

CHAPTER 1 INTRODUCTION

In this chapter, I explain what my dissertation topic is, identifying my research questions and showing how I will answer them. First, I examine the study's background, where I identify the literature gap and present the problem statement. Second, I describe my research design. Third, I review six major case studies of administrative institutions. After doing so, I discuss the three major themes from all six most relevant to my study. Fourth, before beginning the other chapters, I discuss the Federal Reserve System itself—the way it is organized and administered, how it is insulated from politics and funded, and what its responsibilities are. Finally, I provide an overview of the following chapters.

In my dissertation, I study the legitimacy of the Federal Reserve System. Administrative legitimacy, I argue, is an evaluative (or subjective) concept consisting of two beliefs: first, administrative institutions have a *right* to govern; second, they are *an appropriate* way to handle public tasks.¹ Using this definition, people can challenge an administrative institution's legitimacy by denying *either* claim. The administrative institution, they can argue, has no right to govern, whether on normative or constitutional grounds. *Or* even though they acknowledge the institution's right to govern, the challengers still may claim that it's *inappropriate* in a constitutional democracy like ours. When making this second claim, though, the institution's challengers must connect the inappropriateness to some (generally accepted) political value. People can *defend* an administrative institution's legitimacy, by contrast, only by making *both* claims: they must believe that the institution not only has a right to govern, but is appropriate in our constitutional democracy as well.

After discussing scholarship on legitimacy, I examine the Federal Reserve System, asking two questions about it. First, how have its officials attempted to legitimate both their institution and their actions over time? Second, how have elected officials, scholars, and political activists attempted to (de)legitimate the Fed and its officials' actions?

After framing the issue, I answer my research questions by studying the “fully-developed” Federal Reserve System, beginning in 1970 (with the appointment of Arthur Burns as chairman of the Board of Governors) and ending in 1995, after the Republican Congressional sweep of the previous year. My dissertation contributes both to scholarship on legitimacy and to scholarship on the Fed. Through this research, I show how the context of public administration (its social, political, and economic environment)

¹ When examining the “right to govern,” I am concerned with normative and constitutional questions, not statutory ones. As a matter of statutory law, the Fed has a *right* to govern because the Federal Reserve Act of 1913 and the Banking Act of 1935 says it does. But this is different from a *normative claim* that the Federal Reserve System, as it exists today, *should* be able to govern. The Constitutional aspects are important as well, since Article I, Section I provides Congress with the monetary authority. Because the Constitution explicitly grants this power to Congress, some claim that the Fed has no right to exercise it. Additionally, the Constitutional aspects are important because of Article II, Section II, which has two important provisions for how “Officers of the United States” can be appointed. Officers of the United States, first, must be appointed by the President and confirmed by the Senate. Or Congress can vest the appointment of “inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments” (Rohr 1986 p. 200).

affects administrative legitimacy. All in all, my dissertation brings theory closer to practice—and practice closer to theory.

THE FEDERAL RESERVE AS INSTITUTION, NOT ORGANIZATION

The Federal Reserve is an institution rather than an organization. Discussing the distinction between institutions and organizations in *Complex Organizations*, Charles Perrow observes that some organizations “are merely organizations—rational tools in which there is little personal investment and which can be cast aside without regret.” Other organizations, though, “become institutionalized.” In that instance, they “take on a distinctive character,” becoming “prized in and of themselves, not merely for the goods or services they grind out.” What happens is that people build their lives around institutions, identifying with them and becoming dependent on them (Perrow 1986 p. 167).

In *Institutions and Organizations*, Richard Scott argues that institutions are “multifaceted systems incorporating symbolic systems—cognitive constructions and normative rules—and regulative processes.” Institutions have regulative, normative, and cognitive aspects, each of which provides “stability and meaning to social behavior.” Even though human beings construct institutions, the institutions themselves “assume the guise of an impersonal and objective reality” (Scott 1995 p. 33).

Clearly the Federal Reserve is an institution. Not a *mere instrument* for achieving important social objectives, it is an agency with unique values. It has regulative, normative, and cognitive aspects—an institution that elected officials, public administrators, and concerned citizens have identified with and become dependent upon. In many ways, all of us have built our lives around the Fed, since its “technical” tasks affect us so intimately. Not incidentally, sophisticated “Fed watchers” have proliferated in both the financial and political communities. Alan Greenspan’s words, virtually guaranteed to be front-page news, can cause the stock market to rise or fall. In the past, they even helped alter a newly elected President’s economic priorities. This is no organization; it is an institution of foremost importance.

BACKGROUND OF THE STUDY:

THE QUESTION OF ADMINISTRATIVE LEGITIMACY

Some scholars of public administration have addressed the administrative state’s legitimacy explicitly, while many more have addressed it implicitly. In my literature review, I examine the work of scholars who have dealt explicitly with the issue: James Freedman (1978), Theodore Lowi (1969 & 1993), Frank Marini (1994), O.C. McSwite (1997), John Rohr (1986 & 1990), Michael Spicer (1993 & 1995), and Kenneth Warren (1993). The work of two scholars who have addressed legitimacy implicitly—Carl Friedrich (1940) and Herman Finer (1941)—will also be examined.

Although the literature on administrative legitimacy has contributed to our understanding of the issue, two important gaps remain. First, scholars have focused primarily on theory. In the process, they have done macro-analyses, attempting to legitimate the administrative state *qua* administrative state. But this raises several questions. What has

this theoretical work meant for specific public agencies? How have public administrators themselves attempted to legitimate both their institutions and their actions over time? What is the relationship, if any, between the political arguments of administrators and the philosophical arguments of scholars?

In my view, these unanswered questions pose two problems for public administration theory. For one, public administration is an applied, interdisciplinary field, so scholars must concern themselves with both theory and practice. If legitimacy is as important as many scholars say (and I think it is), surely scholars should study how administrators themselves deal with the issue.

For another, scholars can gain new insights by studying how administrators legitimate both their institutions and actions, and how political actors (de)legitimate them. By describing how administrators deal with the issue, such studies show how administrative legitimacy relates to administrative practice, and they expand our theoretical understanding of the issue. After studying one agency, for instance, scholars can rethink previous theories, asking whether they need to be reconceived. Additionally, scholars may think that some theories apply to some agencies more than to others; this may lead them to study additional administrative institutions in the hope of better refining theory.

Second, scholars have not always clearly defined the term, “legitimacy.” Even those who have, however, have not used the literature in Sociology and Political Philosophy. By including literature on legitimacy from each of these areas, the scholarship in public administration can be improved, making future discussions of the issue more productive. Indeed, I ground the concept of legitimacy in literature on Sociology and Political Philosophy so scholars can be clear about what administrative legitimacy really *means*.

RESEARCH DESIGN

My research design consists of seven parts. First, I study the scholarly literature in two main areas, legitimacy and the Fed. Then I study the scholarly literature in one supporting area, the Bank of the United States. After analyzing that literature, I have a broad perspective on each area—which will help with the other tasks.

Second, I study Congressional Hearings on issues related to the Fed’s legitimacy. In this vein, I study hearings on the Audit Bill, the Humphrey-Hawkins Act of 1978, and similar legislation. I study confirmation hearings (for the Board of Governors, chairman, and vice-chairman) too. Moreover, I study hearings on broader issues—especially those dealing with the conduct of monetary policy (what its goals should be, how officials should accomplish these, what sort of oversight Congress should provide, and so on) and the organization of the Fed.

