Eastburn, David P., ed.
MEN, MONEY & POLICY; ESSAYS IN HONOR OF
KARL R. BOPP.
Federal Reserve Bank of Philadelphia.

THE ROLE OF THE DIRECTOR: THE IDEAL AND THE REAL

WILLIS J. WINN

A NOMINATION TO BECOME A DIRECTOR of a Federal Reserve Bank is both flattering and puzzling. No call to public service, of course, is ever to be taken lightly by anyone concerned for the effective functioning of a democracy. And to citizens accustomed to viewing the central banking organization as the very apex of the vast financial structure that undergirds our capitalistic system, an invitation to join the board of a Reserve Bank is a signal honor indeed. That the honor and opportunity of directorship are well-recognized is attested by the generally strong boards that have been the rule at the various Reserve Banks throughout the history of the System.

On closer examination, however, it is hard to escape the conviction that the status of the director falls considerably short of what it ideally might be. Nor is this impression greatly altered by actual experience as a director. It is not that rewards in terms of remuneration, influence, prestige, and even of perspective on what is going on are circumscribed. It is the feeling, rather, that achievement is not always up to potential. The very fact that boards are strong exaggerates the anomaly—with boards of lesser competence, the loss from failure to use their talents fully would not matter so much. The boards have been quite conscious of this situation and have been the leaders in repeated questioning and self-appraisals of their role and function within the System. On more than one occasion such discussions have raised doubts as to the viability of the present organization and structure, and also as to the ability of the System to continue to attract strong leadership at the regional level. But the System survives, new directors join the boards, and the debates continue.

Centralization and the Plight of the Administrator

In all facets of our society, from schools and colleges to highest levels of government, we are witnessing serious questioning of highly centralized structures of organization. The discontent arises from the fact that organizational restraint, stemming from central control that is often inefficient, tends to limit the scope of human behavior. Not infrequently, problems confronting organizational structure are so large and complex that they seem to overwhelm the ability of administrators to solve them.

Even the ablest individuals equipped with all the known technical tools cannot hope to deal perfectly with the manifold complexities confronting centralized structures. The remoteness of central direction adds to the oppressiveness and discontent which breed in this environment. It becomes increasingly difficult to persuade individuals, faced by these complexities, frustrations, and potentialities for misunderstanding and personal abuse to participate as leaders of such organizations.

Increasingly, the need for decentralization is being discussed, in government and business circles, with a view to transferring power to smaller units and relating the decision process to the scale of problems to be solved. It is worth noting that these discussions do not envisage the removal of operating guidelines or centrally formulated general policies, rigorous general standards, or centralized supervision. The discussions do indicate, however, that by gaining the counsel of a greater number of individuals, improving two-way communication, and closer personal contact throughout the organization, institutions may become far more viable in our society by becoming more sensitive to the needs of their clientele and more efficient and effective in carrying out their mission.

The Federal Reserve System, unfortunately, is not immune to organizational pains and pressures. No high marks will be given the central bank simply on the basis of its mystique. If such marks are to be accorded they will have to be earned, and to be able to earn them the Federal Reserve System will have to strive continuously to develop the most effective organization possible. Among the major components of any such organization will be the boards of directors of the local Federal Reserve Banks. Directors can play a genuinely vital role only if they are permitted to reach their full potential within the System. Such a role, of course, will carry great responsibilities and challenges.

The Director in the Table of Organization

The Federal Reserve System has been criticized as outdated, archaic, and obsolete from the standpoint of its organizational structure. Nevertheless, with its division of powers among the Board of Governors, the Federal Reserve Banks, and various committees and councils, it may represent a possible forerunner of things to come in more and more business and governmental organizations. Far from perfect in theory and in fact, the organization of the System does contain a number of features sought in the further democratization of both governmental and business activities. Many of these features presently exist, however, only on paper, and the full potential of others remains to be fulfilled.

