That Mysterious FOMC

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The FOMC is one of the most closely watched institutions in the United States, and indeed in the world. Articles on monetary policy or the FOMC members appear in the *Wall Street Journal* almost every day. Other newspapers also report on monetary policy issues several times a week. Yet, as I talk with people about the FOMC, I find that they often regard the institution as somewhat mysterious. My purpose tonight is to dispel the mystery.

I will address six questions. How are the Fed and the FOMC organized? Where do these folks come from? What happens at an FOMC meeting? Does the FOMC know more than anyone else? How does the FOMC spread the word? Finally, is the FOMC really that mysterious? After I finish, I hope you will pose additional questions.

HOW ARE THE FED AND THE FOMC ORGANIZED?

The Federal Reserve System consists of the Board of Governors in Washington, D.C., and 12 Federal Reserve Banks. The seven Board members serve 14-year terms. A member is permitted to serve only one complete term; however, a member serving a partial term may be reappointed and may then serve a full 14-year term. Board members are appointed by the President of the United States and confirmed by the Senate. The President designates one of the seven members of the Board as the chairman for a four-year term and also names a vice chairman. Both designations are confirmed by the Senate.

Reserve Bank presidents are appointed through a different process. Each of the 12 Reserve Banks has a board of directors with powers similar to those of a regular corporate board. Each board of directors has the power and responsibility to appoint the president of its Reserve Bank, although the appointment is subject to confirmation by the Board of Governors. First vice presidents of Reserve Banks are backups for presidents at FOMC meetings, and are similarly chosen. Let me explain the process by recounting my own appointment.

Sometime during the fall of last year, my predecessor, Tom Melzer, informed the St. Louis board of directors that he intended to leave the Bank by the end of January 1998. The board selected a search committee, which followed a process similar to that followed by any large corporation. The search committee considered a wide range of candidates. When I was contacted about my possible interest in early December of last year, I consulted with my wife and decided that I was indeed interested in throwing my hat into the ring. After several rounds of interviews—including a day of interviews in Washington with each member of the Board of Governors—the St. Louis board of directors selected me as president, subject to approval by the Board of Governors in Washington. The Board of Governors approved my appointment as the president of the Federal Reserve Bank of St. Louis last March.

Normally, each Reserve Bank president is appointed to a five-year term. In my case, I was appointed to the remaining four years of the term that President Melzer had begun. In practice, Reserve Bank presidents are ordinarily reappointed at the completion of a five-year term, with no limitation on the number of terms. The board of directors has the power, as does any corporate board, to dismiss the president at any time.

The Federal Open Market Committee is the main monetary policymaking body of the Federal Reserve System. The FOMC consists of the seven members of the Board of Governors and five of the 12 Reserve Bank presidents. The president of the Federal Reserve Bank of New York is always a voting member, and the other 11 presidents vote on a rotating basis. For example, the Federal Reserve Banks of St. Louis, Atlanta and Dallas are in one of the rotation groups. This year was the turn for the St. Louis Fed president to vote, which means that I have been a voting FOMC member. My final vote this year will be cast in a couple of weeks at the December FOMC meeting.

Although only five of the 12 Reserve Bank presidents are voting members at any given time, all 12 presidents attend every FOMC meeting and participate fully in the discussion and debate. Thus, influence over monetary policy through analysis and argumentation is available to every Reserve Bank president at every meeting.

WHERE DO THESE FOLKS COME FROM?

I have outlined the appointment process for members of the Board of Governors and Reserve Bank presidents. Their professional backgrounds vary widely. Most—although certainly not all—have Ph.D.s in economics. Some, like myself, have academic backgrounds. Others come from the banking industry, and some from nonbanking lines of business. Still others have worked their way up through the ranks of the Federal Reserve System or served in government positions. If you are interested in the backgrounds of the current FOMC members, you can find their bios at the web site maintained by the Board of Governors at www.federalreserve.gov.

The diversity of backgrounds on the FOMC is a source of great strength for making monetary policy. Successes in monetary policy depend on collating a wide range of information and making proper use of a wide range of analyses. The current FOMC includes some members who as academics have spent their careers studying monetary economics. Several other members with Ph.D.s have spent many years in the banking industry as market analysts and Fed watchers. Others have less experience with monitoring and studying Federal Reserve policy, but their business backgrounds bring a tremendous depth of knowledge that an academic Ph.D., such as myself, may not have. Still others with backgrounds in public service bring detailed knowledge of government and fiscal issues to the table.