Third, I examine speeches in the *Congressional Record*, seeing what some Congressmen said about the Fed. What I am especially interested in are remarks by major proponents and opponents of the Fed—supporters like Rep. Garry Brown (R-Michigan) and Rep. William Stanton (R-Ohio) as well as opponents like Wright Patman (D-Texas) and Henry Reuss (D-Wisconsin). I examine the *Record*, too, for Congressional discussions of Fed

officials and legislation facing that institution. In so doing, I discover what Congressmen, whether supporters or opponents of the Fed, said about the Fed's legitimacy.

Fourth, I examine *Public Papers of the Presidents* from 1970 to 1995 as well as autobiographies and biographies of presidents, top advisors, and cabinet secretaries who held office during this time. While doing so, I discover how *they* (de)legitimated the Fed over time and how they responded, if at all, to the arguments of Fed officials. This part of my methodology is important, since members of the executive branch, no less than Congress, are concerned with the Fed's legitimacy. In my study, then, it is important to consider the Congress *as well as* the President, his top advisors, and the cabinet secretaries.

Fifth, I study *publications* by members of the Board of Governors—either while they were in office or after they left. Alan Blinder, for example, was a Governor; after leaving office, he wrote *Central Banking in Theory and Practice*, which was delivered as the 1996 Robbins Lectures. This short book, in particular, deals with issues of legitimacy at the Fed, examining the arguments over central bank independence. Similarly, Paul Volcker's lecture 'The Triumph of Central Banking?' was published, and Arthur Burn's 'The Anguish of Central Banking' was too. Henry Wallich, another Governor, wrote *Monetary Policy and Practice: A View from the Federal Reserve Board* while serving on the Board.

Sixth, I examine some publications from Reserve Banks. Unlike the Board of Governors, the Reserve Banks use their annual reports to analyze a current economic or political topic. Sometimes the articles address the System's legitimacy, either explicitly or implicitly. By studying them, I *supplement* the information received from the Board of Governors. What arguments have the Reserve Banks made about legitimacy? Do they support, modify, or oppose those of the Board of Governors?

Seventh, I examine some articles on the Fed from political journals read by the general public. These "popular" magazines, like *The Nation*, *National Review*, *The New Republic*, *The Economist*, and *National Journal*, are usually more involved with the political debate than the scholarly journals. While examining articles from these publications, I show how political actors (de)legitimated the Fed and its officials.

WHY STUDY THE PUBLIC ARGUMENT?

Why should scholars study the *public argument* about the Fed's administrative legitimacy?² Why, in fact, should they study the public argument about any agency's

² By the *public argument*, I mean the public discourse about the Fed's legitimacy that is found in such publications as the *Congressional Record*, Congressional committee hearings, *Public Papers of the Presidents*, and the like. An argument about administrative legitimacy is not about policy matters *per se*: it is about whether the Fed has a right to govern, whether it is appropriate for a constitutional democracy like ours. Following this reasoning, an argument that interest rates should be lower is not an argument about legitimacy—it is simply a preference for one policy over another. If some people argue, by contrast, that the Fed has no right to make monetary policy or that it is inappropriate for a such an institution to exist,

legitimacy? First, scholars usually advance their own arguments about legitimacy rather than looking at those made by political actors and agency officials. For this reason, discussions of administrative legitimacy have an “Ivory Tower bias,” which is disturbing in an applied, interdisciplinary field like ours. By studying the public argument about administrative legitimacy, I have developed a unique methodological tool, one responding to an important need in public administration.

Second, administrative legitimacy is an important issue for many scholars, yet two important questions remain unanswered. What arguments must an agency overcome before *political actors believe it is legitimate*? When defending their legitimacy, what are the most effective arguments for administrators to make? By studying the public argument, scholars can begin to answer these questions. Admittedly, my study answers these questions only *for the Fed*. Similar arguments, though, may occur in the public discourse surrounding other agencies, and other scholars can use a similar methodology. If enough scholars conduct enough studies of the public argument, we may develop a more comprehensive understanding of administrative legitimacy. At the very least, my study lets us see what political arguments one agency must overcome as well as what agency arguments are most effective in debates over legitimacy.

Third, now more than ever, scholars of public administration are concerned with public discourse. According to supporters of the “discourse movement,” administrators should be more than technical experts; they should facilitate “dialogue” between citizens. In *Postmodern Public Administration: Toward Discourse*, Fox & Miller present their discourse theory—which is based on a constructivist ontology and includes such warrants for discourse as sincerity, “situation-regarding intentionality,” “willing attention,” and “substantive contribution”—as an alternative to other perspectives on public administration. In *Legitimacy in Public Administration*, O.C. McSwite present a “discourse analysis” by “unmasking . . . an ideology as a tissue of distortions and fabrications.” My study not only responds to the current emphasis on public discourse, but also expands this area by analyzing *the public discourse about an agency’s legitimacy, both from administrators themselves and important political actors*.

Fourth, by studying the public argument, scholars of public administration can better understand the *ideological environment* surrounding the Fed. This is narrower than the context *per se*, for it is only concerned with the dominant ideas of a given time. As a practical matter, the ideas of a given time are especially important in public administration, since agencies exist in a political environment with strong ideological beliefs. By understanding this ideological environment, scholars can better understand public administration itself.

To sum up, studying the public argument lets us see the conflicting visions of the administrative state. Our political values conflict, which affects both the theory and the practice of public administration. We want freedom, equality, *and* justice. We want efficiency, effectiveness, *and* accountability. We want individual freedom *and*

they are attacking the Fed’s legitimacy. In this case, they are questioning its right to govern and its appropriateness.

community values. We want adequate representation, majority rule, *and* minority rights. These are just a few examples of our conflicting values, the very value conflicts administrative institutions embody—and are expected to “resolve.” With conflicting political values and elected officials’ differences on the role administrative institutions should play in American government, the public argument over administrative legitimacy consists of contradictory claims, appeals to different values, and the like. For good or ill, this is the environment of public administration, with different visions of the administrative state and different theories of administrative legitimacy. To understand public administration, we must study the public argument about administrative legitimacy.

CASE STUDIES OF ADMINISTRATIVE INSTITUTIONS

I am not the only scholar to conduct a case study of a particular administrative institution. Many scholars—Martha Derthick, Philip Selznick, Gary Wamsley, and others—have done so. Now, to connect my study to similar work, I review six major case studies of administrative institutions. After briefly discussing each work, I identify the themes from all six that are most relevant to my study.

SIDNEY BALDWIN: THE FARM SECURITY ADMINISTRATION

In *Poverty and Politics: the Rise and Decline of the Farm Security Administration*, Sidney Baldwin studies this New Deal agency, which was begun under Roosevelt and was abolished under Truman. What Baldwin examines is “the rise and decline of the agency,” hoping to “understand more clearly the interplay of forces—social, political, economic, ideological, and material—which condition and control the efforts of men and governments to cope with human predicaments” (Baldwin 1968 p. 4). In 1935, President Roosevelt issued an executive order creating the Resettlement Administration, an agency to fight “chronic rural poverty.” Less than two years later, the President let this agency become part of the U.S. Department of Agriculture. In September 1937, the Resettlement Administration became the Farm Security Administration. In 1946, President Truman abolished the FSA by signing the Farmers Home Administration Act. With this new law, the FSA was replaced with a new agency, the Farmers Home Administration (FHA) (Baldwin 1968 p. 3).

The Farm Security Administration in the America of the Roosevelt era represented an historic attempt to preach hope . . . to exploit the promise, the power, and the possibilities of politics in securing salvation from the human suffering, social injustice, and economic waste of chronic poverty. *In many ways, the rise and decline of the Farm Security Administration sheds some light on the strengths and weaknesses of the American people, of their political system, and of democracy itself* [my emphasis] (Baldwin 1968 p. ix).