Banking legislation in 1935, which substantially cut the powers of the boards of directors of Reserve Banks, officially recognized and sanctioned the trend toward centralized control over the nation's central banking system. The trend which existed then continues today. It can be argued that much of the elaborate organization and ritual that has been maintained in the System is, in fact, a facade.

In view of the trend toward centralized control in the System, some observers have suggested that the district Banks should be operated solely as service facilities to clear checks and to provide currency and coin for community needs. Such a suggestion would signify abandonment of the remaining feature which has provided the real strength of the System, namely, the sharing of responsibilities for both policy and operations between the Board of Governors and the staffs of the Federal Reserve Banks. This elaborate check-and-balance organization with its procedures for joint decisionmaking has at times been as frustrating to the Chairman of the Board of Governors as it has been to a member of the board of directors of a Federal Reserve Bank. Nonetheless, it probably represents a unique source of strength for the System. Under greater centralized control within the Federal Reserve, the check-and-balance system would tend to disappear and mistakes, which are inevitable under any structure, could be that much bigger. This price could be too high even if the System organization were to become less costly to operate.

The challenge to the System is to make its still relatively decentralized structure function as effectively as is administratively possible. This does not necessarily involve any extensive transfer of power within the System from the Board of Governors to the Reserve Banks or vice versa, but it does call for a conscious effort by each part of the System to carry its full share of the burden while permitting other segments to carry their share.

Only in an appropriately decentralized organization can directors maximize their distinctive contributions to the System. Unlike all other officials within the System, directors of the Reserve Banks have no vested interest in their positions—in any sense of the term. Moreover, they are serving in the public interest to make whatever contributions they can to the effective functioning of our nation's monetary system. It is the obligation of the directors to make the System function as effectively as possible within the guidelines provided by Congress and the Board of Governors, or to get the guidelines changed if this would result in a more efficient monetary system. In fact, they are under obligation to seek changes in the System, as drastic as the possible elimination of the present role of the Federal Reserve Banks, if they feel that such changes would contribute to the better achievement of the nation's monetary goals. The director's place in the organizational structure is that of an independent monitor, counselor, advisor, interpreter—yes, even critic of their place as a regional component in the organizational structure of the Federal Reserve System.

Selection of Directors

The procedures for nomination, election or appointment, and rotation, as well as the personal qualifications of the directors of the Federal Reserve Banks, have been carefully spelled out both in statute and in regulations of the Board of Governors. In practice, these particulars are far more detailed than any description of or statement concerning the duties and functions of a director. The rigid selection process makes it impossible for any group to seize control or to dominate the policies of a Federal Reserve Bank. In addition, they are designed to accomplish certain purposes. Commercial banks which are members of the System elect six directors and the Board of Governors appoints three. Each bank has one vote irrespective of the number of shares it owns, and the member banks in each district are divided into three groups based on asset size. Each group selects two directors—one to represent the member banks on the board and one who is actively engaged in business in the District to represent the interest of business, agriculture, and commerce.

Member bank representatives (Class A directors) have responsibilities for communicating with their constituency. This is normally achieved simply by the selection of officers or directors of a member bank and assumes that in the course of their activities they will be engaged in two-way communication with their constituency. From the communication standpoint alone, it is essential that Class A directorships be filled by active leaders of the banking community. The directorates should not be used as a *pro forma* or honorific post for those who have the time to undertake public service or who are no longer in the mainstream of the operations of their own institutions. A Class B director, elected to represent the business interests of each member banking group, has the responsibility of sharing his expertise and knowledge with officials of the Federal Reserve Bank, but is in no way obligated to report back to the business community. The member banks, the banking system, and the business community are weakened by this gap in the communication feedback system. Class B directors are not selected from any particular size category nor are they necessarily even customers of any bank in the groups they are presumed to represent. Consequently, the size of the businesses represented by Class B directors is not so well-balanced as the member bank representation.

Both Class A and Class B directors are elected for a three-year term, but the latter may be reelected for a second term while the former may not. Each year one A and one B director must stand for election.

