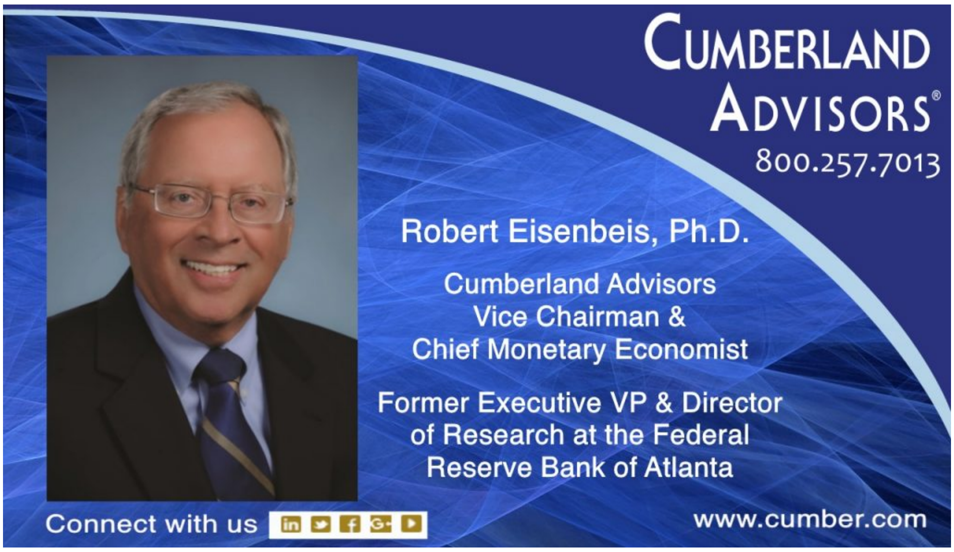
Can the President Fire the Chairman of the Federal Reserve?

The question has arisen, does the president have the ability to fire the chairman of the Federal Reserve. The short answer appears to be no. But few understand the structure of the Federal Reserve and how, by design, that structure both compartmentalizes and is designed to insulate policy making from attempts by outsiders to influence policy.



The Federal Reserve is not a single entity but rather a system composed of two different types of legal entities: The Board of Governors of the Federal Reserve System and the Federal Open Market Committee are both federal agencies and are part of the Executive Branch of the government. Technically, they are among some 61 disparate, independent institutions such as the Commodity Futures Trading Commission, Tennessee Valley Authority, EPA, Federal Election Commission, and General Services Administration, just to name a few.[1] Unlike some of these agencies whose directors serve at the pleasure of the president, as is the case with the CIA and the Office of the Director of National Intelligence, the Board of Governors and

FOMC are truly independent. These entities do not report to the president, and governors (and the presidents of the 12 regional Federal Reserve banks) do not serve at the pleasure of the president. Board members are appointed for staggered 14-year terms, so every two years a term expires, the intent being to limit the number of governors that a sitting president could appoint.[2] The Fed is not subject to appropriations, nor does the president have any authority over its policies or decisions. Section 242 of the Federal Reserve Act provides that a governor can be removed by the president only "for cause," which is usually meant to mean incompetence, neglect of duty, or malfeasance in office. No chairman has been removed for cause, but on several occasions a sitting chairman's appointment to a four year as chair has not been renewed and has left voluntarily vacating an unfinished term as governor, including Burns, Volcker, and most recently Yellen. Finally, by law, what oversight exists is provided by Congress in the sense that the Fed chairman is required to report to Congress twice a year on progress towards the Fed's responsibilities and monetary policy objectives, which are "maximum employment, stable prices, and moderate long-term interest rates."[3]

Although the FOMC is a separate legal body, it has no office or staff except that provided each year by the Board and reserve banks. Its members include the seven members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four other reserve bank presidents whose rotation on and off the committee is defined in the statute.[4] At the Committee's first meeting each year, the initial item of business is to elect a chairman and vice chairman, to appoint official staff from among the staff of the Board of Governors and the respective federal reserve banks whose presidents are voting that year, and to select the reserve bank to execute transactions for the Open Market Account and the manager of the System Open Market Account. By custom, but not always, the vice chairman of the Board of