Many scholars and political activists have offered many reasons to explain the FSA’s decline. For public administration, the most important are those emphasizing the “ideological stubbornness” of the agency’s leaders, the leader’s refusal “to play the game of ‘cooptation,’” and the American Farm Bureau Federation’s hostility (Baldwin 1968 p. 12). For Baldwin, though, the “relevance of the rise and decline” of the FSA is not just a

story of “administrative behavior and institutional survival.” Instead, it is important to examine the “nexus of poverty and politics,” for no public issue has “been more resistant to attention, understanding, and remedy than chronic poverty” (Baldwin 1968 p. 17). The FSA—whether we examine its beginnings, its purposes, its programs, or its policies—has “meaning only in reference to the problem of chronic rural poverty” (Baldwin 1968 p. 17).

Agency officials, interest group leaders, and agency clientele were dealing with serious *issue conflicts*, which Baldwin believes helps explain the FSA’s demise. Throughout its history, the FSA faced conflict over core issues in politics and administration, not peripheral ones. These included, for example, conflicts over “administrative discretion, allocation of funds, definition of eligibility standards, recruitment and compensation of personnel, civil service protection, the role of farmer’s committees, experimentation in cooperative enterprises, the organization and function of regional offices, equity for the Negro” (Baldwin 1968 p. 413).

When examining the FSA’s demise, Baldwin places special emphasis on the way political actors *perceived it*. To opponents, it was a dangerous agency—an “un-American experiment in governmental intervention, paternalism, socialism, or communism”—that must be opposed at all costs. The FSA was, they believed, an “organized conspiracy to undermine the *status quo* in rural America.” To supporters, however, it was a “heroic institution” promoting social justice and relieving chronic poverty. The FSA was seen by supporters as “a unique and largely successful experiment in creative government,” Baldwin reports.

More than anything else, the FHA and the FSA had different strategies, different attitudes. The FSA provided funds for case poverty, where the “causes . . . lie within the poor themselves.” But the FHA had a broader constituency, directing funds toward “insular poverty” caused by “economic circumstances affecting [an] area or region.” While the FSA helped “chronically impoverished families at the very bottom,” the FHA helped rural communities and nonfarm borrowers. One writer, writing in a commercial banking journal in 1966, argued that the FHA’s “growth plans . . . will make many a private lender green with envy” (Baldwin 1968 p. 404).

Yet the “essential difference” between the two agencies remains “mood, method, and subjective attitudes.” The FSA, quite simply, was seen as a challenge to the status quo—one social conservatives were certain to oppose. The FHA, by contrast, developed warm relations with both Congress and the agricultural groups, becoming acceptable to established interests. The FSA was an active agency; the FHA was a “docile agency.”

And both paid a price. The FSA generated “excitement and hope” *as well as* extreme hostility. All this led to its demise. The FHA generated no hostility, but it didn’t speak to the hopes and dreams of poor Americans either. In this crucial respect, it failed, even though it survived. “He who innovates,” Baldwin reports Machiavelli as saying, “will have for his enemies all those who are well off under the existing order of things, and only lukewarm supporters in those who might be better off under the new” (Baldwin

1968 p. 404).

MARTHA DERTHICK: THE SOCIAL SECURITY ADMINISTRATION

In *Agency Under Stress*, Martha Derthick studies the Social Security Administration. At the outset, she argues that “agency performance cannot be understood apart from its institutional context.” Because the tasks of public agencies are “defined by policymaking institutions”—such as the Congress, the Courts, and the President—repeated agency failures may result from “the source of instruction rather than the objects of it” (Derthick 1990 p. 3).

Derthick analyzes the SSA’s “poor performance” in the “initiation of the supplemental security income program in 1974 and a review of the eligibility of recipients of disability insurance in the early 1980s” (Derthick 1990 p. 5). In the 1970s, SSI “replaced the federally aided programs that had prevailed for several decades” to protect the needy disabled, blind, and elderly. In all too many ways, the SSA was not prepared to administer the SSI: faulty computer systems, mob-scenes at SSA field offices in big cities, insufficient staff, and insufficient program support were some of the problems it faced.

Nor was the disability review any easier. Congress, believing the disability program was being abused by recipients, “ordered the SSA to undertake periodic reviews of the eligibility of recipients.” Every three years, recipients who were not permanently disabled would be reviewed, SSA officials decided. By reviewing recipients, it was believed that millions could be saved. Unfortunately, truly needy citizens were denied benefits because of the program, causing much opposition to it. More and more, the federal courts ruled against the SSA’s decisions to terminate disability benefits—so the SSA administrator, in the Spring of 1984, terminated the review “pending the development of fresh legislation” (Derthick 1990 p. 5).

For my study of administrative legitimacy, the details of these two cases are not very important. What is important is Derthick’s discussion of “administration in constitutional theory,” which raises the legitimacy issues I am interested in. It is not accurate, Derthick observes, to claim that the Founders were indifferent to good administration. Still, the Founders “had relatively little to say . . . about how administration was to fit into the constitutional scheme” (Derthick 1990 p. 8).

Because the *individual states* were expected to manage domestic affairs, the “creation of administrative agencies at the national level” faced serious obstacles:

Advocates of national action of any kind—and specifically the creation of national administrative agencies—have faced a heavy burden of proof. They had to establish that the function was one that the national government constitutionally could, and otherwise should, undertake. And if this threshold were successfully crossed and national administrative agencies were created, it was then necessary to confront the deeper constitutional question of how they were to be held

accountable. *All uses of governmental power must ultimately, even if indirectly, be subject to popular control* [my emphasis] (Derthick 1990 p. 9).

As the federal government became more powerful, creating administrative agencies to accomplish national tasks, a “theory covering the place of administration in the American regime” became more important than ever. What developed was the idea of Presidential responsibility, as scholars of public administration favored “concentration of authority and responsibility in the president as elected chief executive.” Public administrators, on this view, are responsible to the President, who is at the top of “an ‘official hierarchy’ with ‘large if not complete powers of appointment, removal, direction, and supervision” (Derthick 1990 p. 16).

But Congress has “never subscribed to the theory of presidential responsibility” (Derthick 1990 p. 17). Members of Congress, rather, have attempted to supervise public administrators closely—so closely, in fact, that many scholars accuse it of “micromanaging” administrative agencies. Although Presidents see administrators as agents of the elected executive, Members of Congress see them as agents of the elected legislature.

In making delegations to them or calling them to account, it does not feel bound by any obligation to defer to the president. As a matter of constitutional principle, it feels entirely justified in combating him. The laws that agencies carry out are laws that Congress has enacted; the money they spend is money that it has appropriated. The will of the legislature, in the legislature’s view, should control administrative acts.

The federal courts—only sometimes an “arbitrator” of conflicts between the Congress and the President—have often been “an independent source of supervision of administrative agencies.” In a nation of laws not men, judges see administrative agencies as *agents of the law*. Judges intend to hold administrators legally accountable.

In her study of the SSA, Derthick shows how it “illustrates the constitutional tensions to which federal administrative agencies are subject.” Over time, the SSA’s form has changed regularly. In 1935, it was a bipartisan, three-member Board. In 1939, the Board was made part of the Federal Security Agency, which an administrator responsible to the President headed. In 1946, the Board was abolished altogether, its functions given to the federal security administrator—who “delegated them to a commissioner of social security.” In 1953, the Commissioner of Social Security became a Presidential appointee. That year, too, the Federal Security Agency became the Department of Health, Education, and Welfare (HEW). During the Carter Administration, Education became a separate department, so HEW became the Department of Health and Human Services (Derthick 1990 pp. 20 – 21). Even as recently as 1994, after Derthick’s book was published, the SSA changed. It became an independent agency once again.