In sum, I must say that I have an extraordinarily gifted group of colleagues. They are remarkable both in the knowledge they bring to monetary policy debates and in the high quality of analysis they provide. I believe that the appointment processes for the Board of Governors and the Reserve Bank presidencies have over time yielded a stronger and stronger set of individuals on the FOMC.

WHAT HAPPENS AT FOMC MEETINGS?

The FOMC meets eight times a year, or about every six weeks. Each of us arrives at the meeting with a thorough briefing by our own staff and a large pile of briefing material put together by the staff at the Board of Governors. The Chairman calls the meeting to order promptly at 9 a.m. The first item of business is approval of the minutes of the previous meeting. Next comes a review of domestic and international market operations by the manager of the Open Market "Desk" at the Federal Reserve Bank of New York. The Open Market Desk is the operating arm of the FOMC; the Desk implements FOMC policy decisions by buying and selling government securities. After reporting on open market operations, the manager usually answers questions from around the table.

Following the Desk manager's report, a senior Board staff member provides an overview of the state of the economy and the staff's best "guess" on the economic forecast. I say "guess" because forecasting is an imperfect art. Every forecast has a range of uncertainty around it, and on some occasions the uncertainties are quite substantial. The staff presentation is followed by additional discussion with questions and comments from the FOMC members and replies by staff experts.

Next comes a go-around in which each Reserve Bank president and each member of the Board of Governors provides a summary of his or her views on the state of the economy. Presidents typically provide information on economic conditions in their own Districts, commenting on special considerations that might bear on the national outlook.

Following the review of economic conditions is another go-around, this time on the policy outlook. Chairman Greenspan kicks off the policy discussion by detailing his interpretation of what the statistical data mean for the economic outlook. He wraps up this discussion by indicating his view on policy and making clear his recommendation as to what action, if any, the FOMC should take. The presidents and Board members then outline the major policy considerations as they see them and indicate the policy stance they think is appropriate at the time. In recent years, the policy decision has focused on the intended level, or target, for the federal funds rate.

Finally, the Chairman has the FOMC secretary call the roll of the voting members and each votes "yes" or "no" on the policy directive. The policy directive, when adopted by majority vote, then provides the instructions for the Open Market Desk at the Federal Reserve Bank of New York until the next FOMC meeting.

When the meeting ends, typically around 2 p.m., the Committee releases a short written statement to the press. Current practice is to provide a brief explanation for any change in the target for the federal funds rate. When the Committee votes to keep the target rate unchanged, a representative of the Committee simply makes an oral statement to the press. This statement says that the meeting has ended and there will be no announcement. Stories about the policy action, or lack thereof, quickly appear on the wire services, and the market responds that very afternoon.

DOES THE FOMC KNOW MORE THAN ANYONE ELSE?

I have emphasized that the FOMC is a group of highly qualified people. However, it is fair to say that most of the information upon which the FOMC acts is generally available to all analysts, both inside and outside the government. Systematic economic data, such as the unemployment rate, employment, housing starts, GDP and so forth, are all available to any interested observer. The FOMC as a body does not obtain this information ahead of the world at large, although the Chairman gets some information a few hours ahead of the rest of us. For example, the Bureau of Labor Statistics releases the unemployment rate for a particular month on the first Friday of the following month. The release time is 8:30 a.m. ET. The afternoon before the release—ordinarily late in the day—the BLS notifies the chairman of the Council of Economic Advisers. The CEA chairman then writes a short memo with the information to the President of the United States, the secretary of the Treasury and the Federal Reserve Board Chairman. Thus, the Fed Chairman receives the information approximately 12 to 15 hours ahead of the official release.

The Federal Reserve does have a large and talented staff that is unmatched in the private sector. If the Fed has an information advantage, it is because the staff is able to conduct thorough analyses of all the available data and distill from them a better understanding of the current state of the economy and its probable evolution over coming quarters. Still, I believe that it is correct to say that the Federal Reserve operates on essentially the same information base as outside experts. In fact, careful study of the accuracy of Federal Reserve economic forecasts suggests that these forecasts are not notably more accurate than those of leading commercial forecasters.

It is also worth noting that the debates within the Federal Reserve are essentially the same as the debates among policy experts outside the Fed. Given that everyone has essentially the same information, has studied the same theories and read the same articles in the professional journals, and has observed the same events in the markets, it is to be expected that the debates inside and outside the Fed are largely the same. Although FOMC members do not talk about a meeting with those who do not have FOMC clearance, it is always a safe guess that the debates on the inside are largely the same as those on the outside. Anyone who follows the *Wall Street Journal*, *New York Times*, *Washington Post*, as well as various market newsletters, will have a very good sense as to what a given policy debate is about.

