

CHAPTER 6

THE GATHERING STORM

1976 - 1980

As 1976 began, Arthur Burns remained Chairman of the Board of Governors, a position he would hold for two more years. That year, too, Gerald Ford was defeated in his bid to retain the Presidency by Jimmy Carter, who took office in 1977. More important than anything else, perhaps, was the dysfunctional American economy—which was producing high unemployment *and* high inflation. “Stagflation,” the economic context in which the Fed’s legitimacy would be debated, was beginning to cause problems for the institution, as this chapter will show.

ARTHUR BURNS:

“THE INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM”

Throughout his term as Chairman, Arthur Burns actively sought to legitimate both the Federal Reserve and its officials’ actions. But during the final years of his term, Burns was even more philosophical than in the beginning. On May 22, 1976, the Fed Chairman delivered a commencement address at Bryant College in Rhode Island entitled, “The Independence of the Federal Reserve System.”

In this address, Burns recognized that the United States—like all industrial nations—is increasingly relying on monetary policy “to promote expansion of production and employment, to limit any decline that may occur in overall economic activity, or to blunt the forces of inflation” (Burns 1979 p. 379). What policymakers have discovered, Burns observed, is that fiscal policy can be “a rather clumsy device for dealing with rapidly changing economic developments.” To reach a consensus on changes to fiscal policy, Members of Congress and Presidents face a “complex and time-consuming” process, so monetary policy becomes the dominant tool of macroeconomic policy by default (Burns 1979 p. 379). With fiscal policy, too, elected officials are “rarely willing to increase tax rates or to restrain the rising curve of governmental expenditures,” yet another reason why monetary policy is so important (Burns 1979 p. 380).

Compared to fiscal policy, monetary policy has an important advantage: flexibility. With monetary policy, government officials can make changes “promptly and—if need be—frequently.” In the American polity, the Fed “can make the hard decisions that might be avoided by decision makers subject to the day-to-day pressures of political life” (Burns 1979 p. 380). Many elected officials, especially those faced with difficult reelection campaigns, develop short-time horizons. If these officials were responsible for monetary policy, they might make policies that are harmful over the long-term.

The Fed’s legitimacy, then, cannot be completely separated from the policy area it is responsible for. This is so for several reasons. First, the Constitution provides *Congress* with the monetary authority. In consequence, opponents of the Fed can claim that only Congress, certainly not the Fed, should exercise it. Second, monetary policy is more flexible than fiscal policy, but only because the Fed rather than Congress has responsibility for it. At the Fed, like other administrative institutions, decisions are easier to reach than in Congress—where legislation must be “marked up” in various committees

and approved by both the House and the Senate, then sent to the President for his signature. At any point, this lawmaking process (the ability to make a final, binding decision) can break down. Such a breakdown is much more likely to happen in Congress than it is at the Fed.

Recognizing how important institutional foundings are for public organizations, Burns examined the Founding argument of 1913. “The founders of the Federal Reserve System were well aware of the dangers that would inhere in the creation of a monetary authority subservient to the executive branch of government—and thus subject to political manipulation” (Burns 1979 p. 380). While chairing the National Monetary Commission, Nelson Aldrich foresaw “the need for a strong monetary authority capable of exercising discipline over the financial affairs of a nation.” As Chairman of the House Banking and Currency Committee, Carter Glass foresaw the Federal Reserve as “a distinctly nonpartisan organization whose functions are to be wholly divorced from politics” (Burns 1979 p. 380). President Wilson, an early scholar of public administration, made certain “to avoid any suggestion of interference with the newly created monetary authority.” As such, he established “a precedent that has been usually followed by succeeding presidents” (Burns 1979 p. 381).

Because America has a devotion to its Constitution and its founders, Burns’s use of the *concept of a “founding”* was a clever rhetorical strategy. By appealing to the beliefs of this *particular institution’s founders*, Burns accomplished two goals. For one, he showed that its Founders shared his goal of removing politics from the monetary policymaking process, a goal that is fundamental to the Fed’s legitimacy (at least as Burns perceived it). For another, by appealing to the Founders, he privileged one view of the Fed’s legitimacy: the Fed is appropriate for a constitutional democracy like ours, Burns claimed by appealing to these important people, because it reduces “political manipulation” of the money supply.

Moving from institutional foundings to Constitutional law, Burns argued that “the concept of independence” of the Fed “within the structure of government is congenial to the basic principles of our Constitution.” To support his assertion, Burns cites Alexander Hamilton—who supported dividing the powers of government because doing so was “essential to the preservation of liberty” (Burns 1979 p. 381).

Senator Carter Glass once stated that intelligent and fearless performance of the functions of the monetary authority “involves as much of sanctity and of consequence to the American people as a like discharge of duty by the Supreme Court of the United States.” *We at the Federal Reserve have in fact sought to model our conduct on that of the Supreme Court* [my emphasis] (Burns 1979 p. 382).

While exercising “our adjudicatory responsibilities,” all members of the Board of Governors “scrupulously avoid any contact with interested parties.” Similarly, when making policies for money and credit, they do not provide “the slightest consideration . . . to questions of political partisanship” (Burns 1979 p. 382). Given Sanford Rose’s

sensational charges about the 1972 Presidential election, this was an extremely important statement for Burns to make. He continues:

Every member of the Board, and every member of the Federal Open Market Committee, weighs the issues of monetary and credit policy solely from the viewpoint of the public interest and the general welfare. My colleagues at the Federal Reserve are highly qualified individuals possessing a diversity of skills essential to the management of the nation's financial affairs. They live and work under a Spartan code that avoids political entanglement, conflicts of interest, or even the appearance of such conflicts (Burns 1979 p. 382).

The Governors, of course, do not exist in isolation from other political actors. Actually, each member of the Board—and “particularly its chairman,” Burns insisted—has “close contact” with the President as well as members of the administration and legislators in the Congress (Burns 1979 p. 382). Such contact is necessary to make certain “the activities of the Federal Reserve are appropriately coordinated with what other branches of government are doing” (Burns 1979 p. 382). By making this assertion, Burns implied that the Fed *is a branch of government*, which is untrue. To many critics, the Fed acts like an independent “fourth branch” of government; maybe the Chairman believed it should be one.

The way the Fed operates today is “the way the founders of the Federal Reserve intended” it to, which is yet another appeal to tradition and history. Some “well-meaning individuals,” however, want the Fed’s authority to be “circumscribed.” Rather than discuss particular proposals, Burns simply acknowledges their underlying theme: the executive branch should control the monetary authority (Burns 1979 p. 383). If Congress provided the executive with control over the Fed, it would be taking a most “unwise and even dangerous” step. The American people, surely, would not “want to see the power to create money lodged in the presidency—which may mean that it would in fact be exercised by political aides in the White House” (Burns 1979 p. 383).

Such a step could create a potential for political mischief or abuse on a larger scale than we have yet seen. Certainly, if the spending propensities of federal officials were given freer rein, the inflationary tendency that weakened our economy over much of the decade would in all likelihood be aggravated (Burns 1979 p. 383).

