Strengthening the Fed's Governance and Accountability

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Note: This presentation solely reflects the views of the presenter and should not be interpreted as reflecting the views of any other person or institution.

Three Questions about U.S. Monetary Policymaking

- **Centralization**: Should monetary policy be determined by a "central bank" located in Washington DC, or by a "federal system" with regional members?
- **Hierarchy**: Should monetary policy be determined by a single leader, or by a committee of individually accountable experts whose chair is "first among equals"?
- **Politicization**: Should monetary policymaking be viewed as part of the executive branch, like a cabinet office, or as a constitutional duty of Congress that is delegated to an independent agency?

Design Principles for Independent Agencies

The design of the Interstate Commerce Commission , established in 1887, encapsulated principles that have guided the basic governance of independent agencies:

- **Terms of Office**: An uneven number of commissioners appointed to staggered terms of a fixed period extending beyond the term of the U.S. President.
- **Non-Partisan**: No more than a bare majority of members can be affiliated with the same political party.
- **Insulation from Political Interference**: Members can only be removed by the President "for inefficiency, neglect of duty, or malfeasance."

The Design of the FOMC's Governance

The FOMC was designed to ensure individual accountability as well as an even greater degree of insulation from political interference:

- Federal Reserve Board members appointed to staggered 14-year terms of office, and only removable by the President "for cause".
- Fed Bank presidents appointed by regional boards subject to "approval" by the Federal Reserve Board, and only removable by the Fed Board "for cause".
- FOMC decisions determined by majority vote of 7 Fed Board members and 5 Fed Bank presidents.

The Diminishing Independence of the Regional Fed Presidents

- **Appointment Process**
  - **From 1913-2014, the Fed Board limited its role to giving final approval of the directors' nominee.**
  - **Since 2015, the Fed Board has been directly involved throughout the search & selection process.**
- **Budgets & Staffing**
  - **The Fed Board has 700+ staff working on macroeconomic analysis and monetary policy.**
  - **Each regional Fed Bank has a staff of about 10-12 economists analyzing macro/monetary issues.**

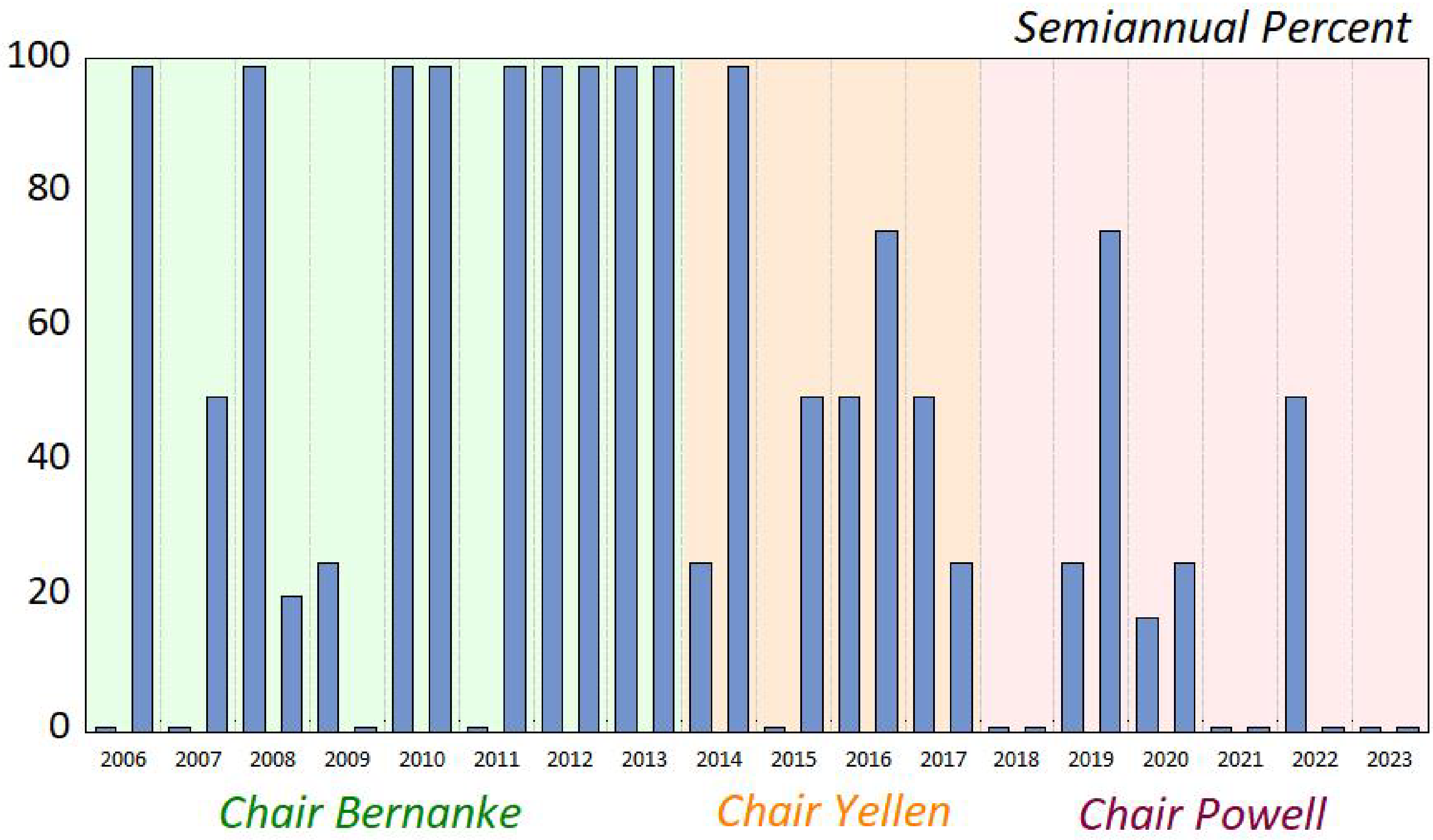
The Diminishing Independence of the Regional Feds *(contd.)*