FREDERICK MOSHER: THE GAO

In *The GAO: The Quest for Accountability in American Government*, Frederick Mosher examines the origins and development of the General Accounting Office as well as its role in American government and the justification for it. Mosher's book is divided into two parts—the first examining the evolution of the GAO, the second discussing the “emerging roles of the GAO.” Because I am studying administrative legitimacy, I briefly review the second part rather than the first.

To justify the GAO, supporters have seen it is a way to hold “the executive branch of the federal government and its responsible officers . . . accountable for their actions, particularly in the realm of finances” (Mosher 1979 p. 233). Ironically, the GAO itself has enjoyed “substantial independence so that it may more effectively hold others accountable” (Mosher 1979 p. 233). In its early years, the GAO was controversial: every President from Harding to Roosevelt, with the exception of Coolidge, made “frontal assaults on its locus in the government, its powers, the tenure of its chief, and its very existence as an agency” (Mosher 1979 p. 239). After Roosevelt, however, these attacks no longer occurred. Since 1939, the GAO was not included in any Presidents' plans for executive reorganization.

Examining the GAO's independence, Mosher distinguishes the constitutional question from the operational one. *Constitutionally*, a “legal problem” for the GAO “arises from the separation of powers.” In the Budget and Accounting Act of 1921, Congress made the GAO—which was “independent of the executive departments”—responsible for financial controls. In this Act, Congress did not say to whom the GAO's head (the Comptroller) would be responsible. In truth, the GAO is accountable to Congress, but the Comptroller “insists on his independence even of Congress in selecting the majority of his projects and in the objectivity of his investigations” and recommendations.

Since the GAO exercises quasi-executive and quasi-judicial authority, questions about the separation of powers have been raised. Sometimes Attorneys General have argued, for instance, that the Comptroller General's opinions are nothing more than advice to the executive branch. Only the courts, if this view is correct, could force the executive branch to change its “final decision” on a matter the GAO is concerned with. Above all, the Comptroller General has a dual role in American government, serving as “an officer of Congress and as an independent officer.” This dual role, Mosher reports, has “been recognized and affirmed in one federal court case,” yet the “question has not reached the Supreme Court” (Mosher 1979 p. 242).³

³ Since Mosher's book was published, the U.S. Supreme Court decided *Bowsher v. Synar*, which does address the Comptroller General's role in American government. In that case, the Court ruled on the Balanced Budget and Emergency Deficit Control Act of 1985, a statute allowing the Comptroller General “to trigger automatic spending cuts” (Levinson 1987 p. 527). When the nation's deficit targets were not met, the Comptroller General determined which cuts, on a program by program basis, must be made to meet them (Abikoff 1987 p. 1541).

In *Bowsher*, the Court held that the Comptroller General is an agent of Congress, so he cannot execute the laws. The Balanced Budget and Emergency Deficit Control Act required the Comptroller General to perform an executive function—interpreting a Congressional statute and exercising considerable discretion while doing so, the Court said, is “the very essence of ‘execution’ of the law.” For this reason, the

Operationally, the GAO has been criticized for “violating a first principle of administration.” By infringing on the “administrative responsibilities of the managers of the executive branch,” this criticism holds, the Comptroller was interfering with “the tools” a manager has “to direct and control his organization” (Mosher 1979 p. 243).

As a legislative officer, he should confine his work to a prompt postaudit of executive branch activities. And he cannot do that objectively and disinterestedly if he has a major part in the current controls and decisions; otherwise, he is in effect auditing his own work (Mosher 1979 p. 243).

At first, these criticisms were common, as “almost every scholar who wrote on the subject” made them. Even Willoughby, who helped draft the Budget and Accounting Act, later recognized that letting the GAO exercise both audit and control functions had caused “much trouble” for the executive branch (Mosher 1979 p. 243 - 244). But after World War II, these criticisms were no longer advanced, for the GAO’s operations were reformed by internal changes within the institution and Congressional passage of the Budgeting and Accounting Procedures Act of 1950. No longer would the GAO “keep books for the whole government.” From 1950 on, the GAO recognized that the operating agencies had primary responsibility for “developing and operating their own accounting systems.” Increasingly, the GAO conducted “comprehensive postaudits,” and its officials encouraged agencies to develop their own internal auditing systems (Mosher 1979 p. 244).

Yet some questions remain even today. Rather than question the GAO’s independence, elected officials have wondered how much freedom the agency should have in choosing its projects, conducting its studies, and writing its reports. Many in Congress, for example, have seen the GAO as “insufficiently responsive” to their “needs and requests.” What has happened is that the GAO “perceives its roles and its purposes in somewhat different terms than do the committees, subcommittees, and individual members and staffs of Congress” (Mosher 1979 p. 244).

provision conferring executive authority on the Comptroller General was declared unconstitutional (Abikoff 1987 p. 1541).

In the public administration literature, *Bowsher* has been criticized, with Louis Fisher arguing it places “at risk . . . the status of the GAO, the independent regulatory commissions, the Federal Reserve Board, and the U.S. Archivist” (Fisher 1987 p. 213). According to Fisher, this decision presents a “highly formalistic model” of Congressional-Presidential relations. Taken to its logical conclusion, it challenges the “customary role of Congress to supervise the work of executive agencies” (Fisher 1987 p. 213). Over the past twelve years, however, the Court has not restricted Congress’s ability to supervise executive agencies. Nor has it challenged the independent regulatory commissions’ constitutionality, as Fisher and others feared it might. Questions about separation of powers will always be serious in the United States, but they are largely concerned with where to draw the line. At any rate, if the Court *consistently* adopted a rigid interpretation of separation of powers, American government would ground to a halt. I doubt this will ever happen.

FREDERICK MOSHER: COMPARATIVE ANALYSIS OF THE GAO & OMB

In *A Tale of Two Agencies*, Frederick Mosher presents a comparative analysis of the General Accounting Office (GAO) and the Office of Management and Budget (OMB). Both agencies can be traced to the Budget and Accounting Act of 1921, which established the GAO and the Bureau of the Budget (BOB, the OMB's forerunner). Mosher studies these agencies' histories, paying particular attention to the social and political context of different eras. He studies, too, their relations with the Congress, the President, and other federal agencies.

In some ways . . . these agencies are the most striking yet enduring institutional expressions of the separation between the executive and legislative powers in the national government. Both grew out of an issue as to Presidential-Congressional powers with respect to finances that has been festering ever since the Constitution was drafted in 1787 and that even then had precedents in British and Colonial times (Mosher 1984 pp. 3 – 4).

In 1921, the BOB was “truly a newcomer,” while the GAO was the “product of a simple transfer of certain powers, responsibilities, and resources from an executive department (Treasury) to independent and Congressional status” (Mosher 1984 p. 1). Assuring that agencies' financial transactions were “proper, accurate, and legal”—this was the GAO's original purpose (Mosher 1984 p. 2).

Originally part of the Treasury Department from 1921 to 1939, the OMB has long been one of the “principal support agencies” to the President. Other than the White House staff, the OMB is the only Presidential support agency with “generalized jurisdiction.” On the President's behalf, the OMB has always supervised the creation of the *Budget of the United States* and published the document once it is complete. At the same time, virtually from the beginning, the OMB has coordinated and cleared “proposed legislation and agency comments and presidential action thereon” (Mosher 1984 p. 2). Since Roosevelt's third administration, the BOB (later the OMB) has dealt with the management and organizational issues facing the executive branch (Mosher 1984 p. 2).