Of particular importance here is Burns’s attitude toward the *White House staff*. Even more than agency administrators, the White House staff’s position in American government is ambiguous. According to President Roosevelt’s Executive Order 8248, which established the White House Office, the staff was to “serve the President in an intimate capacity in the performance of the many detailed activities incident to his immediate office” (Relyea 1997 p. 46). The President’s administrative assistants were “personal aides to the President”—but had “no authority over anyone in any department or agency . . . other than the personnel assigned to their immediate offices.” Never were the assistants expected to interfere with the ability of executive officers to either

administer their departments or make policy. “In no event shall the Administrative Assistants be interposed between the President and the head of any department or agency, or between the President and any one of the divisions in the Executive Office of the President,” the Order said (Relyea 1997 p. 47).¹ Although that is what the White House staff is required to do legally, they often do much more, becoming personally involved with both policy and administration.

In their study of the White House Office, Karen Hult & Charles Walcott observe that the Constitution “provides for no such entity as the White House staff” (Hult & Walcott 1995 p. 1). Article II, however, assumes executive officers will exist, as it mentions “executive departments” and their “principal officers.” So from a Constitutional standpoint, more questions are raised when the White House staff exercises government power than when public administrators do the same.

The early Congresses, recognizing the Constitution’s silence on the matter, provided no funding for Presidential aides. Before James Buchanan’s administration, in fact, Presidential aides were primarily volunteers. If they were paid at all, it was from private funds. Not until the Hoover Administration did Presidential aides become the subject “of sustained concern” to scholars, journalists, and the public—this even before the Executive Office of the President was established. By appointing three secretaries, while previous Presidents had had only one, Hoover made the staff an issue. And it has remained one ever since. In the *American Mercury*, Hoover’s decision was greeted with nostalgia for “bygone days”:

It was to be expected that the appearance in the White House of a Big Executive should see an accompanying enlargement of office quarters, expansion of equipment and massing of secretarial help. In bygone days, the President had *a* secretary. Good, bad, or indifferent, but only one. But that was before the era of the Super-Administrator, before Efficiency came to the White House. Now there is a whole machine-gun squad to handle the work (Walcott 1995 pp. 1 – 2).

Over time, the White House staff has been attacked for having too much power. During the Eisenhower Administration, for instance, commentators wondered what would happen “if Sherman Adams died and Ike became President” (Hult & Walcott 1995 p. 2). But Reagan’s White House staff, more than any other, raised the most serious questions about who exercised government power. As President, Relyea observes, Reagan “brought a disengaged management style to the White House.” In daily administration,

¹ As established by Executive Order 8248, the *Executive Office of the President* included not just the White House Office, but the Bureau of the Budget, the National Resources Planning Board, the Office of Government Reports, and the Liaison Office for Personnel Management as well (Relyea 1997 p. 24). Here I focus on the White House Office, however, because *it* is what Burns has in mind when he attacks the “political aides in the White House.” Since its creation, the Executive Office of the President has expanded, now including the Council of Economic Advisors, the National Security Council, the Office of the Special Representative for Trade Negotiations, and the Council on Environmental Quality (Relyea 1997 p. 25).

Reagan was detached, delegating authority to his administrative assistants. Reagan's White House Counselor Ed Meese described him as a "big-picture" man, someone who set the major goals then relied on staff "to handle the details" (Relyea 1995 pp. 75 – 76).

In reality, the White House staff handled more than mere "details," as Donald Regan admits they often set the goals themselves. At the beginning of Reagan's second term, Regan presented him a list of public policy objectives; these were the major goals, not the minor ones. Reading the memo, Reagan made no comments—he returned it as is, and Regan's suggestions were accepted. Afterwards, Regan realized that the President expected him to "make the necessary arrangements to carry out policy." While recognizing Reagan was not "an aggressive manager," Regan still saw his management and policy style as "an absolutely baffling way of doing things" (Relyea 1995 p. 76).

All in all, administrators in executive departments and administrative agencies have a higher status than the White House staff does. At the very least, public administrators like Burns can claim, we are officers of the law; we work for agencies established by Congress; we make public decisions because the Congress has given us authority to do so. If the President were given authority to make monetary policy, Burns imagined, White House aides may *actually* make decisions in this area, so more questions would be raised about *that* arrangement than the one we have now. Executive Order 8248 was issued by President Roosevelt "by virtue of the authority vested in me by the Constitution and statutes"—the statutory basis being the Reorganization Act of 1939—but this Order did not provide the White House staff with the authority to govern. As a result, if the White House aides made decisions about monetary policy, this would be more suspect than the present arrangement, where Fed officials are responsible for this area.

Of course, Burn's argument asks us to assume that the White House staff rather than the President would make the monetary decisions, even if the law provided him with the authority to do so. Most importantly, most reform proposals would provide the Treasury Department (the Secretary of the Treasury) with the monetary authority, doing so on the assumption that that official is responsible to the President. But as long as the Treasury Secretary actually made monetary policy, refusing to give the White House staff control over this area, Burn's hypothetical concerns would not be an issue.

Now let us return to Burn's speech, where he examined other countries' experiences with central banks and monetary policy. While doing so, Burns asserted that the "need for a strong monetary authority to discipline the inflationary tendency inherent in modern economies is evident." More than other countries, the United States and West Germany have "achieved the greatest success . . . in resisting inflationary pressures." More than other countries in the 1970s, too, America and Germany had independent central banks. In some European countries, where monetary policy "is dominated by the Executive or the legislature," the government has adopted "inflationary financial policies." Sometimes, he argues, these policies have been so inflationary that they have "brought economic chaos and *even extinguished political freedom*" [my emphasis] (Burns 1979 p. 383).

Despite his strong views about the Fed's "independence," Burns ended by qualifying these beliefs. Because we live in a democratic society, he observes, the "*independence of a government agency can never be absolute*" [my emphasis] (Burns 1979 p. 383). As a government agency, the Fed is "subject not only to the provisions of the Federal Reserve Act, but also to the Employment Act and numerous other statutes." Moreover, Congress has a "significant role" in developing "the economic and financial objectives" the Fed is expected to pursue. Congress's "significant role," though, is limited in significant ways:

The oversight responsibilities of the Congress for the conduct of the monetary authority do not, however, require congressional involvement in the details of implementing monetary policy. The technical complexities of adjusting monetary or credit instruments to the needs of a modern industrial economy *are far too great to be dealt with by a large deliberative body* [my emphasis] (Burns 1979 p. 384).

Senator Percy, commenting on this very speech, could not agree more. For Percy, the "increasing and disturbing tendency to blame the Federal Reserve for real or perceived failures in the economy" was unfortunate, especially since the economic problems largely reflect failures in *fiscal policy* rather than monetary policy. In any event, proposals to have "greater executive or legislative political control" of the Fed will not work (*Congressional Record* June 3, 1976 p. 16370).

As a response to Burns's speech, Percy argued that the "independence of the Federal Reserve is the key to three aspects of the Board's operation that make it far superior to either the executive or legislative branches guiding the Nation's monetary affairs." In addition to the flexibility it provides to monetary policy, which is extremely important, the Fed is "not subject to or influenced by political repercussions" from unpopular actions. Also the Fed is "not bound by the political programs of a particular administration or party" (*Congressional Record* June 3, 1976 p. 16370). For all these reasons, the Fed is a legitimate federal agency. Without it, both the nation's economic system and its political system would be much worse off.

