Making the Federal Reserve Fully Public: Why and How

Jordan Haedtler, Andrew Levin, and Valerie Wilson*

August 2016

Abstract: The Federal Reserve's governance structure is outdated and inadequate for ensuring that the Fed serves the public interest. In this paper, we examine the case for making the Fed fully public ("why"), and then we consider specific proposals for doing so ("how"). Our analysis indicates that pragmatic and nonpartisan reforms can strengthen the Federal Reserve's governance while enhancing its operational independence to pursue its statutory mandate without political interference. In particular, the Fed should be a fully public institution whose decision-makers are selected by open and transparent processes; indeed, we find that making the Fed fully public also yields significant benefits for American taxpayers. Moreover, the Fed should be held to the same standards of transparency and accountability as every other public agency, including comprehensive annual reviews by the Government Accountability Office (GAO) and applicability of the Freedom of Information Act (FOIA) to all aspects of the Fed's procedures and operations.

---

* Haedtler is the campaign manager of the Fed Up Coalition, Levin is a professor of economics at Dartmouth College, and Wilson is director of the Economic Policy Institute's Program on Race, Ethnicity, and the Economy. We appreciate very helpful comments, suggestions, and background research from Maggie Corser, Ady Barkan, Dean Baker, Josh Bivens, Jared Bernstein, and Bill Spriggs.

I. Introduction

When the Federal Reserve System was founded in 1913, its fundamental purpose was to serve as the "*bank to the bankers"*—that is, a secure depository for bank reserves and a source of funds during liquidity shortages. Thus, like nearly every other central bank of that era, the twelve regional Federal Reserve Banks were established as essentially private institutions, owned and managed by commercial banks under the broad oversight of the Federal Reserve Board (which is an independent federal agency).

Over the past century, however, the Federal Reserve has evolved into *America's central bank,* and its monetary policy decisions now affect the everyday lives of practically every American family. For example, when the Fed acts to adjust the level of short-term interest rates, that adjustment is reflected in a wide array of interest rates and asset prices, including auto loan rates, home mortgage rates, savings deposit rates, business financing costs, and so forth. And those financial effects reverberate on the broader economy, affecting consumer spending, business hiring and investment, and the determination of wages and prices.

Unfortunately, the Federal Reserve's governance structure is outdated and inadequate for ensuring that the Fed serves the public interest. The presidents of the Federal Reserve Banks sit on the Federal Open Market Committee (FOMC), which determines the course of monetary policy, but the Federal Reserve Banks are private institutions owned by commercial banks. Indeed, commercial banks select two-thirds of the directors of each Federal Reserve Bank, including half of the directors responsible for appointing its president. Moreover, while the demographics of America have grown increasingly diverse over time, the leadership of the Federal Reserve Banks (that is, the presidents and the directors) has remained overwhelmingly white, male, and insular—dominated almost exclusively by long-time Fed insiders and individuals with a financial background.

Moreover, the Fed's private ownership is now out of step with practically every other major central bank around the world. For example, the Bank of Canada and the Bank of England became public in 1938 and 1946, respectively, while the European Central Bank has been a public institution since its inception in the 1990s. Nearly all of the 19 national central banks in the eurozone are fully public; the lone exceptions are Belgium, Greece, and Italy. And the Bank of Japan and the Swiss National Bank each have miniscule amounts of outstanding shares, the majority of which are held by other public institutions.[1]

In this paper, we examine the case for making the Fed fully public ("why"), and then we consider specific proposals for doing so ("how"). Our analysis indicates that pragmatic and nonpartisan reforms can strengthen the Federal Reserve's governance while enhancing its operational independence to pursue its statutory mandate without political interference. In particular, the Fed should be a fully public institution whose decision-makers are selected by open and transparent processes; indeed, we find that making the Fed fully public also generates significant benefits for American taxpayers. Moreover, the Fed should be held to the same standards of transparency and accountability as every other public agency, including comprehensive annual reviews by the Government Accountability Office (GAO) and applicability of the Freedom of Information Act (FOIA) to all aspects of its procedures and operations.

[1] The paid-in capital of the Bank of Japan (BOJ) is fixed at a miniscule amount of 100 million yen (roughly $1 million) that accrues a tiny stream of dividends (about $50,000 per year). Moreover, the Japanese government owns 55 percent of the BOJ's paid-in capital, and its other shareholders do not have any role in the BOJ's oversight or management. The paid-in capital of the Swiss National Bank is fixed at 25 million CHF (about $25 million), of which roughly two-thirds is held by public institutions.

II. The Rationale for Fed Reform

A. Deficient Selection Procedures

As noted above, the FOMC sets the nation's monetary policy. Under the Federal Reserve Act, the FOMC has a nuanced structure in which the seven members of the Fed's Board of Governors and the president of the Federal Reserve Bank of New York are all permanent voting members, while four of the other eleven presidents serve as voting members on a rotating basis. That design was intended to ensure that the Federal Reserve Bank presidents—as heads of private institutions—would only constitute a minority of the voting members of the FOMC. In recent years, however, the Fed's Board of Governors has regularly experienced multiple vacancies, reflecting a more extensive timeframe for vetting potential nominees as well as a more protracted duration of the Senate confirmation process. Thus, the members of the Board of Governors have constituted a voting majority at only half of the FOMC meetings from 2001 to 2008 and less than one-third of the FOMC meetings since then.[2] In effect, increased political gridlock has expanded the influence of the Federal Reserve Bank presidents in setting the nation's monetary policy.[3]

Despite the crucial role of Reserve Bank presidents in determining the nation's monetary policy, the process for selecting them takes place entirely behind closed doors. Recent Reserve Bank presidential appointments have revealed a process that is opaque, inbred, and largely *pro forma*. The Federal Reserve Act establishes the procedure for selecting Reserve Bank presidents. The Federal Reserve Board describes the process as follows: "To conduct the search, the Reserve Bank's board of directors forms a search committee composed of Class B and C directors. That committee hires a search firm to help identify a broad, diverse, highly qualified candidate pool. The committee considers a large nationwide pool of candidates, both within and outside the Federal Reserve System, who meet the position's qualifications."[4]

