THE WALL STREET JOURNAL.

Fed Draws on Academia, Goldman for Recent Appointees

Josh Zumbrun

November 10, 2015

When the Federal Reserve was established, Congress called for its policy makers to have "fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country."

But Fed officials have recently been drawn from just two backgrounds—academics, either at universities or Fed research departments, and alumni of the financial services firm Goldman Sachs & Co.

The announcement Tuesday that Neel Kashkari would become president of the Federal Reserve Bank of Minneapolis marked the third Goldman Sachs alumnus in a row to be picked to become a Fed bank president. The other two— Dallas's Robert Steven Kaplan and Philadelphia's Patrick Harker —took office earlier this year.

Mr. Kashkari is a former investment banker at Goldman Sachs and a former Treasury official who ran the government's Troubled Asset Relief Program (TARP) during the financial crisis. He takes the helm of the Minneapolis Fed Jan. 1, 2016.

Of the 17 Fed officials in office next year—five members of the Board of Governors and 12 regional bank presidents—all but three will have professional backgrounds as academics or with Goldman Sachs. The exceptions will be Atlanta Fed President Dennis Lockhart and Fed governor Jerome Powell, who worked at other banking institutions, and Kansas City Fed President Esther George, who was primarily a bank supervisor.

"The obvious downside of this is there's more of a groupthink within the Fed," said George Selgin, the director of the Center for Monetary and Financial Alternatives at the Cato Institute, a libertarian-leaning think tank, referring to the shift toward a narrow range of backgrounds at the central bank. "That can be very dangerous if the groupthink is based on ways of thinking about the economy that are not necessarily sound."

Mr. Kaplan, a former Harvard Business School professor, had worked as a vice chairman of Goldman Sachs Group Inc., leading investment banking activities. Mr. Harker, the former president of the University of Delaware, served as a trustee of Goldman Sachs Trust and its Variable Insurance Trust.

New York Fed President William Dudley also spent most of his career at Goldman, ultimately serving as its chief economist.

Since the central bank's founding a century ago, the background of Fed officials has undergone a dramatic shift.

In the early days after the Fed began in 1913, the people selected to run the nation's central bank were primarily small bankers, reflecting that in the early days, the Fed's key function was providing banking services to a highly fragmented banking industry. The notion of using Fed policies to steer the broader economy had not yet taken hold.

Through the Fed's first 40 years, the backgrounds of officials grew increasingly diverse. In the late 1940s, for example, Fed officials included Chester Davis, a former agriculture commissioner and grain marketer; Laurence Whittemore, of the Boston and Maine Railroad and H. Gavin Leedy, a private practice attorney.

The central bank's leadership also contained many functionaries who rose through the ranks as Fed administrators, such as Robert Gilbert, who in his 20s become one of the first 14 employees of the Dallas Fed. He worked as a loan and discount clerk and in the war loan department, before becoming manger of the Dallas Fed's El Paso branch and eventually the Dallas Fed President.

Such quaint backgrounds were common among officials in the central bank's early days but were beginning to dwindle by the 1960s. Today Fed officials who rose through the ranks are almost entirely Ph.D. economists who headed the regional banks' research departments; the lone exception is Ms. George, who worked as a bank supervisor and Kansas City Fed administrator. Ms. George holds an M.B.A.

Gradually backgrounds in industry, law, and other aspects of government or administration fell out of favor.

"Keep in mind, for much of the Fed's first half, the focus was really on financial stability," said Sarah Binder, a George Washington University professor who is also a senior fellow at the

Brookings Institution, a Washington think tank. "There wasn't a well-worked out body of knowledge about monetary policy."

As it became apparent that Fed policy held vast sway over the economic fortunes of the country, presidents and regional Fed boards increasingly turned to Ph.D. economists to guide the central bank and to be effective participants during the debates of the policy-making Federal Open Market Committee.

Ms. Binder thinks the narrow range of backgrounds among Fed officials may lead to a central bank that is thin on expertise when it comes to "the responsibilities that are laid on top of the board, in particular, that extend beyond monetary policy."

The central bank is tasked, for example, with regulating much of the financial system, not only the giant Wall Street banks, but also community banks, insurers and other financial institutions. The Fed retains some responsibilities for consumer protection and community development, is responsible for the nation's payment systems and continues to operate the discount window and other low-profile back-office banking functions.

Liberal activist groups, led by the Center for Popular Democracy, have pushed for diversity in the appointment of new Fed officials, pressing for representatives of workers and consumers or labor and community leaders. They have had no luck, and with the filling of the Minneapolis Fed presidency and inaction in Congress over two current nominees to the Fed board, there are no looming vacancies for the central bank's composition to begin a shift.