THE CARTER ADMINISTRATION & THE FEDERAL RESERVE SYSTEM

As important as the Fed was to the nation's economy and to Carter's reelection effort, the President rarely criticized the institution in public. Actually, Carter's attitude as President differed from his attitude as a candidate, when he proposed that "the President be given the power to appoint his own chairman of the Federal Reserve who would serve a term coterminous with the President's" (*Congressional Record* May 10, 1976 p. 13086). At the time, Carter acknowledged that the Fed "should maintain its independence from the executive branch." He just thought it "important that throughout a President's term he have a chairman . . . whose economic views are compatible with his" (*Congressional Record* May 10, 1976 p. 13086). To make such a statement is to challenge the Fed's legitimacy. Because Carter did not press the issue as President, however, I think it is fair to say that *while in office* he publicly supported the Fed's legitimacy. Even during his reelection bid, when the economy was performing very poorly and the Fed was getting the blame, he only attacked *its policies*, not its legitimacy.

Yet privately, Carter was hardly oblivious to the Fed's importance. Nor was the President as supportive of an "independent" Fed as his public posture usually suggested. Like Richard Nixon, he hoped to use his appointments to the Board of Governors—and especially its Chairmanship—to influence the Fed.

From the very beginning of Carter's administration, Arthur Burns wanted to be reappointed, this time by a Democrat. One Fed staff member reported, for example, that Burns "wanted desperately to be reappointed by a Democrat and go down in history like Bill Martin as a bipartisan chairman" (Greider 1987 p. 346). To achieve his goal, Burns began to discretely lobby "key members of the Carter Administration, hoping to win their friendship and approval." Another Fed staff member, in a memo to Burns, observed that "Carter can be seduced," since reappointing the Chairman would make the President "out to be a high minded statesman" (Greider 1987 p. 346). But reappointment would come at a price, this staffer warned:

Carter will have to be reassured that, if you are reappointed, you will not continue to publicly criticize everything that is near and dear to him . . . Any seduction program would have to reassure the President that you won't criticize him publicly every six months (Greider 1987 p. 346).

White House liberals did not want another four years of Burns, and Carter agreed with them. Once the President decided not to appoint Burns, he nominated William Miller—the former CEO of Textron, Inc. Miller was a Democrat, though a "moderately conservative" one, who had supported Carter in 1976. According to William Greider in *Secrets of the Temple*, Miller was "warmly regarded by the President and his economic advisors." Indeed, the Carter Administration saw Miller as a "team player," someone who made the policies *they preferred*. As far as Wall Street analysts were concerned, however, Miller was "much too cooperative, too timid about raising interest rates high enough to suppress inflation" (Greider 1987 p. 20).

FED APPOINTMENTS & CABINET SHUFFLES

The "Cabinet shuffle" of 1979, which led to Paul Volcker's appointment as Chairman, provides interesting insights into Carter's attitude toward the Fed. But first, even before he made the Cabinet changes, Carter was criticized for a Board appointment. In 1978, Carter appointed Frederick H. Schultz as Vice-Chairman, causing "suspicions" that "Carter might be naming an old crony from Southern politics to be second-in-command at the Fed." Opponents of Schultz were concerned about whether he would "politicize" monetary policy. Would Schultz, they wondered, support policies just to improve Carter's reelection prospects? (Greider 1987 p. 22).

Congressional critics quickly claimed that Schultz was "too parochial for the job," too closely tied to the President. In their minds, these concerns were well founded. For eight years, Schultz was a member of the Florida House; two of these he had served as Speaker. After leaving the legislature, Schultz became Chairman of the Florida Democratic Party. In 1976, he was an active supporter of Carter, raising considerable

amounts of money for his campaign. Despite the controversy surrounding Schultz, the Senate confirmed him anyway.

Not long after Schultz was confirmed, Treasury Secretary Blumenthal resigned, so Carter needed someone to fill this Cabinet position. Unfortunately for the President, all the people he asked to become Treasury Secretary rejected the offer. Eventually, a top aide recalls, the “idea surfaced—I’m not sure where—that Bill Miller take the job.” Once Miller accepted, Carter needed to appoint a new Fed Chairman. And he needed to do so quickly, since the financial markets were extremely nervous (Greider 1987 p. 21).

On July 22, 1978, Vice President Mondale’s Chief of Staff—Richard Moe—was researching potential appointees. During his calls to influential people, Paul Volcker’s name was mentioned over and over. The political and economic context, as Moe observes, was difficult:

The big factor was: we’ve got to reassure the markets. That’s all we heard. Coming in the wake of the Camp David meetings and the Cabinet changes, people were very nervous about the direction we were going. I wouldn’t call it panic but there was clearly a level of concern. We’ve got a problem on our hands and we have to do it right (Greider 1987 p. 34).

Without doubt, Volcker was a good choice professionally. He held a Masters of Public Administration from Harvard University. He currently served as President of the New York Reserve Bank. Before coming to the Federal Reserve System, he had served as Under Secretary of Treasury for Monetary Affairs during Nixon’s Administration. Nonetheless, someone can be a good choice professionally, but not politically. Over and over, leading Democrats as well as top administration officials said Volcker was “not a team-player” and was “very independent.” Moe reports:

The only real negative that showed up on Volcker was whether he was going to be a team player like Bill Miller. Nobody ever questioned his intellectual credentials, and people knew he was a very conservative fellow, but that never dissuaded the President on appointments anyway. The only question was whether he would work with the White House the way Bill Miller had. *Miller was very close to the White House on monetary policy. That’s the way any White House wants it* [my emphasis] (Greider 1987 p. 35).

Bert Lance, the former Budget Director, also advised the White House about the Fed appointment. Speaking to White House aide Gerald Rafshoon, Lance said, “I don’t know who the President is thinking of for Fed chairman, but I want you to tell him something for me. He should not appoint Paul Volcker. If he appoints Volcker, *he will be mortgaging his re-election to the Federal Reserve*” [my emphasis] (Greider 1987 p. 47).

Moe, like Lance, was extremely concerned about Volcker, who “set off alarm bells” for this Chief of Staff. “He’s a very strong-willed person who may or may not be prepared to coordinate policy with you,” Moe reported to the President. So concerned was Moe, in fact, that he urged Carter not to appoint Volcker (Greider 1987 p. 35).

Carter listened to Moe’s assessment, even going so far as to call Tom Clausen from Bank of America to see if he would become Chairman. Clausen, after discussing the offer with his wife, declined. The next day, Volcker visited the White House, where he was offered the Chairmanship. The word on Wall Street was that Volcker “warned Jimmy Carter that he would be *totally independent* of the White House”—but after interviewing administration officials, Greider found this was not entirely true [my emphasis].

Volcker did deliver a standard speech on the importance of the Federal Reserve System’s independence, to which Carter assented. Volcker also elaborated the reasons why the Federal Reserve’s monetary policy should be tightened. The President neither agreed nor disagreed (Greider 1987 p. 46).

Two months later, the FOMC—at Volcker’s urging—adopted Monetarist policies. As a result, interest rates climbed to record highs. Like other Presidents, Carter “did not have a strong grasp of the issues of monetary policy” (Greider 1987 p. 121). The American “tradition of Fed independence,” Greider observes, encouraged elected officials to see monetary policy as “something left to the experts, a forbidden area where politicians were not supposed to intrude.” Even President Nixon, who was interviewed by *The American Spectator* in 1984, said he never understood the Fed (Greider 1987 p. 121).

Although interest rates were rising rapidly, Carter quickly realized that neither the unemployment rate nor the inflation rate would drop substantially soon. American citizens, economists reported, had significant “inflation expectations.” Only when they believed the Fed was truly committed to low inflation would their expectations change.