Beyond these legal guidelines, very little information is publicly available regarding how Reserve Bank presidents are chosen. The public is kept in the dark about the candidates being considered, the timeline for their selection, and the criteria used to assess candidates' qualifications. When the Reserve Bank presidents in Philadelphia, Dallas, and Minneapolis announced their retirements in 2014, the stage was set for a preview of the re-appointment process set to take place in 2016. One by one, the presidential vacancies at all three Reserve Banks were filled by individuals who had previously been affiliated with the same large bank, and the Board of Governors unanimously approved each of those appointments.[5] At the Dallas and Philadelphia Reserve Banks, the individuals chosen had been involved in their own selection.[6]

These, however, are not the only examples of Reserve Bank presidents having an inside track to selection. A 2015 analysis conducted by the Bipartisan Policy Center found that 17 of the 25 Reserve Bank

---

[2] Indeed, there have been three FOMC meetings at which there were only four members of the Board of Governors, and hence they comprised a minority of the voting members of the FOMC.

[3] *http://www.brookings.edu/~/media/research/files/papers/2015/03/02-fed-banks-21st-century/pcb_workingpaper10_june24_final.pdf*.

[4] *https://www.federalreserve.gov/faqs/how-is-a-federal-reserve-bank-president-selected.htm*.

[5] *https://www.thenation.com/article/why-do-former-goldman-sachs-bankers-keep-landing-top-slots-at-the-federal-reserve/*

[6] *http://www.bloomberg.com/news/articles/2015-06-03/not-far-to-look-fed-s-newest-president-searched-found-himself*; *http://bizbeatblog.dallasnews.com/2015/08/dallas-fed-names-harvard-business-professor-as-new-president.html/*

presidents since 1990 "have been immediate past employees or board members of a regional bank." [7] In response to recent concerns members of Congress raised about the re-appointment process for Federal Reserve Bank presidents being an "inside game," leaders at the Fed noted that the Board of Governors conducts "ongoing monitoring" and an annual review of Reserve Bank presidents' performance, and that when the time came to re-appoint or replace presidents, the Board of Governors would "act on the recommendations" of the boards of directors.[8] In 2016, all Reserve Bank presidents were re-appointed to new terms.[9]

The re-appointment process is *pro forma* and insular. Indeed, Federal Reserve Bank presidents do not conceive of their own appointments as having five-year terms; rather, they mostly expect to serve until they retire or are aged out. One example of the process' perfunctory nature is the routine re-appointment of presidents who can't possibly serve the bulk of their term due to mandatory retirements.

To ensure that a wider breadth of candidates—not just those with backgrounds at the Fed and within the financial sector—are considered, the Fed must bring this process out from the shadows.

B. Lack of Diversity

In 1977, Congress amended the Federal Reserve Act to include reforms requiring that Federal Reserve leaders "represent the public, without discrimination on the basis of race, creed, color, sex, or national origin, and with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor and consumers."

Despite these efforts to formally align the institution with current antidiscrimination laws and to expand diversity on Federal Reserve Bank boards of directors, the Federal Reserve remains wholly unrepresentative of the public, in terms of racial, gender, and professional diversity:

- No African American or Latino has ever served as president of any Federal Reserve Bank.
- At present, ten of the twelve Federal Reserve Bank presidents are white men; two are women, and only one is non-white.
- The directors of the Federal Reserve Banks are predominantly white men; specifically, 83 percent are white and nearly three-fourths are men.
- About five years ago, the GAO reported that consumer groups and labor organizations were significantly underrepresented on Federal Reserve Banks' boards of directors.[10] Since then, however, the share of directors from banking and commerce has increased even further.
- Less than 5 percent of all Federal Reserve Bank directors represent organizations governed by community members and employees.

---

[7] http://bipartisanpolicy.org/blog/reform-the-fed-get-rid-of-groupthink/
[8] https://www.c-span.org/video/?c4580569/sen-jack-reed
[9] https://www.federalreserve.gov/newsevents/press/other/20160219a.htm
[10] http://www.gao.gov/products/GAO-12-18

C. Consequences for Decision-Making

Diversity is more than just a symbolic gesture of fairness and inclusion. Empirical analysis clearly shows that diversity, especially within public organizations, enhances the pursuit of policies and practices that meet a broader range of public needs and expectations and even improves organizational performance.[11] This operates through direct as well as indirect channels. When included in decision-making roles, members of underrepresented groups tend to act to ensure that the interests of those who share their group identities are not overlooked. Additionally, their presence in these roles also influences non-minority decision-makers by exposing them to information that may be beyond the scope of their personal experience.

The advice of Federal Reserve Bank directors and the background of Federal Reserve Bank presidents are undoubtedly key factors that contribute to the FOMC's deliberations. The attitudes, perspectives, and life experiences that Federal Reserve Bank presidents and board directors take to the FOMC have an enormous bearing on the Federal Reserve's decisions, which in turn have major implications for public well-being. The outsized voice of the commercial banks in selecting regional Federal Reserve directors significantly affects the capacity of the Federal Reserve Banks to fulfill their responsibility for assessing and characterizing economic conditions in their respective regions. And the resulting lack of diversity of the Federal Reserve Bank presidents—in terms of race, ethnicity, gender, educational background and professional experience—has substantive consequences for comprehensively and accurately assessing the strength of the economy in advance of making monetary policy decisions.

