

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.