In his analysis, Mosher shows how each agency has changed as America has changed—the nation's evolving society, values, and technology as well as its changing expectations of government have affected the GAO and the OMB greatly. The movements for scientific management, efficiency, and effectiveness in government were largely responsible for the agencies' creation, but these values are not responsible for their continued existence. Only by responding to new values and accepting new responsibilities has each survived.

From 1921 to Roosevelt's first term, the agencies placed primary emphasis on “economy, efficiency, compliance with law, and strict central control.” Once Roosevelt began implementing New Deal policies, the agencies' leaders were “distressed, sometimes heatedly.” As a result, BOB's leadership changed in the early 1930s, and GAO's did too

in 1939 and 1940. In the Brownlow Report, the President's Committee on Administrative Management argued that the BOB was the President's "major agent" in improving the "management of the executive branch," a view written into law in 1939.

For the GAO's part, after World War II, it began "professional auditing of agency accounts and agency accounting systems." Before the War, GAO had conducted "detailed voucher checking" of agency activities, which was attacked as too much interference with agencies' operations (Mosher 1984 p. 11). Since 1950, both the GAO and the OMB have had expanded missions—the GAO assuming responsibility for program evaluation, the OMB assuming responsibility for general management and policy issues (Mosher 1984 pp. 87 – 162).

The GAO is a Congressional agency; the OMB is a Presidential agency. The roles they have played, Mosher observes, "have been different, joined in only the most general terms by a common intent to make national government more efficient, economical, and effective" (Mosher 1984 p. 164). As different agencies with different branches, they have had "different tools and modes of entrée into government," producing different analytical products and other outputs. Nevertheless, since World War II, their "concerns and capacities have been moving toward each other" (Mosher 1984 p. 164).

In the end, Mosher concludes that the GAO and the "BOB/OMB" are similar in some ways, dissimilar in others. Consider similarities. First, they were created by the same law, the Budget and Accounting Act of 1921. Second, they both retain "a fundamental bent toward saving money and eliminating extravagance, waste, and fraud" (Mosher 1984 p. 168). Third, neither's staff has grown since World War II, mainly because they are identified "with economy in government." To survive, both have had to "be models of what they preach—frugality" (Mosher 1984 p. 169). Fourth, they generally play the role of "reactor" or "counterpuncher," receiving ideas and regulations then responding to them (Mosher 1984 p. 169). Finally, both are "generalists," agencies capable of analyzing virtually any subject.

Their differences, however, are equally important. First, the GAO's staff is much larger than the OMB's—about ten times so, in fact. Second, despite the staff differences, the BOB/OMB is "closer to the central founts of government decisions." The BOB/OMB's staff, in particular, is more educationally diverse; more of its personnel are in top executive grades. Third, virtually all GAO employees are career personnel, while the BOB/OMB has political appointees in its top dozen or so positions. Fifth, the GAO has "widely dispersed field offices"; the OMB does not (Mosher 1984 p. 173). Finally, most of BOB/OMB's work is "disciplined and scheduled," coinciding with the budget cycle, but the GAO's is not.

PHILIP SELZNICK: THE TENNESSEE VALLEY AUTHORITY

In *TVA and the Grass Roots*, originally published in 1949, Philip Selznick studied the Tennessee Valley Authority. His analysis is presented in three parts: the creation of an official doctrine, the development of an administrative constituency, and the ambiguities of participation. From the beginning, Selznick relates the TVA to the idea of "democratic

planning.” In modern society, citizens have demanded more and more from government, so it is necessary to study administrative institutions like the TVA “proposed as contributions to the technique of democratic planning” (Selznick 1949, 1980 p. 3).

Created in 1933, the TVA was a response to “a long period of pressure for the disposition of government-owned properties at Muscle Shoals, Alabama.” By passing the TVA Act, the Congress gave a “major victory” to those favoring government operation in the area. Because of this Act, Muscle Shoals became a *public investment*, a publicly owned enterprise, which was “provided with new goals” and was “vastly expanded” (Selznick 1949, 1980 p. 4).

At the time, the TVA was unique. It was a “relatively autonomous public corporation” generally free from “the normal financial and administrative controls exercised over federal organs.” In his message recommending the creation of the TVA, President Roosevelt said an organization “clothed with the power of government but possessed of the flexibility and initiative of private enterprise” was necessary to develop the Tennessee River (Selznick 1949, 1980 p. 5). Most importantly, the Act establishing the TVA provided the institution with much discretion to execute its “primary purposes,” discretion justified by elected officials because it “would invite those in charge to recognize the social consequences of specific activities” (Selznick 1949, 1980 p. 6). Moreover, the TVA had “freedom to devise methods of dealing with local people and institutions” (Selznick 1980 p. 6).

For progressives and liberals, the TVA was an important symbol. “It is primarily as a symbol that TVA excites allegiances and denunciation,” Selznick reports. Consequently, progressive and liberal activists defended the institution during “controversies over finance and accountability,” and they promoted *the idea of the TVA* as “a model for regional development in other areas” (Selznick 1949, 1980 p. 19). As for the TVA itself, its administrative leaders recognized the need to develop an “official doctrine.” This doctrine, eventually operationalized in the TVA’s response to its environment, was “grassroots administration.”

The leading exponent of grassroots administration was David E. Lilienthal, Chairman of the TVA’s Board until 1946. During the Great Depression, the federal government became more active than ever before. Suddenly it was responsible for relieving unemployment, counteracting big business, and responding to important interest groups. The new federal functions, however, did not necessarily require “top-heavy organizations centered in and administered from Washington.” According to Lilienthal:

This country is too big for such a pyramiding of direct responsibilities. For in spite of our triumphs over time and space, Washington is still remote from the average citizen and is sheltered from participation in his daily struggles (Selznick 1949, 1980 p. 24).

So the dilemma was this: the federal government must exercise more power, but centralized power was seen as “always a menace to democracy.” Using de Tocqueville’s

distinction between centralized government and centralized administration, Lilienthal developed the idea of “grass-roots administration” to respond to this dilemma. By translating the “theory of decentralized administration” into practice, TVA officials believed, they could “check the growing tendency toward excessive centralization of federal administration.” In their public pronouncements, TVA officials described their institution as “the boldest and perhaps most far-reaching effort of our times to decentralize the administration of federal functions.” If this effort succeeds, the United States “shall have added strength to the administrative defenses” protecting “the future of our beleaguered democracy” (Selznick 1949, 1980 p. 26).

Ultimately, TVA officials used the idea of decentralized administration to legitimate their institution. To operationalize this theory, administrators demanded managerial autonomy in their “relation to the federal government,” so the TVA was not subject to Civil Service Commission regulations. Recognizing that institutions already existed in the Tennessee Valley, the TVA’s administrators began cooperating with them. To justify the TVA as both “legitimate and efficient,” its administrators sought out and even established “local institutions to mediate between the TVA and the people of the area.”

It was felt that an imposed federal program would be alien and unwanted, and ultimately accomplish little, unless it brought together at the grass roots all the agencies concerned with and essential to the development of a region’s resources: the local communities, voluntary private organizations, state agencies, and cooperating federal agencies. The vision of such a working partnership seemed to define “grass-roots democracy at work” (Selznick 1949, 1980 p. 37).

Working through these state and local agencies, TVA administrators argued, would give the jurisdictions “more effective means” to “direct their own destinies” (Selznick 1949, 1980 p. 37). In this way, administrators solved the conflict between strong national government and local self-determination.