Of course, the Fed is not charged with alleviating the full range of structural factors that lie at the root of racial inequality, and its monetary policy tools would be poorly suited to address those factors. However, monetary policy actions can significantly affect the pace of an economic recovery and hence have effects on employment and wages by shifting the balance of power between workers and employers. These effects tend to be disproportionately large for specific demographic groups because tighter labor markets also make it more costly for employers to discriminate. Thus, it is appropriate for the Fed to consider those effects in setting the course of monetary policy, but the transcripts of FOMC meetings provide little evidence that Fed officials have actually done so.

In particular, African American workers suffer disproportionately from labor market downturns and benefit markedly from economic recoveries. The unemployment rate for blacks typically moves twice as much as the national unemployment rate.[12] And the unemployment rates of black teenagers and young adults—especially those without a college degree—are even more sensitive to shifts in the stance of monetary policy.[13] Nonetheless, even as national unemployment hovered at crisis levels in 2010, the FOMC meeting transcripts reveal that Fed officials never made a single reference to the abysmal labor market conditions of African Americans.[14]

---

[11] J.J. Hindera, Representative bureaucracy: Further evidence of active representation in the EEOC district offices, *Journal of Public Administration Research and Theory* 3(4):415-429, 1993. S.E. Page, *The difference: How the power of diversity creates better groups, firms, schools and societies*, Princeton University Press, 2007. S.C. Selden, *The promise of representative democracy: Diversity and responsiveness in a government agency*, M.E. Sharpe, 1997.

[12] *http://www.epi.org/publication/the-impact-of-full-employment-on-african-american-employment-and-wages/*

[13] *http://www.npc.umich.edu/publications/working_papers/paper10/03-10rev2.pdf*

[14] *https://sites.google.com/site/kocherlakota009/home/policy/thoughts-on-policy/1-18-16*. In 2010 the unemployment rate for African Americans exceeded 15 percent—more than 5 percentage points higher than the national unemployment rate.

To see the positive side of these dynamics, it is helpful to revisit the experience of the late 1990s. By 2000, the average annual unemployment rate had fallen to 4 percent—its lowest level in generations, and the deviation between unemployment rates for blacks vs. whites was only 4.1 percent—notably smaller than in the 1980s or the 2000s. In addition to these substantial employment gains, the real wages of black workers grew by 2 percent per year during the late 1990s—a tad faster than the wage growth of 1.7 percent per year for whites *[Figure D from Full Employment tables & figures.xlw]*. These employment and wage gains translated into improved living standards for African American households. The share of African American households in the middle 60 percent of the income distribution rose 3 percentage points between 1995 and 2000, whereas that share declined during the recoveries of the 1980s and the 2000s.

It is important to note that these desirable outcomes stemmed from a full employment economy *without* any acceleration in the rate of inflation, suggesting that policymakers should be willing to experiment aggressively with low rates of unemployment for the sake of improving conditions in some of America's hardest-hit communities without undue concern about keeping inflation rates in check. Such considerations may be more likely to occur among a group of policymakers who are familiar with the wide range of economic outcomes in an increasingly diverse and unequal society.

The Fed's lack of sectoral diversity is also a problem. When major corporate figures from a variety of industries are included on the Reserve Banks' boards, the Fed considers its requirement to represent an array of economic interests fulfilled. But multi-millionaire CEOs have an inherently different understanding and perspective than small business owners, debtors, students, middle- and low-income workers, and those seeking credit.[15] In practice, that lack of diversity has frequently skewed concerns within the Fed toward inflation and downplayed the importance of achieving full employment. Indeed, Baker and Bernstein (2013) analyzed the deviation of unemployment from its full-employment level and found that the cumulative gap from 1980 to 2012 was about 31 percentage points.

Finally, the Fed's current governance structure contributes to a "group-think" approach that may explain why policymakers failed to recognize key warning signals prior to the onset of the financial crisis. Indeed, Greider (2014) notes that "...reliance on a narrow frame of reference produces institutional blind spots and gross errors…The telling evidence lies in what the Fed does not talk about. If you scan the public record over the last generation, you might conclude that the policy-makers were unaware of the grave disorders that were steadily accumulating. Or that they believed the economic pressures assaulting citizens were not relevant to monetary policy. Whatever the explanation, the Fed missed the big story—the steady economic deterioration stalking the middle class—just as it did not see the reckless behavior in banking that would lead to collapse."

[15] *http://www.bizjournals.com/twincities/news/2015/08/19/general-mills-ceo-ken-powell-pay-layoffs.html*

III. Strengthening the Fed's Governance

Legislative action will be required to make the Federal Reserve into a fully public institution. Of course, amending the Federal Reserve Act is a delicate matter, and it is crucial to ensure that such legislation strengthens the Fed's governance and enhances its operational independence to carry out its statutory mandate. In this section, we provide a detailed analysis of the governance reforms proposed by Levin (2016), and then we compare this approach to the proposals of Conti-Brown (2015) and Fisher (2016).

A. Ownership

Current Law. Each regional Federal Reserve Bank is a private institution that is legally owned by commercial banks—referred to as *member banks*—whose headquarters are located within its district.[16] Indeed, the Federal Reserve itself refers to the member banks as "stockholders" who purchase shares of equity and thereby supply the Fed with paid-in capital.[17] Those shares cannot be transferred or sold; i.e., each Federal Reserve Bank is in essence a privately-held corporation.

The equity issued by each Federal Reserve Bank—and hence the amount of its paid-in capital—is determined by the equity of its member banks. Specifically, each member bank is required to provide paid-in capital to the Fed that is equal to three percent of its own equity (that is, its capital plus surplus).[18] If a member bank's equity increases, then it must purchase a corresponding amount of additional shares from its Federal Reserve Bank. Conversely, if a member bank is liquidated or its equity shrinks, then the Federal Reserve Bank cancels the corresponding amount of shares and refunds that amount back to the member bank.

