CHAPTER 3
CENTRAL BANKING & THE FEDERAL RESERVE SYSTEM:
A LITERATURE REVIEW
In this chapter, I review the literature on central banking and the Federal Reserve relating to the
Fed’s administrative legitimacy. In the literature, the Fed has been studied extensively. It has not
just been the subject of scores of books and articles, but inspired almost two hundred dissertations.
Fortunately, much of this literature is of purely economic interest, so I exclude it. Even after doing
so, much literature remains, as many economists have studied both the Fed’s economic and its
institutional aspects.

Overall, the literature I study is of six types: (1) general overview of the Fed; (2) central banking
theory and practice; (3) political-administrative relations; (4) the politics of monetary policy; (5)
leadership; (6) critiques. In chapter one, I presented the introductory literature. In the chapters on
1970 - 1995, I will discuss the scholarly critiques, depending on when they were published. As a
result, only four types of literature are examined here: central banking theory and practice;
political-administrative relations; the politics of monetary policy; and leadership. By proceeding
this way, my narrative should be more interesting, and the answers to my research questions should
be clearer.

CENTRAL BANKING THEORY & PRACTICE
Literature on the theory and the practice of central banking is extremely important to my
dissertation. In this section, I first discuss the literature examining the concept of “central bank
independence” and its effect on policy outcomes. Then I examine central banking in Western
Europe. Through the Western European studies, I show that other Western countries—not just the
United States—struggle with the legitimate role of a central bank in a democratic society.

THE CONCEPT OF “CENTRAL BANK INDEPENDENCE”
What does the concept of “central bank independence” mean? Not all scholars answer this
question the same way, with different ones distinguishing different types of independence. In “The
Autonomy of Monetary Authorities: The Case of the U.S. Federal Reserve System,” Richard Sylla
assesses “in what sense the Federal Reserve System is independent.” While doing so, he
distinguishes two meanings of independence. With political and legal independence, Sylla is
concerned with whether Fed officials “without prior approval of the President or the Congress of
the United States, or of any interest group outside the Fed itself” establish monetary policy, even if
it is “not preferred by the President, the Congress, or other interests?” For the most part, the Fed
has such independence, though “even this fundamental concept of independence can be, or can be
threatened to be, set aside at particular times” (Sylla 1988 p. 25).

With functional independence, by contrast, Sylla is concerned with whether Fed officials can
achieve their goals “independently of the actions of others.” In general, the Fed does not have this
independence. If the Fed’s goal is low inflation and low interest rates, for example, its officials
cannot accomplish these when the nation’s fiscal policy is producing huge deficits. In the past,
huge deficits have resulted from Presidents who are unwilling to raise taxes and Congresses
unwilling to cut government spending (Sylla 1988 p. 25). These deficits, in turn, have affected the
Fed’s ability to maintain low inflation and low interest rates.
In “Central Bank Independence Revisited,” Stanley Fischer distinguishes goal independence from instrument independence. If, on the one hand, a central bank controls the tools of monetary policy, it has instrument independence. If, on the other hand, a central bank “sets its own policy goals,” it has goal independence. According to Fischer, the “most important conclusion of both the theoretical and empirical literatures is that a central bank should have instrument independence, but should not have goal independence” (Fischer 1995 p. 202).

Rather, the central bank should be given a clearly defined goal or set of goals, and the power to achieve them, and should be held accountable for doing so. Accountability is needed for two reasons: first, to set incentives for the central bank to meet its goals and explain its actions; and second, to provide democratic oversight of a powerful institution.

Not surprisingly, different countries hold their central banks accountable in different ways. In New Zealand, the Governor is “accountable to the Finance Minister in a precise way.” In the United States, the Board of Governors is “generally but not precisely accountable to the Congress.” In Germany, the Bundesbank is “accountable to the public” (Fischer 1995 p. 203). Any of these approaches may work, Fischer believes, but “precise accountability to elected officials is more likely to be effective than vague public accountability” (Fischer 1995 p. 203).

With instrument independence, a central bank “should be free of any obligation to finance government budget deficits, directly or indirectly.” It should have the power, too, to “determine interest rates.” Should the central bank supervise and regulate banks? This question, Fischer contends, “remains open, but is not of much importance” (Fischer 1995 p. 203).

In “Democratic Accountability and Central Bank Independence,” Robert Elgie distinguishes political independence from economic independence. Political independence, he reports, is concerned with how accountable central banks are to elected officials. To determine how politically independent a central bank is, we must determine “whether or not the government is responsible for appointments to and dismissals from the bank, whether or not the bank must report to the legislature, whether or not the government can veto the bank’s decisions, whether or not the bank’s capital is publicly owned, and so on.” To determine how economically independent a central bank is, we must answer different questions. Does it have one mission or many? Does the bank or the government set monetary policy? Does the bank or the government set interest rates? Similar questions are asked of exchange rates, regulation, government lending, and the central bank’s budget (Elgie 1998 p. 70).

MORE INDEPENDENCE OR LESS?

In Central Bank Independence and Regulatory Responsibilities: The Bank of Japan and The Federal Reserve, Thomas F. Cargill summarizes the general arguments made by opponents and proponents of central bank independence—with independence understood as both economic and political. Those who want the central bank to have independence generally make three arguments. First, they argue that “monetary policy should be isolated from the political process because the political process is inherently short run oriented.” Accordingly, this orientation causes problems because inflationary monetary policy is beneficial in the short-run, but harmful in the long-run.
Inflationary monetary policy that is to some degree unanticipated will temporarily increase unemployment because of a short-run Phillips curve tradeoff between unemployment and inflation. Rigidities such as non-indexed tax rates or interest rate ceilings will render even anticipated inflationary policy capable of redistributing income to politically favored sectors of the economy. Thus, a less independent central bank offers too many opportunities for the political process to influence monetary policy in ways that will be decidedly harmful to society in the long run (Cargill 1989 p. 6).

Second, supporters argue that “the decision to establish a less independent monetary authority” still “leaves unresolved the issue of which component of government” will have the power to make monetary policy (Cargill 1989 p. 6). In other words, some institution of government—whether executive, legislative, judicial, or administrative—must make decisions about monetary policy. Supporters of an independent central bank, then, believe that an autonomous central bank should do so.

Third, supporters argue that independent central banks can provide “outside input on government policy questions” (Cargill 1989 p. 6). Because central bankers have substantial knowledge about both the international and the domestic economy, they can “offer meaningful input to government policy discussions.” With an independent central bank, these officials’ opinions are “given greater weight” than they otherwise would have.

Those who want less central bank independence, however, make three arguments as well. First, opponents argue that monetary policy is a “major responsibility of government,” since it affects the economy so strongly. Public officials, such as Presidents, are elected “on the basis of actual or proposed economic policies,” Lester Thurow observes. As a result, Thurow and others do not believe the Fed should “be permitted to act independently of government” (Cargill 1989 p. 6). Expanding on this argument, Cargill observes:

The institutions responsible for the formulation and execution of monetary policy should not be based on a fundamentally different principle than other governmental institutions. Western concepts of government are based on the view that government needs to be responsive to the general public and at various times and in various ways subject itself to a vote of confidence by the general public. Why should the monetary authority be exempt? (Cargill 1989 p. 6)

Second, opponents argue that the central bank’s policies, if independently formulated and executed, “may conflict with other government policies.” In technical terms, social welfare policies may “have a higher weight in the economy’s social welfare function.” Both elected officials and private citizens, for example, may “be fully willing for the monetary authority to increase employment in the short run even though inflation may be higher in the long run” (Cargill 1989 p. 6). But an independent central bank can disregard their preferences, which conflicts with basic democratic principles.

Third, opponents argue that central bank independence makes it more difficult to coordinate monetary and other government policies—even when the independent monetary authority and the
government do not face serious conflicts (Cargill 1989 p. 7). Overall, a less independent central bank “increases the efficiency of government and improves overall government economic policy” (Cargill 1989 p. 7).

THE RELATIONSHIP BETWEEN CENTRAL BANK INDEPENDENCE & POLICY OUTCOMES

In the literature on central banking, scholars are especially concerned with the relationship between central bank independence and policy outcomes. Many scholars believe that “politically independent central banks bring about relatively low and stable inflation rates,” Alberto Alesina & Roberta Gatti report. In their American Economics Association article, “Independent Central Banks: Low Inflation at No Cost?,” they ask a theoretical question: Must countries with an independent central bank “pay for this outcome with more real instability?” (Alberto & Gatti 1995 p. 196). In many ways, Alberto & Gatti’s article is a response to Kenneth Rogoff, who argues that “an independent and inflation-averse central bank reduces average inflation but, as a result, increases output variability.” If Rogoff is correct, an independent central bank “reduces the inflation bias, due to the time-inconsistency problem, but stabilizes less” (Alberto & Gatti 1995 p. 196). Rogoff’s claim, however, is not supported by empirical studies. For OECD countries, at least, studies generally “do not find that . . . more independent central banks are associated with more variability of growth or unemployment” (Alesina & Gatti 1995 p. 196).

Alesina & Gatti’s article provides the “theoretical underpinnings to the finding that independent central banks bring about low inflation at no apparent real costs” (Alesina & Gatti 1995 p. 196). They distinguish two types of variability: economic and political. Economically, variability can occur because of “exogenous shocks that monetary policy is supposed to stabilize . . . money demand shocks or supply shocks.” Politically, variability can occur from “uncertainty about the future course of policy.” From this standpoint, a nation may have two dominant parties, each of which have “different preferences over inflation and unemployment.” Without an independent central bank, this nation may have more economic instability, since citizens do not know which policies future governments will adopt. “By insulating monetary policy from political pressures,” Alesina & Gatti argue, “an independent central bank can reduce the political variability (Alesina & Gatti 1995 p. 196).

Scholars who study monetary policy and officials who make it, Cukierman, Webb, & Neyapti observe, “generally believe that the degree of independence of the central banks from other parts of government affects the rates of expansion of money and credit.” If so, central bank independence affects “important macroeconomic variables, such as inflation and the size of the budget deficit” (Cukierman, Webb, & Neyapti 1992 pp. 353 ñ 354). In “Measuring the Independence of Central Banks and Its Effect on Policy Outcomes,” these authors examine how central bank independence relates to policy outcomes in 72 countries—21 industrial, 51 developing.

These authors distinguish formal independence from actual independence. Formally, a central bank’s independence—or lack thereof—depends on the law. Actually, however, central bank independence “depends not only on the law, but also on many other less-structured factors.” These include, for instance, “informal arrangements between the bank and other parts of government, the quality of the bank’s research department, and the personality of key individuals in the bank and the (rest of the) government” (Cukierman, Webb, & Neyapti 1992 p. 355). Examining independence based solely on law, they report, has two problems. For one, the “laws are
incomplete,” since they “cannot specify explicitly the limits of authority between the central bank and the political authorities under all contingencies.” Legal gaps appear, and these are “filled by tradition at best and power politics at worst.” For another, even if the law is clear, “actual practice may deviate from it” (Cukierman, Webb, & Neyapti 1992 p. 355).

