

# After Greenspan

BY ANDREW FOERSTER

## Choosing the Next Chairman of the Federal Reserve

**EDITOR'S NOTE:** *As this issue went to press, President Bush nominated Ben Bernanke, chairman of the Council of Economic Advisers, to succeed Alan Greenspan. Confirmation hearings are pending.*

*Alan Greenspan  
August 1987 – January 2006*



*Paul A. Volcker  
August 1979 – August 1987*



*G. William Miller  
March 1978 – August 1979*



*Arthur F. Burns  
February 1970 – January 1978*



*William McChesney Martin, Jr.  
April 1951 – January 1970*



When Alan Greenspan's term ends on Jan. 31, 2006, he will have served as Chairman of the Board of Governors of the Federal Reserve System for 18 years and five months. That is the second-longest tenure in the Fed's history, just four months shorter than the one served by William McChesney Martin from 1951 to 1970.

Greenspan has earned a reputation as a deft handler of monetary policy. His era coincided with several significant economic shocks, including the stock market crash in 1987, the terrorist attacks on Sept. 11, 2001, recessions in the early 1990s and the early 2000s, and booms in the stock market and now the housing market. His success in navigating those and other pitfalls has helped him gain popularity outside of the usual realm of Fed watchers. All types of media monitor his Congressional testimony and various speeches, the likes of which produced now-famous phrases like "irrational exuberance."

Whoever his successor turns out to be will have a difficult act to follow. Markets are now accustomed to the policies that the Greenspan Fed has pursued. There is general confidence that the Fed will keep the economy in good order. At the same time, it is difficult to articulate precisely why the

Greenspan Fed has succeeded. The decisionmaking process during the Greenspan era has become more transparent over time, but there is still some uncertainty about how the Fed will build on its recent success. Will Greenspan's successor move more in the direction of rules-based decision-making, such as adopting an inflation target, or maintain the more discretionary approach of recent years?

The process for choosing a new chair is itself both discretionary and rules-bound. It involves input from the executive and legislative branches of government, similar to the appointment procedure for many other government posts. The Federal Reserve Act (FRA) of 1913, which established the Federal Reserve System, dictates who is eligible for positions on the Board of Governors, their term limits, and the rules for appointing the chair of the Federal Reserve. Ultimately, however, the new Chairman can be virtually anybody. The nominee's background, qualifications, and economic outlook are largely the choice of the appointing President.

### Appointing a Governor

The FRA declares, "The Board of Governors of the Federal Reserve System... shall be composed of seven

members, to be appointed by the President, by and with the advice and consent of the Senate.” In this manner, governorships are similar to many other governmental positions that require the Senate to confirm a presidential appointment.

Usually, because Governors serve until the end of their term or give advance notice of their resignation, the President is able to give some thought into the nomination before there is a vacancy. This is the case with Greenspan’s pending retirement, since it was common knowledge that he could not serve beyond January 2006. Occasionally, a Governor will decide to resign on a given date, which creates a vacancy if a replacement has yet to be appointed. Currently, for example, the positions held by former Govs. Ben Bernanke and Edward Gramlich remain unfilled. As a result, the President may have varying time frames to find replacements. The administration can look anywhere for possible nominees for Governor positions. In the past, nominees have come from banking, government, academia, and from within the Federal Reserve System.

The FRA states: “In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country.” Furthermore, the individual may not hold other employment while serving as a Governor.

After the administration chooses a nominee, the process moves to the Senate, where the nominee appears before the Committee on Banking, Housing, and Urban Affairs. The nominee delivers a prepared statement, and then fields questions from the members of the committee. The process usually focuses on the nominee’s qualifications and a discussion of monetary policy or banking issues. Next, the entire Senate votes to confirm the nomination, with a simple majority vote needed to pass. Finally,

within 15 days of Senate confirmation, the appointee must take the oath of office, and then the term begins.

Governors are appointed to 14-year terms, each of which begins on Feb. 1 of even-numbered years. Consequently, the terms cycle, with a different term ending every two years. The fact that many Governors do not fill their entire term means that nominations have to occur more often than once every two years. Instead of a new term beginning with a new appointment, if a Governor resigns during his term, a new nominee simply replaces the outgoing Governor and keeps serving the unfulfilled term. If the term ends, the nominee can be selected for a new term if the President chooses to keep the Governor on the Board. This means that the term limit applies only to the Governor’s own term; Governors themselves can actually serve longer than 14 years. Chairman Greenspan has served for 18 years by spending the first four serving the end of a different term, and then being appointed to his own term that began in 1992.

The Governors’ 14-year term limit ranks among the longest in U.S. government. These lengthy terms are intended to help the Fed preserve its independence from the political process. Governors are free to pursue what they feel is the best policy for the economy even if those policies conflict with what elected officials might want. In a world with less independence for the Fed, the President might threaten Governors with removal or withholding of their reappointment if the Fed refused to help the administration.

For example, the President may want a large short-term monetary stimulus right before an election, and if the Governors weren’t independent of presidential control, they might oblige the demand. While the Governors generally do not serve their entire term, the simple presence of lengthy terms helps remove the control of monetary policy from the political sphere.

### **Appointing a Chairman**

A simple qualification to become Chairman, as stipulated by the FRA, is

that the person must be a member of the Board of Governors. In theory, this requirement might suggest that only people with experience on the Board can be elevated to Chairman. Historically, this has not been true, though, as candidates have normally been simultaneously appointed as Governor and Chairman.

In addition to the normal 14-year term limit that applies to all Governors, the chair is appointed to four-year terms. Unlike the longer terms applied to Governors, the four-year term for the chair has no set starting and ending date — the four years begin as soon as the chair takes office. The Chairman can serve multiple four-year terms; the only restriction is that he must remain a Governor. Greenspan was first appointed Chairman in 1987, and his fifth and current term began June 19, 2004.