As with many privately-held corporations, each Federal Reserve Bank pays dividends to its shareholders. Under current law, the dividend rate for the larger member banks (assets exceed $10 billion) is given by the yield on 10-year U.S. Treasury notes, while the smaller member banks (assets less than $10 billion) receive a fixed dividend rate of 6 percent.[19] As of year-end 2015, the Fed's paid-in capital totaled $29.5 billion, of which $27.4 billion was provided by the larger member banks, and $2.1 billion was provided by the smaller member banks.[20]

Proposed Reform. All of the regional Federal Reserve Banks should become public corporations that are fully owned by the American people. This transformation would be remarkably straightforward, because the Fed can simply follow the procedures that it already uses for making adjustments to the shares of individual member banks. *Each Federal Reserve Bank will cancel all of the shares of its member banks* and refund their paid-in capital along with the prorated amounts of any accrued dividends; those refunds will be issued by crediting each bank's account at the Federal Reserve Bank.

---

[16] All nationally-chartered banks are required to be members of the Federal Reserve System. Such membership is voluntary for state-chartered banks, but in practice only a few small banks decline that option.
[17] *https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160218a1.pdf*
[18] Under current law, the Board of Governors has authority to call on each member bank to provide additional paid-in capital up to a maximum of 6 percent of its own equity; however, that provision has never been used in practice.
[19] These dividend rates became effective on January 1, 2016; prior to that date, all member banks accrued dividends at the fixed rate of 6 percent.
[20] The total amount of paid-in capital is shown in the "Federal Reserve Banks Combined Financial Statements" of the Federal Reserve's annual report (*http://www.federalreserve.gov/publications/annual-report/2015-contents.htm*). The subtotals corresponding to large member banks and smaller member banks, respectively, were obtained from the FDIC database of "Statistics on Depository Institutions" (*https://www5.fdic.gov/sdi/*).

This approach to making the Federal Reserve fully public does not involve any change at all in the current value of U.S. government debt. Moreover, this measure will not have any effect on the size of the Fed's balance sheet but will simply *modify the composition of the Fed's liabilities*. In effect, the Fed will be paying off one form of liability—namely, member banks' paid-in capital—by expanding another type of liability, namely, member banks' reserves held at Federal Reserve Banks.

Indeed, this measure will *augment the Fed's net income*, because the stream of dividend payments is much more costly than paying for the equivalent amount of bank reserves held at the Fed. For example, the dividend rate that the Fed pays to the larger member banks (i.e., the 10-year Treasury yield) is now close to 1.5 percent—roughly a percentage point higher than the rate of interest that the Fed currently pays on bank reserves. Of course, the precise magnitude of this spread varies somewhat over time, but the consensus of professional forecasters is that the spread will remain roughly unchanged over the coming decade.[21] As for the smaller member banks, the interest rate on reserves is currently far below the fixed dividend rate of 6 percent, but that spread is expected to narrow over time as the level of short-term interest rates moves gradually upwards.

Thus, making the Federal Reserve fully public will generate *significant benefits for American taxpayers*, because the Fed generally transfers all of its net income to the U.S. Treasury.[22] For example, at the current level of interest rates, the annualized amount of the Fed's dividend payments is about $540 million.[23] By transforming its paid-in capital into bank reserves, the Fed would instead pay about $150 million in interest. In effect, this transformation would increase the Fed's annual net income by nearly $400 million per year. Even with the level of interest rates rising gradually over time, the benefit to taxpayers will continue to exceed $300 million per year.

Indeed, if we cumulate the annual amounts over the coming decade, *the savings to taxpayers from making the Fed fully public is likely to be well over $3 billion*. As we have already emphasized, the fundamental rationale for making the Fed public is to enhance its governance, accountability, and transparency. Nonetheless, the magnitude of these fiscal benefits is substantial and thereby makes the case for enacting this reform even more compelling.[24]

---

[21] The Federal Reserve Bank of Philadelphia regularly collects professional forecasters' projections of the longer-run average level of interest rates *(https://www.philadelphiafed.org/research-and-data/real-time-center/survey-of-professional-forecasters)*. In the most recent projections (published last February), the median projection was 2.5 percent for the 3-month Treasury bill rate and 3.4 percent for the 10-year Treasury yield; i.e., the spread between those rates is expected to average 0.9 percent over the next decade—just a notch lower than the current spread.

[22] Under current law, the Federal Reserve maintains a surplus capital account that is capped at $10 billion, and any net income exceeding that amount must be remitted to the U.S. Treasury. The Fed's net income has remained positive throughout its history, but if its net income ever turned negative the Fed would draw down its surplus capital and suspend the transfer of funds to the U.S. Treasury.

[23] As noted above, the Fed is currently paying a dividend rate of about 1.5 percent on the $27.2 billion of paid-in capital provided by the larger member banks and a fixed dividend rate of 6 percent on the $2.3 billion in paid-in capital provided by the smaller member banks; consequently, those annual dividends are about $410 million and $140 million, respectively. By transforming all of its paid-in capital into bank reserves, a fully public Fed would instead pay its current interest rate of 0.5 percent on those bank reserves.

[24] Making the Fed fully public may also be viewed positively by commercial banks, because the Fed would refund all of their paid-in capital, which the banks could then invest in the broader economy. Indeed, that is precisely the rationale for H.R. 5027, a bill recently proposed by Rep. Neugebauer that would return most (but not quite all) of the Fed's paid-in capital to the banks.

B. Appointment of Federal Reserve Bank Officials

A key element of making the Fed fully public is that the appointment of Federal Reserve Bank officials—that is, directors and presidents—should occur through an open and transparent process that provides extensive opportunities for public input.