Their study expands on previous studies in three ways. First, it uses a larger number of countries, a total of 72. Second, it goes back farther in time, extending to 1950s, if the bank existed then. Third, it “uses a wider range of information on central bank independence.” More important than the “letter of the law,” they believe, is its spirit. So they not only code characteristics of the central bank law, but also examine “the actual frequency of turnover of central bank governors and at the questionnaire responses from specialists on monetary policy in a subsample of 23 countries” (Cukierman, Webb, & Neyapti 1992 p. 355). While doing this, they develop a comprehensive view of central bank independence. Based on the questionnaire, they correlate central bank independence, in purely legal terms, with average annual inflation. Next they compare the turnover rate with average annual inflation. Because “the correlation across these indexes is not high, they can be usefully combined to obtain a better measure of overall central bank independence” (Cukierman, Webb, and Neyapti 1992 p. 369).

In industrial countries, they found that “legal independence is an important determinant of inflation.” In developing countries, by contrast, governors’ turnover is “strongly and positively associated with inflation.” Because of this finding, they believe that developing countries may have “larger divergences between actual practice and the law” than industrial countries (Cukierman, Webb, & Neyapti 1992 p. 356).

Legally, from 1980 to 1989, the United States had one of the world’s most independent banks—behind only the Federal Republic of Germany’s, Switzerland’s, Austria’s, and Denmark’s (Cukierman, Webb, & Neyapti 1992 p. 362). Similarly, the Fed’s Board of Governors has long had a relatively low turnover rate. From 1950 to 1989, for example, only 1.3 Governors (on average) left office each year (Cukierman, Webb, & Neyapti 1992 p. 364). After combining legal independence with Governor(s) turnover rates, the authors conclude that these variables “can predict a reasonable amount of the cross-country variation in inflation in the 1980s.” They conclude, too, that “all the industrial countries are above the median of overall independence . . . and most of the developing countries are below it” (Cuckierman, Webb, & Neyapti 1992 p. 382).

None of this, however, means that central banks cause low inflation:

Preliminary results here indicate a two-way (positive in both directions) causality between inflation and turnover of central bank governors, a proxy for lack of independence. Lower independence induces higher future inflation, which, in turn, reduces the subsequent actual level of central bank independence, and so on. Success in controlling inflation, however, seems to enhance the independence of central banks (Cuckierman, Webb, & Neyapti 1992 p. 383).

Central Banking in Western Europe

In “Democratic Accountability and Central Bank Independence,” which was published in West European Politics in 1998, Robert Elgie observes that “a general move towards greater central bank independence in Europe” has occurred. Such countries as France, Britain, Spain, and
Belgium, for example, have “all increased the autonomy of their respective central banks” (Elgie 1998 p. 53). Because of the Maastricht Treaty, too, central banking in Western Europe has become more important rather than less. (The Maastricht Treaty required the Member States to “start the process leading to the independence” of their “central banks” during the European Monetary Union’s (EMU’s) second stage, a stage beginning on January 1, 1994. Once the third stage began, the Treaty mandated, the Member States should have completed this process. Most notably, the Maastricht Treaty established the European Central Bank.) After discussing the central banks of France and Britain, Elgie argues that “the European Central Bank is a departure from the norms of political accountability,” so there is “a distinct ‘democratic deficit’” that “needs to be addressed” (Elgie 1998 p. 53).

Industrial democracies, according to Brian Snowdon, face a dilemma: How can they “introduce institutional reform” to “reduce the political incentives which exist for the overzealous use of short-term discretionary action without threatening the basic principles of democratic government?” (Elgie 1998 p. 53). In Western Europe, where this has been especially important, many believe that governments have adopted “institutional reforms at the expense of democratic government.” By attempting to “eliminate the propensity towards short-term, electorally motivated business cycles,” many Europeans believe that their governments “have ceded monetary policy-making powers to unelected central bankers”—ultimately, skeptics argue, all this weakens “the prospects for democratic, representative government” (Elgie 1998 p. 54).

For Elgie, the “recent moves towards central bank independence in Britain and France have not challenged the basic foundations of indirect political accountability.” Elgie discusses the history of central banking in the two countries, where both the Bank of England and the Banque de France “were created in the pre-democratic era.” The Bank of England is the “second-oldest central bank in the world,” as it was established in 1694 during war, which “had provoked a severe crisis of the state’s finances.” The Banque de France is much younger—it was “established in 1800” during the “period of instability following the French Revolution and shortly after Napoleon Bonaparte’s rise to power” (Elgie 1998 p. 58).

Although the banks were initially “privately-owned institutions” with considerable autonomy, “political control” increased over time. After World War II, governments nationalized them. During the 1990s, however, they “were once again given a large degree of independence” (Elgie 1998 p. 58).

Consider the most recent reforms. In May 1997, Labour Chancellor Gordon Brown provided the Bank of England with “operational responsibility for setting interest rates,” and he began to reform “the Bank’s structures and procedures.” From a statistical standpoint, Elgie calculates that that reform “resulted in a shift on the continuum of independence from a score of 0.20 to a score of

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1 This fundamental change was made administratively rather than legislatively, which is especially important for scholars and practitioners of public administration. Once Chancellor Brown decided to provide the Bank with operational responsibility for establishing interest rates, he sent a letter to the Governor of the Bank of England, in which he explained the change. This was, as Elsie observes, “an unexpected announcement,” one that “fundamentally changed the relationship between the Bank and the government” (Elgie 1998 p. 58). To read the letter Brown sent to the Bank of England, see the May 7, 1997 issue of the Financial Times, where the text was reprinted in its entirety.
0.48” (Elgie 1998 p. 58). As such, the nation’s central bank, which was once “extremely dependent,” has become “relatively independent.”

In 1993, the French government increased the Banque de France’s independence. Gaullist Prime Minister Edouard Balladur, Elgie reports, provided the Banque with “a considerable degree of policy-making autonomy.” Statistically speaking, this produced a shift “from an extremely dependent central bank in comparative terms to a relatively independent central bank,” with its score moving from 0.18 to 0.59 (Elgie 1998 p. 59).

In both countries, as expected, these reforms were attacked for harming “the system of democratic accountability.” England’s MP Denzil Davies, to name just one Labour Party official, opposed any legislation making “the Bank of England independent without democratic accountability. It is extraordinary that a party committed to opening up government and reducing the powers of unelected officials should take this kind of step.” Former Conservative Party MP Kenneth Clarke suggested, too, that “he was against the reform precisely because it undermined the government’s accountability to Parliament” (Elgie 1998 p. 59). Central bank independence, Andreas Busch notes in “Central Bank Independence and the Westminster Model,” makes little sense in Britain. In British government, based as it is on parliamentary sovereignty, “every political action or decision can be reversed by Parliament, and this is incompatible with the principle of an independent central bank” (Elgie 1998 p. 59). The government’s 1997 reform, Elgie observes, “marked a major shift not just in policy-making responsibilities but also basic constitutional thought.”

In France, three leading Gaullist MPs attacked the government’s reform. “As if democracy,” they contended, “really had something to gain from a system in which an exorbitant amount of power is given to a clan of technocrats and notables, who cannot be dismissed what is more, and who are so independent that there is no one from whom they can receive orders and no one to whom they must account” (Elgie 1998 pp. 59 - 60). On the left, opposition emerged too. Former Socialist Party Minister Jean-Pierre Chevenement, for instance, sees “the denationalisation of the Banque de France” as part of “the ongoing movement” that “is emptying the concepts of democracy and citizenship of all their substance” (Elgie 1998 p. 60).

Unlike Britain, the French system does not operate according to the principle of parliamentary sovereignty. Nevertheless, the reform of the Banque de France was still criticized by Chevenement for being part of a tendency towards “republican deconstruction,” which weakened the link between the people and the process by which decisions that affect the people are made (Elgie 1998 p. 60).

Distinguishing political independence from economic independence, Elgie argues that these reforms have not reduced democratic accountability. “All other things being equal,” he believes, “a low level of central bank political independence equates with a high level of indirect democratic accountability and vice versa” (Elgie 1998 p. 60).

Even if a bank was operationally responsible for a great many policy instruments (and, hence, registered a high score for economic independence), if that bank was also subject to complete political control (and, hence, registered a lower score for political independence), then those charged with making its operational decisions
would still be politically accountable. Conversely, if a bank had few policy instruments at its disposal (and, hence, registered a low score for economic independence) and yet its decision makers were not subject to any political control (and, hence, registered a high score for political independence), then those decision makers would still be able to use whatever powers they possessed free from the fear of political interference (Elgie 1998 pp. 60 - 61).

The Bank of England, Elgie reports, has less political independence than economic independence. Most importantly, it has less political independence today than it did from 1694 to 1931. In the 1990s, the Bank of England “has a relatively large number of economic policy instruments at its disposal,” but it is more politically dependent now than during the pre-Great Depression era. The Bank has not returned to “the pre-1931, mainly pre-democratic situation in terms of political accountability,” since the government has included “procedures for indirect accountability in the newly reformed institution.” Because of these procedures, the government has “maintain[ed] a degree of political control.” (Elgie 1998 p. 61).

Similarly, the Banque de France has more economic independence than political independence. Certainly the Banque is “much more independent now than it was immediately prior to the 1993 reform,” but it is less politically independent and more politically accountable “than it was from 1800-08 and only slightly more politically independent now than it was from 1808 – 1936” (Elgie 1998 p. 62).

What about the European Central Bank (ECB)? Writing in 1992, Daniel Wincott argues that the ECB “was clearly modeled on the German Bundesbank.” With the ECB, which was established on January 1, 1999, Europe now has a “federal institutional structure for the management of monetary policy” (Wincott 1992 p. 111). Elgie analyzes the ECB—even though it existed then “only on paper”—to see whether it is sufficiently accountable to the democratic process. “Superficially at least,” he argues, similarities exist “between the themes and issues surrounding the proposed creation of the ECB and those concerning the recent reforms of the Bank of England and the Banque de France” (Elgie 1998 p. 63). The European Central Bank not only has “a very high overall score on the continuum of independence (0.68),” but also has “been criticized for being politically unaccountable.” Philippe Seguin, a leading opponent of the Maastricht Treaty, was especially concerned about the European Central Bank. He said:

The choice of [ECB] independence is based on the conviction that the currency is too serious or too dangerous a matter to be left in the hands of politicians . . . As for me, when it is a question of monetary choices, the economic and social consequences of which are considerable, I believe that democratic control is always a better guarantee than technocratic irresponsibilityi (Elgie 1998 p. 63).

In Globalization in Question, Paul Hirst & Grahame Thompson make similar complaints. For them, the “effect of the ‘independence’ of the European central bank would be to allow virtually unaccountable officials to dictate economic policy, at a time when the central organs of the EU will still lack legitimacy and citizen identification” [my emphasis] (Elgie 1998 p. 63).
Despite the similarities with the Bank of England and the Banque de France, they are different from the European Central Bank: the European institution, unlike its domestic counterparts, has more political independence than economic independence. For this reason, Elgie believes that ECB is more like the French and British central banks of “the mainly pre-democratic seventeenth, eighteenth, and nineteenth centuries” (Elgie 1998 p. 63). With political independence alone, for instance, the ECB’s level is “much greater than the level . . . for the Bank of England and the Banque de France” (Elgie 1998 p. 63). The European Central Bank, then, is “much less politically accountable” than the central banks in Britain and France (Elgie 1998 p. 64). Indeed, the ECB is even less politically accountable than the Bundesbank. According to Hirst & Thompson, “unlike the Bundesbank, the broadly representative council of which both protects its substantial degree of independence and ensures its accountability, [the ECB] will lack legitimacy” (Elgie 1998 p. 64).

