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RESEARCH SUMMARY

Federal Reserve Governance Reform: Increasing Transparency and Reversing the Democracy Deficit

The Federal Reserve System (Fed) was established more than a century ago to govern the nation's monetary policy and financial system. Because it was last reformed during the Great Depression, there is debate over whether the institution is up to the task in the modern era. According to a new study by Peter Conti-Brown, it isn't—but it could be.

In "Restoring the Promise of Federal Reserve Governance," the author considers how the history of the Fed led to its current challenges. He also explains how bipartisan efforts can reshape the Fed into the system it was designed to be.

TODAY'S FED IS NOT WHAT CONGRESS DESIGNED

In 1913 Congress formed a federalist central banking system. Comprising 12 Reserve Banks in the states, it struck a compromise between centralized and decentralized authority and between public and private control. Reforms in 1935 broke the Fed into two governing committees:

- The seven-member Board of Governors, appointed by the US president and confirmed by the Senate
- The Federal Open Market Committee (FOMC), led by the seven governors and (on a rotating basis) five of the twelve Reserve Bank presidents

The Board of Governors was designed to be the people's voice and to provide a balance against the private bankers principally governing the Fed. The 12 Reserve Bank presidents were intended to bring geographical diversity and prevent the Fed from becoming too centralized.

Over time, these roles have become distorted. Sixty-nine percent of Reserve Bank presidents are former Fed employees, eroding the state-based interests they were intended to represent. Moreover, the 1980s and 1990s saw the rise of the "imperial Fed chair." During the tenures of prominent Fed chairs, such as Paul Volcker and Alan Greenspan, the Fed moved further from its original vision of broad committee governance.

Emboldened by this cultural shift, nonvoting and politically unaccountable bank presidents have become eager participants in FOMC committee meetings, discouraging participation from the Board of Governors.

THE FED MUST ADDRESS FIVE PROBLEMS TO RETURN TO ITS ORIGINAL INTENT

1) The lack of transparency surrounding the selection and oversight of Reserve Bank presidents
2) Increased vacancies on the Board of Governors and a lack of public and presidential will to fill them

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3) Growing disparity between the salaries of Reserve Bank presidents and those of governors, which makes it harder to attract and retain qualified individuals to serve as governors

4) A majority of bank presidents being hired from within the Federal Reserve, which limits diversity in perspective and experience

5) Governor nonparticipation in FOMC meetings

RECOMMENDATIONS FOR REFORM

- Increase salaries for Fed governors to keep up with inflation and to be commensurate with the high status that Congress initially designed for them
- Decrease governor term lengths to make accepting the position less imposing and decrease Board vacancies
- Make it a presidential priority to fill Board vacancies and work cooperatively with Congress to swiftly approve nonpartisan appointees

KEY TAKEAWAY

The Fed's politically accountable Board of Governors was intended as its primary overseer—not Reserve Bank presidents or an all-powerful Fed chair. Congress and the president can restore the Board of Governors to its proper role by more quickly filling Board vacancies, increasing members' salaries, and shortening their terms.