- **Threat of Removal**
  - Under the Federal Reserve Act, the Fed Board can only remove a Fed Bank president "for cause".
  - However, the White House Office of Legal Counsel (OLC) has concluded that there are no practical limitations on the Fed Board's removal power.
- **The New York Fed**
  - The NY Fed president votes at every FOMC meeting and traditionally provided an independent voice.
  - No NY Fed president has dissented since 1985.

The Diminished Independence of the Regional Fed Presidents

- **Legal Analysis**
  - In 2019, the White House Office of Legal Counsel (OLC) concluded that Fed Bank presidents should be viewed as **"subordinates"** of the Fed Board.
  - No Federal Reserve official has ever commented on that legal analysis or disputed its conclusion.
- **Institutional Culture**
  - In 2021 there were no dissents by any of the 5 Fed Bank presidents who were FOMC voters.
  - Among the current 12 Fed Bank presidents, only one has ever dissented in the past six years *(Loretta Mester, who will be retiring in June)*.

FOMC Dissents by Fed Bank Presidents



Source: Federal Reserve Bank of St. Louis, authors' calculations

The Governance of the Federal Reserve Board

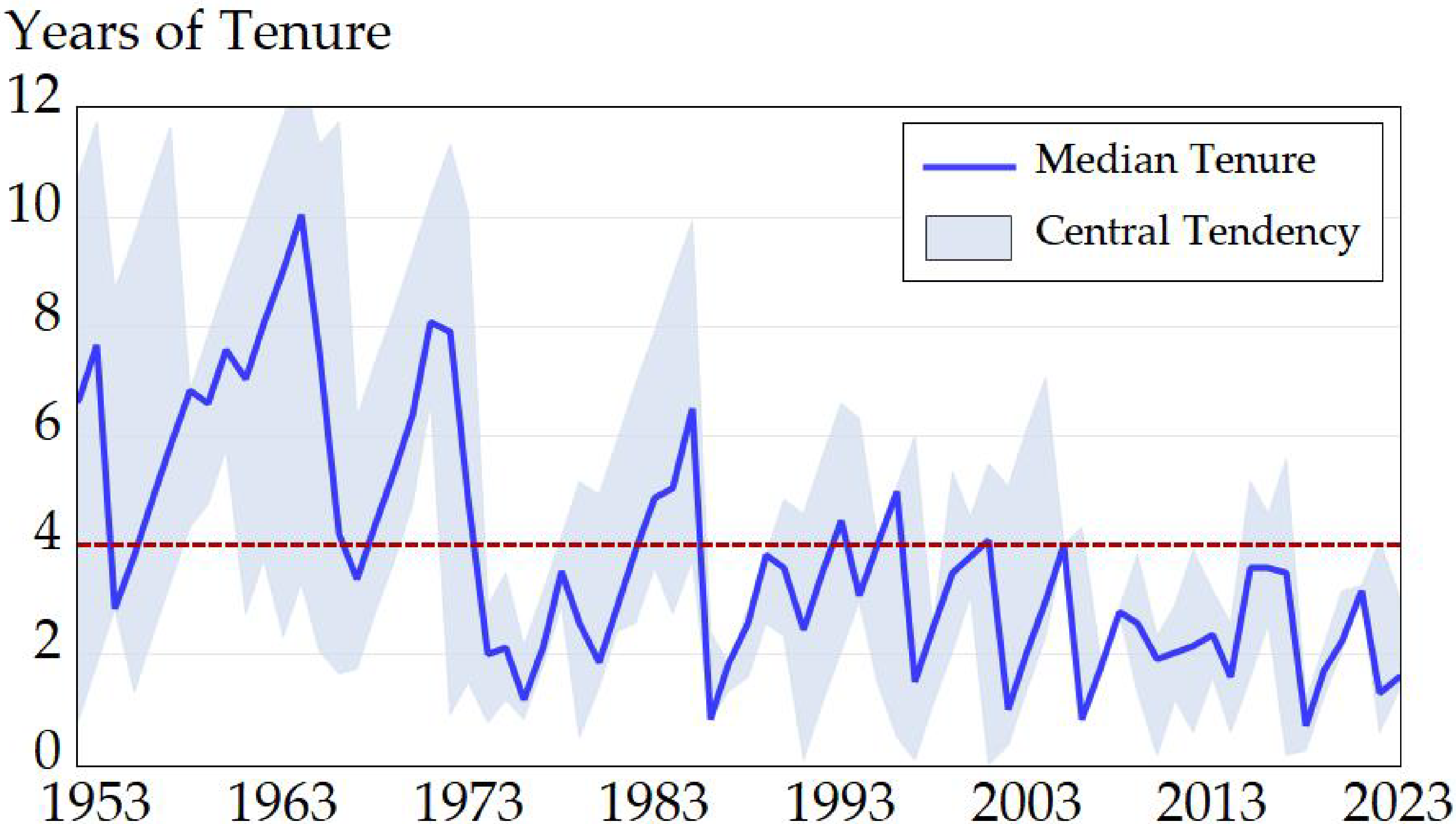
- **Leadership**
  - The Fed Chair **sets the agenda for FOMC meetings**, including specific policy options for deliberation (with "alternative B" as the Chair's preferred policy).
  - Under the Federal Reserve Act, the Chair is the **"active executive officer"** to whom all staff report.
  - That clause may have seemed innocuous in 1933 when the Board's staff was miniscule.
  - At present, however, the Fed Board's huge economics staff produces the Tealbook as the baseline for the FOMC's economic outlook & policy judgments.
  - In effect, the Fed functions like **a corporate board with a dual CEO/chair and non-executive directors**.

The Governance of the Federal Reserve Board *(contd.)*

- **Terms of Office**
  - **The Fed Chair serves renewable 4-year terms and then resigns from the Fed Board if not reappointed.**
  - **The Fed now has two Vice Chairs, each of whom serves for a 4-year term and then resigns.**
  - **Other Fed Board members often stay for just a few years before taking a position elsewhere.**

