

THE *Balance* OF *Power*

THE POLITICAL FIGHT FOR AN INDEPENDENT CENTRAL BANK, 1790 - PRESENT





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The Political History OF CENTRAL BANKING IN THE UNITED STATES *1790 - PRESENT*

1791 – 1811 **THE FIRST BANK *of* THE UNITED STATES**
The brainchild of Alexander Hamilton was controversial from its inception. Public distrust led to the failure of a bid to renew its original 20-year charter.

1817 – 1841 **THE SECOND BANK *of* THE UNITED STATES**
The Second Bank was also not widely understood by the public and strongly opposed by President Andrew Jackson. The Second Bank's charter renewal became an issue during Jackson's second presidential campaign, and he vetoed the bill in July 1832. The bank's role dwindled, and it was eventually transformed into a state bank before closing.

1908 **THE ALDRICH-VREELAND ACT**
After the Panic of 1907, the legislation provided for the issuance of emergency currency and created the National Monetary Commission to determine what changes might be needed to the monetary system and laws related to banking and currency.

1913 **THE FEDERAL RESERVE ACT**
President Woodrow Wilson signed legislation creating the Federal Reserve on Dec. 23, 1913. Public concern about too much power being centralized on Wall Street or in Washington led to a decentralized structure. The 12 regional Reserve Banks opened on Nov. 16, 1914.

1927 **THE McFADDEN ACT**
Although related primarily to bank regulation, the Act also erased the Federal Reserve's original 20-year charter, giving the Fed permanence.

1933

THE BANKING ACT of 1933

Among other things, the Act created the FDIC and separated deposit and investment banks. For the Federal Reserve, the Act reined in the New York Federal Reserve Bank, which had made a concerted effort to position itself as the leader of the entire Federal Reserve System, especially in the area of international financial dealings. The Act also created the Federal Open Market Committee (FOMC).

1935

THE BANKING ACT of 1935

The Act centralized control over the Federal Reserve System at the Board, taking away much of the autonomy of the regional Reserve Banks. Among other things, the Act also removed the Treasury secretary and the comptroller of the currency from the Board, and created the modern structure for the FOMC.

1949

REMOVING THE STRAIT JACKET

Federal Reserve Chairman Thomas B. McCabe announced that the Federal Reserve would conduct monetary policy with a primary regard to business conditions, a step that McCabe later said marked “the removal of the strait jacket in which monetary policy had been operating.” Fed policies during the war and post-war years had been conducted in support of long-term debt prices to help the government finance spending.

1951

THE ACCORD

The culmination of the battle that started with McCabe’s 1949 announcement. The Accord solidified the Federal Reserve’s independence from the Treasury, allowing the central bank to conduct monetary policy without Treasury approval for the first time since 1934.

1950S-70S

WRIGHT PATMAN

The Texas congressman had an ongoing political battle with the Federal Reserve. Patman believed the Federal Reserve functioned better when it was under Treasury control.

1970S

INFLATION

Various legislative efforts attempted to control and influence the Federal Reserve as the nation faced economic turmoil. Among the ideas finding varying degrees of congressional support were a proposal that would “request” a specific money supply growth target and an effort to give the president greater control over the Federal Reserve.

1979-1993

THE REAGAN AND BUSH YEARS

Amid soaring inflation and a climbing jobless rate, public and political attacks on the Federal Reserve escalated. The Treasury began criticizing Federal Reserve policy, and some lawmakers started calling for Paul Volcker’s ouster and legislation giving Congress more control over the Federal Reserve. Under orders from Treasury Secretary Donald Regan, the administration started work on a major review of the Federal Reserve and its conduct of monetary policy. The efforts came to an end when the economy began to recover. The Federal Reserve faced numerous political battles including a lawsuit arguing that the Reserve Bank presidents should be presidential appointees and a lengthy fight with Texas Congressman Henry Gonzalez that was reminiscent of Wright Patman.

2008-2012

CRISIS AND AFTERMATH

Criticism has increased during the recent financial turmoil and its aftermath. The passage of Dodd-Frank resulted in General Accountability Office audits of the Fed’s emergency programs and governance structure in 2011. In 2012, Rep. Ron Paul held a hearing in which proposals to change the makeup of the FOMC and alter the Federal Reserve’s mandate were discussed.

Preface to the Second Edition

In order to better understand the Federal Reserve's role as an independent institution that is accountable to the public it serves, the Federal Reserve Bank of Kansas City's Board of Directors requested an in-depth examination of the political pressures the central bank has faced throughout its history. As a result, we published this volume in 2009 to shed light on the tensions that are inherent with any institution operating within a strong system of checks and balances.

This, the second edition of *Balance of Power*, is presented with that same goal. Since the publication of the first edition, the Federal Reserve has continued to respond to the 2008 crisis with new tools and programs, most notably the large-scale asset purchases known as quantitative easing and the continuation of accommodative policy rates for an extended period. Meanwhile, Congress responded to the factors leading up to the crisis with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This law expanded the Federal Reserve's responsibilities and contained numerous new regulations for the financial industry, some of which have become the subject of intense political discourse.

In addition, Congress, which is responsible for determining the Federal Reserve's mandate, is once more asking questions about the Federal Reserve's role in monetary policy, as well as the central bank's structure and governance. These questions continue the nation's long tradition of debate about the Federal Reserve's purpose and its responses to economic change. Although answers have yet to come, history has made it clear that an independent central bank is well equipped to foster long-term financial stability. Furthermore, the experiences of other nations have demonstrated the importance of establishing boundaries between monetary policy decisions and fiscal actions.



Esther L. George
President and Chief Executive Officer
Federal Reserve Bank of Kansas City

—June 2012

Foreword

The directors of the 12 regional Federal Reserve Banks fill a crucial role in connecting our nation's communities to the national policy deliberations of the central bank. These individuals in each Reserve Bank District, with backgrounds in business, consumer issues, banking, labor and agriculture, are charged with oversight of their regional Federal Reserve Bank and ensuring that the Fed receives input from a broad spectrum of the public.

It is an important part of the system of checks and balances that we rely on for our most valued institutions. These directors have a wide range of backgrounds and a thorough understanding of their businesses and communities. However, many come to the Bank unfamiliar with the Federal Reserve's history, especially as it relates to the political pressure on an independent central bank.

Directors often question the nature of the role of and relationship between the political elements of the Federal Reserve and its independence. This volume was created to help Federal Reserve Bank directors who are responsible for the governance of their Districts and the guardianship of the Federal Reserve System.



Thomas M. Hoenig,
President and Chief Executive Officer,
Federal Reserve Bank of Kansas City

1991-2011

SET TO BETWEEN OLD HICKORY AND BULLY NICK.



This celebrated fight took place at Washington in 1805. Hickory was assisted by Little Ben and Major Jack Downing, with the Financier for both sides. Long Harry and Black Sam were Nick's seconds, and Old Mother Rand both sides. Several legs and arms were broken, and from the immense mass of money of the day were taken in a large amount. Old Mother B. is said to have backed her champion to the tune of more than \$40,000. Nick's weight of metal was superior to that of his opponent, but neither were collected for the plank and wood of Hickory, who showed his thorough training and sound resolution in ultimately that in the last round Nick was unable to come to land and parry.

The battle between President Andrew Jackson and Nicholas Biddle, president of the Second Bank of the United States, was depicted quite literally in this editorial cartoon from the 1800s. The populist Jackson was suspicious of the power of all banks and believed the country would be better off without Biddle's institution.

Introduction

“A (central) bank has to be Independent because one cannot really trust the politicians – they are all a rotten lot and any of them might seek to get out of a hole by printing money.” – **KARL BLESSING,**
PRESIDENT, DEUTSCHE BUNDESBANK, 1958-69

Central banks are unique institutions. They have important responsibilities for a nation’s financial system and economy, and yet, ideally, they are outside of government influence.

Politicians certainly have reasons for wanting to keep central banks under control.

“It is always easier ... to float a weakening economy by loosening the moorings of monetary policy rather than cutting taxes or increasing spending,” Dallas Federal Reserve President Richard Fisher said in a 2008 speech.¹ “It is easier to allow inflation to finance ambitious social programs or bail out a government from the burden of debt.”

In addition to political concerns, central banks are engaged in extremely complex work that is perhaps not widely understood, and much of it is done outside of the public eye. As a result, central banks are frequent and popular targets, especially in periods of financial difficulty.

Central banking in the United States has always had more than its share of turf battles, going back literally to the nation’s founding. The Federal Reserve’s unique public/private structure is designed to provide a checks and balances system that is common in the nation’s most important institutions; however, it can also lead to friction. Additionally, the individual regional Reserve Banks have, on occasion, fought to be the “first among equals” or collectively against the Board of Governors in Washington, D.C. More frequent have been the political interventions by Congress and, less frequently, the White House. In some of these cases, there has been a significant impact on the Fed while, in other cases, events that seemingly dominated the headlines at the time have passed into history with little fanfare.

In all cases, however, these political battles have had the potential to bring about sweeping changes, not only to the Federal Reserve System, but also on the nation’s economic and financial systems. And at the core, they have all centered on a common question, as elaborated by Treasury Undersecretary Beryl Sprinkel in 1982 while the Treasury was in the midst of one of its many power struggles with the Fed: “The major issue is, what do we mean by ‘independence?’”²

1. Richard Fisher speech, Feb. 7, 2008, in Mexico City.

2. The Wall Street Journal, June 21, 1982.



Alexander Hamilton, the nation's first Treasury secretary, was an economist who recognized the young country needed a central bank. Some of the other founding fathers, however, did not agree with his vision.

First Bank OF THE UNITED STATES

Alexander Hamilton, the nation's first Treasury secretary, had considered the need for what would today be considered a central bank for a decade or more before finally raising the idea publicly with a proposal in 1790.

His plan called for the creation of a national bank that would serve the public interest and help the country address the massive war debt. It would improve the new nation's creditworthiness by providing a currency, and, it would lend directly to businesses. The bank would also be considered a private institution, with about 80 percent of it owned by public shareholders and the rest held by the government.

Although Hamilton's bank would prove to be successful, the founding fathers did not welcome the idea. The bank was strongly opposed by Thomas Jefferson, who questioned its constitutionality, and James Madison, who viewed bankers as "swindlers and thieves."³

Many in the South openly despised banks, seeing them as tools for the wealthy to take advantage of the rest of the population. For those with agricultural interests, the proposed bank was seen as too closely aligned with the financial powers in the Northeast. For some, the idea of a central bank connected very closely to the issue at the core of the Revolutionary War:

"What was it (that) drove our forefathers to this country?" asked Georgian James Jackson. "Was it not the ecclesiastical corporations and perpetual monopolies of England and Scotland? Shall we suffer the same evils to exist in this country?"

When Hamilton said the bank was for "the general welfare," Jackson responded angrily, "What is the general welfare? Is it the welfare of Philadelphia, New York and Boston?"⁴

If the questions surrounding the central bank were primarily a battle of urban versus rural interests, then it is notable that Hamilton presented Congress with his bank proposal one day after introducing another plan that pit these same factions against each other – a tax on distilled spirits.

The tax, as eventually approved by Congress, had an unfairly harsh impact on small, and generally poor, agricultural producers. The result, in the summer of 1794, was the so-called "Whiskey Rebellion," which eventually resulted in George Washington leading

3. *Joseph J. Ellis, Passionate Sage: The Character and Legacy of John Adams. New York: W.W. Norton, 1994.*

4. *M. St. Clair Clarke and D.A. Hall, "Legislative and Documentary History of the Bank of the United States (1832)," as appearing in H.W. Brands, The Money Men, New York: W.W. Norton, 2006.*

armed militia forces into areas of Pennsylvania to quell the uprising.

Hamilton was able to get his bank legislation through Congress, but the support came almost entirely from congressmen north of the Potomac River, while those to the South opposed the proposal. The bill stalled on Washington's desk. The first president was a farmer who was extremely sympathetic to the agricultural interests of those in the South and was also believed to be strongly influenced by Jefferson's views. The combination gave him ample reason to oppose a central bank. Hamilton finally authored a 15,000-word report about the bank that eventually convinced Washington that the bank was in the nation's best interest and that he should lend his signature to the bill.

Historians often point to the political battle for the First Bank as the emergence of partisan politics and political parties in the United States.

"As philosophical views increasingly dovetailed with geographic interests, one could begin to glimpse the contours of two parties taking shape," historian Ron Chernow writes in his 2004 biography of Alexander Hamilton. "Individual issues were coalescing into clusters, with the same people lining up each time on opposite sides."

The First Bank of the United States opened on Dec. 12, 1791, in Philadelphia with a 20-year charter. When it came up for renewal in 1811, those who had opposed the bank held the political majority. Commercial banks opposed the recharter because they wanted to hold the government deposits that had instead gone into the First Bank. Others, who had opposed the bank from the start, were particularly outraged about British investors holding a stake in the institution. With Hamilton, the bank's champion, now dead after his duel with Aaron Burr, the charter renewal failed. The First Bank of the United States closed March 3, 1811.



The First Bank of the United States building was completed in 1797. The building is located at 116 S. Third St. in Philadelphia.

Second Bank OF THE UNITED STATES

Almost exactly one year after the close of the First Bank of the United States, the nation was at war with the British in the War of 1812. As the fighting continued, President Madison fell victim to a temptation that Hamilton had feared: he began printing un-



The Second Bank of the United States building was completed in 1824 at 420 Chestnut St. in Philadelphia. It is less than two blocks from the First Bank of the United States building.

supported money, sending the nation's finances and economy into turmoil. As the fighting escalated, state banks, which could issue their own currency at that time, stopped redeeming their notes. The result was a banking panic.

“(A)bout the time the British burned the Capitol and the White House, Madison conclud-

ed that Hamilton had been right regarding the need for a national bank, at least in times of crisis,” H.W. Brands writes in his 2006 book, *The Money Men*.

Again, the idea was hotly opposed.

“This Bank is to begin with insolvency. It is to commence its existence in dishonor: It is to draw its first breath in disgrace,” said Daniel Webster, who was then a congressman.⁵

The opposition, however, was overcome, and the Second Bank of the United States was approved by Congress in 1816. The bank opened on Jan. 7, 1817, with a 20-year charter. While larger than its predecessor with \$35 million in capital compared with \$10 million at the First Bank, the two banks had much in common. The government owned 20 percent of the institution with the rest owned by stockholders, but while stockholders appointed all of the First Bank's directors, the government appointed five of the Second Bank's 25 board members.

The Second Bank struggled under its early leadership with imprudent, and sometimes fraudulent, lending. It was able to reverse course, however, when Nicholas Biddle, a

5. M. St. Clair Clarke and D.A. Hall, *Legislative and Documentary History of the Bank of the United States* (1932),” as appearing in H.W. Brands, *The Money Men*, New York: W.W. Norton, 2006.

member of the bank's Board of Directors who had been appointed by President James Monroe, became the bank's president in 1823.

As a member of the Pennsylvania legislature in 1810, Biddle had supported the First Bank, and his politics and economics were both Hamiltonian.⁶ He also had another bizarre connection to the life of the man who is today revered as the father of central banking in the United States. In 1807, the 18-year-old Biddle was at his parents' home in Philadelphia when Aaron Burr arrived seeking refuge. Burr, who had been a long-time friend of Biddle's father, Charles⁷, was essentially on the run and headed west after being indicted for Hamilton's murder in their famous duel. Nicholas Biddle, who was preparing to head for France where he would work on financial details of the Louisiana Purchase, was outraged by what Burr represented, writing, "The violence of party ... disgraces our country."^{8 9}

At the Second Bank, Biddle made sweeping changes. Among the more notable: He implemented what was essentially a crude open market operation by buying or selling state bank notes to loosen or tighten credit conditions.

He was also able to eliminate monetary exchange rates between various parts of the country by transferring funds more efficiently. Brokers, who profited on the discount of western bank notes, were angry with Biddle. Because the Second Bank also dealt directly with the public, many commercial bankers were also outraged at Biddle, who they believed was taking their customers. The Bank's most stringent critics believed Biddle's bank was an affront, even a threat, to democracy.