Directors. Each Federal Reserve Bank should continue to be overseen by a board of nine directors who serve staggered three-year terms. Under current law, the member banks select six of those directors—namely, three employees of member banks, and three individuals not employed by any member bank—while the remaining three directors are appointed by the Fed's Board of Governors. In contrast, once the Fed becomes fully public, it would no longer be appropriate for the commercial banks to have any special role in selecting any of the directors. Instead, all of the directors should be selected through a process overseen by the Board of Governors and involving elected officials of each Fed district.

A fundamental reason for the Fed's regional structure is to ensure that the nation's geographical diversity is reflected in the Fed's monetary policy decisions. Thus, every candidate for director should be nominated by at least one senior elected official—either a governor or member of Congress—from the geographical area covered by that particular Federal Reserve Bank. The Board of Governors would appoint a search committee to narrow down the list of candidates as needed, and then the Board of Governors would make the final decision through a recorded vote.

The appointment process should ensure that directors are broadly representative of the public in terms of racial/ethnic and gender diversity, educational background, and professional experience. The majority of directors on each board should be affiliated with small businesses and non-profit organizations, including community and consumer groups, labor unions, and academic institutions. To avoid conflicts of interest and protect the integrity of the Federal Reserve's role in regulating the banking industry, individuals affiliated with financial institutions overseen by the Fed should be prohibited from serving as directors.

To ensure a sufficiently high degree of transparency, the appointment process would include the following elements: (i) publication of the selection criteria and timeline; (ii) public forums at which members of the public can meet with the search committee; (iii) publication of the names of all candidates under consideration; and (iv) opportunities for members of the public to submit questions to the candidates, either electronically or at a public forum.

Presidents. The board of directors of each Federal Reserve Bank should maintain responsibility for appointing and overseeing its president. Under current law, that appointment is made by only six of the directors, namely, the three non-bankers chosen by the member banks and the three individuals appointed by the Board of Governors. In contrast, once the Fed becomes fully public, all nine directors would be responsible for making that decision.

To ensure a high degree of transparency, the process of appointing Federal Reserve Bank presidents should be reformed so that each board of directors takes nominations from the public, publishes a list of all eligible nominees, and engages in a selection process involving genuine public participation through public forums and other forms of input and feedback.

C. Terms of Office

Terms of office play a crucial role in ensuring that a central bank has an appropriate degree of operational independence and accountability. If the term of office is fairly short and subject to renewal, then policymakers may be susceptible to political interference that could impair the central bank's ability to carry out its statutory mandate. Conversely, it would not be appropriate for central bankers to have permanent lifetime appointments, because the central bank is an agency with delegated authority, *not* an autonomous branch of government like the judiciary.

In their comprehensive study of central bank independence and transparency, Eichengreen and Dincer (2014) have noted that the international best practice is for monetary policymakers to be appointed to a *single nonrenewable term that exceeds the length of the political cycle*.[25] Indeed, that standard is already followed by several other major central banks. For example, the president of the European Central Bank and the governor of the Bank of England each serve a single nonrenewable term of 8 years, while the governor of the Bank of Canada has a 7-year term.[26]

By contrast, the current terms of office of Federal Reserve policymakers are not consistent with that standard. The Federal Reserve's Chair is appointed to a renewable term of 4 years, and hence the question of whether a current Fed chair will be reappointed has occasionally arisen as an issue in U.S. presidential campaigns.[27] The members of the Fed's Board of Governors are appointed to staggered 14-year terms, but in practice their tenure has averaged only about 4 years.[28] Finally, as previously noted, the Federal Reserve Bank presidents have renewable 5-year terms, but in practice their reappointments have been *pro forma* and hence they typically hold office for two decades or more.

Thus, making the Fed fully public provides a crucial opportunity to strengthen the Fed's operational independence and accountability. Every Fed policymaker—including the Chair, the Vice Chairs, the other members of the Board of Governors, and the presidents of the Federal Reserve Banks—should have a single non-renewable term of 7 years, and those terms should be evenly staggered over time. Of course, some appointees may not end up serving a full 7-year term due to circumstances that could not be anticipated at the time of their appointment to office. Nonetheless, the vetting process should aim to ensure that every appointee intends to serve the full length of their term.[29] That constraint might be binding for some potential nominees who would otherwise be highly qualified. But fostering the Fed's

---

[25] See criteria 1a, 1d, 5a, and 5e in Table 18 of N. Dincer and B. Eichengreen, "Central Bank Transparency and Independence: Updates and New Measures", *International Journal of Central Banking*, March 2014, pp.189-253 (*http://www.ijcb.org*).

[26] Since 1987 each governor of the Bank of Canada has served a single term of office; that practice has been a matter of convention rather than a statutory requirement.

[27] For example, Chairman Arthur Burns was appointed by President Nixon in 1970 and reappointed by President Ford four years later, but the Fed's policies were questioned in the 1976 presidential campaign, and in 1977 Chairman Burns tried unsuccessfully to persuade the Carter administration to support his reappointment to a third term. *[insert reference here]* Indeed, the issue of the Fed Chair's reappointment has arisen in the current campaign; see *http://www.wsj.com/articles/donald-trump-says-he-would-replace-janet-yellen-supports-low-interest-rates-1462465158*.

[28] Under current law, a member of the Board of Governors may initially be appointed to fill out the remainder of someone else's 14-year term and then reappointed to a full 14-year term; moreover, as noted above, the appointment of the Fed Chair is subject to renewal every four years, subject to the constraint that the Chair must be a member of the Board of Governors. Consequently, a Fed Chair's tenure may also be very long, as in the cases of William Martin (1950-1970) and Alan Greenspan (1987-2006).

[29] For example, academic institutions typically allow tenured faculty to take a leave of absence for up to two years; thus, a number of such individuals have been appointed to the Board of Governors and then resigned within 18 to 24 months in order to return to their academic positions.

operational independence is crucial to its effectiveness, and hence it is essential to ensure that the tenure of Fed policymakers extends beyond the length of the political cycle.

