Throughout its history, the U.S. Federal Reserve has faced accusations, on the left and the right, that it is the mere institutional puppet of powerful bankers who control it from within. Marriner Eccles, the liberal Fed chairman during the 1930s and 40s, called it the “instrument by which private interests alone could be served.” Ron Paul, the former Republican Texas congressman, writes that through the Fed “our money and credit are constantly manipulated for the benefit of a privileged class.”

Today, because President Obama and, to a lesser extent, Senate Republicans have mismanaged the appointments to the Fed’s governing board, these views have become harder to dismiss. Under the Obama administration, for the first time in its history, Federal Reserve Bank presidents—essentially private bankers—have held a majority of votes on the Federal Open Market Committee (FOMC), the arm of the Fed that sets interest rates. In other words, by legal structure, private bankers, and not public appointees, can dictate U.S. monetary policy from the inside.

The debate over private control of public money is nearly as old as the republic itself, dating back to the days of Alexander Hamilton, who built America’s first attempt at a
central bank, and Andrew Jackson, who dismantled the second. By 1913, at the founding of Federal Reserve System, two rival views had emerged of what a modern central banking system should be. Some Democrats wanted a system in public hands—that is, a government-controlled central bank that could not be a front for the “Money Trust” dominated by New York City bankers. But Republicans almost uniformly argued that a government-run system was tantamount to socialism. They preferred a private-run system, based in New York, over which the government would have essentially zero control.

Woodrow Wilson’s election in 1912 led the way to a compromise that put most monetary policy decisions in the hands of 12 privately run Federal Reserve Banks—all but one located outside of New York City—but subject to mostly ill-defined supervision by a government-controlled Federal Reserve Board based in Washington, D.C.

This Wilsonian compromise produced a failed experiment in central banking. In the absence of statutory clarity, personalities clashed within the system as Reserve Bank presidents fought each other and against the Fed board for dominance. In 1935, at the Roosevelt administration’s insistence, Congress abolished the old system and replaced it with one where the private bankers would wield significantly less power. In fact, the administration’s proposal originally eliminated the bankers from the business of monetary policy entirely. President Roosevelt’s proposal created an FOMC of purely public appointees, all based in Washington. But the bankers’ supporters in Congress pushed back and preserved a minority status on the FOMC. The new design would give the committee 12 spots, with seven for presidentially appointed, Senate-confirmed members of a new Board of Governors and only five to represent the private Federal Reserve Banks.

This seven-to-five public majority is the source of the FOMC’s democratic legitimacy today. It’s also key to the constitutional integrity of the Fed as a whole. Under a recent Supreme Court precedent, the FOMC structure almost certainly couldn’t pass constitutional muster; its only potential saving grace is the governors’ numerical majority.

For decades, the public majority held strong. From Truman to Ford, under presidents and Senate majorities of both parties, vacancies on the Board of Governors were filled promptly, as they became open. In fact, the governors lost their majority on the FOMC for just 16 days over the course of 32 years.

But after declining slightly in the 1980s and more in the 1990s, that majority has become increasingly fragile. Under the five years of the Obama administration, the public majority has held just 42 percent of the time, according to my calculations.

It gets worse. There are now only four sitting governors out of the required seven: Janet
Yellen (the chair), Jerome Powell, Jeremy Stein and Daniel Tarullo. Powell’s term has in fact already expired, though the administration has nominated him for another term, along with two new potential members. Stein has just announced his resignation effective May 28. So if May 28 arrives without the confirmation of these pending nominees, there will be just two governors serving within their appointed terms.

Since the FOMC’s modern creation in 1935, there have never been five vacancies at one time. Until now, there had never been four vacancies. And there have been three vacancies just three times in history—all of which have occurred during the Obama administration. The Reserve Banks’ representatives can now, if they act in concert, take control of the nation’s monetary policy. The public has no say on their appointment. Neither does the president. Nor the Senate.

The blame for the neglect of these appointments lies in part with the Republicans in the Senate. Republicans rejected the nomination of MIT economist Peter Diamond in 2011, arguing that he was unqualified for the job. Diamond is a Nobel laureate and one of the most distinguished economists of his generation. His rejection is inexcusable, and almost certainly the most egregious example of politics over substance in the history of Fed appointments.

But Diamond rejection’s is unusual, even unique. The main problem is that the president has failed to advance nominees in the first place. Yes, three nominees are currently pending before the Senate: Powell, economist Stanley Fischer and former Treasury official Lael Brainard. These are eminently qualified nominees. But their nominations are not enough: Even their confirmations would bring the vote on the FOMC to a five-to-five tie, because two vacancies remain on the Board of Governors. The president has simply not kept up.

Some will argue this is an imagined crisis. Most of the focus on the Fed is, after all, on Yellen, the newly appointed chair of the Board of Governors and, simultaneously, chair of the FOMC. Yellen is certainly a worthy focus of that attention. She is the most experienced individual ever to take the Fed’s helm, with deep experience as a scholar and central banker. And since Yellen just went through a very public vetting, nomination and confirmation, there is little question of her democratic bona fides. Besides, whatever the status of the Reserve Bank presidents in 1935, surely today they are “public officials” by another name.

There are two answers to these objections: First, by the terms of the Federal Reserve Act, it is the majority vote of the FOMC that makes the Fed’s monetary-policy decisions, not the Fed chair. Each member of that committee gets one vote. And while the chair can and does
wield influence beyond her single vote, there is little but tradition and force of personality keeping the Reserve Banks from running the show.

Second, the Reserve Bank presidents are not public officials. First of all, they are paid more. For example, William Dudley—a former partner and managing director at Goldman Sachs and the current president of the Federal Reserve Bank of New York—earns $410,000 per year. That’s not much, perhaps, by Wall Street’s standards, but it’s more than the president of the United States, and more than twice as much as Yellen makes. But more importantly, the political—and constitutional—reality is that these Reserve Bank presidents are selected in large part by the purely private banks the Fed regulates, and not by the public. (See here for an explanation of the rather convoluted process by which Reserve Bank presidents are selected and, though it rarely if ever happens, removed.) To be sure, their exact statuses are murky; they prefer to think of themselves as central bankers rather than private bankers, and would no doubt bristle at the characterization that they are mere representatives of private bankers. But public officials they are not.

This is not to say that Yellen cannot control the Reserve Bank presidents, or that the Reserve Bank presidents have sacrificed public duty for private interest. The point is one of democratic and constitutional principle. We must care about the administration’s neglect of the public character of the FOMC not because of some ongoing and nefarious banker plot to hijack monetary policy, but because we want our institutions to bear the democratic imprint they were given in the halls of Congress, as required by the Constitution.

The president’s mismanagement of Fed appointments undermines these democratic and constitutional principles. It also demonstrates a profound neglect of arguably the most important governmental institution in the history of the republic. Fortunately, the solution is simple: The president must nominate, and the Senate must confirm, qualified candidates to fill every board vacancy as it comes open. Failure to do so provides compelling support for the argument that the nation’s money is squarely in the hands of the bankers. We expect that argument from outside the Fed; we should not see it from within the Fed, too.


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