For his part, Biddle initially tried to keep the bank out of politics. Before he was considered for the post, Biddle said it should be filled by someone who is "known to, and stands well with, the government – not an active partisan – not even a party man – but a man in whom the government can confide."¹⁰

6. *H.W. Brands, The Money Men, New York: W.W. Norton, 2006.*
7. *The Biddles were a prominent family, with Charles Biddle previously working as Pennsylvania's vice president under Pennsylvania President Benjamin Franklin.*
8. *Correspondence of Nicholas Biddle, ed. Reginald C. McGrane (1919), as appearing in H.W. Brands, The Money Men, New York: W.W. Norton, 2006.*
9. *Interestingly, Biddle's own brother, Thomas, died in an 1831 duel with Missouri Congressman Spencer Pettis. Ironically, the source of their feud was the Second Bank of the United States. Pettis heavily criticized Nicholas Biddle during an 1830 campaign address, after which Thomas Biddle went to Pettis' St. Louis hotel room and whipped the congressman with a piece of cowhide, which eventually led to the duel. Because Thomas Biddle was nearsighted, the two were only 5 feet apart when they drew their weapons. Pettis also died because of injuries suffered in the duel.*
10. *Biddle to unidentified recipient, Oct. 29, 1822. Correspondence of Nicholas Biddle, ed. McGrane (1919) appearing in H.W. Brands, Andrew Jackson: His Life and Times. New York: Anchor Books, 2005.*



President Andrew Jackson's fight against the Second Bank of the United States was a popular topic for cartoonists.

Later, as head of the bank, Biddle repeatedly noted that the institution had no political leanings, writing, “It is only a bank.”

“There is no one principle better understood by every officer in the Bank than that he must abstain from politics. The course of the Bank is very clear and straight on that point. We

believe that the prosperity of the Bank and its usefulness to the country depend on its being entirely free from the control of the officers of the Government, a control fatal to every bank which it ever influenced. In order to preserve that independence it must never connect itself with any administration – and never become a partisan of any set of politicians.”¹¹

Despite Biddle’s efforts, the bank found itself in a political fight against a man who was considered a hero to many of the bank’s detractors: President Andrew Jackson.

The roots of Jackson’s presidency were firmly planted in populism. In the 1824 presidential election, Jackson had received the most popular votes, while the electoral votes were split among four candidates. The election was thrown into the House of Representatives, which selected John Quincy Adams. Four years later, Jackson easily beat the incumbent Adams.

In his first annual message to Congress, a written report that modern Americans would equate with today’s annual State of the Union Address, Jackson referenced the Second Bank’s upcoming recharter, which was then still more than six years in the future.

“Both the constitutionality and the expediency of the law creating this bank are well questioned by a large portion of our fellow citizens, and must be admitted by all that it has failed in the great end of establishing a uniform and sound currency,” Jackson wrote, vowing that he would veto any charter renewal that crossed his desk.

In regard to Jackson’s comments, Biddle told a friend: “They should be treated as the honest though erroneous notions of one who intends well.”¹²

11. *Correspondence of Nicholas Biddle to Samuel Smith, Dec. 29, 1828, as appearing in H.W. Brands, Andrew Jackson: His Life and Times. New York: Anchor Books, 2005.*

12. *Correspondence of Nicholas Biddle, ed. Reginald C. McGrane (1919).*

Biddle believed that Jackson's closest counselors did not agree with Jackson's view, and that once there was a thorough consideration of the issue, Jackson would side with the bank. Biddle held that view despite the fact that Jackson had previously told the banker privately that he did not trust banks – a position that Biddle apparently thought he could change.

Another reason for Biddle's confidence was that he knew Jackson's question about the bank's constitutionality had already been settled by the Supreme Court. In early 1818, Maryland had passed a law taxing banks that were not chartered in the state. John McCulloch, the cashier of the Second Bank's Baltimore Branch, refused to pay the tax and was sued by the state. McCulloch countersued. The court's March 1819 ruling in *McCulloch v. Maryland* was in the Bank's favor, with Chief Justice John Marshall writing,



For Andrew Jackson, the seventh president of the United States, the battle against the Second Bank of the United States became personal. Jackson said that the Bank was trying to kill him, "But I will kill it."

was then seen as the final step before the presidency. Clay wanted to be in the White House, and the battle over the nation's central bank would be part of his ticket there. Clay contacted Biddle in the fall of 1830, suggesting it would be in Biddle's interest to renew the

ing, "Let the end be legitimate, let it be within the scope of the Constitution and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the Constitution are Constitutional."

If Biddle took comfort in the ruling, his first mistake was in not realizing the difference between politics and law.

His second mistake was breaking his own longstanding prohibition on involving the bank in politics.

Biddle was befriended by Henry Clay, who had served in the Adams administration as the secretary of state – the job that

bank's charter early.

Clay said that he had the necessary votes in both chambers to gain an approval of the renewal question. With those votes, the charter would head to Jackson, who could either hold firm with his planned veto or sign the legislation. Either way, the issue would come to the political forefront and be a key issue for the next election.

And what if Jackson was re-elected? Biddle became convinced that a post-election Jackson would have more political strength to reject the charter outright.

Biddle started what would today essentially be considered a pre-emptive publicity campaign about the bank, but he stopped short of pushing the recharter.

As the next presidential election drew near, and Jackson's popularity remained high, Clay recognized he needed an explosive political issue to unseat his rival. He told Biddle that not only did he have the congressional votes necessary for renewing the charter, but also that he believed Jackson would have to sign the bill ahead of the election.

Biddle applied for the renewal.

While he said the issue was beyond politics, Biddle clearly understood the role politics would play – he believed in his favor.

“If the bill passes and the President negatives it, I will not say that it will destroy him, but I certainly think it will, and moreover, I think it ought to,” Biddle wrote.¹³

The bill narrowly passed the Senate while getting through the House somewhat more easily. In both cases, opposition was strongest in the western and southern United States, which were the farthest removed from the bank and where suspicions about its influence



Nicholas Biddle, president of the Second Bank of the United States, put the Bank into a political battle against Andrew Jackson, attempting to force Jackson into renewing the Bank's charter. Biddle, however, underestimated the president's resolve.

13. *Biddle to Charles Ingersoll, Feb. 11, 1832, appearing in H.W. Brands, Andrew Jackson: His Life and Times. New York: Anchor Books, 2005.*

were the highest.

Jackson received the renewal bill on July 4, 1832. Vetoes were rare – the first six presidents had vetoed a combined total of only 10 bills, but Jackson had done that many on his own.

He was not intimidated by the bank bill. It was promptly vetoed.

Unexpectedly, the turn of events left both Jackson and Biddle happy. Jackson, who believed the bank was unconstitutional, was pleased at being able to carry out his promised veto prior to the election. Biddle, meanwhile, wrote to Clay that he was “delighted” by Jackson’s actions because he believed Jackson had done something that would lead to his defeat. Biddle even went so far as to have the veto message printed in massive quantities and distributed nationwide.¹⁴

Despite Biddle’s thoughts of a Clay presidency, Jackson easily beat Clay, 219 electoral votes to 49.

Throughout the remainder of Jackson’s term, the president and the central banker continued to fight bitterly, with Biddle tightening the money supply in an effort to essentially create a financial panic. What modern historians call Biddle’s “scorched earth policy” ended only when Biddle’s supporters started turning their backs on the banker. There was a minor recession that scholars say was caused partly by Biddle’s action but clearly was exacerbated by the heated rhetoric from both sides.¹⁵

Jackson, with an October 1833 executive order, finally pulled the government’s accounts from the Second Bank, famously telling Vice President Martin Van Buren, “The Bank ... is trying to kill me. But I will kill it.”

Jackson directed that future government deposits go to specified state banks. These banks, as it turned out, had been generally favorable to Jackson.

The Second Bank’s importance dwindled in the final years of its charter with its share of federal deposits falling from 97 percent to 30 percent in the first quarter of 1834.¹⁶ But even after the charter expired, Biddle kept the bank open under a state charter, as the U.S. Bank of Pennsylvania. After a series of poor management decisions, including risky loans and an effort to corner the cotton market, the bank failed in 1841.

14. *Ralph Catterall, Second Bank of the United States. Chicago, 1903, 240-41.*

15. *Jacob P. Meerman, “The Climax of the Bank War: Biddle’s Contraction, 1833-34,” The Journal of Political Economy, Vol. 71, No. 4, pp. 378-388.*

16. *Jane Knodell, “Rethinking the Jacksonian Economy: The Impact of the 1832 Bank Veto on Commercial Banking,” Journal of Economic History, 66 (3).*

The Federal Reserve Act

The end of the Second Bank of the United States had consequences for the national economy as private banks suddenly had access to government funds that would have gone into the central bank.

Economists today estimate that between 1834 and 1836 the money supply grew at an average annual rate of 30 percent compared with 2.7 percent annual growth in the three previous years.¹⁷ The result was a speculative bubble in land and commodities that burst with the Panic of 1837. A depression followed, lasting until 1843.

“(Jackson) professed to be the deliverer of his people from the oppressions of the mammoth – but instead he delivered the private banks from federal control and his people to speculation,” economic historian Bray Hammond later wrote.¹⁸ “No more striking example could be found of a leader fostering the very evil he was angrily wishing out of the way.”

The 1837 panic was the first in a cycle of panics that regularly hit the United States in the years that followed while the nation had no central bank. Among the more notable and severe was the Panic of 1873, which came after a period of post-Civil War economic overexpansion. The collapse was caused largely by the failure of Jay Cooke & Co., then a massive investment bank that was deeply involved with Northern Pacific Railroad. The bottom fell out when the market for railroad bonds collapsed after revelations of corruption emerged in the building of the Union Pacific.

A sign was posted on the door of Cooke & Co. offices on Sept. 18, 1873: “Owing to unexpected demands on us, our firm has been obliged to suspend payment.”

A *Boston Globe* article on the then-unfolding crisis published only two days later said that it did not think the full panic would reach that city, but also cautioned that “the financial interests of our country are so interwoven that our bankers must be affected to some extent.”

The panic did hit Boston and the rest of America with its full force, causing a depression which, until the economic collapse of the 1930s, was known as The Great Depression.¹⁹ It lasted for more than five years.

17. Jane Knodell, “Rethinking the Jacksonian Economy: The Impact of the 1832 Bank Veto on Commercial Banking,” *Journal of Economic History*, Vol. 66 (3).

18. Bray Hammond, “Jackson, Biddle and the Bank of the United States,” *Journal of Economic History*, Vol. 7, (1).

19. This depression is now sometimes referred to as *The Long Depression*.

The ongoing series of financial panics finally culminated in the Panic of 1907.²⁰ The start of the '07 panic is usually blamed on Augustus Heinze, a native New Yorker who came back to the city after making a mining fortune in the West.²¹ Heinze used his Western wealth to become heavily involved in the city's banks, trusts and insurance companies. When a Heinze family bid to corner United Copper failed and the stock market sank, bank customers ran to institutions with which Heinze was affiliated to salvage what funds they could.



Augustus Heinze hoped to use his mining fortune to become a powerful banker and wealthy financier. When his plan collapsed, it set off a financial panic.

With the nation falling into another financial crisis, and the United States the only one of the world's major financial powers without a central bank, finance mogul J.P. Morgan stepped in. Morgan, who had bailed the government out of a financial crisis in 1895, organized his friends to make investments and arrange lines of credit to stabilize the economy. Recognizing that the nation could not be in a position where it was reliant on wealthy individuals to stem an economic and financial crisis, Congress passed the Aldrich-Vreeland Act on May 30, 1908. The legislation provided for the issuance of emergency currency and also created the 18-

member National Monetary Commission, chaired by Sen. Nelson Aldrich, to determine what changes were necessary to the nation's monetary system and laws related to banking or currency.



Financier J.P. Morgan, who famously bated having his photo taken, coordinated an effort among bankers to restore stability during the 1907 panic. Morgan had played a similar role in 1895.

20. To give some idea of the frequency of financial panics in that era: between the 1873 depression and the 1907 panic, the nation suffered another panic and recession in 1893, along with a financial crisis in 1895 and a slight stock market collapse in 1901.
21. A perhaps unexpected side note to Heinze's life: The man who started the financial crisis leading to the Federal Reserve's creation died three weeks before the Federal Reserve Banks opened. He was only 44 and for years his hair had been white, which some saw as a result of his role in the panic.

The Aldrich Act

Over a three-plus-year span, the Commission traveled to the major capitals of Europe and hosted a number of hearings in the United States. In January 1911, Aldrich unveiled a plan which, after a year of revision by the Commission, was presented to Congress in 1912, calling for a National Reserve Association.

Although the bill did not come forward until 1912, it had been under development for years, going back to a November 1910 meeting involving investment banker Paul Warburg and others on Jekyll Island, Ga. The then-secret meeting was organized by financiers and bankers who recognized the nation's need for a central bank and wanted to begin the process. Because they did not think the public would welcome a plan crafted by bankers, they made extraordinary efforts to keep the meeting secret, such as using only first names and telling others that they were on a duck hunting trip. Details of the meeting were made public years later and, as it turned out, the shroud of secrecy has made the meeting an especially popular target for Fed critics even today. One of the best-known written criticisms of the Fed, in fact, is G. Edward Griffin's 1994 book, *The Creature from Jekyll Island*.

Aldrich's proposal was attacked by committees in both chambers for giving too little control to the government or public and too much power to bankers, especially those with the largest banks – some small bankers, in fact, opposed the plan. Among other features, the plan called for a 46-member Board with only six appointed by the government and one of those – the head of the organization – selected from a list of three names supplied by the association. Unlike the First and Second Bank of the United States, the government would have no stake in the National Reserve Association.

Former Treasury Secretary Leslie M. Shaw, a Republican, was among those heavily critical of the plan: "Such an institution, whatever its name, puts the business of the United States of America absolutely and irretrievably in the hands of Wall Street."²²

The Glass Bill

After the 1912 election, any chance the Aldrich plan had of success was gone. Opposition to the proposal was a plank in the Democratic platform.

With Democrat Woodrow Wilson winning the election, and Democrats holding control of both houses, the banking community, which had strongly backed the Aldrich plan, became anxious about what plan the new administration would propose, fearing it would be unfavorable to bankers.

22. J. Lawrence Laughlin, *The Federal Reserve Act – Its Origin and Problems*. New York: The Macmillan Company, 1933.



Carter Glass, a Virginia congressman, led the House effort to gain approval of the Federal Reserve Act. Glass opposed the idea of a central board, instead favoring as many as 20 regional banks throughout the United States.

Glass, in fact, favored as many as 20 regional banks throughout the country and did not like the idea of a central coordinating board.

“One of the arguments for decentralization was the necessity of ensuring the representation of local interests. A second argument was the fear that big bankers would capture the operation of a centralized system,” economist and historian Robert Craig West later wrote.²³ “The point was made that the banks should have as much information about local business conditions and the member banks as possible. Better credit decisions concerning any local paper or the needs of the banking community would be the result. Such familiarity would make decisions about discount rates easier and would allow better control of the local money markets.”

Glass believed firmly in autonomous regional banks.

He later wrote: “In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries, there is no argument, either of banking theory or of expediency, which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted.”²⁴

The House Banking and Currency Committee assigned a subcommittee under the leadership of Rep. Carter Glass to explore reform proposals. Glass quickly enlisted the help of Henry Parker Willis, a professor at Washington and Lee University. Willis, who also wrote for the *Journal of Commerce*, would come to wield enormous influence over a subcommittee whose members had little knowledge of banking and finance.

The legislation put forward by Glass had some aspects in common with Aldrich, but there were some major differences, notably, where the capital would be held. While Aldrich had a central body, the Glass bill located the capital in the regional banks.

23. Robert Craig West, *Banking Reform and the Federal Reserve, 1863-1923*. (Ithaca, N.Y.: Cornell University Press, 1974) p. 107.

24. Carter Glass, *An Adventure in Constructive Finance* New York: Doubleday, Page and Co., 1927, p. 82.

Glass also did not like the idea of government control. Like Aldrich, his plan gave most of the authority to bankers.

Wilson, however, felt the plan needed a central board. He also believed strongly that neither Congress nor the public would support a proposal that gave the government little control. Early on, Glass had suggested that the comptroller of the currency perform a coordinating function over the system, but Wilson favored a central board. A provision creating the Federal Reserve Board was added to exercise a considerable amount of authority over the banks. It was made up entirely of presidential appointees, either ex officio members because of their cabinet positions or appointees to the Board for specific terms. To provide bankers with a voice, Wilson created the Federal Advisory Council, a group of 12 bankers elected by the regional banks that would occasionally meet with the Board.