Meanwhile, Carter did not attack the Fed’s right to make these decisions—even though they made his reelection less likely. Stuart Eizenstat, director of the Domestic Policy Staff, asserts that Carter was “basically a very honest guy who believes in the integrity of the political system. He had put that guy [Volcker] in there and, by God, he was going to stand by him” (Greider 1987 p. 121). Besides, the political consequences of attacking the Fed were serious. The President, Eizenstat argues, “had to be very careful about taking on the Fed,” since he did not want “to take on a populist campaign that would drive the dollar down further” (Greider 1987 p. 121).

William Greider is one of the strongest critics of the Fed’s role in American governance. He has nothing but scorn for Carter’s refusal to attack the Fed’s legitimacy.

Two months earlier, Carter had chosen Paul Volcker almost by accident. Now the President was implicitly surrendering control to him. The Federal Reserve would steer the national government’s

economic policy now. Over the coming years, the Fed's true role in the American system would become more and more visible to ordinary citizens, as Volcker asserted its leverage over economic life. He would be personally reviled and praised, recognized in public-opinion polls as the second most powerful person in the land. In hindsight, it would be understood that the Autumn of 1979 was a historic juncture in the political course of the nation. *What was not understood was that this crucial transaction occurred with an enfeebled President's acquiescence, but not with his approval* (Greider 1987 p. 122).

Eventually, during his campaign for reelection, Carter began attacking *the Fed's policies*. While doing so, though, he attacked neither its right to govern nor its appropriateness for a constitutional democracy like ours. In September 1980, Carter participated in a "town meeting" in Landover, Pennsylvania. The attack he made on the Fed's policies there, Greider asserts, was "slightly out of character for Carter, who had made a point during his Presidency of not trying to pressure the Fed with public criticism"; he had even refused to let his economic advisors do so. Yet Carter said he did not "have to sit mute" while the Fed made decisions he disapproved of.

My own judgment is that the strictly monetary approach to the Fed's decision on the Discount rate and other banking policies is ill-advised. I think the Federal Reserve Bank Board ought to look at other factors and balance them along with the supply of money (Greider 1987 p. 217).

Even while attacking the Fed's policies, however, Carter acknowledged its legitimacy. Carter recognized, for example, that the "Fed is independent of the President." Like Arthur Burns, Carter emphasized that the Fed is "*just like the judicial system*" [my emphasis]. All this means the President does "not have influence on it" (Greider 1987 p. 217).

THE CONGRESS & THE FEDERAL RESERVE SYSTEM

From 1976 to 1980, Congress addressed the Fed's legitimacy in several ways. In this section, I will discuss several things. First, I review the attempts to enhance the Fed's accountability, primarily by passing such new legislation as the Federal Reserve Reform Act. Second, I examine the Government in the Sunshine Act. Third, I examine attempts to make the Fed a more representative institution, primarily by providing consumer and labor and agriculture groups with more representation on Reserve Bank directorships. Fourth, I discuss leadership at the Fed—the confirmations of G. William Miller and Paul Volcker, both of whom served as Chairman during this time. And, lastly, I review the attacks on the Federal Open Market Committee (FOMC).

ATTEMPTS TO ENHANCE THE FED'S ACCOUNTABILITY

During this period, one of the main challengers to the Fed's legitimacy was Representative Henry Reuss of Wisconsin. In 1976, he spoke on the need to reform the institution, claiming the Fed "designed in 1913 to be a 'banker's bank' to deal with

periodic financial panics is in 1976 a very different institution with a different mandate.” Now the Fed is America’s “most important economic stabilization agency, the central organ of monetary policy,” a much larger role than it had in 1913. By the 1970s, the Fed’s decisions were “affect[ing] every aspect of American economic life” (*Congressional Record* April 8, 1976 p. 9967). As for the Fed’s “independence,” Reuss observed:

When we speak of the independence of the Federal Reserve, we speak of its independence from the executive branch and not from the Congress. Congress could have delegated its monetary power to the Executive. It chose instead to delegate it to the Federal Reserve (*Congressional Record* July 18, 1977 p. 23469).

Reuss’s remarks show how important administrative history is. As agencies develop, their responsibilities sometimes increase, which raises additional questions of legitimacy. When the Fed was founded, no one anticipated that it would become so powerful. Yet over time, the Fed has gained incredible power over the nation’s economy—partly because of historical and economic factors, such as the birth of modern macroeconomics, and partly because of legal factors like the Banking Act of 1935. Because the Fed of 1976 was so different from the Fed of 1914, Reuss could use administrative history to delegitimize the institution. Years ago, the Fed did not have a great deal of power over the economy. So it may have had a right to govern then; it may have been appropriate for a constitutional democracy like ours. By the 1970s, however, the situation was very different: the Fed, miraculously, had become the nation’s most important economic agency. As a consequence, its legitimacy could be questioned in ways it once could not.

On September 12, 1977, Reuss reintroduced “the Federal Reserve Reform Act.” Speaking in support of this legislation, Reuss argued that it was “an important step in making the ‘Fed’ more accountable to Congress and the public.” Apparently, other Members of Congress agreed with him, as the legislation passed unanimously in the House Banking, Finance, and Urban Affairs Committee (*Congressional Record* September 12, 1977 p. 28868).

This legislation had four purposes. First, the bill would provide “clear guidelines for the conduct of monetary policy,” with the Fed also having to attend “quarterly oversight hearings as a matter of law.” At the same time, the Fed would have to not only disclose its targets for money growth for the next year, but also assess “the impact of these targets on the economy.” By engaging in this “expanded dialogue,” Reuss believed, the Fed would “provide Congress and the public with a better understanding of what monetary policies are needed to achieve the Nation’s economic goals” (*Congressional Record* September 12, 1977 p. 28868).

Requiring the Fed to disclose its money targets, reformers have long argued, would be a step toward the coordination of monetary policy with fiscal policy. The coordination of monetary and fiscal policy, in one sense, is a policy matter—so it does not raise questions of administrative legitimacy. In another sense, though, it does raise questions of

legitimacy, since the *underlying issue is who should make economic policy*. All too often, those who favor “coordination” of monetary and fiscal policy really want elected officials to make them both. Milton Friedman, for example, told a House Committee that he “did not share the view of those people who say you should have a nonpolitical monetary policy any more than you should have a nonpolitical fiscal policy” (*Congressional Record* April 8, 1976 p. 9968). Representative Reuss agreed:

There must be coordination between fiscal policy, which is made openly in debate in the executive and legislative branches, and monetary policy, *which is made in the private recesses of the Federal Reserve, importantly influenced by private persons in the financial and business world* [my emphasis] (*Congressional Record* April 8, 1976 p. 9967).

Second, the bill would “broaden representation on the boards of directors of the 12 reserve banks.” *Rather than representing commercial banks*, all of these directors would be required to represent the public (*Congressional Record* September 12, 1977 p. 28868).

Third, the bill would require Senate confirmation of the Chairman and the Vice-Chairman. Originally, because the Senate only confirmed members of the Board, it did not have *a separate confirmation process* for the top two officials. In the Federal Reserve Act of 1913, members of the Federal Reserve Board were appointed for ten-year terms by the President, subject to the advice and consent of the Senate. “Of the five persons thus appointed,” according to the 1913 Act, “one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board” (Moore 1990 p. 185). At the time, the “governor” was equivalent to the today’s Chairman; the “vice governor,” to today’s Vice Chairman. In the Banking Act of 1935, the Federal Reserve Board became the Board of Governors; the Treasury Secretary and the Comptroller General were removed from the Board; Governors’ terms were increased from ten to fourteen years; the Chairman and the Vice Chairman were given four-year terms. Despite these changes, the Banking Act of 1935 did not establish a separate confirmation process for the Chairman and Vice Chairman. Considering the “enormous responsibility lodged in the Chairman,” however, Reuss asserted that a separate confirmation was necessary for this position.