What, if anything, should be done to remedy this situation? For Elgie, reform could be one of two types. First, the European Union could establish “some sort of ‘economic government,’” such as the one recently proposed by the French. By doing so, the Europeans would establish “an institution . . . [to] oversee the ECB’s work and, perhaps, have the power to veto, delay, or at least discuss its decisions.” Unfortunately, this solution would do little to make the ECB more accountable, so long as EU institutions themselves remain largely unaccountable (Elgie 1998 p. 67).

Second, the Europeans could reform the EU itself. Specifically, by directly electing the Commission or giving the European Parliament more power, Europeans could increase “the general level of EU accountability.” Now, though, this reform is “scarcely on the agenda,” and it “would not be introduced solely to make the ECB more accountable.” Criticisms of the ECB, as a result, are “likely to persist and . . . may become yet more pertinent still” (Elgie 1998 p. 67).

POLITICAL-ADMINISTRATIVE RELATIONS
Now I discuss literature on political-administrative relations, which examines the relationship between Fed officials and elected officials. First, I frame the issue by examining Kevin Corder’s discussion of the “puzzle of central bank autonomy.” Second, I review two views on the Fed’s autonomy. Third, I examine, in a very general way, the Fed’s relationship with the President and the Congress. Fourth, I discuss the Fed’s relationship with Congress in greater detail. Fifth, I discuss the Fed’s relationship with the President in greater detail. Finally, I offer a public administration perspective on the Fed’s relationship with these two constitutional masters.

THE “PUZZLE OF CENTRAL BANK AUTONOMY”
In Central Bank Autonomy: The Federal Reserve System in American Politics, J. Kevin Corder examines “the puzzle of central bank autonomy.” After discussing the Fed’s independence—officials have long terms of office as well as discretion over public policy and agency expenditures; the institution has conflicting objectives (maximizing employment, minimizing inflation, maintaining moderate long-term interest rates)—he questions how a federal agency gains such power. He observes, quite rightly, that “the development of the contemporary Fed . . . is in many ways an incredible story” (Corder 1998 p. 3). Just fifty years ago, in 1949, the Fed was “simply an administrative agent for the Department of the Treasury and, as a result, under the strict political control of the president and his cabinet,” Corder notes. Yet Paul Volcker, who
became chairman of the Board of Governors in 1979, encouraged the FOMC to adopt Monetarist policies, which virtually doomed President Carter’s reelection campaign. How does an agency, Corder asks, “undergo such a transformation, from subordinate to autonomous, in less than thirty years?” (Corder 1998 p. 3).

**HOW MUCH AUTONOMY DOES THE FED HAVE?**

To even begin answering Corder’s question, we must examine the controversy over how autonomous the Fed really is. Economists and political scientists have studied “the relationship between elected officials and Fed policy choices,” Corder observes (Corder 1998 p. 7). While doing so, “two perspectives on political control of monetary policy” have emerged. According to the first perspective, the Fed is subordinate—in the most stringent way—to elected officials, especially the President. It has, Corder reports, become “conventional wisdom among some political economists that the president ‘gets what he wants’ from the Fed.” If this view is correct, the Fed is just “an agent of the executive branch,” so monetary policy should vary depending on which President is in office and which party he represents (Corder 1998 p. 7). Similarly, monetary policy should respond to elections, the issue of the political monetary cycle, which I discuss under the politics of monetary policy.

This first perspective has some empirical support. Both Woolley (1988) and Beck (1984), for example, have developed statistical tests of Presidential influence, and their studies “suggest that presidents do in fact influence the behavior of the central bank” (Corder 1998 p. 7). In a study of “Presidential signaling,” which was published in 1987, Havrilesky argues that “redistributive campaign promises lead elected officials to seek increases in the money supply.” Under an “aggressively redistributive Democratic administration,” large increases are demanded, while under a “modestly redistributive Republican administration,” smaller increases are demanded (Corder 1998 p. 7). Ultimately, Havrilesky argues, the Fed is “responsive to the demands of elected officials (especially the White House)” (Corder 1998 p. 7).

But his study has been criticized. The index Havrilesky develops, James Alt observes, “predicts a small part of changes in money growth.” That index, for instance, explains only “about 3 percent of the variance,” and it “is itself a function of economic conditions, like the congressional attention index” (Alt 1991 p. 67). Most importantly, Havrilesky’s study—no matter how “scientific” it may appear—disregards how much autonomy the Fed really has. In *Secrets of the Temple: How the Federal Reserve Runs the Country*, William Greider interviewed many officials of the Reagan administration. Despite the Fed’s formal independence, Greider notes, “sophisticated outsiders” assumed that it “regularly coordinated with the executive branch in a private manner, seeking informal approval for its decisions.” For political scientists “who defended the Fed’s odd position in democratic government,” this assumption was especially important. No matter how undemocratic the Fed may appear, they argued, its officials were “discreetly responsive to elected government, though unseen channels of private collaboration” (Greider 1987 p. 362).

But Greider’s book shows that this “unseen collaboration” does not exist, at least not during Reagan’s Presidency. What Greider examined were the “confidential memoranda on the Fed written by Reagan’s economic advisers.”
None of the confidential memos contained even a hint of inside knowledge of the Fed’s decisions. The President’s policymakers were compelled to discuss the central bank’s actions and intentions in the same uncertain tone used by Wall Street’s Fed watchers offering expert hunches, but no sure knowledge of what was happening (Greider 1987 p. 363).

The second perspective, which I think is much more realistic, views the Fed as “somewhat autonomous.” Sometimes this autonomy produces positive outcomes; other times it produces negative ones (Corder 1998 p. 7). According to Rogoff (1985) and Alesina & Gatti (1995), the autonomy “frees central bankers to pursue policies consistent with social welfare” (Corder 1998 p. 7). Others, such as Toma & Toma (1985), take a more negative view—for them, autonomy allows central bankers to “oversupply inflation in order to enrich their agency,” a pessimistic perspective if one ever existed (Corder 1998 p. 7).

In his book, Corder favors the second perspective, arguing that “there is compelling evidence to support the belief in the Fed’s bureaucratic autonomy.” First, economists studying “legislative activity in the late 1970s concluded that Congressional oversight was disorganized and ineffective.” Fed officials, they found, “exploited technical sophistication and other information asymmetries to foreclose meaningful political oversight” (Corder 1998 p. 7). Second, “high and persistent inflation in the United States in the 1970s” confirms the “propensity of the central bank to oversupply money in order to satisfy narrow organizational objectives.” Third, an “autonomous central bank may be perceived by the various social actors to be a long-run optimal solution to democratic governance of the economy” (Corder 1998 p. 8). Unlike the 1970s, recently the United States has had extremely low inflation rates, which leads some scholars to “highlight to salutary effects of delegation to conservative (and autonomous) monetary authority.” Applying economics to politics, many economists believe elected officials provide the Fed with “sufficient independence to optimize the trade-off between potential revenue from inflation and efficient financial market intermediation (potentially disrupted by unanticipated inflation)” (Corder 1998 p. 8).

**THE FED’S RELATIONSHIP WITH THE PRESIDENT & THE CONGRESS**

In the literature on the Fed, a major issue is the institution’s relationship with the President and the Congress. Unfortunately, comparing different studies is often difficult because scholars ask different questions. In Wooley’s study, for instance, he is concerned with whether the Congress or the President is the Fed’s “superior.” Other scholars ask a similar question. In Corder’s study, by contrast, he is concerned with which institution—the Congress or the President—benefits the most from the Fed’s autonomy.

Wooley’s study is concerned with “the relationships between ‘superiors’ or would-be goal setters, and ‘subordinates’ or ‘implementors’” (Wooley 1984 p. 16). By “superior,” he means someone who “aspires to achieve particular policy goals,” yet must rely “on a subordinate to follow instructions” (Wooley 1984 p. 16).

A superior will have the greatest success achieving policy goals when: (1) the superior can clearly specify his or her own policy goals; and (2) subordinates are trustworthy and competent. If both of these are true, then superiors know that failure must be due to the difficult of doing the job, not to incompetence or
sabotage. However, when superiors doubt the truth of (2), their lives become much more difficult, and so should those of their subordinates (Wooley 1984 p. 16).

In the real world, these conditions are not always met—perhaps only rarely so. Presidents, members of Congress, and agency heads “often do not know exactly what they want, and they cannot, or are reluctant to, reveal explicitly how they rank various outcomes.” At the same time, “subordinates have their own objectives,” and these might be different from their superiors.” Or the subordinates “may not be entirely competent” (Wooley 1984 p. 18). Notice that Wooley is discussing superiority in a political sense, not a Constitutional one. From a Constitutional standpoint, the Fed has three masters: the Congress, the President, and the Courts. By itself, however, that tells us nothing about which of the three masters, if any, exerts the most influence over it.

Congress, Wooley observes, “has a firm legal claim to be the final authority on the Federal Reserve’s existence” (Wooley 1984 p. 20). Formally, the Fed does not have to answer to the President; it does have to answer to the Congress. Nevertheless, some statutes charge the President “with responsibility for macroeconomic policy, and the Federal Reserve is obviously important in this realm” (Wooley 1984 p. 20). At the same time, Congressional statutes from the 1970s “state that monetary policy should be consistent with the president’s economic program” (Wooley 1984 p. 20).

Despite Congress’s formal power, Wooley offers several reasons why the President may exert more influence than Congress. For one, the President is the “Chief Executive,” and it is easier “consistent policy position in the executive branch” than the legislative (Wooley 1984 p. 22). For another, the President may be more influential than Congress because “of the expertise available to him and because of his domination of fiscal policy” (Wooley 1984 p. 22).

**THE CASE OF CONGRESS**

Now let us discuss Congress in greater detail, considering how it can affect the Fed—as well as the limits to its influence. Formally, Wooley observes, Congress “is the Federal Reserve’s superior” (Wooley 1984 p. 131). And Fed officials seem to recognize this fact. In interviews, for instance, Fed officials seem to “perceive Congress as basically unpredictable, rather whimsical, capable of practically anything.” At its worst, Congress could even destroy the Fed (Wooley 1984 p. 131). Wooley continues:

Members of Congress have jealously asserted their right to guide the System, and have occasionally aided the Federal Reserve in fending off administrations seeking a larger role in monetary policy. Members of Congress have repeatedly demanded a pledge from members of the Board of Governors that the Federal Reserve is responsible to Congress. In one exchange in the 1950s, Board Chairman William McChesney Martin was provided with a slip of paper reading “The Federal Reserve is an agency of Congress” and asked to tape it to his mirror so that he could see it each morning as he shaved [my emphasis] (Wooley 1984 p. 131).
At different times, members of Congress and their staffs have attempted to use their formal authority to restrain the Fed. In “Congressional Oversight of Monetary Policy,” Steven M. Roberts, a staffer, maintains that the “independence of the Federal Reserve should not be used as a pretext for sheltering the Federal Reserve from close scrutiny.” When it created the Fed, Congress wanted the institution “to be independent of the executive branch of the government and political influence, but it is still accountable to the Congress,” he argues (Roberts 1978 p. 543).

Second, Congress’s policies can affect the Fed indirectly. By making fiscal policy, financial policy, housing policy, and so on, Congress affects the economic environment the Fed must respond to—sometimes even creating a political dilemma for the institution. In the past, the Fed has faced federal budgets it considers too stimulative, which led it to tighten monetary policy. Nevertheless, by adopting a restrictive policy, the Fed causes “members of Congress to question the legitimacy of the System’s actions.” “By what right,” Wooley asks rhetorically, “does [the Fed] contradict congressional policy?” (Wooley 1984 p. 132).