Much of the early congressional criticism of the bill focused on the fact that the subcommittee had largely done its work secretly with Republicans having little involvement in crafting the legislation. The more substantive debate, however, focused on the issues of control, especially the power of the central board.

The historian West sums the criticisms into three categories:

- Too much control
- Too little control
- Control by the wrong people

Most Republicans wanted more power for bankers while Democrats felt that bankers had too much power already.

“This bill creates a ‘central bank.’ This plan is much more centralized, autocratic and tyrannical than the Aldrich plan,” Iowa Republican Congressman Horace M. Towner argued.²⁵ “It is true that we are to have 12 regional banks; but these are but the agents of the grand central board, which absolutely controls them. The power is not with them; they are not in any material matter given the right of



Robert L. Owen, an Oklahoma senator, led efforts in the Senate to gain the Federal Reserve Act's approval. From his background in Oklahoma banking, Owen had first-hand knowledge of the impact of a banking panic.

25. *Congressional Record*, 63d Cong., 2d sess., pt 1: pp. 4691; 4896.

independent action; they must obey orders from Washington.”

In the Senate, the debate was generally much more informed and varied than in the House, with the senators generally favoring more centralization. Support also began to emerge for a substitute bill offered by Oklahoma Democratic Sen. Robert L. Owen, which was similar to the House bill, but with a few changes including reducing the number of regional banks throughout the country – the House bill said a minimum of 12 banks while Owen called for eight to 12. Owen also removed the secretary of agriculture and the comptroller of currency from the Federal Reserve Board and changed the capital of the system to 6 percent of member banks’ capital and surplus from 20 percent of capital in the House bill. The move was seen as favorable to smaller banks.



Woodrow Wilson's ability to negotiate a compromise between various versions of the Federal Reserve Act was a key part in the legislation's final approval. Wilson signed the Act on Dec. 23, 1913.

The Owen proposal eventually prevailed over the ideas of another group led by Nebraska Democratic Sen. Gilbert M. Hitchcock that favored government control at all levels, even within the regional Reserve Banks. Hitchcock also favored only four banks throughout the country and would sell all of the stock of those banks to the public.

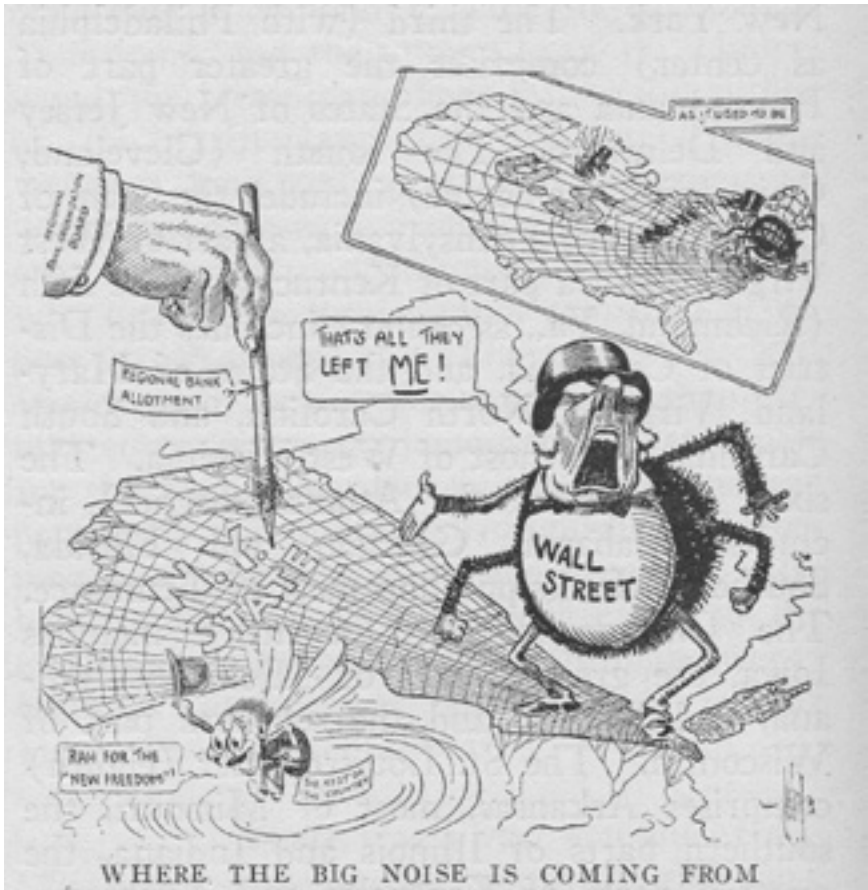
In regard to the final bills that passed both chambers, there were certainly differences, but they had much in common. Matters worked out in committee included the number of Reserve Banks, which ended up being between eight and 12; and the makeup of the Federal Reserve Board, including the return of the comptroller of the currency to the Board. As far as the terms of the Federal Reserve governors, they agreed on staggering terms and extending them from the six or eight years in the approved bills to 10 to ensure no president could appoint all governors during a two-term presidency.

The Federal Reserve Act was signed by President Wilson on Dec. 23, 1913, and the 12 Reserve Banks opened on Nov. 16, 1914.

In encapsulating the congressional deliberations that led to the Act finally gaining the president's signature, the historian West makes an interesting statement that captures not only the spirit of the debate, but also reflects on the Federal Reserve's decentralized and unique structure.

“An interesting feature of the debate was the different way in which the two bodies viewed the Glass Bill. House members believed . . . that the measure provided a large degree of decentralization, but many senators saw the measure as a central bank in everything but name. This paradox no doubt explains the fact that the bills passed by the House and Senate were very similar though the debate was very different. The House passed a bill which they claimed created a decentralized banking system. The Senate passed a very similar bill believing that for all practical purposes it provided a central bank. This duality was reflected in the Federal Reserve Act; it was possible to interpret the structure in different ways.”

Those competing interpretations would be at the core of numerous battles in the years to come.



This cartoon from the Columbus, Ohio Dispatch, shows America rejoicing as the Federal Reserve's regional structure reduces Wall Street's control on the rest of the country. The key reason for the regional Reserve Banks was to make sure viewpoints outside of Wall Street and Washington were part of the Fed's deliberations.

Growing Pains

The early Federal Reserve was not the institution known today, playing a largely supportive role to the Treasury, especially during World War I. However, within the Fed there was a struggle for control between the regional Reserve Banks and the Board.

In fact, some saw that battle already emerging on the horizon before the Banks even opened for business.

“I have a little feeling – in fact it is growing on me – that the Federal Reserve Board in Washington is inclined toward dominating the District Banks,” wrote Chicago Fed Director H.B. Joy more than five weeks before the Banks opened.²⁶

Among the first battles was an effort by four of the Federal Reserve Board members to reduce the number of Banks by as much as half. In his book *Adventure in Constructive Finance*, Glass says the Banks headed for the chopping block were those in Atlanta, Dallas, Kansas City and Minneapolis, with the possibility of Richmond and Boston also getting consideration for review.

The proposal, led by Paul Warburg, would have turned the Banks in question into branch offices. It would have also required the redrawing of Federal Reserve Districts – a potentially sticky issue politically because two ex officio members of the Federal Reserve Board, Treasury Secretary William McAdoo and Comptroller of the Currency John Skelton Williams, had been responsible for determining the District boundaries and the Reserve Bank cities. Additionally, Federal Reserve Chairman Charles S. Hamlin had previously worked under McAdoo and also supported the status quo.

It was largely the same battle as had taken place in crafting the Federal Reserve Act, with four board members seen as representing the large banks and the other three representing government control. Both sides made their case to President Wilson, who reportedly considered dissolving the entire Board and starting again.²⁷ The matter was finally dropped after the attorney general determined that the authority for redrawing the Districts required an act of Congress and was not something the Board could implement.

The governors of the Federal Reserve Banks (a position that has become today’s president) formed a Governors Conference led by New York Fed Governor Benjamin Strong.

26. *Board of Governors File, box 659 Oct. 10, 1914, as printed in Allan Meltzer’s A History of the Federal Reserve Volume 1: 1913-1951, Chicago, IL: University of Chicago Press, 2003 p. 75.*

27. *A. Jerome Clifford, The Independence of the Federal Reserve System, Philadelphia: University of Pennsylvania Press, 1965, p. 92.*

The Conference operated as if it had control of the Federal Reserve System and that the Board was in a position to only approve their actions. Among other instances, there were cases where the governors informed the Board that measures the Board wanted taken were not appropriate and that they would not be implemented until a later time.²⁸

In January 1916, the Board attempted to control the Governors Conference, saying that it would not authorize any additional meetings or approve any incurred expenses, a move resulting in the angry resignation of two bank governors. The Board's action was enforced throughout the War. Later efforts to reform the Governors Conference in 1922 led to meetings that were of increasingly less importance.

The Discount Rate

Another major fight within the Federal Reserve focused on who controlled the discount rate, which was the System's most important policy tool, and later, open market operations when they became a policy tool.

Section 14 of the Federal Reserve Act granted the Reserve Banks the authority to set rates of discount, "subject to review and determination of the Federal Reserve Board." Although it seems difficult to imagine today, under the original Act, rates were expected to vary throughout the country, with the idea that the Reserve Banks would best understand regional credit conditions. One of the most substantial criticisms of the Aldrich proposal, in fact, had been that it set a single rate for the entire nation.²⁹

Although the possibility of various rates among the Districts was clearly in the spirit of the decentralized system envisioned by the Federal Reserve's creators, in practice it had an obvious weakness: Institutions seeking a more favorable rate would simply make a deal with an institution in the Fed District with the lowest rate. Eventually, the Board took control of the discount rate, telling the Banks they had to submit their rate target weekly. The Board could then reject the requests and force the Banks to resubmit, repeating the process until the rate was at the Board's target.

The regional Banks were outraged and prepared to fight the Board's move, but the outbreak of the War put those efforts on hold. The Banks became particularly infuriated later in 1919 when the Board held the rate down despite the efforts of the Reserve Banks to raise rates amid inflationary fears.

Finally, Glass, who by this time was

28. Clifford, *The Independence of the Federal Reserve System*. Philadelphia: University of Pennsylvania Press, 1965 p. 95.

29. West, *Banking Reform and the Federal Reserve, 1863-1923*. Ithaca, N.Y.: Cornell University Press, 1974, p. 220.

secretary of the Treasury, asked the attorney general for an opinion on the Board's action. Unexpectedly, the attorney general supported the Board.³⁰

The Banking Act of 1933

Although the McFadden Act of 1927³¹ erased the Federal Reserve's initial 20-year charter and gave the Fed permanence, arguably the first major changes to the Federal Reserve Act came in 1933. As approved, the Banking Act of 1933 had numerous components beyond the Fed. It created the Federal Deposit Insurance Corporation, separated deposit banks and investment banks, prohibited investment banks from taking deposits, and banned interlocking directorates for commercial and investment banks.



Carter Glass, as a senator, continued to defend the Federal Reserve. Among his concerns about the central bank was the control that the U.S. Treasury wielded over the institution.

For the Fed, however, the legislation focused debate on the now-familiar questions of authority and the relationship between the Reserve Banks and the Federal Reserve Board.

Glass, who became a U.S. senator in 1920 when he accepted an appointment after the death of Virginian Thomas Staples Martin, first offered the bill in 1930. In addition to the economic and financial turbulence of the time, Glass was also concerned about the Treasury's seeming control of the Federal Reserve and the need for the Board to have more authority over open market operations.

Early open market operations – the purchase or sale of securities – had been in the control of the Reserve Banks. Initially, it had been handled by a five-member Open Market Investment Committee, with governors of the New York, Philadelphia, Chicago and Cleveland Reserve Banks. The Board was finally able to wrest some control over these operations, although New York Fed President Benjamin Strong still held enormous sway.

The leadership position was a comfortable role for Strong, who frequently operated

30. West, *Banking Reform and the Federal Reserve, 1863-1923*. Ithaca, N.Y.: Cornell University Press, 1974, p. 222.

31. *The Act dealt primarily with interstate banking regulation.*

more as head of the Federal Reserve System than the leader of one of the Reserve Banks. Among the actions taken by Strong that outraged Glass was the New York Fed's lead in international dealings that Glass thought may have contributed to the financial crisis of the early 1930s.

Strong's career put him in the middle of the action at some of the key events in U.S. financial history. In 1907, he worked for J.P. Morgan and was one of Morgan's top assistants on the financier's bailout of Wall Street. Three years later, Strong was one of only a handful of invitees to the Jekyll Island meeting and is believed to be one of the principal authors of the resulting Aldrich Act. Oddly for someone who later held the top position at the New York Fed, Strong had campaigned vigorously against the approval of the Federal Reserve Act in 1913.

Strong became only more prominent in international finance at the New York Fed. When the Federal Reserve was trying to find its way after opening in 1914, Strong "was quick to exploit the uncertainty about who was in charge," historian Liaquat Ahamed writes in his 2009 book *Lords of Finance: The Bankers Who Broke the World*.³²

"While the New York Fed ... was on paper merely one among the 12 regional Federal Reserve Banks and theoretically under the supervision of the Federal Reserve Board in Washington ... it was by a long way the largest of the reserve Banks, and Strong, not a man to wait upon orders, made himself the chief pilot of the whole system."

After the end of World War I, the heads of the Bank of England and the Reichsbank along with the deputy governor of the Bank of France came to the United States to meet with Strong in a session that Winston Churchill, then chancellor of the Exchequer, touted as the first time "the highest financial authorities in Germany, France, Great Britain and the United States" had met.³³ Strong returned the favor – one of several trips to Europe in an official capacity – visiting the heads of European central banks and, on his way back, signed papers committing the New York Fed to nearly half of a \$75 million line of credit for Italy.³⁴ The commitment was one of several Strong signed on behalf of the New York Fed to help support foreign economies. One of the most heavily criticized involved a \$200 million, two-year standby loan in 1925 to the Bank of England. For his part, Strong argued that he had sought and received approval from the Federal Reserve Board for the loan.

Strong was also attacked for seemingly holding down the New York Fed's discount

32. Liaquat Ahamed, *Lords of Finance: The Bankers Who Broke the World*. New York: The Penguin Group, 2009, p. 91.

33. New York Times, June 28, 1927.

34. New York Times, Dec. 28, 1927.

rate in an effort to help the Bank of England. Although Strong's counterparts throughout the United States were moving rates to 4.0 percent, Strong held at 3.5 in an apparent bid to reverse gold flows to England and out of the United States – in that way, he was successful.³⁵ The concern in the United States, however, was that the artificially low rate was contributing to the rise in stock market speculation. Amid the criticism, Strong argued that money to finance stock purchases came from throughout the United States and raising the New York rate would only move activity to another part of the country and not impact the stock market. (Later, the New York Fed attempted on 10 separate occasions to raise rates by 1 percentage point to 6 percent, and in each case, the Board vetoed the moves.³⁶)

Given Strong's long list of actions taken on behalf of the entire Federal Reserve System, it is not surprising that Glass launched a brutal attack on the New York Fed during a May 1932 hearing. Glass also went after the Federal Reserve Board for being “weak and vacillating,” in the words of one reporter.³⁷

“For a period of six years, one of the Federal Reserve Banks has given more attention to stabilizing Europe and to making enormous loans to European institutions than it has given to stabilizing America,” Glass said.³⁸

He went on to note that his bill had provisions spelling out “the restraint the Federal Reserve supervisory authority here in Washington should exercise over the foreign and open market operations of a bank which assumes to be the central bank of America. We did not think we were having a central bank. We thought we were having 12 regional Banks.”

Glass was especially critical of how Strong, who had died in 1928, had been treated as the head of the Federal Reserve



Benjamin Strong, governor of the New York Fed, was criticized for positioning himself as the de facto head of the entire Federal Reserve System. Ironically, Strong had earlier opposed the legislation that created the Federal Reserve.

35. Meltzer, *A History of the Federal Reserve* Volume 1: 1913-1951. Chicago: University of Chicago Press, 2003, p. 209.

36. Abamed, *Lords of Finance: The Bankers Who Broke the World*. New York: The Penguin Group, 2009, p. 322.

37. Chicago Daily Tribune, *May 10, 1932*.

38. Chicago Daily Tribune, *May 10, 1932*.

while abroad and how he had behaved as the head of the Federal Reserve while receiving visitors in the United States.