The procedure to appoint the chair of the Board of Governors works exactly the same as for appointing Governors. The nominee has a hearing in the Senate and then is approved by a majority vote of that body. If the nominee for the chair position is simultaneously chosen for a Governor position, he goes through the process only once, although presumably with increased scrutiny.

Previous chairmen have made a custom of offering their resignation upon the election of a new President. This tradition allows the President to appoint a new chair upon entering office, one with similar priorities. However, while it is customary to offer the resignation, the President is not under any obligation to accept the offer. Greenspan, for example, although appointed initially by Reagan, has kept his position during both Bush administrations, plus the change of party to the Clinton administration.

### **The Evolution of Chairmen**

The nature of individuals who have become chairmen of the Board of Governors has evolved since Charles Hamlin became the first Chairman in 1914. While his primary career

was as a lawyer in Boston, Hamlin tried unsuccessfully to get into politics, including two candidacies for Massachusetts' governor, first in 1902 and then in 1910. In 1913 he was appointed undersecretary of the Treasury by Woodrow Wilson, and then appointed as a Federal Reserve Governor and the first Chairman in 1914. His tenure as Chairman was brief, ending in 1916, but he stayed on as a Governor through 1936, a length allowed before modern term limits were enacted.

Roy Young, who served as Chairman from 1927 to 1930, was the ultimate Fed insider. Originally a banker, Young became president of the Federal Reserve Bank of Minneapolis in 1919, where he served until his appointment as Governor and Chairman in 1927. After overseeing the Fed during the stock market crash in 1929, Young resigned the chairmanship and his Governor position in 1930, and promptly took the position of president of the Federal Reserve Bank of Boston. He returned to the private banking sector in 1942 after holding three of the most important positions in the Federal Reserve System for 23 years.

While Hamlin was a politician and Young a banker, Marriner Eccles, who served as Chairman from 1934 to 1948, was a combination politician and banker. Eccles started as a private banker in Utah, but when the Great Depression hit, he became convinced that fiscal policy was needed to help the economy. So he moved to the Treasury Department, where he helped President Franklin Roosevelt and Congress draft the Emergency Banking Act of 1933, the Federal Housing Act of 1934, the Glass-Steagall Act of 1933 that created the Federal Deposit Insurance Corporation, and the Banking Act of 1935, which restructured the Federal Reserve System.

In 1935, Eccles was appointed Chairman of the Board of Governors, where he served until 1948. He was not reappointed as Chairman by President Harry Truman, but he retained his position as Governor until 1951.

William McChesney Martin, the

longest-serving Fed Chairman, served from 1951 to 1970, and followed a path in the financial world and corporate governance to the Fed. His meteoric rise started as a broker in St. Louis, after which he moved to the New York Stock Exchange, where he eventually became president of the exchange at the age of 31. He left the exchange during World War II, and was nominated for the Fed chairmanship in 1951. During his tenure, Martin led the Fed into the modern era following the passage of the Treasury-Fed Accord, and gained a reputation for pursuing monetary policy independent of the four administrations that came and went while he was Chairman.

The selection of Martin's successor, Arthur Burns, signified a shift in the type of person who would be tapped for Chairman of the Board of Governors. While his predecessors had been bankers and politicians, Burns was an economist by training. He had served on President Dwight Eisenhower's Council of Economic Advisors from 1953 to 1956, and also helped pioneer studies of the business cycle with Wesley Mitchell at the National Bureau of Economic Research. The famous monetary economist Milton Friedman was Burns' student at Rutgers University in the 1930s, though Friedman would later heavily criticize the Burns Fed for its "stop-go" policies that brought on double-digit inflation.

Paul Volcker, who preceded Greenspan, jumped around several times during his career, including stints at Chase Manhattan, the Treasury Department, and then president of the Federal Reserve Bank of New York. From his position at the New York Fed, he was nominated by President Jimmy Carter in 1979 to become Chairman. The Volcker Fed began the long road back from high and erratic inflation to a period of credibility in the Fed's fight against rising prices.

Volcker served two terms as Fed Chairman, before resigning in August of 1987. Following his departure, some questioned whether Alan Greenspan had the political independence to

act effectively as Fed Chairman. Although much of his career was spent as a partner in the business consulting firm Townsend-Greenspan, he also had been long active in Republican politics, serving as Chairman of the Council of Economic Advisors for President Gerald Ford and Chairman of the National Commission on Social Security Reform under President Reagan. As a result, Greenspan was viewed by many as more of a "team player" than Volcker, who in his later years had developed a sometimes contentious relationship with the Reagan administration.

In his 1987 book, *Volcker: Portrait of the Money Man*, reporter William Neikirk noted that in "the instant analysis that followed Greenspan's selection, it was often suggested that he would not be as tough as Volcker when the White House put the pressure on and that he would, in an election year, expand the money supply to take care of whoever the Republican presidential nominee is." This, of course, proved to be untrue. Just four years later, the Greenspan Fed was widely blamed by Republican politicians for costing President Bush re-election by not aggressively cutting interest rates during the 1991 recession.

### **The Post-Greenspan Fed**

Greenspan's successor may continue the trend away from bankers toward economists. Early chairmen such as Eccles and Martin were bankers by training, while Burns, Volcker, and Greenspan can generally be thought of as business economists. Some of the popular names in the news media for possible successors are academic economists. Such a selection would move the position even more in favor of people with rigorous theoretical backgrounds.

Greenspan has succeeded with a healthy combination of grounded practicality and theory. It will be up to his successor to mix the two and apply the newest insights of monetary economics to the real world issues that face the Board of Governors. **RF**