Third, Congress can use the appointment process to challenge the Fed, which may have a direct effect on the institution. United States Senators, for their part, can “reject appointees or delay approval until policy direction changes.” As a more direct challenge, Congress can “remove the symbols of independence the System cherishes—relative insulation from the budgetary process, relative secrecy, the private status of the district banks, lengthy terms of appointment, and so forth.” As an even more direct challenge, Congress can “prescribe monetary policy in great detail,” or it can “subordinate the System to the president” (Wooley 1984 p. 132).

Fourth, Congress can “hold oversight hearings and conduct investigations of the Federal Reserve.” In the process, Congress can give critics of the Fed a “highly visible forum.” In these forums, scholars and political activists can “raise doubts about the System’s technical competence,” while questioning its “willingness to consider the decisions of elected officials as binding” (Wooley 1984 p. 133).

Despite the power Congress could exert, most scholars who study the Fed “take the absence of effective congressional supervision of monetary policy as a matter of fact” (Corder 1998 pp. 8 - 9). Actually, Kevin B. Grier’s article, “Congressional Influence on U.S. Monetary Policy: An Empirical Test,” is one of the only studies attempting to quantify Congress’s influence over the Fed. In that study, Grier first recognizes how “Congressional influence is generally discounted or ignored in political models of Federal Reserve behavior” (Grier 1991 p. 201). Then Grier challenges this traditional view, showing how “changes in the leadership of the Senate Banking Committee are significantly correlated with monetary base growth.”

More liberal Committee leaders are associated with significantly higher base growth, other factors held constant. The result is shown to hold across several econometric specifications and different definitions of the congressional preference variable (Grier 1991 p. 201).

If Greir is correct, Congress “as represented by the Senate Banking Committee leadership” has “a significant influence on monetary policy” (Grier 1991 p. 217).
Unlike many other scholars, Corder concludes that Congress rather than the President gains the most from the Fed’s autonomy and its existence. Two factors, he believes, “explain central bank autonomy”: members of Congress and officials of the Fed (Corder pp. 3 - 4). To protect their autonomy, Fed officials “systematically update monetary policy institutions to remove critical elements of monetary policy choices from representative control.” Members of Congress, in response, “tolerate these developments because they benefit from central bank autonomy in two important ways”. For one, Congress benefits because—Corder claims—Presidents “are severely handicapped by central bank autonomy.” If the monetary authority were under the Treasury Department, Presidents would have much more control over it. With an independent central bank, the President’s influence must be informal and “behind-the-scenes” at best. For another, members of Congress “can independently develop new federal credit institutions to protect narrow segments of financial markets from Fed choices.” Consequently, the Fed’s autonomy is a “joint product of the strategic actions of Fed decision makers and the desire of members of Congress to frustrate executive control over monetary policy outcomes” (Corder 1998 p. 4).

To those who think Congress has little influence at all, Corder responds that it is “difficult to explain unambiguous and controversial long-term changes in American politics—like the growth of the autonomous Fed—without introducing members of Congress” (Corder 1998 p. 11). He continues:

In the period of increasingly independent central bank activity between the end of World War II and the 1981 recession, Congress began to assert more and more control over the activities of other executive agencies and appointees. Aberbach (1990) documents an increasingly sophisticated and watchful committee monitoring system that challenges executive control and intervenes fairly directly in the activities of agencies. Shick (1983) describes a new congressional assertiveness that challenged executive control over substantive outcomes in a variety of policy areas. Finally, observers of oversight activity like McCubbins and Schwartz (1984) have challenged the earlier description of oversight motivations and behavior that informed critical assessments of Congress. Our understanding of what motivates Congress and our descriptions of congressional activity have changed in ways that seriously undermine the explanations that have conventionally been invoked to explain the absence of effective congressional control of the Fed (Corder 1998 pp. 11 - 12).

By examining history, too, we find that Congress has paid substantial attention to the Fed. In 1950, 1952, and 1966, the Subcommittees of the Joint Economic Committee conducted “special congressional investigations of the Fed and monetary policy” (Corder 1998 p. 12). Members of Congress have sometimes “advocated statutory changes to bring the Fed under the appropriations process,” though these have gone nowhere. Still others have “proposed legislation to subject Fed activities to detailed audits, change the composition of the Board of Governors . . . and require frequent appearances of the Chairman . . . before the Banking Committees of Congress.” Looking at these Congressional actions, it is difficult to believe the Fed is dealing with “disinterested legislators” (Corder 1998 p. 12).

THE CASE OF THE PRESIDENT

The Fed, according to those who believe the “President is superior,” usually provides the President with whatever monetary policy he wants (Wooley 1984 p. 109). Much of our nation’s monetary history, Robert E. Weintraub argues, is “explained just by noting who the President was when the policy under review was in effect.” Nathaniel Beck, a political scientist, reviewed the history of monetary policy during the 1970s, and he concluded that the Fed “did appear to respond to the desires of the incumbent president.” Even a former Governor, Mr. Maisel, reports that “the most significant influence on the Federal Reserve comes from the President and other members of the Administration” (Beck 1987 pp. 314 - 315). But how does the President get such power? According to Beck, it is from his “appointment power, his control over nonmonetary financial policy, and his status as an elected official (as contrasted to the unelected and relatively unknown board of governors)” (Beck 1987 p. 314).

No matter how convincing such analyses may sound, Wooley notes, they leave many questions unanswered. Most notably, they never explain exactly “how this compliance with the President’s wishes is brought about.” Kane, for example, argues that “the Federal Reserve does what the president wants because it needs presidential support to ward off attacks from Congress” (Wooley 1984 p. 109). In a separation of powers system, however, the Fed would not be able to “ward off attacks from Congress” by doing whatever the President wanted. By doing so, under our system of government, the Fed would just be exposing itself to \textit{more attacks}, not less. Why, members of Congress would ask, should we insulate the Fed from political pressures if it’s just going to follow the President’s lead?

Admittedly, many CEA chairmen can be “quoted to support the proposition that the relationship between the president and the Federal Reserve is generally cooperative.” Yet they also acknowledge the Fed’s independence. Paul McCracken, for instance, reported that “on the whole, I think the coordination of monetary and fiscal policy over the years has been pretty good.” Despite this “pretty good” coordination, he still reported that “for a very important instrument of macro policy, namely monetary policy, you don’t have the dials in the President’s office. Certainly, if Arthur Burns is chairman of the Fed, then you find that out quite explicitly!” (Wooley 1984 pp. 109 ñ 110).

Similarly, Herbert Stein, Chair of the Council of Economic Advisors in the Nixon Administration, observed that “we didn’t have any problems about what the objectives of [Federal Reserve] policy were, and I believe their objectives were pretty similar to ours.” Presidential-Fed relations, though, were “always rather touchy because of the Federal Reserve’s independence and the feeling that we should not intrude in it.” At any rate, Stein observed that “I would not regard [the Federal Reserve] as part of the President’s team. It certainly was not hostile—Arthur was not hostile—but he didn’t feel any obligation to us; he operated in a very independent way” (Wooley 1984 pp. 110 ñ 111).

Even Beck, who Wooley identifies as believing that the “President is superior,” admits that the “powers of the president over the Fed are not limitless” (Beck 1987 p. 314). The Fed has “great legitimacy among the financial community,” and Presidents need that community’s support. As a
result, Presidents are “limited in the actions [they] can take in opposition to the Fed.” President Carter, for example, “needed Volcker to give him some semblance of credibility on Wall Street.” As for the President’s appointment power generally, that is limited as well. At first, William McChesney Martin was appointed by a Democratic President. Later, he was “reappointed by a Republican, reappointed by a relatively conservative Democrat (Kennedy), and then reappointed by the liberal Johnson” (Beck 1987 p. 314). Surprisingly, a former Fed staffer has “suggested . . . that even Arthur Burns was almost reappointed by Carter” (Beck 1987 p. 314).

To believe the President has as much influence as Beck and others suggests, Wooley contends, requires us to ignore much contemporary scholarship, scholarship finding that “presidential power is primarily ‘the power to persuade’” (Wooley 1984 p. 110). Even in times of crisis, Presidents have often had difficulties controlling their cabinets. Why would we expect the Fed to be fundamentally different? Why would we expect the President to be able to dominate this institution, especially since he has so little legal authority over it?

Typically, [the President as superior] thesis has been supported with evidence showing that there is a general consistency between monetary and fiscal policy, or that policy shift points tend to coincide with changes in the administration. This is not the same thing as saying that monetary policy is what the president wants, and it certainly does not mean that through some covert means, the president gives the orders and the Federal Reserve jumps to (Wooley 1984 p. 110).

So why do scholars find a high level of agreement between the Fed and the executive branch? For Wooley, three factors explain this agreement: personnel exchanges, frequent and close interactions, and shared understandings of the problems (Wooley 1984 p. 111). Regarding exchanges of personnel, “informal communications networks link economists throughout the executive branch, especially those at the CEA, the Treasury, and the Federal Reserve.” In the American polity, Presidents and their advisors, like Fed officials, usually have “mainstream” economic views. Consequently, Presidents and their top advisors “are not likely to be very distant in ideology or economic theory from the Federal Reserve” (Wooley 1984 p. 111). Consider, too, how personnel are exchanged at the highest levels—William McChesney Martin was appointed Chairman of the Board of Governors after not only working for the Treasury, but also negotiating the Treasury-Fed accord. President Truman’s final appointment to the Board was James Louis Robertson, who had served as “a career official with the Office of the Comptroller of the Currency,” which is “a division of the Treasury” (Wooley 1984 pp. 111 - 112). Arthur Burns, Chairman from 1970 to 1978, had previously “served as chairman of the CEA for Eisenhower and as an advisor to Nixon” (Wooley 1984 p. 112).

Regarding contacts between executive branch officials and Federal Reserve officials, the Fed’s officials interact frequently with executive branch leaders (Wooley 1984 p. 112). Beginning with the Eisenhower Administration and continuing to the present day, regular meetings of the Quadriad—which includes “heads of the CEA, Federal Reserve, Treasury, and Office of Management and Budget (OMB)”—have taken place. Not just Quadriad meetings, but “frequent telephone calls, weekly lunches, periodic meetings, interagency councils, and interagency staff
groups to facilitate the exchange of views and the coordination of policy” have occurred too, Wooley reports.

Regarding *shared understandings*, the Fed and the President cooperate “because they are in the same boat” (Wooley 1984 p. 114). They must, for example, “respond to the same economic crises.” At the same time, economists for the President and economists for the Federal Reserve analyze economic options “in similar terms.” According to Wooley, both the President and Fed officials view Congress as “an obstacle to swift and well-crafted policy.” Accordingly, both hope that the Fed will “compensate for this shortcoming.” Arthur Okin, a former Chairman of the Council of Economic Advisors, reported on economic policymaking in 1966, noting that the Fed shouldered “the thankless burden” when Congress refused to take action (Wooley 1984 p. 114).