“For a long time that great Bank resisted any suggestion ... that it should be brought within the limitations of the central authority here at Washington,” Glass said. “At one time it was so – and I think it is so now – that all Europe regarded this Federal Reserve Bank (of New York) as the central bank of the United States.”

Although Glass’ second bill was rejected as being too rigid, Glass was successful with his third attempt. The legislation is often referred to today as the Glass-Steagall Act, after Glass and House Sponsor Henry B. Steagall of Alabama.

For the Federal Reserve, the Act placed supervision of bank holding companies under the Federal Reserve Board, lengthened the terms of governors to 12 years from the previous 10, gave the Board power to remove bank officers who violated laws and gave the Board the power to set ceiling rates on time deposits. It also created the Federal Open Market Committee as a legal entity with all 12 Banks as members. The Banks could only engage in open market operations under the Board’s regulations, but the Board could not initiate actions, only approve or reject the steps taken by the Banks. The Banks, however, could opt out of market operations with 30 days’ notice.

On one point, however, Glass failed. He had initially wanted to remove the Treasury secretary from the Board to lessen the Treasury’s influence over the Federal Reserve. The Treasury secretary, however, rejected the idea, and Glass finally relented on this point.

Banking Act of 1935

Less than a year after the 1933 legislation was approved, a Treasury panel began work on additional banking legislation. The Federal Reserve decided to form a System committee to work with the Treasury on the bill, establishing a legislative committee on June 25, 1934.

When Marriner Eccles became chairman of the Federal Reserve five months later, however, he immediately



Thomas D. McAvoy/Time & Life Pictures/Getty Images

Marriner Eccles was appointed Federal Reserve chairman in 1934. He quickly embarked on his plan to consolidate the Fed’s power in Washington under his control.

abolished the committee. The new Fed chairman dramatically told the System committee's chair that one of the primary reasons he accepted the Fed position was to work on a legislative program that was at odds with what the panel was likely to recommend.

Although the System group was exploring various issues, one of its key efforts focused on blocking a push to give more authority over the System to the Board in Washington, arguing that structural changes would not solve the problems facing the nation at that time.³⁹ Among other things, the group's final report suggested improving supervision and regulation by unifying exams and supervision under the Reserve Banks.

Many of the Fed's creators had viewed the Federal Reserve as a network of regional Banks and not a central bank. However, that question had remained open to some degree and the dispute was at the core of many disagreements about the Fed.

The new Fed chairman was planning to resolve the issue once and for all.

"Eccles wanted a central bank with authority concentrated in Washington, specifically in his hands," historian and economist Allan Meltzer later wrote.⁴⁰

Less than two weeks before his appointment, Eccles spelled out the steps for increased centralized authority in a memo to President Franklin Roosevelt.

"The adoption of these suggestions would introduce certain attributes of a real central bank capable of energetic and positive action without calling for a drastic revision of the whole Federal Reserve Act," Eccles wrote.⁴¹ "Private ownership and local autonomy are preserved, but on really important questions of policy, authority and responsibility are concentrated in the Board. Thus, effective control is obtained, while the intense opposition and criticism that greets every central bank proposal is largely avoided."

When 1935 opened, Eccles had made a preliminary move to increase the Board's power with a directive to the regional Reserve Banks declaring that no member of a regional

Reserve Banks' Board of Directors could serve for more than six years with the exception of the chairman. The order was seen as an effort to prevent the regional boards from becoming more firmly established than the Federal Reserve Board in Washington.⁴²

Glass was outraged by the move, saying, "It would be better to put a limit

39. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, pp. 471-472.

40. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 470.

41. *Everything about Eccles was a major change in the Federal Reserve. Eccles was the first Federal Reserve chairman to host weekly press conferences and the first to raise such issues with the public. Previous Fed chairmen had largely stayed out of the limelight, with most of their public comments coming only as a response to a question from congressmen or other officials.*

42. *Christian Science Monitor*, Jan. 19, 1935.

on the service of the members of the Reserve Board here (in Washington) and keep it from getting stale.”⁴³

The issue of local directors, however, was relatively minor compared with what was proposed a month later.

The bill sent to Congress in February 1935 was essentially drafted in secret by Board staff under Eccles’ direction. Despite the efforts of the System committee formed prior to Eccles’ arrival, there was no input from the Reserve Banks. Even the Federal Reserve Board was not asked to approve the proposal and only kept advised of its progress.⁴⁴

As presented, the bill clearly concentrated control of the Federal Reserve in Washington. Among the provisions touted by Eccles:

- Give the Federal Reserve Board the right to approve the governor (president) of each Reserve Bank and eliminate the position of Reserve Bank chairman;
- Put open market operations under the control of a five-member committee comprising three Federal Reserve Board members and two governors (presidents) from the regional Reserve Banks;
- Move authority to specify eligible paper from the Reserve Banks to the Board.

While the bill was calling for major changes in the Fed’s structure, Eccles actually favored even more centralization. Meltzer notes in his 2002 book *A History of the Federal Reserve, Volume 1* that during congressional testimony, Eccles said he believed open market operations should be controlled entirely by the Federal Reserve Board and that the leaders of the regional Reserve Banks should have only a consulting role.

The then-current structure of the Fed had “been put to a severe test and has not stood that test,” Eccles told reporters.⁴⁵ “(It) has proved to be an element of weakness in our economic structure that has aggravated and prolonged the worst phases of the depression.”

Without the changes, he argued, the nation would be set for a continuing cycle of recovery and crisis. Those who opposed him were viewed as being under the control of New York’s powerful bankers.

“(Eccles) never mentions, and seems unaware, that the proposed move toward a central bank and the weakening of the System’s regional structure was seen as a substantive issue of great importance in many sections of the country and by

43. The Washington Post, Jan. 23, 1935.

44. John M. Blum, *From the Morgenthau Diaries: Years of Crisis, 1928-1938*. Boston: Houghton Mifflin, pp. 352-353, as referenced in Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 476.

45. Christian Science Monitor, Feb. 9, 1935; The Washington Post, Feb. 9, 1935.

many groups,” Meltzer wrote.⁴⁶ “Even bankers who favored a central bank did not want the bank controlled from Washington.”

President Roosevelt, apparently recognizing that the legislation would not win favor with some bankers, had the bill put with two other pieces of legislation. One liberalized FDIC assessments and required banks to join the insurance fund; the other changed a provision of the 1933 legislation related to bank officers repaying loans.

The bill was approved with virtually no change in the House, 271-110, almost entirely along party lines, with the Democrats supporting the proposal.

In the Senate, however, the bill had to go through the Banking and Currency Subcommittee, headed by Glass, who believed centralization had already gone too far.

In hearings, Glass said that the bill did not reflect the 1913 Federal Reserve Act, which he said gave the Board supervisory responsibility for the System, but not the control of policy. Glass and Michigan Sen. James Couzens also asked repeatedly about what could have been done differently if the bill had been in place during a situation such as the stock market collapse. Eccles could not answer that question during the hearing and later wrote a letter saying that the powers would not have made a difference in 1929, but would have had an impact later in 1931, with much more considerable open market operations.

“The Eccles bill strikes chiefly at the autonomy of the Reserve Banks under the existing law,” reads a report on the debate in the June 9, 1935, edition of *The Washington Post*. “Besides stripping the 12 Banks of most of their self-governing powers, it expands greatly the Reserve Board’s powers of initiating and directing the policies of the System’s Banks.

“Thus the critics of the measure point out the danger of political domination, as since the President’s power over the Board is likewise enlarged, the entire System could be influenced by political considerations in Washington.”

Specifically, Eccles’ critics noted Washington’s reluctance to approve efforts by the New York Fed to raise rates in the late 1920s amid heavy stock market speculation.

The Senate finally approved a bill with many changes authored by Glass. Notably, Glass had managed to get the Reserve Banks a role in open market operations with the Federal Open Market Committee comprising seven Board members and five Reserve Bank representatives chosen by a committee of Reserve Bank directors.⁴⁷ Glass also obtained the

authority for the Reserve Bank directors to choose Bank officers subject to approval of the Federal Reserve Board.

46. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 469.

47. *Rotations of the Reserve Bank presidents on the FOMC started in 1942, although the rotation differed from the system in use today.*

Other changes in the Act included making the heads of the regional Reserve Banks presidents instead of governors, turning the Federal Reserve Board into the Board of Governors of the Federal Reserve System, removing the Treasury secretary and the comptroller of the currency from the Board, and setting 14-year terms for the newly titled governors.

While Glass had some successes, and took much credit for the final bill, the Board had gained substantial power over the Banks.

“(The) compromise gave Eccles many of the changes he wanted,” Meltzer wrote.⁴⁸
“The 1935 Act permitted the Federal Reserve to become a central bank.”

Establishing Independence

For some, the changes brought about in the Banking Act of 1935 were not substantial enough.

In 1937, Rep. Wright Patman introduced a bill that would have nationalized the Reserve Banks and put the Treasury secretary and comptroller of the currency back on the Board of Governors. Additional steps called for putting the head of the FDIC on the Board along with one representative from each Federal Reserve District. The massive combined group would have also served as the Federal Open Market Committee (FOMC).

Patman boasted that his bill had 150 co-sponsors and vowed to “make it an issue in every State and Congressional district next term,” if others did not come on board.⁴⁹

The initiative ran out of steam only after Fed staff was able to convince Patman that nationalizing the Reserve Banks would give the government no additional power – while commercial banks owned stock in the Fed, they did not control the System.

Board of Governors staff actually favored some of Patman’s ideas, such as eliminating the Federal Advisory Council and giving the Board total control of the FOMC.⁵⁰ The support is perhaps not surprising given some of the initiatives Eccles had favored only a few years earlier.

In the years that followed the Patman proposal there were relatively minor changes to the Fed, such as the permanent addition of the New York Fed president to the FOMC in 1942.

Eccles went back to Congress in 1947 during a special session that lawmakers convened to provide support to Europe. During the session, Eccles asked Congress for increased statutory reserve requirements, temporary authority for the FOMC to impose a special reserve requirement and other steps. The request was rejected with both the Treasury secretary and the New York Fed president opposing Eccles’ plan.

Some wrote later that the rejection of Eccles’ request was a sign that his once-impressive Washington influence was beginning to wane.⁵¹ If Eccles felt that way, the belief was affirmed less than a year later, in early 1948, when he was told he would not serve another term as chairman.

49. The Washington Post, *May 9, 1937*.

50. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 489.

51. A. Jerome Clifford, *The Independence of the Federal Reserve System*. Philadelphia: University of Pennsylvania Press, 1965, p. 209.

“I think the president got the feeling that Marriner wasn’t being 100 percent cooperative and perhaps not quite 100 percent loyal in carrying out policies,” John Steelman, assistant to President Harry S. Truman, later recalled.⁵² “(Truman) delegated me to do the job of either firing Marriner outright, or getting him to give up the chairmanship and remain on awhile.”

Eccles, who had offered to resign when Truman took office after Roosevelt’s death in 1945, was angered by the move. The Fed chairman sought and received a meeting with Truman, where the president asked Eccles to stay on as a governor, but not as chairman. Eccles finally agreed.

Later, he wrote that he believed Truman was acting under pressure from California’s Giannini family, controllers of both Bank of America and Transamerica. Under Eccles’ leadership, the Fed had been working to take steps that would prevent Transamerica’s expansion.

Meltzer writes that though the Gianninis may have played some role, Eccles had given Truman ample reasons for his removal.⁵³ Among the more notable issues were the icy relationship Eccles had with the nation’s banking industry and that he was often at odds in the Fed’s delicate relationship with Treasury Secretary John Snyder, who was also a close friend of Truman’s.

Eccles’ successor was Thomas B. McCabe, a director and chairman of the Philadelphia Fed who had led Scott Paper Co. from a small operation to a multinational firm. McCabe’s tenure with the Fed would be brief, but it would encompass one of the most important events in Fed history.



Thomas B. McCabe had led Scott Paper Co. and served as chairman of the Philadelphia Fed prior to being appointed Federal Reserve chairman. Although his tenure was brief, it encompassed one of the most tumultuous periods in the central bank’s history as it worked to gain full independence from the Treasury and the administration.

52. Oral History Interview with Dr. John R. Steelman by the Harry S. Truman Library and Museum, Jan. 15, 1963. On file with the Truman Library and Museum, Independence, MO.

53. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 656.

The Treasury

There had always been friction between the Federal Reserve and the Treasury. The first governor (chairman) of the Federal Reserve Board was Charles Hamlin, who came to the position after serving as assistant secretary of the Treasury under William G. McAdoo. At the Treasury, McAdoo had played a key role in the Fed's development and, as Treasury secretary, he was now also a member of the Federal Reserve Board. Further implying the Fed's subservience to the Treasury, the new central bank operated out of offices within the Treasury building.

Henry Parker Willis, who played an important role in the Fed's creation and was the Federal Reserve Board's first secretary, later said that the Treasury arrangement was especially unpopular with the Fed. One Federal Reserve Board member went so far as to suggest, perhaps only half-jokingly, that the Federal Reserve Board should relocate to Chicago in an effort to make it impossible for McAdoo to attend the meetings.⁵⁴

"The (Federal Reserve) itself never had the courage to act upon its own instincts and the result was that as time passed it gradually became more and more dependent upon Treasury dictation and less and less able to assert itself independent of the Treasury authorities," Willis wrote.⁵⁵ "This was perhaps the most fundamental error in the process of organization, since it forever condemned the Board to a position of subordination and definitely established it as in fact, even if not in theory, a portion of the organization of the (Treasury) Department."

A question about the Fed's standing as related to the Treasury was clarified in a letter from President Woodrow Wilson to McAdoo as the regional Federal Reserve Banks were opening in November 1914:

"In the anxious times through which we have been passing, you have, my dear Mr. Secretary, been able to do many noteworthy things to strengthen and facilitate the business operations of the country. Henceforth, you have a new instrument at hand which will render many parts of your task easy."⁵⁶

Although the Fed was eventually able to gain degrees of independence – the Treasury secretary was removed from the Board by the 1935 legislation and the Fed relocated into a new facility along Constitution Avenue in 1937 – it still remained subservient to the Treasury in many ways. In fact,

54. *A. Jerome Clifford, The Independence of the Federal Reserve System. Philadelphia: University of Pennsylvania Press, 1965, p. 79.*

55. *H. Parker Willis, The Federal Reserve System: Legislation, Organization and Operation. New York: The Ronald Press Co., 1923, p. 674.*

56. *As reprinted in A. Jerome Clifford, The Independence of the Federal Reserve System. Philadelphia: University of Pennsylvania Press, 1965, p. 49.*

Meltzer suggests the Treasury actually exercised more influence over the Fed in the years immediately after the Treasury secretary was removed from the Federal Reserve Board. Notably, the Fed implemented policies through the war and post-war years supporting the prices of long-term debt, thereby helping to finance government spending.

What might be considered the opening salvo in the most substantial battle between the Fed and the Treasury was fired in the summer of 1949 when Fed Chairman McCabe announced that the Fed would conduct open market operations with a primary regard to business conditions. McCabe later said that he believed the announcement marked “the removal of the strait jacket in which monetary policy had been operating for nearly a decade.”⁵⁷

In the fall of that year, McCabe and other Fed officials were able to make the Federal Reserve’s case during testimony before a subcommittee of the Joint Committee on the Economic Report. However, Meltzer writes that during the hearings, McCabe seemed the most willing to accommodate the Treasury – much more so than his announcement had implied – while New York Fed President Allan Sproul was the stronger supporter of an independent Fed.⁵⁸ Sproul, in fact, had been the primary force in pushing the Fed to end pegged interest rates and restoring some of the seemingly lost independence.⁵⁹

The hearings focused primarily, however, on the Fed/Treasury relationship. In that regard, the subcommittee took the Fed’s side by opposing the subordination of monetary policy to debt management in its final report.

The Accord

The situation between the Fed and the Treasury, however, continued to deteriorate as the United States entered fighting in Korea and inflationary pressures rose. Disagreements between the two continued on various issues until finally both McCabe and Snyder met with Truman on Jan. 17, 1951. During the meeting, Truman indicated a desire to maintain the long-term interest rate at 2 ½ percent, but McCabe said he had some doubt that the long-term bond could stay at that level. Snyder did not mention during the meeting that he would be speaking on the issue the following day in New York. During that presentation, Snyder referenced the meeting with Truman and McCabe and said they agreed that the rate would remain at 2 ½ percent.