HOW DOES THE FOMC SPREAD THE WORD?

As already noted, the FOMC issues a brief statement at the conclusion of each FOMC meeting. Two days after a meeting, the Committee releases minutes of the previous meeting. For example, after the November 17 meeting, the Committee released a brief statement reporting both that it had voted to reduce the target for the federal funds rate to 4¾ percent and why it had done so. Two days later, on November 19, the Committee released the minutes of its previous meeting, which was held on September 29, and a report on its October 15 conference call. These minutes do not attribute particular positions to named individuals, but they do provide an accurate sense of the nature of the debate at the meeting. Any information obtained under an understanding of confidentiality is not disclosed. Such information can come to the FOMC from various business sources or from foreign governments or foreign central banks.

The FOMC releases verbatim transcripts of its meetings on a five-year lag. The transcripts identify speakers by name. The only information omitted from these transcripts is that obtained under a pledge or practice of confidentiality. Anyone who believes that the FOMC is mysterious should pick up one of these annual volumes for bedtime reading. I will guarantee that if you read 10 years of these transcripts—or maybe just one of them—all of the mystery will be gone!

Beyond the minutes and transcripts, the Federal Reserve spreads information on its policy in numerous ways. The most formal of these are the February and June congressional hearings on monetary policy at which the Chairman reports to Congress. Member of the Board of Governors also testify at other hearings on monetary policy and a variety of other subjects. Their formal statements and the question and answer periods convey a great deal of information about monetary policy. In addition, Board members and Reserve Bank presidents give numerous speeches and meet routinely with bankers, business people and community groups, among others. Federal Reserve publications and web sites provide another source of information. Anyone who has a serious interest in monetary policy can find an ample amount of material—written for people of all educational levels.

For example, in October I gave four speeches—on similar subjects, but to different audiences. On October 2, I spoke to 65 high school students about the importance of studying economics. Later in the month, when I spoke to business leaders in St. Louis and then in Louisville, I presented my view about what had happened in the credit markets since mid-August and how those events might impact the U.S. economy over the long run. In October, I also spoke in Washington at a research conference sponsored by CATO. That speech was a scholarly discussion of why I believe an inflation rate of zero is better than moderate inflation. The news media were invited to all these events and three of the speeches are available on the St. Louis Fed's web site.

By the way, if you have not viewed our web site, I suggest you check it out. I think you will find it is rich with valuable information. And the St. Louis site isn't unique among Reserve Banks. All the Reserve Banks and their presidents, as well as the Board of Governors, are committed to making information easily available.

IS THE FOMC REALLY THAT MYSTERIOUS?

Over the years I have known many FOMC members. I can tell you that they are highly qualified and also quite approachable and accessible. The "mystery" about the FOMC, I think, comes from the importance of its responsibilities and the complexity of monetary issues. Monetary policy is indeed complicated, as is nuclear physics. I find nuclear physics puzzling, or mysterious, simply because I don't understand much about it. Monetary policy is not inherently mysterious, anymore than is any other subject. But it does take a concerted effort and accumulation of knowledge over time to understand what the monetary policy debates are all about.

One of the enjoyable things about this subject matter is that it is possible to go far into it without being a trained economist. And it is also true that a person such as myself who has been following monetary policy and macroeconomics for the whole of his or her professional career can still find endless fascination with the subject. There is much that we do not know, and the economic world is constantly tossing surprises at us. I feel truly fortunate to be so intimately involved in this responsibility, being paid for something that is so exciting and so much fun to me.

As I close my remarks today, I hope I am leaving you with a positive impression of an FOMC that is very capable and highly committed. I also hope you sense my own personal enthusiasm and energy. All of us in the Fed are aware that exercising the power to print money is one of the most important responsibilities in our society. Indeed, given the central role of the United States in the world economy, U.S. monetary policy is one of the most important responsibilities in the world. I will not try to tell you that the Fed is infallible. We are not omniscient and our forecasts are not always accurate. We are humans and we do make mistakes. But I will tell you that I and my colleagues share a total commitment to pursuing the most sound monetary policy we know—one that will maintain a low and stable rate of inflation and foster safe, reliable and efficient banking and payments systems. That is our commitment, and we work hard at it.