D. Comparison with Alternative Approaches

Proposals to make the Fed fully public have been debated since the 1930s. Generally speaking, such proposals have involved one of two approaches: (1) the Federal Reserve Banks would be converted into branch offices of the Fed's Board of Governors, and their presidents would become employees of the Board of Governors; or (2) the Federal Reserve Banks would become part of the federal government, and their presidents would become federal officials appointed by the President and confirmed by the Senate. For example, Conti-Brown (2015) has advocated the first approach, while Fisher (2016) has proposed a comprehensive reform package that would incorporate the second approach.[30] Under either approach, the board of directors of each Federal Reserve Bank would no longer have any role in its governance and could be transformed into an advisory council or simply disbanded.

Alternative #1: Making the Federal Reserve Bank presidents into employees of the Board of Governors would risk undermining the decentralized structure of the Fed and consolidating too much power in Washington, DC. As employees hired and fired by the Board of Governors, the chiefs of the Federal Reserve Banks could no longer be independent voices representing diverse perspectives and distinctive geographic regions. Indeed, the entire Fed might become even more susceptible to the "group think" problem noted above.

Thus, rather than curtailing or abolishing the Federal Reserve Banks, it would be preferable to strengthen their effectiveness by making them fully public institutions. Involving the senior elected officials of each region in nominating the directors of its Federal Reserve Bank would help ensure that those directors are broadly representative of their entire region—not just its financial and corporate interests. Moreover, opening up the process of appointing the Federal Reserve Bank presidents would dramatically expand the public's ability to engage in that process at a grassroots level, rather than shifting all of those decisions to officials at the Fed's DC headquarters.

Examining the experiences of other central banks around the world, the advantages of public central banks that encourage regional collaboration become clear. In countries where the population is mainly concentrated in a fairly small geographical area (such as Canada, Japan, Sweden, and the United Kingdom), the central bank's policymakers are appointed by the national government while its regional branch offices carry out purely administrative functions. By contrast, the Eurozone encompasses much greater regional diversity, and hence the European Central Bank (ECB) was intentionally designed to have a governance structure similar to that of the Federal Reserve. Thus, monetary policy for the Eurozone is determined by the ECB Governing Council, comprised of its executive board (whose members are appointed by a joint decision of the heads of all Eurozone countries) and the presidents of the 19 national central banks (who are appointed by their respective national governments). Indeed, that regional governance structure has proven crucial in enabling the ECB to face a number of daunting policy challenges over recent years.

---

[30] See *http://yalejreg.com/nc/do-the-banks-own-the-federal-reserve-let-s-finally-make-the-answer-a-resounding-no-by-peter-conti-br/* and *http://shadowfed.org/wp-content/uploads/2016/04/FisherSOMC-April2016.pdf* .

Alternative #2. The presidents of the Federal Reserve Bank could become federal officials appointed by the President and confirmed by the Senate, thereby preserving their independent role in relation to the Fed's Board of Governors. However, shifting the appointment process to the federal level could lead to a greater number of Federal Reserve Bank presidents with political connections in Washington rather than deep and longstanding ties to their own Federal Reserve district. Indeed, the Board of Governors itself is already supposed to be comprised of individuals from diverse regions, but that legal requirement has rarely been considered in practice.[31]

Moreover, expanding the number of Fed officials to be nominated by the President and confirmed by the Senate could be a recipe for a much greater incidence of vacancies among the Federal Reserve Bank presidents, similar to the problem faced by the Fed's Board of Governors in recent years. One way to avoid that particular pitfall would be to slash the number of Federal Reserve Banks, perhaps following a process similar to the approach used in determining military base closures at the end of the Cold War. Alternatively, as in the comprehensive reform package proposed by Fisher (2016), the Fed's Board of Governors could be scaled down to a single Chair while the number of Federal Reserve Banks would shrink from 12 to 8, so that the Fed would have a single decision-making body comprised of nine voting members—all of whom would be federal officials. Such an approach has substantial implications for how the Fed carries out its responsibilities for financial supervision and regulation, and hence a detailed analysis of that proposal would necessarily go well beyond the scope of our paper.

IV. Strengthening the Fed's Transparency and Accountability

Transparency and accountability are fundamental characteristics of every well-governed public agency.[32] Moreover, the international experience clearly demonstrated that enhancing a central bank's transparency and accountability raises the public's confidence in the integrity of the monetary policy process and thereby strengthens public support for its operational independence in carrying out its legal mandate. In this section, we consider three key elements that would significantly improve the Fed's transparency and accountability, aligning its practices with those of other U.S. public agencies and with many other central banks around the globe.

A. Public Access to Information

Over the past half-century, the Freedom of Information Act (FOIA) has required that every federal agency must make its records "promptly available to any person," subject to a few specific exemptions that are intended to protect national security, individual privacy, proprietary business information, and pre-decisional agency deliberations. As a federal agency, the Fed's Board of Governors is subject to FOIA.

By contrast, *the twelve Federal Reserve Banks are private institutions that are not covered by FOIA.* In fact, the Board of Governors has successfully argued in federal court that it is obliged to protect the secrecy of all Federal Reserve Bank records and guard against their disclosure.[33] The legal premise

---

[31] The law states: "In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country." *(http://www.federalreserve.gov/aboutthefed/section%2010.htm)*
[32] For further discussion, see *http://regulationbodyofknowledge.org/regulatory-process/institutional-design/* and *http://www.worldbank.org/en/topic/governance/overview*.
[33] *http://www.courthousenews.com/2015/04/02/jpmorgan-aig-bailout-records-remain-secret.htm*

is that the Board of Governors is the federal agency that oversees the Federal Reserve Banks, and hence its responsibilities are the same as any federal agency that must protect the confidential information of a private institution. The federal court strongly endorsed that argument in its final ruling:

> *"...as the Board points out, the fact that it can require examination of the Federal Reserve Banks is no different than any other financial institution subject to mandatory supervision by a federal regulator. If a financial institution cannot expect confidentiality, it may be less cooperative and forthright in its disclosures, even if an examination is mandatory. There is no reason to believe the Federal Reserve Banks would not react the same way."*
>
> *U.S. District Court for the District of Columbia, Case 13-cv-603-tsc*
> *(Laurence M. Ball vs. Board of Governors of the Federal Reserve System)*

It is deeply troubling that a federal court has accepted the premise that the public release of their records could lead the Federal Reserve Banks to become "less cooperative and forthright" in their interactions with the Board of Governors. Unfortunately, that prospect is a direct consequence of the fact that the Federal Reserve Banks are currently structured as private institutions owned by commercial banks.