57. As reprinted in A. Jerome Clifford, *The Independence of the Federal Reserve System*. Philadelphia: University of Pennsylvania Press, 1965, p. 213.

58. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, pp. 686-690.

59. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 723.



Harry Truman was the first, and so far only, U.S. president to call the entire Federal Open Market Committee to the White House. The administration and the Fed would later give the public widely divergent views of the meeting.

The announcement infuriated Fed officials, who, by Snyder's comments, felt they were now committed to an inflationary policy. The Treasury secretary was also attacked in the press.

“Central banks in their general policies may from time to time make concessions to the temporary needs of the Exchequer, but when and if they do they announce the fact themselves,” wrote *New York Times* columnist Edward H. Collins.⁶⁰ “In the opinion of this writer, last Thursday constituted the first occasion in history on which the head of the Exchequer of a great nation had either the effrontery or the ineptitude, or both, to deliver a public address in which he so far usurped the function of the central bank as to tell the country what kind of monetary policy it was going to be subjected to. For the moment at least, the fact that the policy enunciated by Mr. Snyder was, as usual, thoroughly unsound and inflationary, was overshadowed by the historic dimensions of this impertinence.”

At Snyder's urging, Truman called the FOMC to the White House for a Jan. 31 meeting. It was the first, and so far only, occurrence of its type – an incident that Meltzer, with understatement, called “a most unusual breach of independence.”⁶¹

Little was accomplished during the meeting, with the president talking about the seriousness of the war and the need to maintain confidence in the government's credit. Some FOMC members felt the meeting had been a wasted opportunity.

60. *New York Times*, Jan. 22, 1951.

61. Meltzer, *A History of the Federal Reserve Volume 1: 1913-1951*. Chicago: University of Chicago Press, 2003, p. 7.

The day after the meeting, the White House issued a statement saying that the Fed had agreed to support the president and the stability of government securities through the war. The Treasury followed with a statement explaining that interest rate levels would not change for the duration of the conflict.

As the Board considered its possible responses, Eccles, acting independently, went to the press with the Board's own minutes of the meeting, which showed that Truman and Snyder had misled the country about what occurred during the session.

The press, siding with the Fed, went after Truman.

"Mr. Truman wants the Board to become a mere passive agent of the Treasury," editorialized *The Hartford Courant*.⁶² "That would be a complete reversal of the traditional role. Financial experts are already pointing out that every serious currency inflation in this or other countries has been preceded by subordination of the central bank to the will of the government in power."

Raymond Moley, a *Los Angeles Times* columnist, wrote a column suggesting Truman study the history of the Federal Reserve to better understand the reason for its unique structure.⁶³

"All this was to protect (the Federal Reserve) utterly and irrevocably from political control."

The Washington Post gave Truman an unfavorable comparison to Andrew Jackson and his fight against the Second Bank of the United States that plunged the nation into a series of financial panics.⁶⁴

The incident was followed by letters and a series of meetings between Fed and Treasury officials. Finally, they were able to come to an agreement where the Federal Reserve would hold rates steady through the rest of the year, among other measures.

On March 4, 1951, the two sides released a statement reading, in part: "The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the government's requirements and, at the same time, to minimize the monetization of the public debt."

For the Fed, the agreement meant the central bank could conduct monetary policy without Treasury approval for the first time since 1934.

McCabe, who was weakened politically by the battle, resigned at Truman's urging

62. *The Hartford Courant*, Feb. 5, 1951.

63. *The Los Angeles Times*, Feb. 10, 1951.

64. *The Washington Post*, Feb. 7, 1951.

only days after the accord. He was succeeded by William McChesney Martin, Jr., an assistant Treasury secretary, who would hold the position for nearly 19 years.

Martin, who was involved with accord negotiations, had been fearful throughout the negotiations that the Fed/Treasury battle would dramatically weaken the Fed in terms of its independence.

During the dispute, “I felt I had to go to (Treasury) Secretary Snyder repeatedly and argue that central banks should not, in my judgment, be in politics,” Martin told senators during his confirmation hearing.⁶⁵ “My judgment of a central bank is that it is a partner with the Treasury, but it is not in politics.”

65. The Wall Street Journal, Oct. 31, 1951.



William McChesney Martin was the longest-serving Federal Reserve chairman, holding the office from April 2, 1951, until Jan. 31, 1970. During his tenure, Martin battled Congressman Wright Patman, President Lyndon Johnson and others.

After the Accord

Although the accord gave the Federal Reserve independence from the Treasury, it in no way brought an end to political efforts to put the central bank under more direct government control.

Substantial efforts were led by the man who in 1937 had proposed nationalizing the Federal Reserve Banks, Rep. Wright Patman.

The east Texas congressman, cut from the same populist cloth as Andrew Jackson, was involved in several pieces of legislation during a 47-year House career including bills creating credit unions and the Small Business Administration. To many Americans, however, he was best known for his ongoing battles against the Federal Reserve and commercial banking.

“As he saw the world, the (Federal Reserve and commercial banks) eternally conspired to keep interest rates high – and bank profits high – to the detriment of small business men and farmers who needed cheap credit,” *The New York Times* wrote in a lengthy profile of Patman after his death.⁶⁶ “Mr. Patman never succeeded in forcing a major restructuring of the Federal Reserve System or the banking system, but he won a number of limited victories in this area.”

At the very least, he made things uncomfortable with a virtual nonstop assault on the central bank.

Among other things:

- In one instance, he sent Fed officials 245 questions that took nine months and \$100,000 in research to answer.⁶⁷
- In 1952 he headed a subcommittee that recommended numerous changes to the Fed, including reducing the Federal Reserve Board to five members appointed by the president for six-year terms and requiring each of the 12 Reserve Banks to send their annual budgets to Congress for approval.⁶⁸
- He brought the Federal Reserve Board as well as the presidents of the 12 regional Reserve Banks in front of a 1954 congressional panel for what was expected to be a roundtable discussion.⁶⁹ Although surprisingly little occurred during the hearing, it was the first time the entire group had come before Congress.⁷⁰ It was certainly not the last such event. Patman called either the full FOMC or the Federal Reserve

66. *The New York Times*, *March 8, 1976*.

67. *The Washington Post*, *March 8, 1976*.

68. *Chicago Daily Tribune*, *July 3, 1951*.

69. *New York Times*, *Dec. 8, 1954*.

governors to testify jointly at hearings throughout the remainder of his political career.

- During a 1964 hearing, he questioned Cleveland Fed President W. Braddock Hickman about a series of “questionable expenditures” that Patman’s investigators found in a review of the Cleveland Fed’s books, including \$4,698 spent on an annual dinner, \$32 for cigars, and \$21.54 for 36 table tennis balls and six paddles.⁷¹ He did the same thing at least one other time. In 1975 he raised questions about such expenditures as the New York Fed spending \$9.67 on bowling score sheets and the Louisville Branch of the St. Louis Fed spending \$1,226 on dinner and drinks for 19 people.⁷²
- He repeatedly, and with various criticisms, called for Martin’s resignation. In 1965, he said Martin viewed himself as the president of the United States⁷³ and in 1968 he accused Martin of malfeasance and said he had done as much damage as the Viet Cong.⁷⁴

“Mr. Patman, a cheap-money zealot, always sees red where Mr. Martin is concerned,” wrote *New York Times* columnist M.J. Rossant in a 1967 article.⁷⁵ “(Patman) recently accused the Federal Reserve head of running a ‘monetary dictatorship’ resembling the Soviet Politburo. He also charged that Mr. Martin has cost consumers ‘\$200 billion in excess interest charges’ since taking over the chairmanship in 1951.”

Economist William B. Harrison traces Patman’s anger not back to Martin’s chairmanship directly, but to the ’51 accord.

“While Federal Reserve officials viewed the accord as ushering in a new period of monetary independence and effectiveness, Patman felt that it ended a time when the Fed had served the public best,” Harrison wrote in 1981.⁷⁶

Although Patman would continue his attacks until the early 1970s, Harrison says the efforts resulted in only one substantive change: The Fed hired an outside accounting firm to annually audit its books.

70. *The event was only one of Patman’s attempts at grandstanding. During a 1941 hearing on price control legislation, Patman tried to embarrass Federal Reserve Chairman Marriner Eccles by challenging Eccles to recite the wording on a dollar bill. The incident was diffused to some degree when, after Eccles said he could not recite the wording, Patman also was unable to recite the wording and none of the 40 individuals in the hearing room would provide him with a dollar bill* (The Washington Post, Oct. 2, 1941).

71. The Washington Post, June 30, 1964.

72. The Washington Post, July 23, 1975.

73. The Washington Times Herald, June 16, 1965.

74. The Chicago Tribune, Feb. 15, 1968.

75. The New York Times, Mar. 20, 1967.

76. William B. Harrison, “Wright Patman and the Federal Reserve System,” published in the *American Journal of Economics and Sociology*, Vol. 40, No. 3 (July 1981) pp 317-320.



Wright Patman was an east Texas congressman who strongly opposed the Federal Reserve. Patman wanted the Fed under government control.

casting the deciding vote.

It was not an easy decision for Martin, who knew what the president expected.

“We should be under no illusions,” Martin told the governors prior to the vote, “a decision to move now can lead to an important revamping of the Federal Reserve System, including its structure and operating methods. This is a real possibility and I have been turning it over in my mind for months.”⁷⁷

Martin was called to Johnson’s Texas ranch the following day to discuss the matter. Johnson, who was recovering from gall bladder surgery, had already ordered aides to begin searching for someone to replace Martin.

“You’ve got me in a position where you can run a rapier into me and you’ve done it,” Johnson told the Fed chairman.⁷⁸

Martin argued that the Federal Reserve Act gave the Fed responsibility for interest rates and that “this is one of the few occasions where the Federal Reserve Board decision has to be final.”

It was a two-hour meeting followed by a press conference. Unnamed sources told

While the Fed had Patman to battle in Congress, there was also pressure from the White House, notably in 1965 when President Lyndon Johnson wanted lower interest rates as he worked to expand domestic programs and fight the war in Vietnam. In late 1965, the Reserve Banks, which throughout the Fed’s history have been less vulnerable to pressure from the administration or Congress, asked for a rate increase. On Dec. 3, the Board of Governors voted to increase the discount rate by a 4-3 margin, with Martin



President Lyndon Johnson, angered by an interest rate increase that he believed hampered his efforts to expand domestic programs and fight the war in Vietnam, ordered staff members to find a replacement for Federal Reserve Chairman William McChesney Martin. The two met at Johnson’s Texas ranch where Martin refused to back down.

77. Board of Governors, minutes, Dec. 3, 1965, as appearing in Robert P. Bremner, Chairman of the Fed, 2004 (Yale University).

78. Martin Oral History, as appearing in Robert P. Bremner, Chairman of the Fed. Yale University, 2004.

The New York Times that the meeting was amiable, in an apparent attempt to cover the friction between the two men. Both men smiled during the press conference and Johnson joked that while it was the media's job "to provoke a fight, mine is to prevent one."⁷⁹

Johnson also told reporters that neither man had changed the other's mind.

Later, historian Robert Bremner wrote that standing up to Johnson at the Texas ranch was one of Martin's "finest moments."⁸⁰

"Lyndon Johnson rarely heard such stern words delivered to him during his presidency."

Inflation

President Richard Nixon appointed Arthur Burns to replace Martin at the end of Martin's term in 1970.

In 1975, with the nation facing a severe recession, rising oil prices and the Watergate aftermath, the Fed once again became a political target from both sides. As 1975 opened, House lawmakers introduced legislation that would "request" the Fed maintain 6 percent money supply growth through the first half of the year and report to Congress immediately if it was not possible. The Fed slowed the growth rate the previous year to curb inflation and many lawmakers believed the Fed had caused both the inflationary environment and the following recession. They felt it was time to step in.

"The same Congress that discovered unsupervised executive power led to a Vietnam war and a Watergate scandal is now skittish about permitting the seven-member Federal Reserve Board of Governors to make fundamental decisions about where economic policy should be moving," wrote columnist James L. Rowe in *The Washington Post*.⁸¹

Burns told the House banking subcommittee that legislating the money supply would have major consequences for both the economy and the Fed's international standing.

"Congress has not found it easy to legislate fiscal policy," Burns told the subcommittee.



Arthur Burns was the 10th Federal Reserve chairman. During his tenure, Congress sought greater control over the Fed and some lawmakers wanted to legislate the money supply.

79. *New York Times*, Dec. 7, 1965.

80. Robert P. Bremner, *Chairman of the Fed*. Yale University, 2004, p. 210.

81. *The Washington Post*, March 2, 1975.

“If Congress now sought to legislate monetary policy as well, it would enter a vastly more intricate, highly sensitive and rapidly changing field – with consequences that could prove very damaging to our nation’s economy.”

The hearing did not stop the bill, which continued to gain support from many corners, including Jack Anderson, who used his *Washington Post* column to write about Fed employees being “sheltered” from the real world and receiving benefits “that other federal employees only dream about.”⁸² He focused his ire on the FOMC, which Anderson called “The Anonymous 19,” who came from banking backgrounds and “are closer to the banks than dimes in a five-dollar roll.”

During a Senate hearing on the legislation, Burns noted that while lawmakers wanted to expand the money supply, the problem was not the availability of cash, but that people were not using it “because of a lack of confidence,” and increasing the money supply would not raise confidence

Sen. William Proxmire, chair of the Senate Banking Committee, told Burns that other economists had testified that the Fed could do more.

Burns responded: “Oh sure, we could do more. We could do a lot more. We could wreck the country.”⁸³

The battle took on another dimension when there were reports of an apparent leak of Fed statistics on bank lending rates from the Board of Governors to *Consumer Reports* magazine. The leaked report raised questions about not only who provided the information, which was being investigated by the FBI, but why the information was not public in the first place (*Consumer Reports*, in fact, argued the information was publicly available from the individual financial institutions). Burns was asked in writing by a congressional subcommittee to explain how much money the Fed had spent opposing the Freedom of Information Act.⁸⁴

Further compounding the situation was the revelation only a couple of weeks later that a Board of Governors economist named Reed Irvine was apparently using his office and position at the Fed to further the agenda of his media watchdog group Accuracy in the Media (AIM), which had strong conservative leanings. The issue of Irvine came to light in one of Jack Anderson’s *Washington Post* columns, where he wrote that Irvine was “directing a Watergate-style assault on the press” and accusing him specifically of using Fed letterhead for additional leverage and access. Although media accounts of Irvine’s 1975 activities seem

82. The *Washington Post*, Feb. 23, 1975.

83. The *Washington Post*, Feb. 26, 1975.

84. The *Washington Post*, Feb. 26, 1975.



G. William Miller's tenure as Federal Reserve chairman was brief and difficult. He was once outvoted by the Board and staffers said he showed little interest in the Fed.

to imply his connection to the group had just been discovered, Irvine apparently made no effort to conceal his activist activities or his job at the Fed. His AIM chairmanship and his position at the Fed were both mentioned in a 1973 *Wall Street Journal* article about the group.⁸⁵

With the battles on various fronts, it is perhaps amazing that the primary result from the battle was a congressional resolution directing the Fed to conduct monetary policy in a way that encourages moderate long-term interest rates and more available credit.

The Fed was required to report its progress every six months.

The issue of Fed independence, however, was not out of the limelight for long.

A few months later, Sen. Hubert Humphrey promised legislation that would change the makeup of the Board of Governors and cut the 14-year terms in half to raise the likelihood that a president could appoint a majority of members.

Humphrey said his goal was to “make the (Fed) more responsive to the will of the people and less likely to act like the high priest of finance.”⁸⁶

Although Humphrey's initial bill did not find traction, the idea of giving the president greater control over the Board of Governors did find some support. In 1977, Congressman Parren Mitchell offered legislation that would have put the Fed chairman on a schedule that more closely aligned with presidential terms. Although Burns had earlier voiced support for such an idea, in response to Mitchell's proposal, Burns said he opposed to the idea, saying it would take away some of the Fed's independence.⁸⁷

Only a few months later, President Jimmy Carter announced that he would not reappoint Burns as the Fed's chairman, instead replacing him with G. William Miller, the CEO of Textron whose only Fed experience was serving on the Boston Fed's Board of Directors. Because of the Board's structure, Burns could have stayed on as a governor, although he would not be chairman, as Eccles had done in 1948. Burns, however, was unwilling to accept the move and resigned from the Board.