GARY WAMSLEY: SELECTIVE SERVICE

In *Selective Service and a Changing America: A Study of Organizational-Environmental Relationships*, Gary Wamsley begins with a paradox. On the one hand, most Americans “support drafting young men for military service.” As public policy, the draft has “amazingly solid” support, even though Vietnam was “one of the nation’s most divisive wars.” On the other hand, most Americans disapprove of the System’s administration, with “only 43 percent of the public in December 1966 feeling that ‘the way it works is fair’” (Wamsley 1969 p. 2).

In his study, Wamsley discusses two of the System’s characteristics in detail. First, the System has been able to “achieve acceptance by relating its structure and processes to American political values.” Second, the System’s “rank and file members” were able to resist “examination by outsiders,” *and* the System has promoted “an institutional myth of decentralized power” (Wamsley 1969 p. 3).

Throughout American history, military conscription has run counter to certain key values of American political culture—voluntarism, civilian control of the military, local decisions are better decisions, sovereignty of the states, etc. Selective Service, by identifying its structure and processes with these values, was designed to ease the constraints posed by them. It has thus sought to meet the functional demands arising from defense needs without violating these values. Due to changes in American society and to institutional rigidities developed within the system, it is becoming increasingly more difficult for it to maintain an equilibrium that satisfies both defense needs and societal needs (Wamsley 1969 p. 3).

To adapt to American political culture, the Selective Service System has “seemed most sensitive to issues of local and civilian control” (Wamsley 1969 p. 51). From 1917, when the System was first formed, its leaders believed “their main purpose and principal success” was “developing a System in harmony with these two values.” In “all representations to its environment,” the System’s leaders promoted an “institutional myth,” claiming that the System is decentralized. Within the institution, Wamsley observes, members believed the claim of decentralization was “essential to maintaining legitimacy and acceptance for its conscription function” (Wamsley 1969 p. 52).

To gain legitimacy, the System delegated much decision-making to local boards. But no matter how decentralized the System seemed to be, local decisions had to accomplish the System’s objectives—most notably, drafting young men with minimal economic disruption, minimal political dissent (Wamsley 1969 p. 53). Unfortunately, the functional demands conflicted with the cultural ones. Because of conflicts between the two, decentralization was “a delicate balance between delegation and control of decision-making” (Wamsley 1969 p. 52). The System’s leaders, for their part, saw the local boards as “a legitimating link between the coercive power of government and the individual citizen” (Wamsley 1969 p. 103).

In his conclusion, Wamsley discusses the “strain on institutional equilibrium.” Not only was the “institution’s philosophy . . . out of harmony with political culture,” but its “structures and processes” were as well (Wamsley 1969 p. 218). Although the local boards were expected to legitimate decisions, this function only works in a “localistic and traditionalistic society.” As the *national community* became more and more active—even replacing commitments to local communities—legitimate federal agencies had to promote “uniformity and consistency.” The System’s processes, which contributed to “disuniformity, inconsistency, and inequality,” were “in danger of destroying its symbolic power to legitimate decisions” (Wamsley 1969 p. 218). So the changing political values required a changing Selective Service System.

MAJOR THEMES FROM THESE CASE STUDIES

Looking at these case studies as a whole, what central themes seem especially relevant to my research? I believe that three emerge: the importance of constitutional principles and political values, the importance of political context, and the independent role the agency

has to play. At this point, I discuss each.

THE IMPORTANCE OF CONSTITUTIONAL PRINCIPLES & POLITICAL VALUES

In one way or another, each study emphasizes the importance of constitutional principles and political values. In the United States, one of the most important constitutional principles is separation of powers, a fact emphasized by Derthick as well as Mosher. Because of the separation of powers, the OMB and the GAO developed differently, the first being a Presidential agency and the second being a Congressional one. Because of conflict between the branches, the Social Security Administration has been organized differently at different times. Sometimes it has been part of an executive department; sometimes it has been independent. Yet regardless of where the SSA is in the executive hierarchy, its leaders have a great deal of discretion—since the Congress sees the agency as *its agent*, and the President sees the agency as *his agent*. Despite the difficulties associated with having two masters, this very “problem” gives administrative agencies much discretion. These agencies must decide which constitutional master to obey at a given time, all due to the separation of powers.

Administrative agencies, these studies also show us, are not apolitical enterprises. They embody political values, and they are expected to resolve political conflicts. In Derthick’s study of the Social Security Administration, for example, the agency was forced to stop the disability review program. In American political culture, the disabled are seen as entitled to benefits. When a government agency denies disability benefits to people unfairly, as happened during the disability review, the public is outraged. Even though Congress wanted the SSA to review recipients, the SSA had to discontinue its program.

Other examples could be cited from the other studies. But the important point is how these studies help me analyze the public argument over the Fed’s administrative legitimacy. These studies show that both the Fed’s officials and political actors will respond to important political values, which my definition of legitimacy allows them to do. Supporters of the Fed’s legitimacy can appeal to generally accepted political values to justify its appropriateness; opponents can do so to make the opposite point.

THE IMPORTANCE OF POLITICAL CONTEXT

Not just constitutional principles and political values, but *political context*, is an important theme from these studies. By political context, I mean the environment the institution was created in, how the environment changed over time, how the environment shaped the institution, what the institution did to shape the environment, and so on. More than any other, Wamsley’s study shows the importance of political context. In 1941, when America became involved in World War II, nearly 100% of the population believed the draft boards were doing “an honest and conscientious job.” Nevertheless, the draft was barely renewed that year—passing by one vote in a bitter debate—so the nation had “widespread acceptance of the administration of a public policy despite deep and passionate divisions over that policy.” During the late 1960s, the situation was reversed. Most people supported a draft, but they opposed the way it was administered (Wamsley

1969 pp. 1 – 2).

Nor is this all. When the System was created during World War I, America was a more traditionalistic, more localistic society. It was the states that were expected to manage domestic affairs, not the federal government. By the 1960s, however, the federal government was more active than ever. At the same time, society was neither as traditionalist nor as localist as it once was. In the *national community*, citizens were demanding uniform treatment, something they did not believe the relatively decentralized Selective Service System was providing.

For my study of the Fed, this shows that the political context will be an important factor in determining which arguments the Fed makes and which ones it must respond to. In the Fed's 86 years, the changing political context has caused its basic structure, its public authority, and its governing responsibility to change. In 1913, when the Fed was created, it was a highly decentralized institution. It could not have been anything else, since the federal government was extremely small then. During the Great Depression, the Board of Governors received much more power, which responded to changing social needs, changing political views, and increasing federal power generally. During the late 1970s, while the economy was performing poorly, the Fed fundamentally changed its monetary policy. The Fed's action, however, did not satisfy Congressional leaders—who wanted the Fed to do *something*, but could not agree exactly *what* this should be.

THE INDEPENDENT ROLE OF THE INSTITUTION

In each study, the administrative institution had an active role to play—whether in developing its doctrine, or making important policies, or actively engaging such political actors as elected officials and interest groups, or all of these. Not that it was always successful, as the FSA study shows. But it had an independent role to play, even when it was not successful in legitimating itself or adapting to its environment.

This independent role of the institution is related to the neo-institutional literature, which argues that *government institutions* occupy a “causal position” within politics. Although new institutionalists do not deny “the importance of both the social context of politics and the motives of individual actors,” they *do* see the state and society as interrelated. The society not only affects the state, but the state, too, affects society (March & Olsen 1984 p. 738). Far from being the mere “mirrors of social forces,” the state and its agencies become actors in their own right. “Programs adopted as a simple political compromise by a legislature,” March & Olson argue, “become endowed with a separate meaning and force by having an agency established to deal with them” (March & Olsen 1984 p. 739).