Fourth, the bill would regulate conflicts of interest, which is a familiar part of administrative ethics. What this bill would forbid is “officers, employees, and Directors of the Federal Reserve System from acting where they have a conflict of interest.” According to Reuss, the bill would extend to the Fed “the same kind of conflict-of-interest regulation that already applies in other government agencies” (*Congressional Record* September 12, 1977 p. 28868).

Fifth, the bill’s most controversial provision would coordinate “the terms of the Fed Chairman and Vice Chairman with that of the President” (*Congressional Record* September 12, 1977 p. 28868). Their four-year terms “would be set so that these officials would take office 1 year after the President takes office,” Reuss reported.

Although Representative Stanton agreed with the other provisions, he opposed coordinating the Chairman and Vice Chairman's terms with the President's. To begin with, Stanton said, "there is no demonstrated need for this change." Most importantly, this provision "would politicize the Chairman's appointment."

We are clearly making the Chairman "the President's man" and thus placing into the hands of the Executive greater control over the monetary policy of this country (*Congressional Record* September 12, 1977 p. 28869).

Stanton was concerned, too, about "the consequences of having a lame-duck Chairman." This provision, Stanton believed, could deprive the Fed of "continuity and effectiveness of leadership." Not surprisingly, Fed officials opposed coordinating the terms of the Chairman, Vice Chairman, and President. Testifying about this provision, Arthur Burns said it would likely mean that a Chairman "would not serve his full term and would leave the Board only a year after the President who appointed him left his office." Overall, the provision would lead to "some politicizing of the Federal Reserve," reducing "the independence of the Nation's monetary authority" (*Congressional Record* September 12, 1977 p. 28869).

In November 1977, a modified version of the Federal Reserve Reform Act became law. Under this legislation, the Board of Governors and the FOMC were instructed to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production." As for the relationship between the Fed and Congress, the legislation required the Board of Governors to "consult with Congress at semiannual hearings" before the Senate Banking, Housing, and Urban Affairs Committee as well as the House Banking, Finance, and Urban Affairs Committee. Also this legislation required a separate confirmation process for the Chairman and Vice Chairman. "Of the persons thus appointed," the statute held, "one shall be designated by the President, *by and with the advice and consent of the Senate*, to serve as Chairman of the Board for a term of four years, and one shall be designated by the President, *by and with the advice and consent of the Senate*, to serve as Vice Chairman of the Board for a term of four years" [my emphasis] (Federal Reserve Reform Act of 1977 Public Law 95-188).

Although this was important legislation, the most controversial provisions of Reuss's bill were not included, and they would not be included in future legislation either. The terms for the Chairman and Vice Chairman, for instance, were not *coordinated* with the President's.²

The next year, 1978, Congress passed the Full Employment and Balanced Growth Act, otherwise known as the Humphrey-Hawkins Act. "By 1978," Kettl observes, the "Fed's

² For more detailed information about the Fed's appointment process, please see footnote five, where I use the example of Paul Volcker.

role in governing the economy, especially in influencing interest rates and creating jobs, was irrefutable.” Opponents, therefore, wanted to use this bill to restrict the Fed’s authority (Kettl 1986 p. 149). Initially, it seemed they had done just that. Over time, a very different reality emerged: the legislation was a minor restriction at best.

As passed by Congress and approved by the President, the Humphrey-Hawkins Act forced Fed officials “to explain how [their] monetary goals fit the President’s economic policy.” Within thirty days, according to the legislation, the Fed must respond to the President’s *Economic Report*, explaining how its monetary goals related to the report’s “short-term objectives.” Twice a year, too, Fed officials had to present the FOMC’s projections for the next year’s Gross National Product, inflation, and unemployment. As an added restriction, the Fed could no longer “roll the base,” a tactic used previously to avoid fully disclosing its monetary policy to Congress (Kettl 1986 p. 149).

For good or ill, Fed officials had the last word. Not long after these new requirements were imposed, Burns began undermining them. Examining the Fed’s reports, elected officials and economists alike condemned them as “a disgraceful sham”—a “smoke screen” that did not change the institution’s monetary policymaking process at all (Kettl 1986 p. 149). If nothing else, this shows how much discretion administrative officials have.

THE GOVERNMENT IN THE SUNSHINE ACT

The issue of openness in government was especially prominent during this time—an unsurprising fact, I think, since the Watergate scandal was a very recent memory. In response to the public’s concern about the closed nature of many government agencies, Congress passed the Government in the Sunshine Act in 1976. Certainly this is an important piece of legislation, not just for the Fed but for all other agencies. As Kettl observes, however, the Fed “won exemptions from open meeting requirements” similar to “those for national security” (Kettl 1986 p. 158).

Fed officials, unlike those in many other domestic agencies, have incredible discretion to close their meetings. If discussions at the meeting could lead to speculation by individuals or instability within financial institutions, it can be closed to the public (Kettl 1986 p. 158). Because of this provision, the Fed can keep most of its meetings closed. Almost every discussion Fed officials have in their meetings, whether it is an FOMC or a Board of Governors meeting, can “lead to speculation.” If Fed officials express concern about inflation, for example, the financial markets may believe that monetary policy will become tighter. By the same token, if Fed officials express concern about unemployment, the financial markets may believe that monetary policy will become looser. In either case, speculation or instability could result. Not only while Burns was Chairman, but also when Miller and Volcker and Greenspan served in that position, the Fed has “fashioned a cover broad enough to hide all of the Fed’s discussions” (Kettl 1986 p. 159).

The Government in the Sunshine Act, moreover, did not require the Fed to keep transcripts of any closed meetings. No longer would Fed officials produce

“memorandums of discussion,” so the public would not have any records of its Governors or FOMC meetings. According to Kettl, the Fed has “succeeded in completely blocking the application the application of the sunshine law to its own procedures” (Kettl 1986 p. 159).

“LEASHING” THE FED?

Supporters of the Fed’s legitimacy opposed any legislation that would reduce the institution’s independence. Even before either the Federal Reserve Reform Act or the Humphrey-Hawkins Act were introduced, George Will wrote an article entitled, “The Attempts to Leash the Fed.”

Various politicians, leashes in hand, are tiptoeing toward the Federal Reserve Board. They know that the independence of the Fed is the major remaining obstacle between them and political domination of the economy. The power of the Fed that politicians covet most is power to control the money supply and thereby influence the supply of credit, the level of interest rates, and the general pace of economic activity. The independence of the Fed is, understandably, more of an irritation to liberals than to conservatives because *it is an impediment to control of the economy by elected persons*, which is a goal more important to liberals than to conservatives [my emphasis] (*Congressional Record* May 10, 1976 p. 13086).

In this column, Will compared the Fed to the Supreme Court, which is an analogy many have used to legitimate the Fed. At its founding, for example, agency supporters likened it to the “Supreme Court of finance.” As we have seen, Arthur Burns claimed that Fed officials attempt to model their conduct on the Supreme Court. And President Carter, while criticizing the Fed’s policies, admitted that it was “like the judicial system.”