Miller, meanwhile, took office and the responsibility for continuing the fight against Congress.

85. *The Wall Street Journal*, May 1, 1973.

86. *The Washington Post*, Oct. 18, 1975.

87. *The Washington Post*, June 24, 1977.

Sen. Humphrey and Congressman Augustus F. Hawkins in 1976 had introduced the Humphrey-Hawkins Bill, calling for a reduction in the jobless rate. The legislation was back under discussion in late 1977, but took on additional importance with lawmakers after Humphrey's death from cancer in January 1978.

The bill called for a target of 4 percent unemployment by 1983. Reaching that target, some believed, could not be done with an independent central bank.

"We can't have effective economic policy making if the Fed is outside the political process," Labor Secretary Ray Marshall said during a speech in New York. The Federal Reserve System "should not be autonomous."

The legislation, which had numerous other provisions unrelated to the Federal Reserve, was approved by Congress and signed by President Carter in October 1978.

For the Fed, the legislation mandated the Fed's monetary policy seek to maintain long-run growth, minimize inflation and promote price stability – a mission that remains in place today. The legislation also required the Fed to make a twice-annual Monetary Policy Report to the Congress, extending a requirement of the 1975 congressional resolution that had expired.

Miller's tenure was brief, during a difficult period of stagnant economic growth and rising inflation, climbing joblessness, and soaring oil prices that became known as "stagflation." One sign of his difficulties at the Fed: He was once outvoted by the Board when he opposed a discount rate increase that others supported to help quell inflationary pressures. Miller had opposed efforts by the administration when they favored tighter money, and staffers said later he showed little interest in the Fed or the complexities of its work.⁸⁸

Miller held the Fed's top position for just over a year before Carter moved him to Treasury secretary as part of a cabinet shakeup. Although Miller could have resisted the move, and Carter would have been unable to force the issue on the head of the central bank, Miller agreed to the transition.

"If Nixon appointee Burns lit the fire (of inflation), Miller poured gasoline on it," journalist Steven Beckner later wrote. "Without question (Miller was) the most partisan and least respected chairman in the Fed's history."⁸⁹

88. *William R. Neikirk, Volcker, Portrait of the Money Man, New York: Congdon & Weed, Inc., 1987.*

89. *Steven Beckner, Back from the Brink: The Greenspan Years. Wiley Publishing, 1999.*



Terry Asher/Time & Life Pictures/Getty Images

Federal Reserve Chairman Paul Volcker led the Fed as it fought both inflation and growing public anger. He would regularly receive heartbreaking letters from struggling Americans, but to the outside world, Volcker remained calm, puffing on his trademark cigar.

Fighting Inflation, Congress AND THE *White House*

Carter replaced Miller with Paul Volcker, the president of the New York Fed, who in October 1979 was at the helm when the Fed announced it would not target the federal funds rate, but concentrate instead on the money supply and let the market determine interest rates. As a result, the federal funds rate eventually reached a record high of 20 percent in 1981, and inflation peaked at 13.5 percent the same year.

The solution to the inflation problem was putting the economy into a severe recession where, amid high interest rates, the jobless rate hit nearly 11 percent and businesses had liquidity problems. It is not surprising that the Fed during Volcker's tenure came under widespread public criticism.

"Farmers surrounded the Federal Reserve building to protest the high interest rates," wrote Daniel Yergin and Joseph Stanislaw in their book *The Commanding Heights*.⁹⁰ "Auto dealers sent in coffins with car keys to symbolize the vehicles that went unsold because of high interest rates. Volcker himself would read heartbreaking letters that people wrote to him – about how they had saved for years to buy a house for their parents, but now, because of the high rates, could not. He was deeply upset by these letters, but he still saw no choice."

The economy, along with the Iranian hostage crisis, led to Ronald Reagan's easy victory over Carter in the 1980 presidential election. With the Fed in a position to play a crucial role in the success of the new administration, Reagan's staff wanted to arrange a meeting between the new president and Volcker.

"We offered to have the president go to the Federal Reserve," Reagan aide Martin Anderson said later.⁹¹ "We thought that would be nice, right? Wrong. Volcker was so upset about that, didn't like that idea at all. The reason was that it would in some way be seen as compromising their independence if the president went over there. On the other hand, there seemed to be some reluctance on his part to come to the White House. So finally, we came up with a Solomon-like solution to go to the Treasury."

The two discussed several issues during the meeting, but none to real depth. A member of Reagan's Council of Economic Advisors noted on behalf of the administration that they

90. Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle for the World Economy*. New York: Simon & Shuster, 1998, p. 347.

91. William R. Neikirk, *Volcker, Portrait of the Money Man*, New York: Congdon & Weed, Inc., 1987, p. 94.

recognized the Fed's independence.⁹²

That view was not held by everyone.

Reagan's Treasury Secretary Donald Regan told his senior staff during one of their first meetings, "I don't know why we need an independent Federal Reserve Board."⁹³

With interest rates high in the Volcker-led fight on inflation, the attacks came from both political parties.

"We are destroying the small business man. We are destroying Middle America. We are destroying the American dream," conservative Congressman George Hansen said during a 1981 hearing.⁹⁴

During that same event, Democrat Frank Annunzio shouted and pounded his desk, accusing the Fed of favoring big business, and Texas Congressman Henry Gonzales threatened to introduce a bill to impeach Volcker and most of the Fed's other governors.⁹⁵

A couple of weeks later, the Treasury secretary directly criticized the Fed's position during an interview with a *New York Times* reporter.

"What I am suggesting is that if (money supply growth) stays here, you're going to have a severe recession," said Regan, who then went on to suggest how the money supply needed to be adjusted going forward.⁹⁶

It was an important turning point in the Fed's relationship with the administration, which had publicly supported the Fed in the slow growth of the money supply.

Volcker responded to Regan's guidance at an American Bankers Association meeting in San Francisco two months later, saying the Fed had no plans to ease the tight money supply despite "some unusual public communication from the secretary of the Treasury."⁹⁷ He went on to say that the Fed's concern was to restrain the money supply.

"Inflating the money supply now would only aggravate the situation," he said.⁹⁸



Paul Volcker became Federal Reserve chairman after serving as head of the New York Fed. During his tenure, inflation dropped from 13.5 percent in 1981 to 3.2 percent in 1983.

92. William R. Neikirk, *Volcker, Portrait of the Money Man*. New York: Congdon & Weed, Inc., 1987, p. 95.

93. William R. Neikirk, *Volcker, Portrait of the Money Man*, New York: Congdon & Weed, Inc., 1987, p. 101.

94. *The Washington Post*, July 22, 1982.

95. *The Washington Post*, July 22, 1982.

96. *The New York Times*, Aug. 7, 1981.

97. *The Chicago Tribune*, Oct. 8, 1981.

98. *The New York Times*, Oct. 8, 1981.

Regan, who was at the same meeting, told reporters that the administration did not want the Fed to pump money into the system, but wanted steady growth: “We don’t need flat money supply; we don’t need negative money supply.”⁹⁹

Regan later tried to downplay the apparent fight with the Fed, saying that the central bank and the Treasury both wanted slow growth of the money supply.

“This tourniquet at this time apparently has been a little tighter than the doctor ordered,” Regan said. “We are suggesting that it should be in its normal position.”¹⁰⁰

Volcker, after a reporter asked him what it would take to reverse his policies to align more closely with the Treasury, responded with a one-word answer: “Impeachment.”¹⁰¹

In early 1982, Volcker and the president sat down in a closed door meeting. The session came after Senate Majority Leader Howard Baker said the White House and the Fed needed to “sit down and get away from this business of acting like they are so independent they never communicate.”¹⁰² The meeting also followed Reagan saying publicly, “I think we need to have more cooperation from the Federal Reserve Board

with regard to money supply and a more consistent pattern” in order to bring interest rates down.¹⁰³

By the summer of 1982, House Majority Leader James C. Wright, Jr., was calling for Volcker’s resignation. Wright said he had met with Volcker eight times in hopes of giving the Fed chairman an “understanding” of what high interest rates were doing to the economy, but Volcker was apparently not getting the message.

Volcker “is very pleasant; he smiles, puffs on that cigar and looks at you like a benign Buddha (who) pats you on the head” and promises that everything will eventually turn out fine.¹⁰⁴



President Ronald Reagan said he needed more “cooperation” from the Federal Reserve to bring interest rates down. Meanwhile, his Treasury secretary, Donald Regan, was preparing to launch a major review of the Fed and monetary policy.

99. The Chicago Tribune, Oct. 8, 1981.

100. New York Times, Oct. 10, 1981.

101. The Los Angeles Times, Oct. 18, 1981.

102. The Washington Post, Jan. 30, 1982.

103. The Washington Post, Feb. 17, 1982.

104. The Los Angeles Times, June 9, 1982.

Volcker's forced ouster was just one of several ideas circulating through congressional halls.

Rep. Henry Reuss supported a bill that would order the Fed to increase the money supply: "We in Congress are the Federal Reserve's masters," Reuss told fellow lawmakers.¹⁰⁵

Sen. Alan Cranston told a press conference in San Diego that Congress had to curb the Fed's independence: "It's inconsistent with representative democracy – and contrary to consistent fiscal policy – to have seven people appointed to 14-year terms with vast sweeping powers over the lives and fortunes of the American people who are accountable to no one, not the President, not the Congress, not the people."¹⁰⁶

Sen. Ted Kennedy agreed with Cranston's call for greater control, launching his own effort: "Put (the Federal Reserve) in the Treasury Department where it belongs."¹⁰⁷

In late June, it was revealed that the Treasury secretary had ordered his staff, the Council of Economic Advisers and the Office of Management and Budget, to work jointly on a major review of monetary policy and the Federal Reserve. The effort would consider numerous issues, including many of the ideas offered by various lawmakers from both parties.

"There is, on the one hand, an argument to keep the Fed independent to avoid the problem of an administration running away on an inflationary policy," Treasury Undersecretary Beryl W. Sprinkel told a reporter.¹⁰⁸ "But on the other hand, the president is elected by all the people and he has a right to put his policies into being and to be held accountable for them. And since we have been down here we have not gotten the kind of monetary policy that we asked for."

News that the study was being conducted angered Wall Street.

"Interference with the central bank would be taken very poorly in the investment community," an unnamed money manager told *The New York Times*.¹⁰⁹ "Paul Volcker ... has become the whipping boy for high interest rates and the administration is delighted to have somebody they can point the finger at."

"But, in truth, the administration would be lost without him – and so would the credibility of the fight against inflation."

With investors turning angry, Treasury Secretary Regan seemingly backed off, saying during a press conference, "I think the Fed's independence is a good thing."¹¹⁰

Despite Regan's comment, the battle between the administration and the Fed would be largely determined by one factor:

105. *The Chicago Tribune*, March 16, 1982.

106. *The Los Angeles Times*, Feb. 16, 1982.

107. *The Washington Post*, April 7, 1982.

108. *The New York Times*, June 20, 1982.

109. *The New York Times*, Jan. 28, 1982.

110. *The New York Times*, June 28, 1982.

whether or not the Fed had made the right move.

In July, the data showed that the recession had bottomed out. Volcker told lawmakers that he was backing off his previous targets for tight monetary policy and that a recovery in the second half of the year – long touted and targeted by the Reagan administration – was “highly likely.”¹¹¹ For the Fed, it couldn’t have happened at a better time.

The Constitutionality of the FOMC

Reagan appointed Volcker to another term, but his difficult days were not done. Reagan appointees on the Board of Governors held four positions, and in February 1986, the Board outvoted Volcker to lower the discount rate. Volcker stormed out of the room, but before the vote was reported to the public, which was scheduled for 4:30 that



John Melcher, who represented Montana in both the House and the Senate, had concerns about regional Federal Reserve Bank presidents voting on the FOMC, believing the Bank presidents should be presidential appointees. He eventually filed a lawsuit that was later dismissed by a Federal District Court.

afternoon, the group reconvened and cancelled the vote. The issue of the cancelled vote became public two weeks later and was followed by the resignation of Vice Chairman Preston Martin, who had led the opposition to Volcker.

Meanwhile, on another front, the Fed was facing a legal battle related to the Federal Open Market Committee.

Seven Federal Reserve governors, who are appointed by the president, and five presidents of the regional Reserve Banks are the voting members of the FOMC. Sen. John Melcher filed a lawsuit claiming that the Reserve Bank presidents, who are selected by the boards of their respective Reserve Banks, should be presidential appointees if they are in a position to determine the nation’s monetary policy. Instead, they were unaccountable private citizens.

“The country’s economy is too important to be decided by invisible officials who work behind closed doors without any accountability,” Melcher said.¹¹²

Although the suit was given little chance for success, a Melcher victory carried major ramifications for both the Fed’s immediate future and long-term prospects.

111. The Los Angeles Times, July 20, 1982.

112. The Washington Post, Sept. 6, 1986.

positions, Volcker had strong support from the regional Reserve Bank presidents. That support, along with his minority backing among the governors, gave him a majority in the 12-member FOMC. Losing the votes from the Reserve Bank presidents would put Volcker in the minority on important policy decisions.

More troubling, however, were the long-term prospects that could lead to a rewriting of the Federal Reserve Act – a task many Fed watchers of the day did not think Congress was up to.¹¹³ Assuming Congress was unwilling to reopen the entire 1913 act for revision, the result of a Melcher win would have an ironic outcome: The Democrat Melcher would see the Republican White House gain even more influence over the nation’s monetary policy through the appointed Fed governors.

In September 1986, a Federal District Court dismissed the suit, finding that the Constitution does not prohibit private citizens from carrying out public functions.

“While the composition of the Federal Open Market Committee may be unusual, it is not unconstitutional,” U.S. District Judge Harold H. Greene ruled.

The mixed system of central banking in the United States had a long history and it is “an exquisitely balanced approach to an extremely difficult problem.”

Greenspan, Gonzalez and Reforming the Fed

Melcher appealed the ruling, taking the matter all the way to the Supreme Court,



Alan Greenspan was appointed Federal Reserve chairman by Ronald Reagan. When Greenspan took office, all members of the Board of Governors were Reagan appointees.

which refused to hear the case.

Volcker, meanwhile, although continuing to hold sway over the FOMC, continued to battle Reagan appointees among the governors. With his term set to expire in August 1987, and with no offer forthcoming from the White House to return for another term, Volcker submitted his resignation on June 1, 1987. He was succeeded by Alan Greenspan.

With Greenspan’s appointment, Reagan had appointed the entire Board – a development that troubled some who feared the Fed would be too closely aligned with the White House.

“We are sure Mr. Greenspan will keep himself insulated from political temptations, but (we) would like to hear him say it,” an unnamed Senate aide told a reporter.¹¹⁴ “It’s the kind of thing you want on the record so you can hold someone to what they said.”

In response to questions about the Fed’s independence during his confirmation hearing, Greenspan responded that his policy decisions “certainly would not be made on the basis of politics rather than economics.”¹¹⁵

A year after Greenspan took office, Texas populist Henry Gonzalez was appointed head of the House Banking Committee. Although the Fed would face other battles in the years to come – in 1989, Rep. Lee Hamilton sponsored legislation to put the Treasury secretary back on the Federal Reserve Board; in 1991, Sen. Paul Sarbanes introduced legislation to strip the Reserve Bank presidents of their FOMC votes – for the Fed, Gonzalez would be like a second coming of Wright Patman.

“We shouldn’t have such an embedded, self-perpetuating group in power dictating the monetary and fiscal policy,” Gonzalez said shortly after being named chairman.¹¹⁶

Before taking over the House committee, Gonzalez already had a reputation for being an eccentric. He would regularly give lengthy late-night speeches on the House floor long after his counterparts had departed. These sessions, which drew some media criticism because of the cost of keeping the House chambers open essentially for Gonzalez’s private use, attacked numerous targets including the Fed.¹¹⁷ One reporter wrote, with a seemingly joking tone, that House doorkeepers were relieved when Gonzalez became Banking Committee chair because he used those hearings as his forum instead of keeping the House open all night.