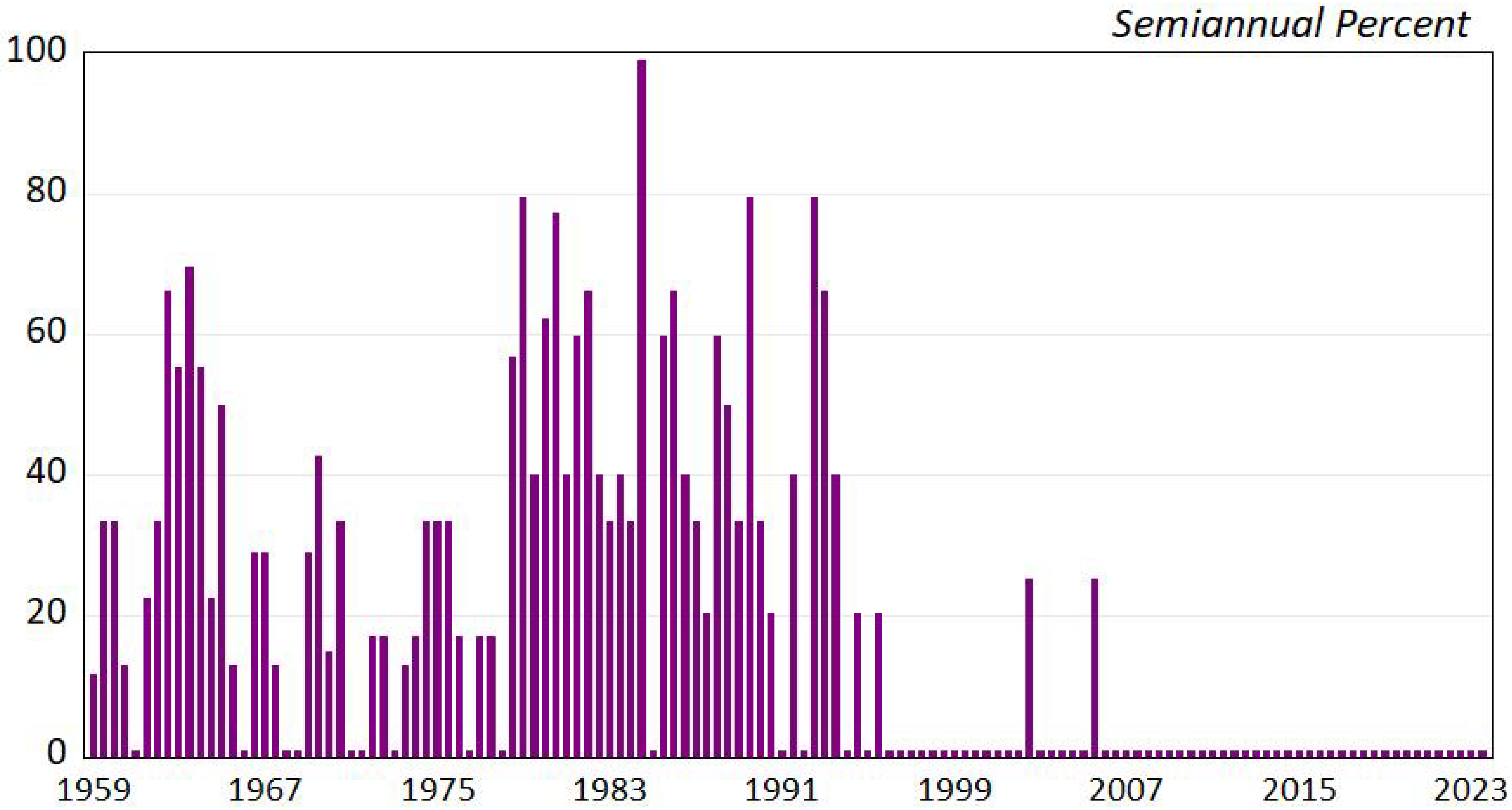
- **Institutional Culture**
  - **Hierarchy: no Fed Board dissents since 2005.**
  - **Politicization: Fed Board composition shifts markedly in conjunction with the presidential election cycle.**

Tenure of Fed Board Members
(excluding Fed Chair)