Ultimately, despite his criticisms of the crude “President is superior” argument, Wooley supports a modified version of it. To him, the President has significant political resources, such as “standing as the nation’s leader,” exercising appointment power, and using “legislative leadership” for his policy priorities. If the President and the Fed, Wooley argues, ever faced “a pure conflict of political power, the president would surely win.” Yet the Fed is not defenseless, for it has support from the financial community and “other anti-inflation groups” (Wooley 1984 p. 111).

Using a principal-agent model, Alt observes that “if the president is the Federal Reserve’s principal, his ability to set incentives has to derive from one of three sources” (Alt 1991 p. 59). For one, the President has appointment power. For another, the President influences “nonfinancial economic policy.” For still another, the President often has “the strength of moral suasion.” Regarding moral suasion, which does exist, “it wears off quickly after elections.” Influence over nonfinancial policy, by contrast, is “most important when coordination with other executive agencies is most useful or necessary for successful execution of monetary policy” (Alt 1991 p. 59). Generally, the appointment power “is limited,” since Fed Governors serve 14-year terms, and the President does not approve the Reserve Bank Presidents (Alt 1991 p. 60).

In Alt’s model, the President power to appoint *the Fed’s Chairman* is his most important power. The theory of the political business cycle, he observes, “makes the president’s desire for reelection a prime policy motive, but why should the president’s desire for reelection be so much stronger than the Fed chairman’s desire for reappointment?” (Alt 1991 p. 60). Alt distinguishes the pre-election period from the post-election one. During the pre-election period, the Chairman wants to be reappointed, but does not know who will be President. Because no Chairman knows which candidate will be elected, he should pursue “a middle course, and not be seen to have done anything significant.” In this way, he can “maximize his probability after the election,” when he knows who the President is.

After the election, according to Alt’s theory, the situation is very different:

> The Fed chairman, formerly up for appointment in year 2 of the presidential term, recently in year 3, has a clear incentive to give the president what he wants, at least initially. If what the president wants is consistent with what the financial community wants, he has even more incentive to do this. The less common history the president and chairman share, the larger this incentive . . . The
SUMMING UP: A PUBLIC ADMINISTRATION PERSPECTIVE ON THE FED’S RELATIONSHIP WITH THE PRESIDENT & THE CONGRESS

In such fields as economics and political science, the debate continues over whether the Congress has more influence over the Fed or whether the President does. From a public administration standpoint, though, it does not matter which one is more important. Perhaps the President is dominant, or perhaps the Congress is. Perhaps, too, which is dominant depends on the prevailing political environment; perhaps it depends on Presidential personalities.

For a dissertation in public administration and public affairs, what matters is that both have influence over the Fed. (As Alt observes, the Fed has “several principals.”) Like all other administrative institutions, the Fed has three constitutional masters: the legislative, the executive, and the judicial branches. Since the judiciary has exercised much less influence over the Fed than many other agencies, the Fed must concern itself primarily with two constitutional masters: the Congress and the Presidency.

In the Orthodox perspective on public administration, a dichotomy exists between politics and administration. In politics, so the theory goes, the government’s will is expressed, and this is done by elected officials. In administration, the theory continues, the government’s will is executed. Public administrators, in the process, become mere functionaries, officials with no real power of their own who merely do what others want them to. But in “Constitutionalism and Administrative Ethics: A Comparative Study of Canada, France, the United Kingdom, and the United States,” John Rohr observes that the “politics/administration dichotomy has . . . been thoroughly discredited on empirical grounds in both the UK and the US” (Rohr 1994 p. 507).

To stress the de facto participation (or even the dominance) of administrators in political affairs, however, misses the constitutional significance of the dichotomy which raises the crucial question for any constitution—who’s in charge? In the UK the answer is clear in constitutional theory: Parliament is in charge (Rohr 1994 p. 507).

In American government, certainly, this “constitutional clarity” does not exist, since we have a separation of powers. So no “single institution of government” is sovereign. Congress is supreme in its respective sphere, and the President is supreme in his, and the Supreme Court is supreme in its. Obviously, the “all-important qualification, ‘respective spheres’ is but another way of saying none of the three is sovereign and therefore no institution is in charge” (Rohr 1994 p. 507).

This is why the politics/administration dichotomy has never made any sense—even in theory—in the US. The theory of the dichotomy demands that the subordinate administration carry out the will of the political master, but the American administrator has three constitutional masters who are not particularly notable for always agreeing among themselves. In the UK there is but one master, Parliament, from whose supremacy there flows logically the fundamental
constitutional principle of British public administration—ministerial responsibility (Rohr 1994 p. 507).

From a public administration perspective, then, political scientists and economists who attempt to determine whether the Congress or the Presidency is dominant are missing the point. What matters is that both institutions have influence rather than which has the most, which is dominant, or which is subordinate. In addition to its legal independence, the differences between Congress and the President provide Fed officials with much discretion to make their own policy judgments. Discussing the “limits of hierarchical control,” Corder notes that when “monetary policy preferences of members of Congress and the White House diverge . . . hierarchical control of the Fed or influence over operating procedures is difficult to achieve, either formally or informally” (Corder 1998 p. 177).

The inherent tensions produced by a polity with three separate yet equal branches affects the Fed, just as it affects other administrative institutions. By attempting to minimize the President’s influence over monetary policy, Corder argues, Congress has ultimately restricted its own influence as well. In response to central bank autonomy:

Members of Congress may do nothing and tolerate occasional and indirect central bank compliance with political demands. Members of Congress have faced this dilemma in the past: the gains from constraining the executive outweigh the losses associated with the unselective application of monetary restraint. Central bank autonomy will continue to expand as long as members of Congress eschew executive control and Fed decision makers retain discretion over monetary policy institutions. Proponents of central bank autonomy have few reasons to expect change. Critics of central bank autonomy have few options to pursue change given the incentives facing members of Congress (Corder 1998 p. 186).

THE POLITICS OF MONETARY POLICY
In this section, I discuss the “politics of monetary policy.” First, I discuss the role interest groups play in monetary policy. Second, I examine the controversy over the “political monetary cycle.” And, finally, I discuss the distributional consequences of monetary policy.

INTEREST GROUPS & MONETARY POLICY
What interest groups, if any, are concerned with monetary policy? What effects do they have on monetary policy? John Wooley makes the following observation:

Business, large and small, agriculture, and construction are well represented in Washington. Labor and state and local governments are also represented, well financed, and ably staffed. There is, however, almost no persuasive evidence that these groups have sustained interest in monetary policy or, at least, that their resources are directed especially toward the Federal Reserve. Perhaps this is no surprise, given the formal independence of the Federal Reserve; that is, perhaps it proves that independence works. However, I think it more plausible that other factors . . . are more important for achieving this result (Wooley 1984 p. 24).
At first, the Federal Reserve seems to be particularly vulnerable to interest group pressure. Most of the groups affected by monetary policy, after all, “have some form of representation in Washington.” Structural features of the Fed—it is “highly centralized in terms of decision making and implementation”—should encourage interest group involvement (Wooley 1984 p. 25). The Fed’s policies, too, are “measurable in relatively precise quantitative terms, and current indicators of policy actions are widely disseminated and easily obtained.” Interest groups that “know what they want from monetary policy,” Wooley observes, “can know rapidly whether or not they are getting it.”

Nevertheless, the monetary policymaking process “appears to be marked by the relative absence of interest group activity in directly shaping policy choice” (Wooley 1984 p. 25). During the early 1980s, when the economy was the worst since the Great Depression, interest groups began “grass-roots mail campaigns aimed at the Federal Reserve.” But this new phenomenon, which reflected how visible monetary policy was then, remains “relatively rare and very intermittent” (Wooley 1984 p. 25).

Not that interest groups have no effect whatsoever. Indeed, Wooley identifies two groups—bankers and economists—as being somewhat important. Regarding bankers, both liberals and conservatives have expressed concerns. For liberals, the Fed’s relations with bankers “may restrict and bias the policy process further in the direction of elite values.” So the Fed may be less concerned about unemployment than inflation. For conservatives, the short-term preferences of bankers may “make it less likely that policy makers will achieve control over the money supply,” hence inflation. By following the short-term needs of banking interests, the Fed may produce more inflation rather than less.

Edward Kane argues that bankers have more influence over the institution than any other group, so I discuss them more than the economists. What political resources do the bankers have? For Wooley, these include control of recruitment, direct pressure, and indirect pressure. Bankers, for instance, have “play[ed] an important role in the selection of Federal Reserve officials.” While doing so, though, bankers do not dominate the Board of Governors or the FOMC, where both bankers and nonbankers serve. Although some of the Fed’s top officials become bankers after retirement, most do not. So bankers have affected recruitment, yet not enough “to guarantee them detailed control of policy.”

As for direct pressure, the American Bankers Association (ABA)—which is “the largest and most inclusive association representing bankers”—has a “large staff of registered lobbyists.” Not surprisingly, many of these lobbyists have “prior experience on Capitol Hill, at the Treasury, or at the Federal Reserve.” Not just the ABA, but “more than ten other national organizations representing different segments of the industry,” represent bankers’ interests in Washington, DC (Wooley 1984 p. 75).

Despite this presence, the banking groups “do little direct lobbying of the Federal Reserve Board about monetary policy.” The ABA “monitors monetary policy only in a general way,” with the Banking Committee’s quarterly oversight hearings being their principal source of information. If anything, other bankers’ groups do even less lobbying of the Fed and Congress regarding monetary
the Association of Reserve City Bankers “does not monitor monetary policy at all through its Washington office” (Wooley 1984 p. 76).

But Wooley has an interesting insight: bankers need not directly lobby the Fed to “make their general preferences known.” Many bank lobbyists, in fact, argue that everyone knows “bankers generally prefer less inflation and a lower rate of growth in the money supply.” In this case, direct contacts would “do nothing more to influence Federal Reserve decisions” (Wooley 1984 p. 76).

On regulatory issues, more contact occurs. Wooley reports:

Each year, delegations from the state banking associations come to Washington to visit their regulators and other relevant officials in the city. These meetings and the continuing involvement in questions of bank regulation reinforce an awareness of and sensitivity to bankers’ concerns. However, bankers are not invited to lobby Federal Reserve Board members personally about specific pending regulatory decisions. Board members are proud of maintaining a formal aloofness from this sort of lobbying by bankers (Wooley 1984 p. 76).

The bankers have formal contacts with the Board of Governors through the Federal Advisory Council. Without doubt, the FAC provides bankers with an opportunity “to clearly express their preferences.” The FAC’s agenda includes both monetary and regulatory affairs, and its “lengthy session[s]” are “usually attended by several board members.” As chairman of the Board of Governors, Arthur Burns saw bankers as “a useful source of information that should be exploited. Nevertheless, the FAC has been “virtually invisible and relatively unimportant” since the 1950s, Wooley concludes.

To what extent have the bankers affected monetary policy? According to Wooley, many Fed officials perceive bankers as “ignorant about monetary policy and politically inept.” Since the Fed’s officials perceive themselves as neutral professionals, they are offended by the bankers, who are so obviously motivated by self-interest. In response to an ABA statement on monetary policy, Governor John Sheehan attacked it for having a “disturbing lack of study and presentation anywhere near to being adequate to the subject.” In interviews for Monetary Politics, a former Board staff member told Wooley that “no member of the Board would ever ask a banker [for advice] about monetary policy” [his emphasis] (Wooley 1984 p. 81). Yet another Board staff member reported:

Bankers don’t know anything about monetary policy. They don’t have the foggiest notion about how it works . . . One way to lose in Congress is to get banking into it. They are stupid, clumsy, and arrogant . . . There are very few issues where you would want the bankers to know anything (Wooley 1984 p. 81).

