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“How Central Should the Central Bank Be?” A Comment

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In the March 2010 issue of the *Journal of Economic Literature*, Alan Blinder of Princeton University considers the structure of the Federal Reserve, discussing its regulatory powers and decisionmaking institutions. I welcome Professor Blinder’s thoughtful contribution to this issue, even if I must disagree with some of his views. Specifically, I believe that Professor Blinder omitted some important facts when discussing the structure of the Federal Reserve District banks:

The twelve district banks are, technically, private corporations with shareholders and boards of directors.* As shareholders, bankers comprise three of the nine members of each Reserve Bank board; and none of the nine are political appointees. Each of these boards, in turn, essentially selects the president of its bank, who sits on the FOMC as a national policymaker.** This is a highly unusual way to select policymakers, to say the least... Yet, unlike Fed governors, none of the Reserve Bank presidents have the democratic legitimacy that is conferred by political appointment. (Blinder, 2010, p. 127)

To characterize the regional Reserve Banks as “private corporations”—although technically true—is misleading because the Reserve Banks do not exist to profit their shareholders but to serve the public interest. The Federal Reserve Act created the decentralized Federal Reserve structure that Congress intended to balance the needs of the public—including financial, agrarian, and industrial concerns. The financial institutions that are “shareholders” (member banks) may not sell or trade their Reserve Bank stock, whose dividend and price are fixed by law. The member banks do

elect six of the nine members of each Reserve Bank’s board of directors but do not retain Reserve Bank profits. The Reserve Banks transfer their annual net earnings to the U.S. Treasury.

The Reserve Bank presidents are fully accountable to our democratic institutions and the decentralized structure promotes healthy debate on monetary policy and regulatory issues.

Moreover, the presidentially appointed Board of Governors exercises considerable control over the Reserve Banks. The Board of Governors appoints three of the nine members of each Bank’s board of directors. While each board identifies candidates for the position of its Reserve Bank president, the Board of Governors interviews candidates as well; the successful candidate must obtain approval from both the Board of Governors and the Reserve Bank board of directors. So political appointees play a key role in selecting Fed presidents. In addition, under its supervisory authority, the Board requires each Reserve Bank to submit an annual budget for approval, including the salaries of senior Bank officers.

Because of their local ties, the Reserve Bank presidents provide a diverse mix of views on regional trends, monetary policy, and regulatory policy to the Federal Open Market Committee (FOMC). For example, Darryl Francis, president of the St. Louis Fed from 1966 to 1976, was a lonely voice on the FOMC warning that monetary policy is the primary force affecting inflation outcomes (see Poole, 2002). More recently, William Poole, president of the St. Louis Fed from 1998 to 2008, presciently warned of the dangers to financial stability created by the housing GSEs, long before the recent

Footnotes from the Blinder article

* A revealing curiosity: Each Federal Reserve Bank is a “.dot.org.” while only the Board of Governors in Washington is a “.dot.gov.”

** Their selections must be approved by the Board of Governors, which virtually always does so. As with private corporations, however, Reserve Bank presidents play huge roles in selecting their own boards.

housing crisis (Poole, 2003, 2005). And Gary Stern, president of the Minneapolis Fed from 1985 to 2009, wrote a book about the “too big to fail” problem in 2004, four years before the big bank problems of 2008 (Stern and Feldman, 2004).

In practice, the structure of the Federal Reserve System has served our country very well for many years: It ensures that the Reserve Bank presidents are fully accountable to our democratic institutions while providing a decentralized structure that promotes healthy debate on monetary policy and regulatory issues. ■

Blinder, Alan S. “How Central Should the Central Bank Be?” *Journal of Economic Literature*, March 2010, 48(1), pp. 123-33.

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Stern, Gary H. and Feldman, Ron J. *Too Big to Fail: The Hazards of Bank Bailouts*. Washington, DC, Brookings Institution Press, 2004.