Governors nominates the Board chair as chairman of the FOMC, the president of the Federal Reserve Bank of New York as vice chairman, and the Federal Reserve Bank of New York as the location for the Open Market Account. There have never been competing or additional nominations, but it is important to note that there is nothing in the law preventing another voting member from being either chairman or vice chairman of the FOMC or preventing the Open Market Desk from being located at another reserve bank besides the Federal Reserve Bank of New York.[5] The importance of this is that removal of the chairman of the Board of Governors does not control who serves as chairman of the FOMC, should any jurisdictional dispute arise between the president and the Fed. That election is specified in the statute and is the prerogative of the voting members. The president has no say in the matter.

In contrast to the Board and FOMC, the 12 Federal Reserve Banks are quasi-public- private entities whose stock is owned by the member banks headquartered in their respective Federal Reserve Districts.[6] Their officers and employees are not federal employees; the bank presidents and first vice presidents are appointed by their respective reserve bank boards of directors, (who also control their budgets) and both appointments and budgets are subject to approval by the Board of Governors.[7] Bank presidents are not appointed by the president, nor are they subject to congressional approval.[8]

The Federal Reserve Act, which lays out the structure and duties of the System, has been modified by Congress many times, and relative roles of the respective legal entities have also evolved. For example, in the original structure, the heads of the reserve banks were called governors, and the board in DC had few responsibilities. It was called the Federal Reserve Board, whose members included the Comptroller of the Currency and the Secretary of the Treasury, who also served as chairman. The Banking Act of 1933 created the Federal Open Market Committee as an independent agency, and the Banking Act of 1935 changed the name of the Federal Reserve Board to "Board of Governors of the Federal Reserve System," and the Board's members were called governors.[9] The number of governors was increased from six to seven, and the Secretary of the Treasury and Comptroller of the Currency were removed from the Board. The Board of Governors moved its offices out of Treasury into its own building, further distancing itself from the Executive Branch. At the same time, titles of reserve bank governors were changed to presidents, thus completing the shift in control of the system and policy from the reserve banks to the Board of Governors in DC.

Just as the organizational structure is Byzantine, so are the structure and responsibilities for the key tools of monetary policy, and those complexities can also frustrate the ability of outside forces to influence policy, since different groups of Federal Reserve officials control different policy levers. There are four principal tools employed in the FOMC's current floor and sub-floor system: the interest rate on reserves (IOER), the federal funds rate target range, the interest rate on overnight repurchase agreements (ON RRP), and the discount rate. The Board of Governors is empowered to set both the discount rate and IOER, whereas the FOMC sets the federal funds rate and ON RRP.[10] The interest rate on reserves (IOER) was envisioned to be a floor for the federal funds rate; but as has been explained in previous commentaries, the effective federal funds rate has often been below the floor because the GSEs and Home Loan Banks were not able to receive interest on their reserve deposits held at the Fed and thus were lending them in the overnight market at rates below IOER.[11] To counter this, the Open Market Desk employs the ON RRP rate, borrowing from reserve suppliers at a rate that is presently 2.25% (the sub-floor) or 15 bp below the IOER's 2.40 percent (the floor).[12] Note that IOER is 10 bp below the upper target range for the federal funds rate of 2.25–2.5%.[13]

In the present policy regime, the discount rate – the rate that the Fed charges banks for borrowing – has become largely unimportant. [14] Historically, however, it was the first policy tool the system employed. It was initially was used to accommodate the cyclical demand for credit during the crop cycle, given the agricultural nature of the economy during the Fed's early years. The discount rate then evolved prior to the financial crisis and passage of permission for the Fed to pay interest on reserves, as the cap or ceiling rate on the FOMC's funds rate target. It remains the responsibility of each reserve bank's board of directors to make recommended changes in the discount rate to the Board of Governors every two weeks. Recommendations are staggered so that there is always a fresh recommendation available to the Board. The Board cannot change the discount rate without a recommendation from at least one reserve bank to make a change.