That lack of transparency is inappropriate and unacceptable, because the Federal Reserve's fundamental purpose must be to serve the interests of the public. By converting the Federal Reserve Banks into public institutions, the entire Federal Reserve System will be covered by FOIA. Consequently, all of its records will become subject to prompt disclosure (apart from the standard exemptions), regardless of whether those records originated at a Federal Reserve Bank or at the Board of Governors.

B. External Reviews

Regular external reviews are a key element of good management for any institution, public or private. Indeed, such reviews have become standard practice at many central banks as well as global organizations like the International Monetary Fund.[34] For example, the Bank of England has a Court of Directors that has authority to examine all aspects of its activities, and those reviews are conducted by an Independent Evaluation Office that reports directly to the Court of Directors.[35] As noted above, such reviews strengthen the public's confidence in the effectiveness of the central bank and thereby enhance its operational independence from political interference.

U.S. federal agencies are generally subject to two forms of external review. First, each agency has an independent Office of the Inspector General that examines all aspects of the agency's procedures and operations, with the aim of identifying and investigating fraud, waste, and mismanagement. Second, each agency is subject to evaluations by the Government Accountability Office, an independent nonpartisan agency whose fundamental purpose is to help improve the performance and accountability of the federal government.[36]

Office of the Inspector General (OIG). The Fed's Board of Governors has an OIG that reviews its procedures and operations, whereas the Federal Reserve Banks are private institutions that do not have any OIG. Moreover, the Board's OIG cannot conduct any investigation at a Federal Reserve Bank unless

---

[34] *http://blogs.wsj.com/economics/2015/02/20/how-some-central-banks-are-reviewed-around-the-world/*.
[35] *http://www.bankofengland.co.uk/about/pages/people/court.aspx*
[36] *http://www.gao.gov/about/index.html*

it obtains explicit prior permission from the president of that Federal Reserve Bank. Similarly, the Board's OIG cannot investigate any FOMC incident involving a specific Federal Reserve Bank without the specific prior consent of that Federal Reserve Bank's president.

Such constraints on the authority of the Board's OIG authority are inconsistent with the overarching goal of ensuring that the Federal Reserve functions as effectively as possible in serving the American people. By making the Fed fully public, the Board's OIG can assume responsibility for conducting independent reviews of all aspects of the entire Federal Reserve System—not just the Board of Governors. Moreover, as with all other major federal agencies, the Fed's Inspector General should be appointed by the President and confirmed by the Senate.[37]

Government Accountability Office (GAO). As noted above, the GAO is an independent nonpartisan agency that has a proven track record in improving the efficiency and effectiveness of federal government programs.[38] In fact, over the past five years, the GAO has saved the taxpayers over $330 billion—a return of about $174 for every dollar spent running the GAO itself.

Nevertheless, the GAO has only limited authority to examine the Fed's procedures and operations.[39] For example, the GAO is currently prohibited from reviewing any Fed operations involving foreign central banks.[40] That prohibition seems particularly unfortunate in light of a recent instance in which the Federal Reserve Bank of New York inadvertently transmitted $81 million to hackers who had broken into the computer system of the central bank of Bangladesh. A subsequent Reuters investigation found that the New York Fed was "slow to react to warning signs" and "lacked a system for spotting potential fraud in real time, even though such systems were already in use elsewhere."[41] Indeed, Congresswoman Caroline Maloney stated that the incident posed "a threat to the confidence people could have in the central banking system."

More generally, the GAO is currently prohibited from investigating any aspect of the Fed's monetary policy process, including the financial transactions conducted by the New York Fed on behalf of the FOMC. One purported rationale for that constraint is that the Fed's financial accounts are already subjected to annual audits by private-sector firms. However, those financial audits are solely focused on detecting specific evidence of fraudulent activity—a far narrower scope than the GAO's mission of identifying inefficiencies, operational risks, and potential improvements in policies or procedures that could be beneficial to the general public or save money for American taxpayers. Moreover, the private firms tasked with conducting Fed audits are by no means impeccable and certainly do not have a public track record like that of the GAO. For example, the accounting firm that conducted the most recent audit

---

[37] The GAO has studied this issue and concluded as follows: "We believe that the differences in the appointment and removal processes between presidentially appointed IGs and those appointed by their agency heads result in a clear difference in the level of independence of the IGs." *(http://www.gao.gov/new.items/d09524t.pdf)*

[38] *http://www.gao.gov/products/GAO-16-272T*

[39] GAO reports on specific Fed activities are posted at http://www.federalreserve.gov/newsevents/reform_audit_gao.htm.