What about economists, another important interest group? In 1963, the Fed established the Economic Consulting Group, hoping “to increase direct control between board members and outside economists.” While liberal Keynesians controlled the Council of Economic Advisors, they felt “a close kinship to the staff economists working at the Federal Reserve.” Over time, however, the Monetarists attacked the Fed’s Keynesian monetary policy, with the Federal Reserve Bank of
St. Louis taking an “active interest in monetarist propositions” (Wooley 1984 p. 99). The Monetarists even established the Shadow Open Market Committee (SOMC), which began holding “semiannual meetings in 1973” (Wooley 1984 p. 100).

Scholars disagree over how much influence economists have had. Some believe that economists have had much influence, noting that “insiders and close observers have almost always attributed a great deal of influence to the economic staff.” Moreover, the Fed has made “several policy changes that appear to have responded to a changed consensus of mainstream economists.” Others believe that economists have not had much influence at all—to them, the economists’ advice is often ignored. The “logical consistency of economic analysis,” to these scholars, “gives way in actual practice of FOMC decision making to casual ad hoc-ery” (Wooley 1984 p. 102). In this view, the Fed is pragmatic, only rarely influenced by the dominant “schools” of economics, whether Keynesian or Monetarist or rational expectations or variants of them.

THE POLITICAL MONETARY CYCLE

Scholars are concerned with whether a “political monetary cycle” exists and, if it does, what this means for monetary policy and the Fed. In “The Fed and the Political Business Cycle,” Nathaniel Beck explores these issues. If a political monetary cycle exists, it has serious “implications . . . for Fed independence” (Beck 1991 p. 26). “Much of the rationale for an independent central bank,” of course, is that “politicians should not be able to easily print money” to “further their political aims.” If the Fed creates a political monetary cycle—which then creates a political business cycle—the “institutional rules purporting to make the Fed independent clearly are not working” (Beck 1991 p. 26).

Discovering electoral manipulations by the Fed would have serious consequences for the System, according to Beck: “Its potential loss of legitimacy would be enormous” (Beck 1991 p. 26).

These costs involve loss of Fed legitimacy. After all, if the Fed is simply another partisan body, then how can one defend the Fed’s prized independence? The major argument for Fed independence is that monetary policy is politically neutral and technical. If the Fed is caught with its hand in the electoral cookie jar, then it can hardly claim to be apolitical in any sense of that word (Beck 1991 p. 27).

The political monetary cycle (PMC), if it exists at all, should be a four year one. To determine whether the PMC exists, Beck examines both qualitative and quantitative information. From a qualitative perspective, he studies eight Presidential administrations, beginning with the second Eisenhower administration and ending with the second Reagan administration. During the second Eisenhower administration, “no evidence exists for a PMC.” During the middle two years, monetary policy “was easier . . . but tight money in early 1960 perhaps led to Nixon’s defeat in November 1960.” During the Kennedy administration, monetary policy showed “a slight easing trend over the course of four years.” During the middle two years, monetary policy declined slightly, which is “consistent with the electoral story, but no strong evidence exists for a PMC in this case.”
During the second Johnson administration, a restrictive monetary policy was adopted “in late 1966, but this tightness ended well before the 1968 election.” The first Nixon administration, by contrast, “fits the PMC pattern well.”

Once again, however, the critical finding is that of a sharp easing in early 1971 rather than that of a smooth four-year cycle. Monetary policy was relatively flat during 1973 - 1976, though the easing of mid-1975 could have been electorally motivated. (Or it may have been simply the end of the OPEC-induced tightness of the previous year and a half.)

Certainly a PMC did not exist during the Carter administration. True, monetary policy eased during late 1980, but it was extremely tight earlier that year. By easing near the end of 1980, Beck notes, the Fed “only partly compensated for the earlier tightness, and the recession of 1980 hardly helped Carter’s reelection chances” (Beck 1991 p. 32).

During the first Reagan administration, monetary policy was “consistent with an electoral story.” At first, the Fed tightened; it eased by the second year. With a strong economy, Reagan was easily reelected. The second Reagan administration, by contrast, was “not consistent with the simple electoral cycle”: monetary policy was easy the first year, but it tightened considerably in 1986. Ironically, this tightening “allowed the economy to be healthy enough in 1988 for Bush to keep Republican control of the White House.” When evaluating the Reagan administration, scholars must recognize how easy fiscal policy was. In Beck’s view, this means that “easy monetary policy was not required for electoral purposes” (Beck 1991 p. 32).

While examining these administrations, we find “two clear instances of ‘classical’ PMC, two possible instances of the cycle, and four instances where monetary policy does not fit the PMC pattern.” On qualitative evidence alone, this “is hardly overwhelming evidence for a PMC.” Nevertheless, the “electoral calendar clearly is associated with monetary policy,” with the Johnson, Nixon, Ford, and one Reagan administrations having “some early-term monetary tightness” and some “ease well before the ensuing election” (Beck 1991 p. 32).

From a quantitative standpoint, Beck examines the monetary base—which includes “currency plus bank reserves.” Although the “base is not an instrument of monetary policy,” the Fed can “control its components” (Beck 1991 p. 34). For a PMC to exist, a “cycle in the monetary base also should exist.” Examining the monetary base, however, Beck does not find “an electoral cycle in the base for any sample periods.” “Not only are the results insignificant,” he observes, “but the cycle implied by the (statistically insignificant) coefficients does not fit the PMC hypothesis” (Beck 1991 p. 34).

With M1, a “clear cycle” emerges, but a cycle does not develop for the “instruments of monetary policy.” As an explanation for this phenomena, Beck argues that the M1 movements are “not causing the PBC (political business cycle).” Instead, the PBC may be “a function of fiscal policy and not monetary policy” (Beck 1991 p. 34).

**DISTRIBUTIONAL CONSEQUENCES OF MONETARY POLICY**
Monetary policy is neither socially nor politically neutral—any monetary policy affects different groups in different ways. In *Monetary Politics*, John Wooley observes that “restrictive policy seems to fall relatively heavily on housing and construction, on small rather than large business (including agriculture), and on small rather than large local government units” (Wooley 1984 p. 23). Because wages are slow to respond to inflation changes, monetary policy has “a notable temporary effect on employment, output, and corporate earnings” (Wooley 1984 p. 23).

Monetary policy affects unemployment rates, which affects the distribution of income. When the unemployment rate rises, the poorest families lose the most, and these losses “are heavier the poorer the family (for families with male heads) and significantly greater for blacks than whites.” With higher rates of unemployment, low-income groups more generally—those with a job paying low wages—have less bargaining power. As a result, high unemployment rates affect not just the unemployed themselves, but the “working poor” too.

Monetary policy affects inflation rates. Although inflation has serious effects for many of us, its exact distribution among “specific social groups is hard to specify” (Wooley 1984 p. 24). As a general rule, though, “net debtors should gain and net creditors should lose from inflation that is not fully anticipated as long as there is no adjustment mechanism in their contract” (Wooley 1984 p. 24).

The expectation that bankers oppose inflation has been based in part on the fact that bankers are net creditors. Studies have shown, however, that nonfinancial businesses in the United States are about evenly divided between creditors and debtors. Pre-1970s inflation has been shown to transfer income from profits to wages and salaries, and to transfer wealth from households to business and government and from upper-income to middle-income groups (Wooley 1984 p. 24).

Monetary policy affects economic growth. More economic growth “should reverse the pattern of unemployment—benefiting groups who would have been harmed by downturns” (Wooley 1984 p. 24). As a geographic matter, neither the benefits nor the costs of economic growth *per se* are evenly distributed. The benefits of economic growth include more employment, more businesses, and a higher standard of living. The costs, by contrast, include more environmental pollution, more price inflation, and the like. As an example of regional disparities, Wooley discusses the “Sunbelt,” which experienced more economic growth during the 1970s and 1980s than the rest of the country.

For liberals and progressives, the *distributional consequences* of monetary policy have been a major concern, especially when compared to the “progressive effects” of fiscal policy. “There could be no greater error,” John Kenneth Galbraith argues in *The Culture of Contentment*, than seeing monetary and fiscal policy as “socially and politically neutral” (Galbraith 1992 p. 43). “The modern reliance on monetary policy and the rejection of tax and expenditure policy emerge from the entirely plausible and powerfully adverse attitude toward taxation in the community of contentment” (Galbraith 1992 p. 44).
Contemporary society differs from past societies, since “the economically and socially fortunate were . . . a small minority” then. Now they are “a majority,” though “a majority not of all citizens but those who actually vote.” For Galbraith, the modern reliance on monetary policy is a direct response to this culture of contentment.

Monetary policy has “major scholarly standing as a design for preventing or mitigating inflation and recession or depression.” What economists do not acknowledge, Galbraith observes, is how relying on monetary policy forces “action away from the discomforts of tax and expenditure policy, and also from a wage and price policy.” Relying on monetary policy, too, “rewards a large and financially influential rentier class” (Galbraith 1992 pp. 95 - 96).

Why is monetary policy so important to the “culture of contentment?” First, it deals with money, so it has an “element of mystification . . . something that economists over the years have done little to dissipate.” Second, monetary policy serves the culture of contentment because the “practical effect of monetary action on the economy” is “ultimately through a substantial control of interest rates.” Through monetary policy, the Fed can either raise or lower “the cost of borrowing by its member banks.” Not that the Fed has complete control over interest rates. But it, according to Galbraith, does have “a substantial, if clearly imperfect, measure of control over the rates at which commercial banks and other financial institutions can lend money” (Galbraith 1992 p. 90).

When interest rates are raised, they “discourage consumer borrowing and expenditure for home ownership and consumer durable goods.” Higher interest rates, on the one hand, are “presumed to discourage investment and associated spending by business enterprises” (Galbraith 1992 p. 90). Lower interest rates, on the other hand, encourage consumer borrowing, home ownership, consumer purchases, and the like.

Third, monetary policy serves the culture of contentment because it “involves virtually no government apparatus, the insignificant bureaucratic establishment apart.” Consider how Galbraith characterizes the Fed:

> The Federal Reserve System in the United States is accorded exemption by law from both legislative and executive authority; it is independent. This independence, it is accepted, is subject to presidential and other public pressures, and it is more specifically compromised by an intimate and statutory relationship with the commercial banks and less formally with the financial community as a whole. The latter have the accepted right to pass judgment on central bank policy, and no Federal Reserve chairman would be thought acceptable were he subject to severe criticism from the banking world. In actual practice, no such criticism is ever thought deserved [my emphasis] (Galbraith 1992 p. 91).

Fourth, the “financial community finds explicit satisfaction in an active central-bank policy.” One of the financial community’s chief goals, Galbraith observes, is preventing inflation. Not just in the financial community but in the contented majority as well, inflation is feared more than unemployment. There is, in the financial community, “an especially strong commitment to interest rates that more than compensate for the rate of inflation.” As a result, the financial community
“seeks to have the central bank move strongly against inflation—more strongly than against recession” (Galbraith 1992 pp. 91 - 92).