The three C directors who are appointed by the Board of Governors to represent the public interest cannot have any affiliation with a commercial bank. There are no other restrictions on them except a requirement of residency within the district and the general prohibition, applicable to all directors, against anyone holding political or public office or holding a major committee post in one of the political parties. In practice, a majority of the C directors have been businessmen. While this may have strengthened the information-gathering network of the System with respect to business developments, it is by no means clear that a somewhat broader representation of the public might not improve the overall information flow into the System and back into the community at large. In the Third District, a conscious effort has been made to assure geographical representation in all three groups of directors.

In spite of the very elaborate structuring of representation on the boards, all members operate as public members, in fact if not in theory. Promoting the general welfare of our society is the predominant objective of both policy and operational deliberations, and an unacquainted observer at the meetings of the board would be hard put to identify the particular constituency of individual directors from the discussion or voting records.

Existing procedures for selection of directors may, in fact, provide an inadequate representation of the banking and financial community on the boards. With only one representative permitted from the large banks and with little or no representation from other large financial institutions, absenteeism or limited knowledge can seriously restrict the informational input of directors in an area of primary concern to the Reserve Banks. Accordingly, provisions designed to avoid any undue influence by a particular group may, in practice, be an obstacle to the more effective functioning of the System.

The rigid tenure restrictions applicable to directors have merit for a number of reasons. For example, the more people who become involved in a responsible way with the Bank and the System, the greater the informational inflow to the System and the larger the number of semi-official representatives of the System in the community. But the tenure restrictions have major disadvantages as well. Limited terms keep the System from tapping most effectively the considerable talent represented on the boards. It takes time for any new director to become familiar with the personnel, operating practices, and problems of the organization. Moreover, time is also essential in order for people to become sufficiently acquainted with one another to work most effectively together and to develop an *esprit de corps* and an operating style. And because of complicated jurisdictional relationships and divided responsibilities between the Board of Governors and the individual Reserve Banks, it takes time for the directors to gain an understanding of their zone of action and to develop into an efficient and effective part of the System structure.

Finally, if the Banks are to attract to directorates the top leadership of the community, the directors must be given the maximum opportunity to use their talents. It is not clear that this objective is achieved if turnover is so rapid that the potential contributions of any board member are never fully tapped. On the other hand, the dangers inherent in relatively permanent boards which have become sterile provide all too pointed examples of the desirability of reasonably limited tenure. Whether present tenure rules are the proper ones is an open question.

Role of Directors

Every job or position has its rewards as well as its burdens and obligations, and a directorship of a Federal Reserve Bank is no exception. Directors who have served with the man who is being honored in this volume are quick to realize that their rewards are manifold and far exceed any obligation they may have incurred. Great teaching is a rare talent; thanks to Karl Bopp, every board meeting at the Philadelphia Reserve Bank became a rich learning experience for the directors and staff that was both exciting and real. The directors' understanding of central banking and economic analysis grew at each meeting, and their admiration for a warm, sensitive, human being whose every breath conveyed a concern for principle and truth, knows no bounds. While the classroom performance of the students may not have merited a Phi Beta Kappa designation, the shape of the learning curve was very real and will remain a prized possession of the group.

At the same time, a directorship does entail its frustrations. Ninety-five per cent of the personnel of the Reserve Bank are engaged in operational activities relating to the flow and storage of money and credit, with only 5 per cent or less concerned with issues of monetary and credit policy. Quite properly, deliberations of the Board of Governors fall into, roughly, the reverse proportions; yet in one sense, the board of directors has almost been divorced from the determination of monetary policy. With the heavy reliance on open market operations as a policy tool, the role of the local Federal Reserve Bank, and more particularly the role of the director, was substantially reduced. While all presidents of the Reserve Banks participate in deliberations of the Federal Open Market Committee, they participate as individuals and are not bound by instructions from their boards of directors. Moreover, they have no obligation to report on these deliberations to their boards. This gap in the flow of information makes some of the advice and guidance offered by directors on policy questions less useful than it might be. In view of the number of individuals currently privy to the deliberations of the Federal Open Market Committee, and in view of the leaks which have occurred within this group, one cannot but wonder if the added secrecy which the present policy affords is worth the sacrifice in terms of directors' morale and in the effectiveness and quality of their advice on policy issues. While board opinions undoubtedly influence the views of the presidents, it is recognized that board reactions are by no means unanimous and the president clearly has the right to his independent judgment. It is the information loop—input into the System from the board and the feedback to the board—which is missing.