[40] Under current law, GAO investigations of the Board of Governors and the Federal Reserve Banks "may not include transactions for or with a foreign central bank, government of a foreign country, or nonprivate international financing organization." (31 USC 714.b.1)

[41] *http://www.reuters.com/investigates/special-report/cyber-heist-federal/*

of the Fed's books has been sued by Fannie Mae for alleged gross negligence, while the firm that previously audited the Fed has been ruled to have been negligent in a separate case.[42]

Despite some common misperceptions, comprehensive GAO reviews of the Fed need not be a partisan issue. Indeed, over the past couple of decades proposals to "audit the Fed" have been advocated by members of Congress from both sides of the aisle.[43] However, a significant pitfall of those proposals has been the prospect that such audits could become a means of political interference. Thus, in initiating full GAO reviews of the Fed, several specific provisions will be crucial: (1) Such reviews should be conducted on an annual basis, not be triggered by any congressional committee or member of Congress. (2) The GAO should freely determine the topics and focal points of each review. (3) The GAO should be prohibited from commenting on any specific monetary policy decision. With those provisions in place, comprehensive GAO reviews will significantly strengthen the Fed's effectiveness and its public accountability without impairing its operational independence to carry out its statutory mandate.

C. Monetary Policy Reports

In accordance with the Humphrey-Hawkins Act of 1978, the Federal Reserve provides semiannual monetary policy reports to Congress. That statute originally contained specific reporting requirements, but in 2000 those requirements were streamlined into a single broad requirement to provide *"a discussion of the conduct of monetary policy and economic developments and prospects for the future, taking into account past and prospective developments in employment, unemployment, production, investment, real income, productivity, exchange rates, international trade and payments, and prices."* Indeed, many analysts have characterized the Fed's semiannual monetary policy reports as largely vacuous.

Thus, in line with the practice of many other central banks, the Fed should begin producing quarterly monetary policy reports that explain the rationale for its monetary policy decisions and characterize the diversity of views among Fed officials.[44] In particular, each report should:

- Present quantitative assessments of the deviation of employment from its maximum level and the deviation of inflation from its mandate-consistent rate, and characterize the degree of uncertainty surrounding those assessments.
- Provide a baseline projection for the economy, including information about the factors that are particularly relevant for specific sectors, regions, and demographic groups.
- Identify material risks to the current economic outlook and explain the Fed's plans for mitigating or responding to those risks.
- Discuss any economic models and benchmark rules that are used in setting the course of monetary policy.

[42] *http://www.washingtonpost.com/wp-dyn/content/article/2006/12/12/AR2006121201386.html; http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/court-upholds-ruling-on-deloittes-negligence-over-livent/article28078784/*

[43] GAO audits were a key plank of the Fed reform bill proposed in 1993 by Democratic Rep. Henry Gonzalez.

[44] For example, quarterly monetary policy reports are produced by the Bank of Canada, the Bank of England, the Bank of Norway, and the Swiss National Bank.

V. Conclusion

In this paper, we have presented the case for a set of pragmatic and nonpartisan reforms that would strengthen the Federal Reserve's governance and enhance its operational independence to carry out its statutory mandate of fostering maximum employment and price stability. Moreover, these reforms would ensure that the Fed is a publicly accountable institution that takes a wide array of economic perspectives into account, thereby enriching the Fed's decision-making process while affirming the norm that those decisions should not be subject to political interference.

At the heart of the proposed reforms is a call to make the Fed a fully public institution whose decision-makers are public officials selected through open and transparent processes. This begins with transferring ownership of the twelve regional Federal Reserve Banks away from commercial banks to the American people. By following procedures already in place for adjusting the shares of individual member banks, the process for carrying out this transition would be incredibly straightforward, and have no effect on the current value of U.S. government debt or the size of the Fed's balance sheet.

Another key element in making the Fed fully public involves changing the process by which Federal Reserve Bank directors and presidents are appointed. In sharp contrast to the current process that is opaque, inbred and largely *pro forma*, we propose a process requiring a higher degree of transparency in selection criteria, timeline, selection of candidates for president and board nominees, and extensive opportunities for public input. To avoid potential conflicts of interest, we further recommend that individuals affiliated with financial institutions overseen by the Fed should be prohibited from serving as directors. Additionally, establishing a single non-renewable 7-year term of office for every Fed policymaker–including the Chair, the Vice Chairs, the other members of the Board of Governors, and the presidents of the Federal Reserve Banks–would strengthen the Fed's operational independence and accountability.

There are clear and measurable benefits to these proposed reforms. Making the Fed fully public would generate a fiscal benefit for American taxpayers of at least $300 million per year. These additional savings would come from larger transfers of net income from the Fed to the U.S. Treasury as a result of the Fed no longer having to pay dividends to commercial banks. In addition to this fiscal benefit, the reforms we've outlined also provide greater capacity for the Fed to more fully represent and serve the best interests of the American people when making monetary policy decisions. As America's central bank, the Fed's monetary policy decisions affect the everyday lives of practically every American family, and have even greater consequences for specific demographic groups. Bringing the appointment process out of the shadows and expanding opportunities for public input in the appointment of Fed officials responsible for making monetary policy greatly increases the potential for assembling a more diverse and inclusive body of decision makers. More diversity, in terms of race, ethnicity, gender, educational background and professional experience, would enhance the Fed's ability to comprehensively and accurately assess the strength of the economy in advance of making monetary policy decisions.

Proposals to make the Fed fully public have been debated since the 1930s. Failure to make that transition has resulted in a Federal Reserve governance structure that is outdated and inadequate for ensuring that the Fed serves the public interest. Moreover, the Fed's private ownership by commercial banks is now out of step with practically every other major central bank around the world. Incremental amendments to the Federal Reserve Act at various points in time have routinely failed to overcome the hindrances of private ownership, or to transform the leadership of the Federal Reserve Banks beyond the status quo, which is overwhelmingly white, male and insular – dominated almost exclusively by long-time Fed insiders and individuals with a financial background.

Overcoming these deficiencies and bringing about lasting change within the Federal Reserve requires Congressional action to make the Fed a fully public institution. Pragmatic reforms that appeal to the nonpartisan principles of good governance, transparency and accountability are the best way to ensure that the necessary Congressional action is taken. While the reforms outlined in this paper are by no means the only options on the table, they undoubtedly meet those standards.