Presently, the discount rate is the same across each Federal Reserve district, but this is true only after each bank's board of directors makes a change request that is submitted and approved, and this is why there is always a separate announcement of the Board's approval of discount window changes. The process can sometimes take a few days, but eventually the rates are equalized. Most recently, the Board approved requests from six Federal Reserve banks to increase the discount rate for primary credit to 3% effective December 20, 2019.

The complex organizational structure combined with split authority for the policy tools has led the Board and FOMC to hold joint meetings in which policy is set.[15] This arrangement was an organizational response by Chairman Bernanke to create a more collegial and cooperative environment for policy setting with all participants present and participating in the decision process. But all this could be undone by another chairman or by a split within the system concerning the relative roles of the Board and FOMC. For example, a return to a low volume of excess reserves and a resurgence of a specific federal funds rate target rate instead of a range would change the relative importance of Board and reserve bank presidents in the policy-setting process. At the same time, the Committee’s flexibility to change how policy is formulated and implemented provides additional potential insulation from outside pressures to affect or influence the setting of policy.

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[1] See https://www.usa.gov/independent-agencies
[2] This intent has been frustrated by resignations, enabling a president to make appointments to fill unexpired terms. President Trump has been able to make four appointments in just the first two years of his tenure. Recently appointed Governor Bowman’s term expires in 2020 and Governor Clarida’s term expires in 2022. Presently unconfirmed appointments of Professor Goodfriend and former Fed staffer Nelly Liang are for terms expiring in 2024 and 2030. People filling unexpired terms may be appointed to a full term.
[3] Section 225a. of the Federal Reserve Act
[4] Presidents rotate membership each year as follows: one from the Federal Reserve Banks of Boston, Philadelphia, and Richmond; one from the Federal Reserve Banks of Chicago and Cleveland; one from the Federal Reserve Banks of Atlanta, Dallas, and St. Louis; and one from the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco.
[5] The events of 9/11 exposed the risks of having the Open Market Desk in New York. Subsequently, the System introduced a back-up structure for both the Desk and the discount window administration for all the reserve banks. There are now designated banks to pick up discount window functions and Desk operations in the event that any of the banks are unable to operate for any reason.
[6] Although member banks own stock in their reserve bank, the stock is nonvoting and carries a fixed dividend.

[7] Traditionally, three nominees are sent to the Board for approval, although recently only one recommendation has been sent for approval. There have been cases in the distant past when a reserve bank's favored candidate has been rejected by the Board.
[8] Board of Governor's email addresses end in @FRB.gov while reserve bank addresses end in @xxx.FRB.org, where the bank's city initials are substituted for *xxx.* Recent proposals have been made to subject the appointment of the president of the Federal Reserve Bank of New York to congressional approval so as to control and limit the influence of Wall Street on monetary policy decisions. However, requiring rotation of the vice chairman position among the voting presidents would ensure even broader regional representation on the Committee
[9] Until a change in the Banking Act of 1935, Federal Reserve Board members were not voting members of the FOMC.
[10] Prior to the financial crisis, the principal tool was the federal funds rate, but under the present regime the Board of Governors controls the floor and lower bands of the policy corridor whereas the FOMC sets only the target range within the corridor.
[11] See "TNB and the Regulatory Dialectic," December 13, 2018: http://www.cumber.com/tnb-and-the-regulatory-dialectic/.
[12] For the rationale for setting the ON RRP rate slightly below the IOER, see Steven Williamson, "Monetary Policy Normalization in the United States," FRB St. Louis *Review*, second quarter 2015, 97(2).
[13] See FOMC Statement and Implementation Notes, December 19, 2018, https://www.federalreserve.gov/newsevents/pressreleases/monetary20181219a1.htm.
[14] There are three main categories of discount lending, and these have varied over time.
[15] The proposed change was the subject of "Conference Call of the Federal Open Market Committee on January 16, 2009, https://www.federalreserve.gov/monetarypolicy/files/FOMC20090116confcall.pdf.

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