Directors do participate in the discussions concerning discount-rate policy. In this role, directors make a unique contribution by presenting information regarding sectors of the economy with which they are familiar. Directors have a feeling for developments in their particular areas of competence, and they can often report those developments to bank officials before statistical evidence becomes available. Their collective input on underlying conditions and attitudes is by no means confined to questions related to the discount rate; it influences all monetary policy deliberations.

The importance of the directors' activities regarding the discount rate is often questioned. Although by law directors establish the discount rate at least every 14 days, any action regarding rates is subject to approval by the Board of Governors. Moreover, relatively little use is presently being made of the discount window by the member banks.

So it is difficult to make discount policies the major contribution of a director. Even if the System should modify the discount rules to encourage greater use of the window by member banks, it is by no means certain that the role of the director in this area would increase materially. It is nevertheless important to recognize the positive contribution that the director makes through his discussion of discount-rate policy, and that the directors' influence on the monetary policy is broader than this. For example, the directors may help in the evaluation of the weights to be assigned to different social or monetary goals at various stages in the political-economic cycle. It is recognized that many of these goals may be in conflict at any particular time. Society clearly needs all that the best minds available have to offer, not only in the resolution of these conflicts but also on the establishment of appropriate priorities.

All too often monetary policy issues focus too simplistic an objective. For example, much of the discussion of the goals of monetary policy treats full employment as an alternative to price stability. The possible conflict between the two goals under certain economic circumstances is recognized, but to accept this conflict as inevitable is to assume the availability of only limited solutions to the problem. The directors can influence policy and issues by asking for a thorough reexamination of underlying assumptions and by pointing up new policy tools both within and without the System to resolve such conflicts. The influence of a single director on policy decisions is miniscule; but the cumulative impact of the opinions of 108 directors of the 12 Reserve Banks can be a significant element in the decision process.

In the operating area, too, it is essential to recognize that freedom of action of each Bank is circumscribed because it is part of a larger System. In spite of each board's lack of autonomy, the directors can nonetheless exert considerable influence on operations. Moreover, these contributions may have real impact not only upon the individual Bank but also upon a wide range of institutions.

Directors play an important role by providing advice and guidance on the internal operations of the Bank. They bring a wide range of expertise and experience to considerations concerning labor relations, salary administration, financing policies, public relations, building maintenance, audit policies, and long-range planning for physical facility needs, to mention only a few. Because officers of Federal Reserve Banks are not permitted to hold outside directorships, Bank management may tend to lose touch with latest management techniques developed in the corporate world. The board of directors assures a considerable degree of protection against the development of institutional insularity by providing a link with the procedures, practices, and policies of other corporate institutions. This role is important not only in terms of the operations of the Reserve Bank; it is highly relevant also in terms of the role the Reserve Bank and its staff can play in improving the operational efficiency of member banks. The same applies to other financial institutions falling within its sphere of influence.

Primary responsibility for selection of bank management rests with the board of directors, and the achievements and success of the leadership exercised by officers depends in part upon the support and guidance they receive from the board. Restraints imposed by the necessity for the Bank officers to operate within restraints and rules of a larger System can be as frustrating as is realization that the director's role is not to direct in the traditional sense of the term. But a strong board of directors can provide the guidance and the balance which will channel these frustrations into useful influences both within and without the System. If the Reserve Banks are to play a constructive and innovative role within the region, and at the same time are to influence the formulation and execution of policy on both the national and international level, top caliber talent is a prerequisite.