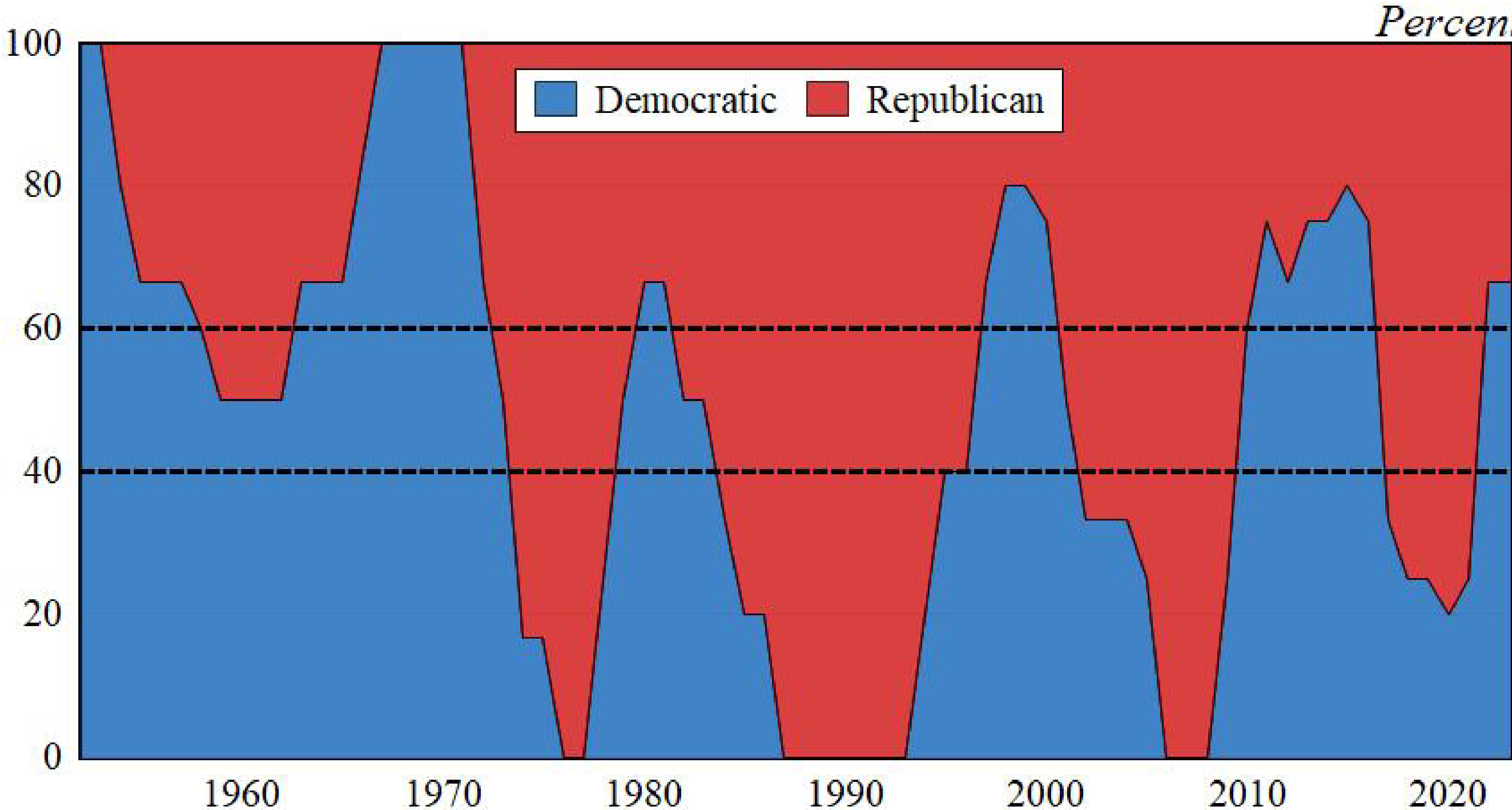
Source: Federal Reserve Board, authors' calculations

FOMC Dissents of Fed Board Members



Source: Federal Reserve Bank of St. Louis, authors' calculations

Political Affiliation of Fed Board Members
(excluding Fed Chair)



Source: Authors' calculations.

Strengthening the Fed's Governance

- **Congressional Watchdogs**
  - The Federal Reserve's IG should become fully independent, with authority to investigate all aspects of the Fed's internal processes.
  - GAO should be authorized to conduct comprehensive reviews of the Fed's monetary policymaking.
- **A New Monetary Commission**
  - Congress should establish an independent commission comprised of distinguished experts.
  - This commission should review the Fed's monetary policymaking and propose specific measures for strengthening its governance & accountability.