Among other things, Gonzalez introduced a bill to have one regulator for all banks and thrifts, and he wanted FOMC meetings video-recorded with the tapes broadcast 60 days later. Gonzalez also wanted to have the regional Reserve Bank presidents appointed by



Henry Gonzalez was a Texas congressman who continued the Wright Patman tradition of strongly opposing the Fed. Gonzalez eventually conducted a House Banking Committee hearing where the Federal Reserve chairman, five Federal Reserve governors and 10 Federal Reserve Bank presidents testified.

114. The New York Times, July 21, 1987.

115. The Wall Street Journal, July 22, 1987.

116. The Wall Street Journal, Feb. 14, 1989.

117. The Washington Post, Dec. 6, 1989.

the president and confirmed by the Senate.

Although his efforts to reform the Fed got sidetracked by the savings and loan crisis, he was finally able to schedule a series of hearings to explore the Fed in 1993.

“I am very determined about reforming the Fed,” Gonzalez told a *New York Times* reporter.¹¹⁸ “This is no subterfuge. If the Fed became more accountable to the public on its own, it would be cause for celebration.”

Ironically, the committee’s October 1993 hearing with Greenspan on reforming the Fed was held in a room named after Patman.¹¹⁹

“This is not radical reform,” Gonzalez said during the hearing, “and there is no cause for the Federal Reserve to proceed as if barbarians are at the gate and it is the end of Western civilization. We should not pretend the Federal Reserve, of all institutions in government, is infallible.”¹²⁰

Greenspan warned that giving politicians too much control over the Fed would be a “major mistake” that would likely hurt the economy in the long run.

“The temptation is to step on the monetary accelerator or at least avoid the monetary brake until after the next election,” Greenspan told the House committee.¹²¹ “Giving in to such temptations is likely to impart an inflationary bias to the economy and could lead to instability, recession and economic stagnation.”

Greenspan, along with five other Federal Reserve governors and 10 of the 12 Reserve Bank presidents, was back in front of the committee a week later. Although the Fed contingent seemed willing to allow the release of detailed meeting minutes five or more years after FOMC meetings, much of what Gonzalez sought, such as videotapes of the meetings, was strongly opposed.

A month later, Gonzalez requested tapes and minutes of every FOMC meeting from the previous 17 years. Greenspan offered a compromise: transcripts of meetings through 1988.

Although Gonzalez was able to make the Fed uncomfortable, and create much work for Fed employees with numerous requests for information, he was not able to generate support for his legislative agenda. President Bill Clinton vocally opposed tinkering with the Fed’s structure, and Gonzalez, who some considered a loose cannon – colleagues called him “Gonzo” behind his back and there was a well-known story about him punching a San Antonio constituent who called him a communist – could not generate support among his fellow lawmakers.

118. *The New York Times*, Oct. 12, 1993.

119. *The New York Times*, Oct. 12, 1993.

120. *The New York Times*, Oct. 14, 1993.

121. *The New York Times*, Oct. 14, 1993.

The Road Ahead

Although the Fed received much criticism after the collapse of the stock market bubble, and the later housing bubble and financial crisis, the political pressure on the central bank has been relatively modest in recent years by historical standards. While Fed Chairman Ben Bernanke has faced heated questioning from Congressman Ron Paul and has been the target of criticism on the campaign trail during the 2011-12 Republican presidential primary, it has yet to match the scope of the Wright Patman era, let alone any of the major legislative efforts that changed the Fed in the 1930s.

There may be a couple of reasons for this.

Certainly, there were significant problems that needed to be addressed.

The Obama administration has been working to shore up the financial system, stem the foreclosure tide and stimulate the economy, all while the president determined his policy priorities. Deliberations about what changes might be necessary to avoid this type of collapse in the future are ongoing, and many proposals have been made a part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.

However, a significant reason that the Fed has so far avoided the type of high-intensity political battles that it saw in the past may relate to the fact that, in many regards, the Fed has capitulated.

In contrast with the Volcker-era Fed, which was constantly at odds with Treasury, the current relationship between the Treasury and the Fed is essentially a partnership – a much closer relationship than at any other time in the Fed’s post-1935 history.

There are reasons for this. Certainly today’s battle is much different from Volcker’s fight against inflation. Bernanke has said that there was a very real risk of financial markets freezing up, which forced the Fed to take unprecedented steps and, because of tight credit markets, the Fed was forced to push rates to historic lows and hold them there.

Looking beyond the concern about creating conditions for an inflationary environment in the future, however, there is also concern about what the close relationship with the Treasury and the administration means for the Fed’s continuing independence.

“The lines between central banks and governments are becoming fuzzier,” New York University Economist Nouriel Roubini recently told a reporter while talking about some of the Fed’s recent initiatives.¹²²

With the Fed purchasing various securities during the current crisis, Stanford

122. *Bloomberg News article, Feb. 9, 2009.*

Professor John Taylor has introduced the term “mondustral” to describe the Fed’s policy – a hybrid of monetary and industrial policy.¹²³

“If policy does not go back to a monetary policy framework, then questions must be raised about the fundamental role, independence and governance structure of the Federal Reserve,” Taylor wrote.¹²⁴

Those questions have been raised.

The administration and congressional leaders have taken a close look at the nation’s financial regulatory structure. In the process, the Fed has received increased scrutiny, especially in an environment of rising populism as Americans grow increasingly angry at powerful public and private institutions. Taylor has suggested some of the questions that might need to be asked include: what was the justification for some of the Fed’s actions, and what is the role of a regional Reserve Bank president versus a Federal Reserve governor? Those types of questions could revive many of the battles the Fed has previously fought and perhaps open the century-old Federal Reserve Act for consideration and revision. In fact, some legislative efforts now underway are seeking to address these questions.

“If Congress is unhappy with the Federal Reserve . . . it can reorganize the Fed’s priorities and reduce its independence on monetary policy or other matters,” Carnegie Mellon Professor and former Richmond Fed Director of Research Marvin Goodfriend told a Reuters reporter.¹²⁵

In the same story, former Richmond Fed President Al Broaddus offered his thoughts.

“You may come out of this with a weaker, less independent Fed that, somewhere down the road, will not be as strong as it was, and not as able to make the unpopular decisions it may need to make.”

123. John Taylor, “The Need to Return to a Monetary Framework,” January 2009.

124. John Taylor, “The Need to Return to a Monetary Framework,” January 2009.

125. Reuters story by Alister Bull, Feb. 1, 2009.

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Twelve Banks:

THE STRENGTH OF THE FEDERAL RESERVE

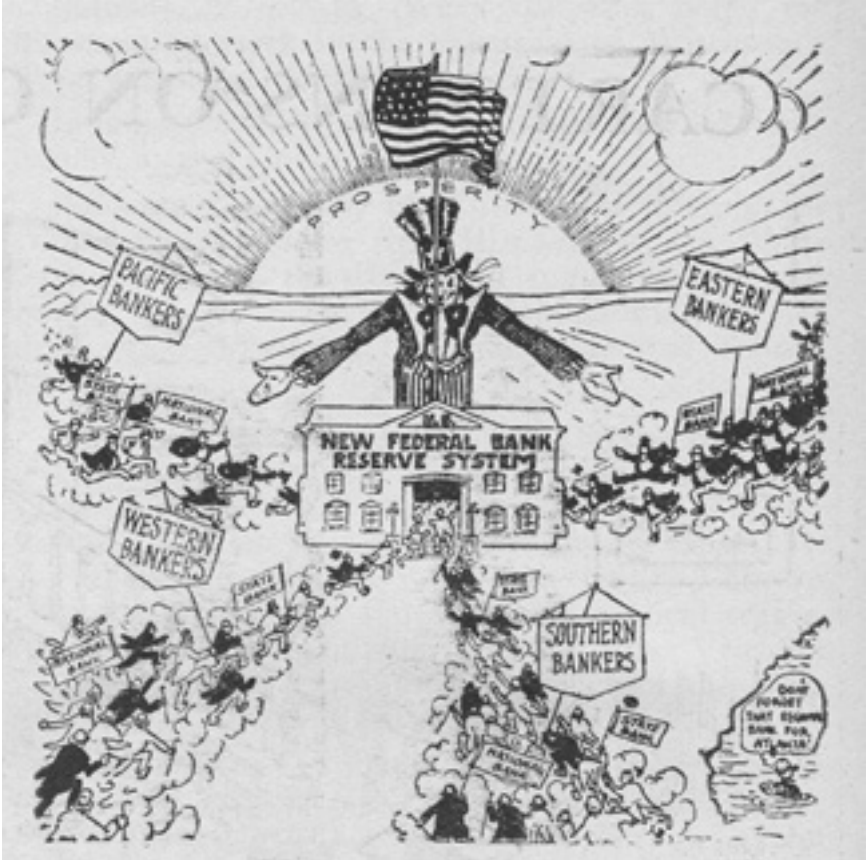
Thomas M. Hoenig

PRESIDENT *and* CHIEF EXECUTIVE OFFICER

FEDERAL RESERVE BANK *of* KANSAS CITY

COPPER MOUNTAIN, COLORADO

SEPTEMBER 15, 2006



*The Federal Reserve's structure, with regional Reserve Banks throughout the country, was designed to give all regions of the country a voice in the central bank's deliberations. Unique among the world's central banks at that time, the structure was lauded throughout the country, as evidenced by this cartoon from *The Atlanta Constitution*.*

Twelve Banks:

THE STRENGTH OF THE FEDERAL RESERVE

From time to time, the question is raised: “Does the Federal Reserve still need 12 regional banks?”

In a *Wall Street Journal* article earlier this year, a former vice chair of the Federal Reserve’s Board of Governors suggested the answer to that question is “no,” saying it is “very clear” 12 banks are no longer necessary and that as few as four might be sufficient.

While some might occasionally suggest a reduction in the number of banks is in order, the Federal Reserve believes in its own future as a 12-bank system. The Federal Reserve has invested in new facilities in Minneapolis, Atlanta and most recently Kansas City, where we will be moving into our new headquarters building in 2008.

However, with the changes occurring in the banking industry, it is understandable why some might raise the topic of the number of regional Reserve Banks and efficiency. The banking and economic structure of the United States obviously has changed in the decades since the Federal Reserve was created. Today, while currency remains in wide use, check writing is in decline, and credit and debit card use is becoming the standard payment means. These developments most certainly have affected Federal Reserve operations nationwide.

So, as a particular business changes, it is perhaps anticipated that some would ask whether a 12-Reserve Bank system is necessary. It is, in this narrow context, a fair question.

However, it is a question that fails to appreciate the founding purpose and structure of the Federal Reserve System. It is a question that, by its very asking, reflects a different understanding of value versus cost.

The Federal Reserve’s 12-bank system was not established as simply a check-processing system. It was designed to serve multiple interests across a variety of regions and financial institutions. It was designed to assure broad input to decisions and to provide a mechanism to build national policy consensus across broad regional, economic and cultural differences. And it was designed as a public-private partnership, accountable to, and yet independent of, the government. To miss these connections is to incorrectly tie the Federal Reserve’s structure to its processing activities rather than to its efforts of assuring trust in the institution.

The 12-bank system reflects the vast economic differences among regions in the United

States. It also reflects the need to provide a mechanism for input to banking and our important credit policy activity for each region.

Our nation's regional differences are illustrated in a variety of forms. For example, some years ago, I spoke with a policy person from another sector of the country making his first visit to the Midwest. During the conversation he quite sincerely noted how impressed he was that the city had such a "full" skyline. Clearly he was surprised. Similarly, an East Coast reporter traveling to Cleveland once phoned and asked us if he could drive by and see the Kansas City Bank during the trip. He apparently thought Kansas City and Cleveland were closer than the more than 800 miles that separate us. Being from Missouri, I have come to appreciate in a personal sense our regional differences. In my travels through the southern United States, I am often called a Yankee, while, in the north, I might be referred to as a Southerner. Most recently I took notice of a *New York Times* article pointedly titled "The Not-So United States."

From an economic perspective, these regional variances can be even more striking. One need only look at the differences in average home prices between any Midwestern community and a similar community on either coast to get some idea of the diversity of our economy. Regional employment and manufacturing can also vary greatly.

The fact is that as homogenous as we like to think we are, we remain a country with large variances in regional perceptions, biases and economies.

The founders of the Federal Reserve were clearly addressing these differences when they created our decentralized system in 1913. Even then, decades before today's high-speed technology, there was no compelling physical reason for having 12 Reserve Banks.

In fact, the nation previously had not one, but two monolithic central banks, both located in Philadelphia.

The first Central Bank of the United States was established in 1791 and was designed by Treasury Secretary Alexander Hamilton. It was controversial from the start. Some protested its constitutionality. Many were fearful of its influence.

When it came time for Congress to renew the Bank's charter in 1811, the Bank's critics were able to stop it. The proposed renewal lost by a margin of a single vote in each house of Congress.

The issue of a central bank reappeared in 1816. For five years, the country had been without a central bank to regulate banking and credit. Meanwhile, the War of 1812 had thrown American finance into chaos. The Second Bank of the United States was chartered

under President James Madison, and once again there was widespread public distrust.

In essence, neither the first nor second central bank of the United States was widely understood by the population at large. In each case, the central bank was structured as a single bank. It was central and I am sure, using today's jargon, it was efficient—but mostly it was distrusted and even hated by some. Andrew Jackson, a populist president, vetoed the renewal of the Second Bank's charter, bringing an end to central banking in the United States for the next eight decades.

Regional distrust and dissatisfaction crippled the nation's first two central banks and contributed to their eventual demise.

Early in the 20th century, as the United States became a growing economic force, it was apparent the banking and financial system needed a "central bank." During this period, the United States faced numerous instances of financial panic as commercial banks across the country suffered serious liquidity problems. Business credit collapsed, and the public suffered significant financial hardship.

But there were a few hurdles to overcome in chartering this third central bank. Among the most important was the question of whether the United States once again would have a highly centralized institution with concentrated authority. Or would it be best to create a new system—a decentralized system that would share authority across the nation?

In his memoirs, Paul Warburg, one of the Federal Reserve's founders, lists the main objections to the establishment of the central bank:

First: The danger of political control,

Second: The danger of control by special interests,

Third: Hurtful competition with existing banks.

The debate regarding the structure of the central bank went on for some time, but in the end, "a system of centralized reserves and decentralized banking power is clearly the system that this country requires," Warburg said.

This time the founders better understood that to provide for a more durable institution they needed a structure that shared the institution's responsibilities and power across the country, not just with the central government and in Wall Street. It was concluded our central bank should reflect the value we Americans place in shared control of some of our more important institutions.

Each Reserve Bank has a board of directors from the region where it is located. These directors not only provide oversight of the Reserve Banks, but also information regarding

their industries and communities. As was noted to me some time ago, “through these 12 Reserve Banks, the Federal Reserve has roots that run deep within our communities, which enables it to garner broad public knowledge and support, and to function far more effectively than if it was located in only a few places.”

The 12 regional banks flanking the Board of Governors keep the Federal Reserve from becoming insulated from Main Street America.

They interact with the public and financial institutions at a local level. In doing so, the central bank demonstrates it is something other than a cumbersome bureaucracy counting its money. The board offers the public unprecedented direct access to the thinking of policy-makers. Each bank is part of the basic fabric of its community, providing a connection between the community and its business and policy roles. This has been a critical element of the Federal Reserve’s long-run success.

This structure and these principles are as important today as they were in 1913, perhaps more so. The Federal Reserve System remains a powerful institution. Its ability to gain and hold a broad base of trust and support is fragile, yet crucial to its success and, even more importantly, to the success of our national economy.

In terms of its overall operations and policy, the 12-bank system has consistently shown itself to be efficient and adaptable to change.

During the recent decades, it is hard to name another organization that has been systematically more effective in carrying forward its missions, whether in providing services to the public or conducting day-to-day policy.

Just as important, the 12-bank system has performed superbly across the nation during numerous crisis situations, ranging from the banking crisis of the 1980s, through the Y2K millennium experience, the tragedy of 9/11, and most recently during the aftermath of Hurricane Katrina.

Of course, it may be argued that the issue isn’t so much about a centralized or decentralized structure but about whether the System should have fewer than 12 banks. That debate also occurred at the Federal Reserve’s founding. There was considerable, and often heated, discussion regarding the number of Federal Reserve Banks. Some wanted as few as five while others wanted more.