As essential as the role of directors in management succession may be, the majority of directors serve out their terms without participation in this process, inasmuch as the turnover in top personnel in the Bank is so low. Even though periodic reviews of personnel planning are conducted by the board, this is hardly a *raison d'être* for a board. Thus the ability to attract strong board members must rest upon a considerably broader base than this.

All components of the System can profit greatly from the challenges and demands continually advanced by an active and imaginative board which not only reacts to the problems placed before it, but is constantly pushing and probing on its own initiative on all fronts.

The Challenge to Directors

Despite their restricted role within the organization of the Federal Reserve System, directors have challenging opportunities to make positive contributions to the System and, thus, to society.

In the operating areas, directors have great opportunities to exercise more initiative than they have evidenced in the past. For example, our understanding of the monetary system and its impact on the economy is far from complete. Under the leadership of their directors, staffs of individual Reserve Banks should be encouraged to attack particular segments of the unknown for concentrated study, e.g., consumer and corporate behavior, organizational structure, regionalism, institutional flows, and money substitutes. Such efforts would not only help to strengthen the research thrust of the Bank and the System in these areas; they also would make it easier to attract top personnel to the staffs and provide new and important bridges to many external interfaces between the Reserve Banks and the community. Innovations in Reserve Bank operations and management techniques can provide important means for establishing better communications and contacts with the banking and business community.

Directors are faced with challenges in the policy area—among them, the effectiveness of voluntary restraints. This challenge is more than just an informational function, important as that may be; it touches on the basic philosophy of *volunteerism* (to coin a clumsy term), i.e., obedience to verbal appeals to follow generally prescribed courses of action in pursuit of desired social and economic goals. There is evidence that wide variations exist in the degree of restraint exercised as a result of such appeals. Among possible causes of the inadequacies of volunteerism is insufficient knowledge, a difference of opinion on the relevance or the accuracy of the underlying conditions leading to these verbal appeals, a simple unwillingness to cooperate, or a cynical evaluation of the rewards from deliberate flouting of the request. The question arises as to what penalties, tangible or otherwise, should be applied when problems arise from failure to cooperate for whatever reason. Can the directors play a role in this milieu, or is volunteerism suspect and inherently weak as an appropriate policy tool?

Congress has the power stemming from the Constitution to issue money and regulate the value thereof. To transfer this power to private interests without adequate regulation or supervision is highly questionable, but abhorrence of centralized control has led to the development of a monetary mechanism which at best is an anachronism. Here again, directors are challenged to reexamine the structure and functioning of the monetary system from their particular vantage point, and to stimulate discussion regarding both strengths and weaknesses. The possible expansion of the type of institution permitted to issue demand deposits, the fragmented coverage of regulatory agencies of the monetizing institutions engaged in the process, and the ability of private institutions to change the structure of the Federal Reserve System more or less at will—all these pose very real problems of both equity and efficiency. Directors can take the initiative in expanding public understanding of the issues involved and in warning of the problems inherent in these conditions. While history provides little evidence of basic changes in our banking structure short of a major crisis, the latter may be closer than we realize. But it is to be hoped that greater public understanding of both issues and problems can provide a corrective mechanism short of the crisis stage.

Perhaps the greatest challenge to directors is to appraise the organization and operation of the Federal Reserve Banks within the context of the Federal Reserve System in order to assure that both attain their realistic potential. By word and deed, directors must play a major role in this appraisal. If they are content merely to follow the traditional ritual of board meetings developed through fifty years' experience, to exercise little or no initiative and to be passive in their actions, the role of a director will be little more than a walk-on part at best. But if they use their wisdom and experience to invigorate the System, they may serve as a critical catalytic agent in multiplying the effectiveness of the System and in demonstrating the strengths of a decentralized organization. Moreover, this can occur without any change in the responsibility, power, rights, or prerogatives of other components of the System.