So the Fed will not be passive. To the contrary, the Fed's officials will be active participants in the political environment, actively seeking to legitimate both their actions and their institution. Arthur Burns, for example, was a strong advocate for the Fed's legitimacy. Considering these case studies and the neo-institutional literature, no one should be surprised to find the Fed's officials—not just Arthur Burns, but others too—actively seeking to legitimate themselves.

THE FEDERAL RESERVE SYSTEM:

ORGANIZATION, ADMINISTRATION, & RESPONSIBILITIES

Before beginning the other chapters, it is important to understand the Federal Reserve System itself—how it is organized and administered, the way it is funded, and what its responsibilities are.

ORGANIZATION & ADMINISTRATION

The Federal Reserve System is not only a public-private institution; it is designed on a “federal” model as well. The System consists of the Board of Governors in Washington, DC, a “central, governmental agency,” and twelve “regional Federal Reserve Banks located in major cities throughout the nation” (Board of Governors 1994 p. 3). Another part of the System is the Federal Open Market Committee (FOMC), which decides what actions the Fed will take in the open market. The FOMC consists of the seven Board of Governors and five Reserve Bank presidents. The president of the New York Fed, who serves as vice-chair of the FOMC, is always a member of this body. The other seats reserved for Reserve Bank presidents are filled on a rotating basis. Depository institutions and advisory committees, furthermore, are an important part of the System (Board of Governors 1994 p. 3).

The Fed is not a “typical” government agency. Its organizational structure, Melton argues, is “an anachronism utterly unlike that of any other governmental agency or business enterprise” (Melton, 1985). The System’s twelve regional banks, for example, “are legally constituted as privately owned banks with special charters” (Melton, 1985). The commercial banks located in each district are the “shareholders” of the twelve regional banks (Melton, 1985).

Consider the System’s four major parts. First, the *Board of Governors*, which was “established as a federal government agency,” consists of seven members appointed by the president, upon advice and consent of the Senate, for fourteen year terms (Board of Governors 1994 p. 4). Governors who have served one full-term cannot serve another. But Governors who have served a partial term (maybe, for instance, they replaced a member who died) can be reappointed. (So theoretically a member could serve much longer than fourteen years.) Board appointments are “staggered so that one term expires on January 31 of each even-numbered year” (Board of Governors 1994 p. 4). The chairman and vice-chairman, who are appointed by the President and confirmed by the Senate, serve for four years; they can be reappointed to these positions. Not surprisingly, the Fed’s Washington staff is large—consisting of 1,700 employees (Board of Governors 1994 p. 5).

Members of the Board interact with elected officials on a regular basis—testifying before committees, offering policy advice, and so on. Under Humphrey-Hawkins, which was approved by Congress in 1978, the Board must “submit a report on the economy and the conduct of monetary policy to Congress by February 20 and July 20 of each year” (Board of Governors 1994 p. 6). The chairman frequently testifies before the Senate Committee on Banking, Housing, and Urban Affairs as well as the House Committee on Banking, Finance, and Urban Affairs (Board of Governors 1994 p. 6).

Second, the *Federal Open Market Committee* (FOMC) has twelve members: the seven Governors and five Reserve Bank presidents. The Board of Governors chairman serves as FOMC chairman; the New York Fed president serves as vice-chairman (Jones 1991 p. 16). The other Reserve Bank positions are filled by the other Reserve Bank presidents—on a rotating basis. Each president, however, *participates* in the FOMC meetings even if they do not vote. The FOMC “meets in Washington, DC approximately eight times a year on a regularly scheduled basis and more frequently in special telephone conferences if conditions dictate” (Jones 1991 p. 16). Each FOMC meeting produces “a policy directive that guides Fed open market operations during the five to six week interval between FOMC meetings” (Jones 1991 p. 16).

Third, the System includes both the twelve *Federal Reserve Banks* and their (sum total of) *25 branches* (Board of Governors 1994 p. 7). Together these institutions administer “a variety of system functions, including operating a nationwide payments system, distributing the nation’s currency and coin, supervising and regulating member banks and bank holding companies, and serving as banker for the U.S. Treasury” (Board of Governors 1994 p. 7).

<u>Reserve District</u>	<u>City</u>	<u>Serves</u>	<u>Branch Cities</u>
1-A	Boston	ME, VT, NH, CT, RI, MA	None
2-B	New York	NY, CT, NJ	Buffalo
3-C	Philadelphia	NJ, DE, PA	None
4-D	Cleveland	OH, PA, WV, KY	Cincinnati, Pittsburg
5-E	Richmond	VA, MD, NC, SC, WV	Baltimore, Charlotte
6-F	Atlanta	LA, FL, MS, AL, TN	Nashville, Birmingham, New Orleans, Miami, Jacksonville
7-G	Chicago	IA, WI, IL MI, IN	Detroit
8-H	St. Louis	AR, MO, IL, IN, TN, MS	Memphis, Louisville, Little Rock
9-I	Minneapolis	MT, ND, SD, MN, WI, MI	Helena
10-J	Kansas City	WY, CO, NM, NE, KS, OK, MO	Denver, Omaha, Oklahoma City
11-K	Dallas	NM, TX, LA	El Paso, San Antonio, Houston
12-L	San Francisco	WA, AL, OR, CA, ID, NV, UT, AZ	Seattle, Portland, Salt Lake City, Los Angeles

The Federal Reserve Banks, which Congress chartered for a public purpose, are “the operating arms of the central banking system, and they combine both public and private elements in their makeup and organization” (Board of Governors 1994 p. 11). Since they are part of the System, the “Banks are subject to oversight by Congress; and like the

Board members, Reserve Bank presidents may testify before Congressional committees” (Board of Governors 1994 p. 11). Not surprisingly, each Reserve Bank “has a staff of full-time officers and employees that manages and operates it” (Board of Governors 1994 p. 11).

Each Reserve Bank has a Board of Directors, consisting of nine members divided into three classes: A, B, and C. Class A directors, who are elected by the District’s Member Banks, represent commercial banks. Class B directors, who are also elected by the District’s Member Banks, represent the public—so they cannot be affiliated with commercial banks. Class C directors, who are elected by the Board of Governors, represent the public too. Like the Class B directors, they cannot be affiliated with commercial banks. The Governors, for their part, select one of the Class C directors to serve as chairman and another to serve as vice-chairman.

All United States currency has “the letter and number designation of the Reserve Bank that first puts it into circulation.” The Reserve Banks, too, carry out functions and implement policies for the “System as a whole, such as administering nationwide banking and credit policies.” And, finally, each Reserve Bank “acts as a depository for the banks in its own District and fulfills other District responsibilities” (Board of Governors 1994 p. 7).

But the Board of Governors supervises both the Reserve Banks and their branches. It, for example, has “oversight of the Reserve Banks’ services to banks and other depository institutions and of their examination and supervision of various banking institutions” (Board of Governors 1994 p. 7). Additionally, each Reserve Bank “must submit its annual budget to the Board of Governors for approval.” Other “types of expenditures—such as those for construction or major alterations of Reserve Bank buildings and for the salaries of Reserve Bank presidents and first vice presidents—are also subject to Board approval” (Board of Governors 1994 p. 10).