Fifth, the high interest rates resulting from tight money “reward[s] with income a very considerable and very influential part of the community of contentment.” Although “the accepted economic attitudes regard Fed policy as ‘socially neutral,’” it really “strongly favors the rentier class, a group that is both affluent and vocal.” Heavy reliance on monetary policy during the 1980s, Galbraith observes, rewarded the rentier class well. During that decade, personal income from interest payments “increased from $272 billion to $681 billion, or by 150 percent.” Wage income, by contrast, increased by 97 percent (Galbraith 1992 p. 92).

In *Secrets of the Temple: How the Federal Reserve Runs the Country*, William Greider discusses the distributional consequences of inflation, paying special attention to the historical debates over monetary policy. For him, all historical eras have made the “money question . . . the bedrock of political choice.” Historically, people have debated the relative virtues of “hard money” or “easy money.” While doing so, they have argued about “which economic class must suffer, creditors or debtors, and which would benefit, those who derived their incomes primarily from their accumulated financial wealth or those who still earned their livings by the ‘sweat of their brow’” (Greider 1987 pp. 245 - 246).

In the United States, elected officials have searched for “a golden mean between the two—an elusive state of neutrality called ‘price stability.’” With true price stability, neither class would “gain at the expense of the other.” In theory, price stability makes sense, but it is “rarely realized in fact” (Greider 1987 p. 246).

For the right, the distributional consequences of monetary policy are important as well. Conservative and libertarian analysts see inflation as not just a secret tax on citizens, but a way for the government to generate revenue. In *Free to Choose: A Personal Statement*, Milton & Rose Friedman assert that “inflation is a monetary phenomenon arising from a more rapid increase in the quantity of money than in output.” Today the government can “determine the quantity of money,” so inflation is caused by the government, generally for dubious purposes (Friedman 1990 pp. 281 - 282).

Governments receive revenue from inflation, according to the Friedmans. By printing additional money, for example, government “builds a road, paying for the expenses incurred with newly printed Federal Reserve Notes.” At first, it seems like “everybody is better off.” After all, no one’s tax bill is higher, and a road now exists “where there was none before” (Friedman 1990 p. 268). But everyone who holds money has “paid for the road,” for the extra money has increased inflation.

The extra money printed is equivalent to a tax on money balances. If the extra money raises prices by 1 percent, then every holder of money has in effect paid a tax equal to 1 percent of his money holdings. The extra pieces of money he now must hold (or book entries he must make) in order to have the same purchasing power in the form of money as before are indistinguishable from the other pieces of paper in his pocket or safe deposit box (or from book entries), but they are in effect receipts for taxes paid. The physical counterpart to these taxes is the goods
and services that could have been produced by the resources that built the road (Friedman 1990 p. 268).

Especially during the inflationary 1970s, prior to federal indexing of the tax code, inflation yielded “revenue indirectly by automatically raising effective tax rates.” Even today, “corporate income is artificially inflated by inadequate allowance for depreciation and other costs,” so inflation still increases government revenues (Friedman 1990 p. 269).

By eroding the value of the government’s debt, inflation generates even more money for the state. “Government borrows in dollars and pays back in dollars. But thanks to inflation, the dollars it pays back can buy less than the dollars it borrowed” (Friedman 1990 p. 269).

LEADERSHIP
At this point, I discuss literature on leadership, which examines certain people or particular institutions within the System—seeing how they affected the Fed over time. First, I discuss the role of the Chairman. Second, I examine different leadership styles as well as the politics of the Chairmanship. Third, I review a survey of Directors of the Reserve Banks and their branches.

THE ROLE OF THE CHAIRMAN
In his book Leadership at the Fed, Donald Kettl places more emphasis on the Chairman than any other Fed official. Throughout its history, Kettl argues, the Fed’s “power over the economy has depended more on the political leadership of its chairman than on any other factor.” The Fed’s independence, while important, is “only a precondition for power, not power itself.” To gain power, the Fed must build political support. In Kettl’s view, the responsibility for doing so has “been the central job of the chairman” (Kettl 1986 p. 193).

The Fed operates in one of the most conflict-laden policy areas, an area where “it must travel a politically acceptable course through irreconcilable demands.” One Fed staff member, for example, reported that the institution “constantly has to walk the fine line from going too far one way or another.” Throughout the Fed’s history, the Chairman has had the “principal task of finding and keeping to that line.” Since Eccles served as Chairman under Roosevelt, it is the person who occupies this position—not the other Board members, or the Reserve Bank Presidents, or anyone else—that has “been the unquestioned center of the Fed’s power” (Kettl 1986 p. 196).

So impressed is Kettl by the Chairman’s role that he claims the “Fed’s history is inseparable from the history of the chairmanship” (Kettl 1986 p. 196). Kettl claims, too, that the Fed’s most important relationship is with the President, though he does not dismiss its relationship with Congress. Over time, the Fed chairman’s relationship with the President has taken three distinct forms: accommodation, confrontation, and transformation. With accommodation, the Fed and the Chairman act “at least in general consensus with the president’s policy goals.” With confrontation, the Chairman and the President “stand in conflict with each other.” With transformation, both the President’s expectations of the Fed and the Fed’s expectations of the President “are fundamentally and permanently changed” (Kettl 1986 p. 197). Below is a table summarizing the patterns of Chairman-Presidential relations.

TABLE ONE:
CHAIRMAN-PRESIDENTIAL RELATIONS, PATTERNS (1934 - 1985)

<table>
<thead>
<tr>
<th>Chairman</th>
<th>Accommodation</th>
<th>Confrontation</th>
<th>Transformation</th>
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<td>New Deal and WW II</td>
<td>the Peg Controversy</td>
<td>Banking Act of 1935</td>
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<td>McCabe</td>
<td>1948 – 1949</td>
<td>1949 – 1951</td>
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<td></td>
<td>the Peg Controversy</td>
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<td></td>
<td>“Operation Twist” and the Tax Cut</td>
<td>Vietnam</td>
<td>“Leaning Against the Wind”</td>
</tr>
<tr>
<td></td>
<td>Stagflation Fighting (though often in a “confrontational style”)</td>
<td></td>
<td>Monetarist Experiment</td>
</tr>
<tr>
<td>Volcker</td>
<td>1982 – 1985 inflation control (the President accommodated the Fed, not vice versa)</td>
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The Chairman’s relations with Congress, Kettl contends, have “followed a much different course than those with the president.” Specifically, the Chairman’s relations with Congress have “been much more visible.” They have “involved far more players.” And they have not “permit[ted] the same subtle relationships that have typified chairman-president relations” (Kettl 1986 p. 203).

When dealing with Congress, Chairmen have adopted one of three strategies: foot-dragging, hardball, and lobbying. Through foot-dragging, “most Fed chairmen have proven skillful in deflecting attack”—even when they were facing heavy attacks from Congress. During the mid-1970s, Congress waged the “most concerted . . . campaign against the Fed’s power.” Despite this attack, Burns “used the shield of the Fed’s independence and technical complexity to ward off the worst—from the Fed’s point of view—congressional efforts to open FOMC decisions to public scrutiny” (Kettl 1986 p. 203).

At some points, Chairmen have used “hardball bargaining.” In 1968, for example, the FOMC was “willing to allow inflation to build enough to make clear to members of Congress the great dangers of refusing the pass the surcharge.” During the early 1980s, Paul Volcker speculated “about how large a deficit reduction program would need to be to reduce interest rates.” If Congress lowered the deficit, Volcker was effectively saying, the Fed would loosen money (Kettl 1986 p. 203).

That meant as well that members of Congress sometimes played the other side of the hardball game. In 1982, congressional resolutions calling for Volcker’s impeachment and for congressionally mandated lower interest rates signaled to the Fed in unmistakable terms that Congress would no longer tolerate the tight
money policy. The use of this strategy has increased with the Fed’s power over the economy . . . (Kettl 1986 p. 203).

With lobbying, Fed Chairmen have often “strengthened their position by mustering support from the agency’s unmatched field network.” Although lobbying is a “risky strategy,” Burns used it in the 1970s. Because of the Fed’s directors, who exert influence over Congress, Burns was able to “resist congressional encroachment.” More than any other Chairman, in fact, Burns used lobbying. Yet throughout the Fed’s history, it is important to remember, the Chairmen “have recognized the value of [their] unparalleled lobbying network” (Kettl 1986 p. 203).

THE POLITICS OF THE CHAIRMANSHIP & LEADERSHIP STYLES
In “The Fed Chairman as a Political Executive,” which was published in Administration & Society, Jack H. Knott questions how “the chairman exercise[s] such dominant control” over the Board and the FOMC. Before making his own argument, Knott reviews two others. One possibility is “the highly sensitive nature of monetary policy,” which John Wooley (1984) and William Yohe (1966) have explored. If this possibility is correct, the “main source of power for the position of the chairman derives from the political situation of the Fed in the national government and the importance of its assigned monetary policy task” (Knott 1986 p. 198). Consider, for example, that the “political and financial environments of the Fed force the organization to discipline internal conflicts and dissents.” So the Fed’s structure and the Chairman’s qualities “play only minor roles in producing the decision consensus” (Knott 1986 p. 198).

Another possibility is the “sameness of the political and economic orientations of the members of the FOMC.” Explored by both Wooley (1984) and Canterbury (1967), this view makes sense, since “many of the Board members and regional bank presidents are economists, bankers, or businessmen who have had similar recruitment and socialization experiences.” When the FOMC makes monetary policy decisions, therefore, we should not find “great differences in policy preferences” among the members. “The seeming dominance of the chairman is only the shared preferences he has with the other FOMC members,” Knott explains (Knott 1986 p. 199).

Although these views are important, Knott faults them both. Neither, in particular, “fully explain[s] the variation in influence that Fed chairmen have exercised from one period to another.” What Knott examines is the “chairman’s internal strategies for building and sustaining a dominant organizational coalition among the Board’s and FOMC’s members. This goal can be achieved in three ways: side payments, policy tradeoffs, and the research staff.

Through side payments, the Chairman controls “the perquisites, prestige, budget, and salary decisions.” These side payments are extremely important, as former staff members observe. “The chairman is extremely influential. He alone has seven votes, not in actuality, but in terms of influence,” a top Fed staff member under Burns said. According to Knott, the chairman “exercises his greatest leverage with side payments over the reserve bank presidents who participate in the voting of the FOMC.” The Reserve Bank Presidents, for several reasons, have little influence over FOMC decisions: they know less about monetary policy than the Chairman; they “abide by the unwritten rule” prohibiting caucusing before meetings; their “appointment, salary, and budget” depends on the Board of Governors’s decisions (Knott 1986 pp. 210 - 211).
Although they have little influence, the Governors “tolerate the bank presidents on the FOMC.” Their membership, some argue, helps the Fed maintain “community support around the country.” Their membership, others argue, helps the Governors remain “in touch with developments throughout the country.” Their membership, still others argue, brings opinions “to the discussions that [are] not so Washington centered” (Knott 1986 pp. 210 - 211.)

Through policy tradeoffs, the Chairman “regularly engages in certain strategies in preparation for and during the meetings of the FOMC.” Ultimately, the Chairman wants to “control the agenda and guide the discussion so that the final vote basically reflects his original preference.” During FOMC meetings, most Chairmen listen to each member’s view, then formulate a compromise position. More than anyone else, William McChesney Martin was “a great compromiser and synthesizer who let everyone have his say and then summed up the discussion with his own point of view.” Even Arthur Burns, who “stated his position forcefully . . . and intimidated others who might dare to disagree,” was willing to compromise somewhat. After calling for “straw votes,” Burns would ask Governors and Reserve Bank Presidents who opposed him: “What changes would make you comfortable?” To be sure, Burns wanted to achieve his overall goal—but he wanted, too, “to maximize the size of the consensus” (Knott 1986 p. 214).