Expanding on this view, Will claimed that both the Supreme Court and the Fed are “a device by which our democracy prudently insulates some important matters from the gusty winds of popular opinion, and from the short-term calculations of elected persons” (*Congressional Record* May 10, 1976 p. 13086). The Supreme Court’s independence, like the Fed’s, has been a frequent target for elected officials. In the 1930s, President Roosevelt attempted to “pack” the Supreme Court with Justices of his liking. Similar attempts have been made at other times. These “assault[s] on the independence of the Court,” Will acknowledges, have “a constitutional dimension” lacking “in the proposals for making the Fed a servant of politicians.” Nonetheless, attempts to reduce the Fed’s independence are “an aspect of the modern impatience” with governmental institutions that do not “conform to the simplistic notion of democracy as a system of unfettered majoritarianism” (*Congressional Record* May 10, 1976 p. 13086).

The Fed deals in complex ways with complex matters. And it is “undemocratic” in the simple sense that it is not responsible to an electorate. And it does not enjoy the public understanding and reverence that the Court enjoys. For these reasons the Fed is a

tempting target for elected persons, and especially for those whose lively sense of personal advantage combines with a predator's instinct for falling upon the defenseless (*Congressional Record* May 10, 1976 p. 13086).

As for Carter's campaign proposal for the President to select his own Chairman, Will believes it "would constitute a bold aggrandizement of presidential power" (*Congressional Record* May 10, 1976 p. 13086).

The American polity, Will reminds us, is not a "pure democracy." Instead, it is a constitutional democracy, a liberal democracy, where rank majoritarianism is not the ruling force. In our system of government, powers are separated and divided, primarily to protect the rights of individuals. This has serious implications for administrative legitimacy. Administrative institutions can protect citizens' rights by checking the power of elected officials—so we hear Members of Congress and other political actors legitimating the Fed by appeals, quite frequently, to its ability to check the President. Dispersing power to administrative institutions, furthermore, can improve the *effectiveness* of government. Of course, advocates of dispersed and separated powers traditionally have not emphasized effectiveness. Most often, advocates have believed the exact opposite: dispersing and separating powers may *decrease* government's effectiveness rather than increase it; but this, they say, is the price of freedom. Although this perspective may apply at the macro-level—when political actors create the political system itself—it does not necessarily apply to the administrative level. If Fed officials are better equipped to make decisions about monetary policy and financial regulation, dispersing power to *it* increases rather than decreases government effectiveness.

A REPRESENTATIVE FED

In 1976, Reuss expressed concern about how unrepresentative the Federal Reserve System was at the Reserve Bank level. Banking and big business interests, Reuss claimed, had "an unhealthy dominance within the Fed's structure" (*Congressional Record* August 23, 1976 p. 27277). Even the Class C directorships, which are supposed to represent the public, "in practice . . . reflect the same narrow concentration as the Class A and Class B categories." According to a House Banking Committee study, only 8 of the Class C directors *are not* executives or directors of corporations.

Even worse, the Reserve Bank directorships did not represent "groups that ought to be included" (*Congressional Record* August 23, 1976 p. 27228). Consider, for example, that no woman has "filled one of the 1,042 positions available since the system was set up in 1913." Of all the directors, too, only two were minorities. As for organized interests, farmers were not represented, and small business was "barely visible" (*Congressional Record* August 23, 1976 p. 27278). Nor did consumer groups have representation.

The concern for adequate representation of *all* demographic groups and organized interests is related to the representative bureaucracy literature. Legitimate administrative

agencies, in Reuss's view, represent the citizenry as a whole. It is inappropriate for agencies to represent the few rather than the many.

Beginning with Mosher's 1968 book *Democracy and the Public Service*, the representative bureaucracy literature has distinguished passive representation from active representation. With passive representation, the public service is similar to the citizenry *demographically*. With active representation, public servants "advocate the interests and the desires of groups sharing their demographic origins" (Selden 1998 p. 22). According to scholars who favor a representative bureaucracy, "passive representation, or the extent to which a bureaucracy employs people of diverse backgrounds, leads to active representation, or the pursuit of policies reflecting the interests and desires of those people" (Selden 1998 p. 22).

What scholars have discovered, in fact, is that passive representation does lead to active representation. Studying the effect representative bureaucracy has on educational administration and policy, Meier & Stewart found that "the increased presence of African-American street-level bureaucrats . . . had a significant effect on policy outcomes favoring African-American students" (Selden 1998 p. 24). In a 1993 study, Meier found that "active representation is most likely when sufficient minority management-level employees are present." Similarly, Hinderer found that the Equal Employment Opportunity Commission—by hiring more African Americans—increased the discrimination charges filed on behalf of this group. Similar results were found for Hispanics. As a result, Reuss's attacks on the Fed's "unrepresentative" nature make sense. If the Fed was more representative, its policies may change, which would please Members of Congress like Reuss and others who frequently attacked their "regressive" consequences.

In his remarks, Reuss was not just concerned about adequate representation: serious conflicts-of-interest existed as well, he argued. Although the System has regulatory authority, "25 of the 108 directors serve now or formerly served as officers or directors of bank holding companies." Regarding the FOMC, where the "banking-big business domination . . . produces the clearest conflict of interest," five of its twelve members depend on reappointment from "bank-dominated directors." "Yet to Washington they go every month, there to participate in the nation's vital monetary decisions," Reuss says with obvious scorn. Continuing with this theme, Reuss argued:

Letting the Reserve Bank Presidents make governmental monetary policy is not only unwise, it is probably unconstitutional. The Supreme Court earlier this year held the Federal Election Commission unconstitutional because the commissioners exercised governmental power without being, under Article II, Section 2 of the Constitution, "officers of the United States" appointed by the President and confirmed by the Senate. The five Reserve Bank Presidents, lacking Presidential appointment and Senatorial confirmation, have no more right to make decisions on money and interest rates than the federal

election commissioners had to make decisions on campaign finances
(*Congressional Record* August 23, 1976 p. 27278).

In this instance, it is important to recognize, Reuss's concern with conflict of interest is a philosophical and a political matter, not a legal one. Admittedly, he believes the selection procedure is unconstitutional, but only because he thinks the Constitution requires them (as "officers of the United States") to be appointed by the President and confirmed by the Senate.³ Recall that the Reserve Bank Presidents are appointed by their Reserve Bank Board of Directors, subject to approval of the Federal Reserve Board in Washington, DC. As a response to his constitutional concern, I suppose the President could appoint the Reserve Bank Presidents; the Senate could confirm them; then they could continue serving part-time as FOMC members and full-time as Reserve Bank Presidents.

If this happened, Reuss would continue to attack the FOMC's membership, claiming it is inappropriate for a constitutional democracy like ours. For his *underlying concern* about conflict of interest, as opposed to his belief about Constitutional law, is that it is *inappropriate for officials to exercise government power over the very areas they represent*. Certainly this is *not* a purely legal matter, as the Federal Reserve Act itself requires Reserve Bank Presidents to serve on the FOMC. And no matter what Reuss asserts about Constitutional law, the federal courts have rejected all challenges to the constitutionality of the FOMC's membership.⁴

³ Over and over, Reuss claimed that all "Officers of the United States" had to be appointed by the President and confirmed by the Senate, but this is not true. According to Article II, Section 2, Officers can also be appointed by "the President alone, in the Courts of Law, or the Heads of Departments" if Congress passes a law authorizing them to do so.