Reserve Banks are important for implementing policy and providing important information to the Board of Governors; they generate data “on economic conditions in virtually every corner of the nation.” This information is useful to members of the FOMC and the Board of Governors, who use it when making policy decisions. The Reserve Banks’ information is published as a special report, informally known as the “Beige Book,” which is released two weeks before each FOMC meeting. Every two weeks, each Reserve Bank’s Board recommends a discount rate. If the Reserve Banks want to change the discount rate, however, their recommendation does not take effect until the Board of Governors approves it (Board of Governors 1994 p. 11).

Finally, the System includes three *advisory committees*: the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. The Federal Advisory Council, which was established by the Federal Reserve Act of 1913, includes one member from each District, usually a banker. By law, this Council must meet four times each year “to discuss economic and banking matters.” The Consumer Advisory Council has thirty members, and it “meets with the Board three times a year on

matters concerning consumers and the consumer credit protection laws administered by the Board.” The Thrift Institutions Advisory Council was established after Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980—legislation that not only forced thrift institutions to meet the Fed’s reserve requirements, but also allowed them to borrow from the discount window. This Council, which was established by the Board of Governors, provides “information and opinions on the needs and problems of thrift institutions.” Council representatives include savings and loan associations, savings banks, and credit unions (Board of Governors 1994 p. 15).

At the same time, the Reserve Banks use advisory committees, most notably on agriculture and small business. Two representatives of both these committees, in fact, meet with the Board of Governors once a year (Board of Governors 1994 p. 15).

THE APPOINTMENT OF OFFICERS OF THE FEDERAL RESERVE SYSTEM

The Fed’s appointment process is not only complex, but also controversial, so a more thorough discussion is warranted. Members of the Board of Governors are appointed for fourteen-year terms, unless they are filling the expired term of someone else. If one Governor resigns after seven years, for example, his replacement will serve only seven years. Once the new Governor’s seven years are complete, he or she can serve another fourteen-year term. (That is, Governors are prohibited from succeeding themselves *only if they have already served a full-term.*) Appointments as Chairman and Vice Chairman, by contrast, are always for four years. When Paul Volcker became Chairman on August 6, 1979, his term lasted for four years, even though G. William Miller (his predecessor) did not serve a full four years. Ultimately, Volcker served as Chairman for eight years, since he was reappointed—his tenure as Chairman began in August 1979; it ended in August 1987. Because Chairmen are appointed for four-years, their tenure is not coordinated with Presidents’. If, as many reformers believe should be the case, the Chairman’s tenure was coordinated with the President’s, each President could appoint “his own person” to head the Fed.

At the Reserve Bank level, too, complexity reigns. *Reserve Bank Presidents*, for example, are appointed by the Directors of their Reserve Bank, subject to approval by the Board of Governors in Washington, DC. All Reserve Banks but Boston’s have branches, which have their “own board of directors of five or seven members.” “A majority of these directors,” the Board of Governors reports, “are appointed by the Branch’s Reserve Bank; the others are appointed by the Board of Governors” (Board of Governors 1994 p. 11).

INSULATION FROM POLITICS & FUNDING FOR THE SYSTEM

From its very beginning, the Fed has been “insulated” from politics in two important ways. First, the System is “self-financing,” so it is independent of the annual appropriations process. The reserve banks “are owned by their member banks,” and they “must purchase stock in the Fed and follow the Fed’s regulations” (Kettl, 1986). The member banks elect their reserve bank’s board of directors, who select the bank’s executive officers. Because the System is structured this way, member banks can influence their regional bank’s affairs (Kettl, 1986). Most importantly, perhaps,

Congress has “never exercised sustained and close oversight of its operations” (Kettl, 1986).

Second, the Fed is a joint public-private partnership—which discourages politics, but does not inhibit it altogether. The institution’s structure, Kettl contends, is best described as follows:

The seven-member Federal Reserve Board, located in Washington, sets the Fed’s basic policies and oversees its operations, but twelve Federal Reserve banks conduct the Fed’s operations . . . [It’s] a public-private board supervising quasi-private reserve banks, a board free from Congressional appropriations and presidential oversight, a board composed of officials exercising Congress’s monetary powers yet possessing great autonomy and broad flexibility (Kettl, 1986).

Michael Reagan describes the System as “a pyramid having a private base, a mixed middle level, and a public apex” (Reagan 1987 p. 287). According to him, the Board of Governors is the “apex” of this model, while the Federal Open Market Committee is at the “middle.” The “bottom” consists of the Reserve Banks, each of which (as previously discussed) has a Board with nine members; the commercial banks elect six of these members, while the Board of Governors appoint three of them (Reagan 1987 p. 287).

Regarding funding for the System, Member Banks must “subscribe to stock in their regional Federal Reserve Bank in an amount equal to 3 percent of their capital and surplus.” In return, Member Banks “receive a 6 percent dividend annually on their stock, as specified by law, and vote for Class A and Class B directors of the Reserve Bank” (Board of Governors 1994 p. 14).

According to the Board of Governors, the System receives most of its income from “the interest on U.S. government securities that it has acquired through open market operations” (Board of Governors 1994 p. 12). It receives interest income from foreign currency investments and loans to depository institutions. And the System receives income from fees charged to depository institutions when providing them with “check clearing, funds transfers, and automated clearinghouse operations” (Board of Governors 1994 p. 12). After paying its expenses, the Fed “turns the rest of its earnings over to the U.S. Treasury.” Since the System began operating in 1914, the Treasury has received about 95 percent of its earnings (Board of Governors 1994 p. 12).

AUTHORITY & RESPONSIBILITIES

Today the Fed has four responsibilities. First, it conducts “the nation’s monetary policy by influencing the money and credit conditions in the economy in pursuit of full employment and stable prices.” Second, it supervises and regulates “banking institutions to ensure the safety and soundness of the nation’s banking and financial system and to protect the credit rights of consumers.” Third, it maintains “the stability of the financial system and contains systemic risk that may arise in financial markets.” Fourth, it provides “certain financial services to the U.S. government, to the public, to financial

institutions, and to foreign official institutions, including playing a major role in operating the nation's payment systems" (Board of Governors 1994 p. 1).

OVERVIEW OF THE ARGUMENT

At the end of my study, I will identify three underlying themes from the arguments of those who believe the Fed is a legitimate institution. I will identify three underlying themes from the arguments of those who believe the Fed is not.

In a democratic system of government, arguments over administrative legitimacy are infinitely contestable. This is especially true in the United States, since our political culture is so distrustful of governmental authority—even if it is wielded by elected officials. This is especially true, too, for the Federal Reserve System: it is not only responsible for monetary policy (the primary tool of economic policy), but also largely insulated from political authority.

The arguments over the Fed's administrative legitimacy did not come out of nowhere. They are grounded in America's unique political culture. When supporters argue that the Fed restrains the power of elected officials and promotes the public interest, they are appealing to values that have long been part of the American philosophy of government. When supporters argue that the Fed is analogous to the Supreme Court, they are appealing to the value Americans have historically placed on independent courts. Similarly, the opponents' arguments—which present a Presidential view of public administration, reject the Fed's right to exercise Congress's monetary authority, and question the institution's public-private character—appeal to values that are a fundamental part of the American polity. In order to understand the argument over the Fed's administrative legitimacy, you must situate it in the American context.

OVERVIEW OF THE CHAPTERS

A brief overview of the chapters to come. In chapter two, I review the literature on legitimacy. In chapter three, I review the literature on the Fed. In chapter four, I show why *the Fed* is an important institution to examine when studying administrative legitimacy. In chapters five, six, seven, and eight, I discuss the periods 1970 to 1975, 1976 to 1980, 1981 to 1985, and 1986 to 1995 respectively. In chapter nine, I conclude by explaining the underlying themes of the public argument and discussing where scholarship on administrative legitimacy should go from here.

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