Through the research staff, the Chairman has great influence over policy outcomes. According to former Fed staff members, the staff “is really a strong personal staff, though the rest of the Board does have access” (Knott 1986 p. 216). At the same time, how much influence a given Chairman has depends on “who he is and how one interprets the close symbiotic relationship between him and the top staff” (Knott 1986 p. 216). Not surprisingly, Burns had an incredible influence over the staff. “You must realize that what the staff presented was not an independent staff view,” a former staff member under Burns says. Instead, their views were “strongly influenced by Burns. It is really a pernicious system in my view. Burns simply controlled the staff estimates” (Knott 1986 p. 216). Yet another staff member explained:

   Usually the chairman reaches his decision on what he wants to do prior to the FOMC meetings and the real issue is how to put it into effect. This is done through the staff presentation. The members know they are always supposed to vote for alternative B; that has become the convention. Or there may be a minor compromise. One time we had four alternatives and we sat around trying to figure out how the members would know what to vote for. But the usual situation is that one is supported by the chairman, and this is presented with two much weaker alternatives (Knott 1986 p. 217).

Studying the literature, we find that certain people—usually Chairmen, but not always—have been particularly important to the Fed’s historical evolution. In many cases, they have had distinct leadership styles. At this point, I briefly examine a few of the most important leaders the System has had. I begin with Benjamin Strong, then discuss each Chairman since Marriner Eccles, who began his first term under President Roosevelt.

During the System’s early years, its recognized “leader,” Benjamin Strong, was not even a Board member. Strong was President of the New York Federal Reserve Bank, which was the System’s
dominant force until the Banking Act of 1935. Strong, with a finance background and presidency of the New York Fed, provided “strong leadership to the System.” Despite his accomplishments, many attacked his leadership style, criticizing him for not only “being too strong-handed and trying to dominate the System,” but also “spending too much time abroad with Norman Montagu, governor of the Bank of England” (Moore 1990 p. 72).

Beginning in Roosevelt’s administration, Marriner Eccles served as Chairman, a position he held from 1934 to 1948. Even before reading Keynes’s *The General Theory of Employment Interest and Money*, Eccles concluded that the federal government should expand the economy through deficit spending. After becoming Chairman, Eccles worked to change the System’s decentralized character into a more centralized one. It was Eccles, too, who forcefully claimed the Fed was “not to act as the captive of any administration but in the public interest.”

Largely because of Eccles’s lobbying on Capitol Hill, he “achieved most of what he wanted,” with the Congress approving the Banking Act of 1933 and the Banking Act of 1935. Of the two, the most important was the Banking Act of 1935, which made more fundamental changes to the System than any other law. This legislation removed the Comptroller of the Currency and the Secretary of the Treasury from the Board, signifying the Fed’s independence from the executive branch. Nor is this all. It provided the Governors with a fourteen-year term, and it “centered power in the Board” by creating a Federal Open Market Committee (FOMC) (Moore 1990 pp. 84 - 93).

Despite Eccle’s accomplishments, President Truman did not trust him. After considering the matter, Truman appointed Thomas McCabe as Chairman in 1948. But McCabe did not remain in the position long; he found “his job nearly impossible [by] lacking cooperation from the Treasury” (Moore 1990 p. 115). Next Truman appointed William McChesney Martin as Chairman, a position he held from 1951 to 1970. Both Democrats and Republicans regarded Martin as a superb diplomat. Chairman Martin’s relations with the President were not always cordial, but they were never antagonistic. Within the Fed, he was a great diplomat as well, acting as a “compromiser and synthesizer.” Some insisted, however, that his “easy-going style was deceptive” (Knott 1986 p. 213).

After Martin left the Chairmanship, President Nixon appointed Arthur Burns as Chairman. Burns held this position from 1970 to 1978, and his leadership style was very different from Martin’s. Unlike Martin, Burns “was firm in his opinions, and as far as he was concerned, he was right.” (As mentioned, despite his heavy-handed style, Burns was willing to compromise when necessary.) If anything, Burns was more forceful and heavy-handed outside the Fed than inside. “Appearing before congressional committees,” Moore observes, Burns “seemed to assume the position of a professor teaching the congressmen a lesson in economics” (Moore 1990 p. 139). Since the nation’s economy was experiencing severe problems during Burn’s tenure, his leadership style was a serious liability.

President Carter did not want to reappoint Burns, who had already served two terms. Instead, he appointed G. William Miller, who was an extremely ineffective Chairman. Having previously served as the Chairman of Textron Corporation, Miller “was an activist and proceeded to conduct the board meetings as if they were meetings of the board of a commercial corporation” (Moore
Indeed, he “limited discussion to three minutes,” and he “even voted against the majority of the board on a request to increase the discount rate” (Moore 1990 p. 145).

With more economic problems in the country and more leadership problems at the Fed, President Carter appointed Miller as Treasury Secretary, making a new Fed Chairman necessary. Paul Volcker, whom Carter appointed in 1979, was an extremely important Chairman. During Volcker’s tenure, the nation’s economy—which suffered, at the beginning of his term, from stagflation—became prosperous once again. According to Moore, Paul Volcker will “be remembered as a man who guided the Fed through major changes and times of question about its ability to act in accordance with the public interest of the nation” (Moore 1990 p. 165).

As for leadership style, Volcker was neither an Arthur Burns nor a William McChesney Martin. What Volcker allowed, rather, was “more dissent than Burns but less free-flowing discussion than Martin” (Knott 1987 p. 215). This style seemed to work, as Knott reports that “most staff members were quite supportive of Volcker and believe that he has created an internal consensus” (Knott 1987 p. 215).

In 1987, Alan Greenspan was appointed Chairman, and he has served in this position ever since. Throughout his tenure, Greenspan has been recognized as an important leader, one who met “the challenge of maintaining stability in the face of threatened depression and inflation in the late 1980s” (Moore 1990 p. 166).

THE ROLE OF THE DIRECTORS

In 1989, William B. Harrison surveyed the Fed’s 275 Regional Bank Directors. In “Federal Reserve District Directors: Support System for a Public Institution,” which was published in the Journal of Economics and Business (1991), Harrison reported his results. Although not all the Directors responded, a substantial number (ninety-four) did.

Harrison surveyed head office directors—the Class A, Class B, and Class C directors for each district as a whole—as well as branch directors. In 1988, the System had “107 directors of 12 Federal Reserve banks’ head offices and 168 directors of 25 branch offices.” The branch directors, unlike the head office directors, “have no functions in initiating discount rate changes.” Also they have “no responsibility for auditing or personnel functions.” What branch directors provide is “general oversight in branch operational matters and to provide opinions about regional economic conditions” (Harrison 1991 p. 272).

Among Harrison’s respondents, 49 were head office directors; 45 were branch directors. Of the head office directors, “20 were Class A, 15 were Class B, and 14 were Class C directors.” Of the branch directors, “20 (BG) were appointed by the Board of Governors, and 25 (HO) were appointed by the head office boards.”
Very briefly, let us consider the directors’ responses to questions about the Fed’s structure and its monetary authority. Overall, the directors’ answers were very supportive of the System. In response to a question about “phasing out . . . Federal Reserve responsibilities in the examination of banks,” 20 were supportive, while 62 were not. In response to a question about privatization, 15 supported privatizing the automated clearinghouses, but 52 did not. Regarding currency and coin services, only 7 supported privatizing it; 75 did not (Harrison 1991 p. 278).

When questioned about the Fed’s monetary policy mandate, supportive answers were received again. Only 17 agreed that “the Fed’s mandate is too broad”; 70 disagreed. Only 6 believed that “price stabilization [should] be the only monetary policy goal”; 81 disagreed. Only 2 supported Milton Friedman’s and James Buchanan’s suggestion to remove “discretionary monetary control power from the Federal Reserve,” while 78 did not (Harrison 1991 p. 280). These results show how supportive the Directors are of the System’s core functions. They show, too, that the Board of Governors in Washington, DC has a great deal of institutional support—despite the System’s relatively decentralized structure.

CONCLUSION

What are the central themes of this chapter? How will they help me study the Fed’s administrative legitimacy? First, I reviewed the concept of “central bank independence,” where I discussed the different definitions different scholars have adopted. For my study, the most useful concept is political independence and economic independence, with the Fed being high on each. From a political standpoint, the bank’s capital is not publicly owned, and elected officials can “veto” the Fed’s decisions only by changing the law. As the law exists today, the Fed can establish a “tight” or “loose” monetary policy, regardless of what elected officials may believe. Despite this significant political independence, the government does appoint the Governors, who must report to Congress periodically. As such, the Fed receives input from elected officials, so the institution is not completely isolated.

From an economic standpoint, the Fed’s officials must achieve potentially contradictory goals—price stability and full employment—which increases administrative discretion. When establishing monetary policy, too, the Fed can use all the instruments available: open market operations, discount rates, and required reserve ratios. Both political actors and Fed officials realize how much political and economic independence the institution has, and this will affect the arguments they make about its legitimacy.

Second, I discussed the relationship between central bank independence and policy outcomes. For the most part, scholars believe that countries with independent central banks have less inflation than other countries, and that is related to the distributional consequences of monetary policy. By working to prevent inflation, sometimes the Fed may increase unemployment—leading people to label it a regressive institution, one concerned less with the working class or the poor than the wealthy. Obviously, this will affect beliefs about the Fed’s legitimacy.

Third, I examined central banking in Western Europe, showing that the debate over central banking is not just an issue in the United States. At the national level, central banking has been especially controversial in Great Britain and France, where the national banks have received much more autonomy recently. At the EU level, the European Central Bank—established by the Maastricht
Treaty—has been a controversial institution. As nations become closer, especially the advanced industrial democracies, understanding them becomes even more important.

Fourth, I examined the Fed’s relationship with the Congress and the President. In the literature, a major issue is whether the President has more influence over the Fed or whether the Congress does. Just the same, some question which gains the most from an “autonomous Fed,” if it is autonomous at all. For a dissertation in public administration and public affairs, it does not really matter which is more influential, which gains the most, and so on. For us, it is important that both influence the Fed. This is what the separation of powers means for administrative institutions. In my study, the tension between the branches—the controversy over Congressional prerogatives, Presidential prerogatives, and the role the Fed plays in reconciling institutional differences—will be especially important. More than anything else, perhaps, views about the separation of powers will affect the arguments officials make about the Fed’s legitimacy. On the one hand, people who believe the President should “manage the executive branch” are not likely to support the Fed’s legitimacy, at least as long as it is independent of the President. On the other hand, members of Congress who believe the President already has too much power are likely to accept the Fed’s legitimacy. To them, the Fed restrains the Chief Executive, and rightly so.

Finally, I examined leadership at the Fed, discussing the Chairman’s role. For Donald Kettl, the Chairman is the most important Fed official—he is, for good or ill, the symbol of the Fed and its power center. If Kettl is correct, I will find political actors, when they argue about the Fed’s legitimacy, personalizing their views. The Fed’s Chairmen, Arthur Burns and William Miller and Paul Volcker and Alan Greenspan, will become symbols of the Fed’s legitimacy. To argue about the Fed’s Chairman will be to argue about the Fed itself, as the two are inextricably linked.
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