⁴ Legal challenges to the FOMC's constitutionality are longstanding. In *Bryan v. FOMC* (1964), a citizen who owned a Treasury Bill sued the FOMC. In his suit, he asked a federal district court in Montana not only to declare that the FOMC's powers "are an unwarranted delegation of power by Congress," but also to prevent "its members from purchasing and selling obligations of the United States on the open market." Because the plaintiff had not shown how he was directly harmed by the FOMC's composition, however, the federal court denied him standing, so his suit was dismissed. In 1976, Rep. Henry Reuss of Wisconsin challenged the FOMC's composition as both a legislator and a citizen. As a Member of Congress, the way the FOMC is composed (Reuss claimed) prevented him from initiating impeachment proceedings against Officers of the United States. Most importantly, it "usurped" his constitutional authority as a Member of Congress to "regulate the value of money, to regulate commerce, and to borrow money on the credit of the United States." As an owner of government securities, Reuss claimed that FOMC actions could deprive him of property without due process. In response, the federal district court of DC denied him standing, holding that his complaints were not redressable in federal court. In 1981, Senator Donald Riegle of Michigan challenged the FOMC's constitutionality. In that case, *Riegle v. FOMC*, the federal district court of DC granted the Senator standing, but dismissed the case "under the doctrine of equitable discretion." Under this doctrine, the federal courts should dismiss a legislator's complaint if he or she can "obtain substantial relief" from "fellow legislators through the enactment, repeal, or amendment of a statute." In 1985, this same court rejected a challenge by private individuals and organizations in *Committee for Monetary Reform v. Board of Governors of the Federal Reserve System*. Participation by the Reserve Bank Presidents, this group of private citizens and private businesses claimed, led to FOMC decisions that caused them harm financially. Rejecting this challenge, the court held that the plaintiffs not only "failed to make a sufficient allegation of causation," but that the courts, too, should not review technical matters of economic policy. In 1986, Senator Melcher challenged the FOMC's composition in *Melcher v. FOMC*. The federal

As the lines between public and private become less clear, such concerns could become more important rather than less—making conflict of interest more of a philosophical issue than a legal one.

LEADERSHIP: THE END OF BURNS’S TERM, THE CONTROVERSY OVER WILLIAM MILLER, & THE NOMINATION OF PAUL VOLCKER

Leadership, a fundamental part of both the theory and the practice of public administration, is very important for the Fed—especially since the Chairman has become so important. From 1976 to 1980, the issue of administrative leadership was particularly prominent, and it had serious implications for the Fed’s administrative legitimacy.

Arthur Burns remained Chairman until 1978. For a time, many of the nation’s elected officials and business leaders campaigned for Burns’s reappointment. Speaking on this matter on December 15, 1977, Senator Percy acknowledged that Burns’s critics claim he has “stymied this nation’s economic recovery and contributed to the unemployment of the 1970s.” Even more important, the critics claim that Burn “has actively worked to counter the President’s economic policies and goals,” an especially strong point for those who challenge the legitimacy of the Fed and its officials (*Congressional Record* December 15, 1977 p. 39444).

Percy, for his part, rejected these arguments. More than anyone else, Burns has provided the necessary “balance to those who would overstimulate this fragile economic and impose further . . . inflation and long-range unemployment.” In Percy’s opinion, Burns has been a “dedicated public servant and provided outstanding leadership,” so he should be reappointed as Chairman (*Congressional Record* December 15, 1977 p. 39444).

Like Percy, George Will wanted Burns to be reappointed, though he recognized this might not happen:

Burns is a strong personality and advocate, and Carter has not surrounded himself with such people. Burns has a coherent philosophy and the political skills to advance it, which make him a reproach to the administration (*Congressional Record* December 15, 1977 p. 39444).

Senator William Proxmire acknowledged this “strong campaign” to “force President Carter to reappoint Arthur Burns,” but he hoped it would not be successful. To be sure, Burns is a “man of great ability and distinction”—someone who, in Proxmire’s words, understands economics “thoroughly from a practical as well as a theoretical standpoint” and is the most “able” committee witness ever. But he should not be reappointed.

district court in DC, once again, dealt with the complaint. This time, the court granted the Senator standing, and it refused to dismiss the case. But it ruled in favor of the FOMC anyway, holding that its composition was not unconstitutional. Congress, it held, could delegate some Article I powers to private citizens, since open market operations are not an “inherently governmental function” (Bernstein 1989 pp. 131 – 134).

Considering the Fed Chairman's influence on society as a whole, he is "the second most powerful man in our nation," Proxmire argued. But from an economic standpoint, judged by his ability to influence the economy, the Chairman is "the most powerful man"—even more so than the President. Despite the Chairman's ability to influence the economy, Burns's tenure was "the most inflationary of any Fed Chairman in our history." Similarly, it was during Burns's tenure that the nation experienced its highest rates of interest ever (*Congressional Record* November 4, 1977 p. 37901). According to Proxmire:

It is clear that no man, no one agency—not even the federal government as a whole—can be held responsible for all the inflation, or the high level of interest rates we suffer. But there is no denying that the Federal Reserve Board for the last 7 years has had a central responsibility for inflation and the level of interest rates and in both respects it has failed dismally. If a general loses battle after battle, you do not demand he be reappointed in order to maintain confidence. If a corporation loses money year after year, the stockholders do not demand he be reappointed to maintain their confidence [my emphasis] (*Congressional Record* November 4, 1977 p. 37092).

Although many in Congress and the White House did not want Burns to be reappointed—and, in the end, he was not—most appreciated the service he had provided to the country. After Carter decided not to reappoint Burns, then, Congress passed a Resolution expressing appreciation to the outgoing Chairman. In Senator Javits's view, Arthur Burns had been "one of the outstanding and dedicated public servants of our people."

Senate Joint Resolution 119

Whereas Dr. Arthur F. Burns has concluded eight years as chairman of the Federal Reserve Board, a position ranked by many observers as second in importance only to the Presidency itself; and

Whereas Dr. Burns has served under five Presidents and has served them and the American people faithfully and well; and

Whereas Dr. Burns, by his tireless efforts to protect the integrity of the American dollar both at home and abroad, and by his counsel and advice in improving the national monetary system, has gained unequalled universal respect among the free nations of the world; and

Whereas Dr. Burns, as an individual, blessed with high moral personal standards combined with a keen sense of humor, and by his courteous, thoughtful, and forthright personality, has won the friendship and admiration of individual members of Congress and the American people; and

Whereas Dr. Burns has served this nation in various capabilities since 1930—as president and Chairman of the National Bureau of Economic Research, as chairman of the President’s Council of Economic Advisers from 1953 to 1956, as a member of the President’s Advisory Committee on Labor-Management Policy from 1951 to 1966, as Counselor to the President in 1969, and as chairman of the Federal Reserve Board from February 1, 1970 through March 8, 1978, now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled: That the Congress herewith express its appreciation to Arthur F. Burns for his long and superb service to the United States of America and its people and does further express the hope that Dr. Burns will continue in his role as senior statesman in economic affairs, reflecting his qualities of economic integrity and stability (*Congressional Record* March 9, 1978 p. 6223).