Even after the System was established with 12 banks, the debate continued for a time. It is interesting to recall that within about two years of the formation of the Federal Reserve, there was a serious confrontation among the members of the Board of Governors about

reducing the number of Districts. In the end, the attorney general of the United States wrote an opinion stating, in essence, that the Board did not have the authority to unilaterally reduce the number of operating Reserve Banks. Senator Carter Glass, one of the lawmakers who helped create the Federal Reserve, said those wanting to reduce the number of Banks were ignoring the will of the Senate.

A system of reserve banks was seen as an essential element to building trust in so powerful an institution, one that would have enormous influence over our economic lives.

It was also Paul Warburg who suggested one strength of the Reserve System lies in one of its weaknesses: protection against the dangers of an autocratic central administration. In this respect, the Reserve System was preferred to a more centralized system. There is no doubt that such a system, if enacted, might have been more efficient, but it certainly would have offered easier and more tempting targets for political attacks. This political superiority of the Reserve System was of immense importance, although it is, at the same time, a weakness.

Obviously, many things have changed during the past eight decades. We have experienced exceptional changes in technology, banking structure, banking products and a greater national and international scope of business and banking. But, the fundamentals that drove the United States toward a 12-bank system are as real today as they were then.

Today, concern for centralized and concentrated financial power understandably remains important in the minds of the American public. The trends in consolidation have only heightened concerns in this regard.

At the same time, although there has been significant consolidation within the financial system, there remain thousands of regional and community banks which continue to play an important role across the nation. Banking activities vary across the nation and are greatly affected by their regional economies.

For example, about 25 percent of New England's banks failed in the early 1990s after local real estate values collapsed. In our own Tenth District, anyone involved in business or banking can recall vividly what happened in this region after the collapse of values in agriculture, energy and real estate. While it would be nonsense to suggest that these crises could not have been addressed in a centralized banking system, it is fair to say they were well addressed in a decentralized, although coordinated, manner.

Knowledgeable working relationships with regional and community banks are critical to understanding change and perhaps even discovering these types of problems in a timely fashion. The 12 Reserve Banks give us a broad distribution of contacts and means of

interaction with commercial banking that is crucial for understanding and responding to local banking markets. Such interaction might be accomplished with fewer than 12 Reserve Banks but, I would argue, not as effectively.

On the justification for having fewer rather than more Reserve Banks as it relates to cost, I would note a couple of points.

The System has been diligent in controlling its costs. Inflation-adjusted expenses for the 12 banks, as reported in the System's budget documents, have increased on average about 1.5 percent a year since 1970, showing actual declines in real terms in recent years.

Moreover, the Federal Reserve has consolidated some of its operations where the opportunity to improve efficiency was apparent. Check processing is one such area. Others include wire transfers, retail electronic payments and support activities. All these actions have served to contain costs.

Yes, there is every reason to pursue cost savings when it makes sense to do so. Certainly repetitive processes often benefit from new technology that simplifies operations.

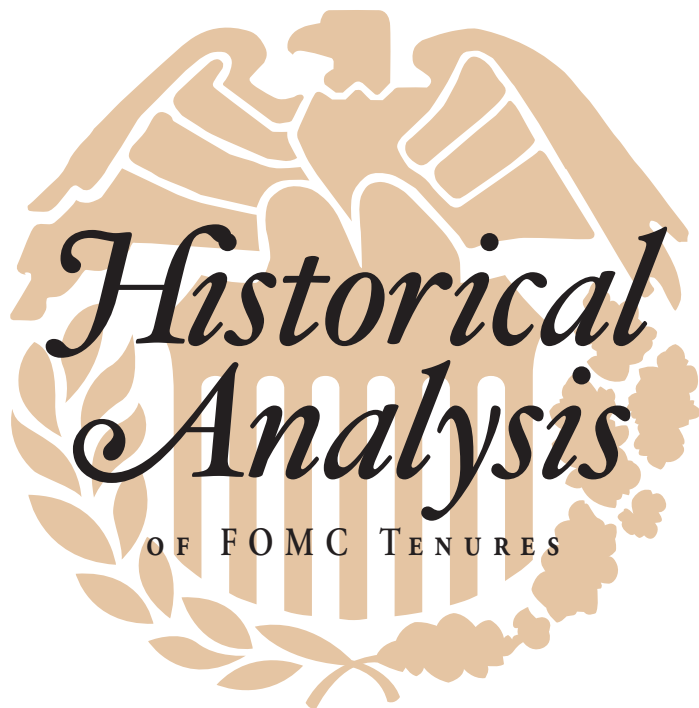
But there is another side to consolidation where costs can rise and performance can decline. When the consolidation withdraws authority for local decision-making, it can lead to cumbersome bureaucracies, slower decision-making and loss of local incentive and performance.

All consolidations involve cost-benefit trade-offs. Balancing the difficult-to-measure benefits of access, communication, broad regional representation and operational delivery against any hard-dollar savings that might come from having fewer banks requires an understanding of bottom-line accounting and organizational purpose. In this context, the value over the cost of our 12-bank system is considerable.

Finally, the value of this structure has been recognized by others. In 1998, the 16-bank European Central Bank was established and modeled closely to the Federal Reserve. Like our nation's central bank, the ECB is responsible to a diverse population across a broad region with varying economic and banking conditions. As with the Federal Reserve, a broad base of support is necessary for the ECB to succeed in its mission.

Robert Bremner, in his biography of Chairman William McChesney Martin, referred to a quote which described the Federal Reserve System as "America's greatest contribution to the science of government."

While this may be hyperbole, looking in the past, this structure has served us well. And looking to the future, it is designed to last.



PREPARED FOR THE
FEDERAL RESERVE BANK *of* KANSAS CITY BOARD *of* DIRECTORS SPECIAL MEETING
APRIL 2009

BY TIM TODD
REVISED *and* UPDATED *by* BILL MEDLEY
JUNE 2012
FEDERAL RESERVE BANK *of* KANSAS CITY



Presidents of all 12 regional Federal Reserve Banks, along with the Federal Reserve governors, participate in each meeting of the Federal Open Market Committee. Although the media often makes a distinction between members who vote on policy and those who do not, all members take an active part in policy deliberations.

Historical Analysis

OF FOMC TENURES

The Federal Reserve has taken numerous unprecedented steps to calm the nation's financial turmoil following the financial crisis. Among the more notable were the Federal Open Market Committee's cut of the fed funds rate to almost zero in December 2008, combined with two rounds of "quantitative easing" involving the large-scale purchases of mortgage-backed and U.S. Treasury securities from November 2008 to March 2010 and from November 2010 to June 2011.

These were historic actions that raised several issues, many related to policy and the steps the Federal Reserve would need to take once it decided to exit from its accommodative policy and return its balance sheet to more-normal levels.

The FOMC's composition of the politically appointed members of the Board of Governors and the independently selected Reserve Bank presidents combines the public and independent elements of the central bank. The FOMC issues directives to the Federal Reserve's open market desk to engage in trades that move interest rates toward the FOMC's prescribed target. That target has been set effectively at zero since late 2008 and is expected to remain there for what appears to be an extended period (until 2014, according to the FOMC's pledge in early 2012). By leaving the Fed's most important policy tool at this level, observers have raised questions about the role of the regional Reserve Bank presidents in influencing other policy decisions over which their authority is limited.

In its online blog "Real Time Economics," on Dec. 20, 2008, only days after the Fed cut the fed funds rate to zero, *The Wall Street Journal* asked "Does Fed Policy Marginalize Regional Bank Presidents?" Earlier that month, a Bloomberg News headline declared "Bernanke 'War Powers' Undermine Fed Bank Presidents." Both articles noted the FOMC's role has traditionally been limited to directing interest rate changes, while other decisions, such as lending to institutions during an emergency, have been under the sole purview of the Board of Governors.

These questions about the Reserve Bank presidents have continued in the aftermath of the crisis. In 2011, U.S. Rep. Barney Frank proposed eliminating the FOMC votes of all Reserve Bank Presidents and replacing those votes with presidential appointees who would be confirmed by the Senate. Frank's proposal was countered in early 2012 by Rep. Kevin

Brady, who proposed making changes to the Federal Reserve's mandate and also called for an expansion in the voting rights of Reserve Bank presidents. Under Brady's plan, all 12 Reserve Bank presidents would have a permanent vote at each FOMC meeting. In addition, a bill introduced in 2012 by Sen. Bernie Sanders seeks to remove bankers from the boards of directors at the regional Reserve Banks.

As with other recent efforts to change the central bank's structure, the prospects of these proposals advancing, especially during an election year, are in question. Nevertheless, the ideas have re-opened a long-standing debate over the Reserve Bank presidents' roles.

Structure and 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 "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 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 individuals now serving as Federal Reserve governors, Chairman Ben Bernanke has the longest tenure, having been appointed as a governor in 2002. Vice Chair Janet Yellen previously served on the Board of Governors from 1994-1997 and was appointed to her current position in 2010. Following Yellen in order of length of tenure are governors Elizabeth Duke (appointed 2008), Daniel Tarullo (appointed 2009) and Sarah Bloom Raskin (appointed 2010).

Two governors, Jeremy Stein and Jerome Powell, were confirmed by the Senate in May 2012. Before their confirmation, there was not an FOMC meeting with seven governors participating since March 2005, and in the vast majority of meetings since that date, only five governors have taken part. Additionally, the term Elizabeth Duke was appointed to fill

expired in January 2012, but she is continuing to serve until a successor is named. The Dodd-Frank Act also called for a new vice chair of supervision to be appointed to the Board of Governors, but as of this writing, no one has been nominated to fill that position.

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 entirely appropriate. Following passage of the Dodd-Frank Act in 2010, six of the nine local directors are allowed to select a Reserve Bank president—the three who are non-bankers elected by member banks and the three non-bank directors who are appointed by the Board of Governors. The three Class A directors—those who are bankers elected by member banks—are no longer permitted to vote on selecting a Reserve Bank president. The selection of a Reserve Bank president by directors is further checked by the ability of the Board of Governors to veto the selection.

In addition, there is very much a public component to the regional Reserve Bank president positions. Most Reserve Bank presidents participate in numerous public events, and they gain significant insight into business and banking conditions through regular contacts with individuals from throughout their respective Districts. In addition to their roles on the FOMC, the presidents act as the chief executive officers of their Reserve Banks and operate with the oversight of their directors as well as the Board of Governors.

Of the 12 Federal Reserve Bank presidents, seven have held their posts for less than five years, and two of those have been Bank presidents for less than two years. The two longest-serving FOMC members are Cleveland Fed President Sandra Pianalto, with more than nine years of experience, and Richmond Fed President Jeffrey Lacker, who has held that position for more than eight 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.

In the same way, today's Board of Governors has been shaped by President Barack Obama, who has appointed each governor, except Bernanke. However, while Bernanke was appointed to a 14-year term as governor by Bush in 2006, his current four-year appointment as chairman, which is set to expire in 2014, was the result of a nomination by Obama.

That multiple appointments would be made by one president is not at all unexpected or unique in Fed history. Because virtually every Fed governor leaves 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 18 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 4.8 years per governor.

These relatively brief tenures in office are not a recent development. The 43 Fed governors appointed since 1965 (excluding current governors) averaged 5.7 years in office. Removing Greenspan's exceptionally long tenure cuts the average number to 5.4 years.

Prior to 1965, governors generally served much longer in office, although even then a full term was a rarity. The 65 governors serving between the creation of the FOMC in 1935 through Kevin Warsh's departure in 2011 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 88 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 25 Federal Reserve Bank presidents serving from the time of Greenspan's 1987 appointment through the most recently retired leader at each Reserve Bank. Their average time in office is 12.2 years, or more than twice the tenure of the average governor.

A look 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 Reserve Bank shows that the 86 presidents, excluding interims and those who died in office, served an average of 10.7 years each.

Interestingly, when accounting for current FOMC members' entire service to the Federal Reserve System—not just their tenure on the FOMC—seven Reserve Bank presidents have worked within the central bank longer than the most experienced governor, Ben Bernanke, who has 15 years of service, including a previous stint as governor from 2002 to 2005 and as a visiting scholar at various Reserve Banks in the 1980s and 1990s.

Based on total service within the Federal Reserve System, Cleveland Fed President Sandra Pianalto is the most experienced FOMC member, having served on the Board of Governors staff from 1976 to 1980 and then joining the Cleveland Fed in 1983. Kansas City Fed President Esther George is close behind Pianalto in terms of Federal Reserve System tenure, having served at the Kansas City Fed since 1982.

The Future

Relatively brief tenures on the FOMC will likely continue in the years to come. Mandatory retirement rules recently resulted in the retirements two of the FOMC's most experienced members—Kansas City Fed President Tom Hoenig and Minneapolis Fed President Gary Stern—who left in 2011 and 2009, respectively. Hoenig retired with 20 years of experience on the FOMC, and Stern left with 24-and-a-half. Including the two newest governors—Stein and Powell—less than half of the full 19-member FOMC would have

more than five years of experience on the committee at the end of 2012.

A breakdown:

- Nine members with less than four years of experience in their current position, including five governors and New York Fed President William Dudley, who is the permanent vice chairman of the FOMC;
- Another seven members with between four and seven years of experience;
- Two members with seven to nine years of experience;
- One member with more than nine years of experience.

Excluding the two newest governors, the average tenure of FOMC members will be less than five years at the end of 2012. That is assuming none of the other current governors or presidents quit over the next year. Based on history, that seems unlikely, especially considering one of the governors, Elizabeth Duke, is serving on a term that expired in January 2012. In addition, given the recent tensions over presidential appointments, it is not clear when the Board of Governors will next have a full seven-member contingent, if any current governors resign.

Under the Political Influence?

The regional Reserve Bank presidents are clearly doing more than contributing their regional perspective to the 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 because they will still be involved in policy deliberations in the future.

One dynamic clearly at play since the financial crisis and the Federal Reserve's historic response has been the role Reserve Bank presidents have had in dissenting from the FOMC's recent policy decisions. In fact, all 19 dissenting votes from 2010 to April 25, 2012, came from the Reserve Bank presidents. Notably, former Kansas City Fed President Tom Hoenig dissented eight times in 2010, and on two occasions in 2011, three members—Dallas Fed President Richard Fisher, Minneapolis Fed President Narayana Kocherlakota and Philadelphia Fed President Charles Plosser—dissented at the same time, the first time three members dissented since 1992.

The dissents have fallen on each end of the policy spectrum. While those cited above

dissented in favor of tighter monetary policy, Chicago Fed President Charles Evans cast a “no” vote twice in 2011 because he “supported additional policy accommodation,” according to the FOMC’s statements.

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. Carter Glass, who was a key author of the Federal Reserve Act while a congressman, 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 post from 2008 suggest that the regional Reserve Bank presidents have been marginalized in the current environment, a view that may be supported by the fact that the politically appointed governors will always hold a majority vote on the FOMC under the its current structure. It may still be some time, until the recent crisis is well behind us, before it is clear how much it mattered.

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ABBREVIATIONS:

FRBKC: The Archives of the Federal Reserve Bank of Kansas City

LOC: Library of Congress, Prints & Photographs Division

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58. Cartoon reprint of “All Coming In!” on p. 296, *American Review of Reviews*, edited by Albert Shaw, The Review of Reviews Company, March 1914 (original appeared in the *Atlanta Constitution*)
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“DIRECTORS OFTEN QUESTION THE NATURE OF THE ROLE AND RELATIONSHIP BETWEEN THE POLITICAL ELEMENTS OF THE FEDERAL RESERVE AND ITS INDEPENDENCE. THIS VOLUME WAS CREATED TO HELP FEDERAL RESERVE BANK DIRECTORS WHO ARE RESPONSIBLE FOR THE *governance* OF THEIR DISTRICTS AND THE *guardianship* OF THE FEDERAL RESERVE SYSTEM.”

When Sen. Nelson Aldrich proposed a central bank for the United States in 1909, there was much concern about the influence Wall Street might have over the institution, as reflected in this cartoon from the Dec. 10, 1909 edition of Puck Magazine. Later, the



Federal Reserve Act was designed specifically to address these concerns, creating a central bank comprised of a system of regional Reserve Banks throughout the U.S. instead of consolidating the power. Although the structure widely distributes the Fed's responsibility, the central bank has remained a popular target for politicians.