In 1978, Arthur Burns last year as Chairman, the Senate began debating the appointment of his successor, G. William Miller. Speaking on January 19, 1978, Senator Pell reported that he had “never spoken with such confidence and belief” about a nominee as he had about Miller. This nominee, Pell observed, had been an outstanding leader of Textron and a major participant in community affairs—serving, to name just a few, on the National Council of the Humanities, the Industry Advisory Commission on Equal Employment Opportunity, and many others. While doing so, Miller served as a Director of the Federal Reserve Bank of Boston, where he has received “particular insight into this demanding job” of Chairman (*Congressional Record* January 19, 1978 p. 72).

In the *Wall Street Journal*, Neil Ulman discussed the challenges Miller would face—as well as the way Miller viewed his role. Interviewing associates of Miller’s, many reported that he was tough, which some believed could cause problems for the Carter Administration. After all, many observers believed that Carter “chose Mr. Miller as a more pliant replacement for the prickly Arthur Burns.” President Carter, according to these analysts, viewed Miller “as someone who could both reassure the business community and be more understanding of a Democratic administration’s need to reduce unemployment while fighting inflation” (*Congressional Record* January 19, 1978 p. 73).

Actually, in personal interviews, Miller gave every indication that he would cooperate with the White House. Unlike Burns—who not only criticized the Administration’s economic policies, but believed he was right to do so too—Miller saw the Chairman’s role in a different way. “Part of my job,” Miller believed, “will be to carry on discussion and open communication with the administration, to use my persuasive powers and find common purposes.” In his view, the Fed and the White House must not just “avoid the cross-purposes that affect confidence,” but establish “a steady . . . and confident course” (*Congressional Record* January 19, 1978 p. 73).

Miller's background was not in economics; he was a businessman with a law degree. In its editorial endorsing Miller's appointment, however, the *Wall Street Journal* was unconcerned about that: "What a Fed Chairman most needs is not economic experience but character," it said (*Congressional Record* January 19, 1978 p. 75).

No matter how sincere this good will was, it did not last long. Soon after Miller became Chairman, Members of Congress began criticizing him, with Senator Proxmire saying he "has earned a D grade on his report card." Proxmire and others were concerned about the rates of inflation and interest, both of which increased rapidly during Miller's tenure (*Congressional Record* September 14, 1978 p. 29459). In the end, Miller's term was unexpectedly short: he became Treasury Secretary in 1979. And Paul Volcker was nominated to succeed him.

While the Senate decided whether to confirm Paul Volcker, the nominee was widely praised. Speaking about the appointment on August 2, 1979, Senator Proxmire commended Volcker in several respects. At no point has a nominee for the Chairmanship had as much "relevant, solid experience," Proxmire argued. As President of the New York Reserve Bank, for instance, Volcker already served on the FOMC, the institution responsible for making monetary policy. Volcker's educational background, which included degrees in economics and public administration, made him an ideal candidate as well. Professionally, he "has a great record," one of "understanding monetary policy thoroughly, of working consistently to have a policy that restrains inflation" (*Congressional Record* August 2, 1979 p. 22264).

Proxmire connected Volcker's appointment to the Fed's administrative legitimacy. The Fed's ability to govern—its independence from the executive branch—has "been threatened in the past frequently." In the process, many citizens have been "concerned about the threat to the independence of the Federal Reserve Board." By nominating Paul Volcker, President Carter has "done a fine job in assuring that we are going to have a Board that will be about as independent as it can be and should be" (*Congressional Record* August 2, 1979 p. 22264). Proxmire added:

Mr. Volcker has demonstrated in his professional capacity that he understands what he is doing. He will not be staff-dependent; he will not be dependent on economists from the executive branch; he will be able to act forcefully, confidently, assuredly, on the basis of strong professional experience, reputation, and authority. Also he has demonstrated in his years as a member of the Open Market Committee his independence. He voted against the majority, against the position that sometimes is represented as being the administration position, without any question when he thought that position was wrong (*Congressional Record* August 2, 1979 p. 22264).

Yet another reason why Volcker should be confirmed, Proxmire argued, is that public opinion is solidly behind him. "Editorials all over the country have hailed this nomination," he reported (*Congressional Record* August 2, 1979 p. 22267). Senator

Armstrong, too, observed that Paul Volcker's nomination "has received widespread praise from U.S. business and the international community." This comment shows that public administration, so often conceived so "professionally," is a popular enterprise as well.

Despite the widespread public support, Armstrong expressed concern about how fast the nomination was proceeding. Only one week after the President sent the nomination to the Senate, a vote was scheduled in the Committee; the next day a vote was scheduled on the Senate floor (*Congressional Record* August 2, 1979 p. 22267). With nominations to the Fed's Board of Governors, adequate time to evaluate a nominee is more important than ever, especially since Volcker would serve a fourteen-year term as a Governor. If Volcker wished, he could serve on the Board of Governors until 1993.⁵

Senator Armstrong recognized the power the Fed Chairman has during his tenure:

During all that time, a casual statement or a chance remark by him, if overheard and published in the newspapers, will have a profound effect on the economy of this country. Long after most of the present Members of this body have gone home to pursue other occupations, he will still be on the Board of Governors of the Federal Reserve System, influencing the prices of goods and services in this country, influencing job opportunities, the way we live—truly the economic future of every family, of every working man and woman, and of every business in this Nation (*Congressional Record* August 2, 1979 p. 22265).

In these remarks, Armstrong connects the issue of administrative legitimacy to the issue of administrative power. According to Professor Meier, author of *Politics and the Bureaucracy: Policymaking in the Fourth Branch of Government*, administrative power is political power by another name. Administrative power is "the ability of a bureaucracy to allocate scarce resources," which is "nothing more than political power exercised by government bureaucracy when it determines . . . who get what, when, and how" (Meier 1993 p. 14).

⁵ As it exists now, the Fed's appointment process is complex, warranting a more thorough explanation than I provided in the text. 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 would like to see happen, the Chairman's tenure was coordinated with the President's, each President could appoint "his own person" to head the Fed. For additional information about the appointment process, see the publication by the Board of Governors, *The Federal Reserve System: Purposes and Functions*, or the book by Carl Moore, *The Federal Reserve System: A History of the First 75 Years*.

As a practical matter, Armstrong was willing to vote for Volcker because “the President has put us in a box.” What President Carter did was send the nomination to the Senate “under circumstances such that our choice is either to let the Federal Reserve System be without a chairman . . . or to act on it in a manner which I think is too fast and compromises the process” (*Congressional Record* August 2, 1979 pp. 22265 – 22266). This shows not only how important the separation of powers is for public administration, but also how differently the legislative and executive branches conceptualize administrative issues. As David Rosenbloom observed in a *Public Administration Review* article entitled, “Public Administration and the Separation of Powers,” Presidents generally conceptualize public administration from a managerial perspective; Congress, a political perspective; the courts, a legal perspective (Rosenbloom 1983 p. 224). In this case, for instance, President Carter knew he needed someone at the Fed very soon, which is a managerial view. Members of Congress, for their part, were more concerned about the political process—letting Senators have time to consider the politics of the nomination, letting Committees have time to deliberate, considering the political positions that Volcker may take, and the like.

Also supporting Volcker’s nomination was Senator Tower, who said the nominee “appears to recognize the need for an independent Federal Reserve.” Having served as President of the New York Fed, Volcker has seen “first hand” why the Fed must be “independent from political pressures.” In the future, Volcker should be able to “maintain the independence of the Federal Reserve” (*Congressional Record* August 2, 1979 p. 22268).

On August 2, 1979, the Senate confirmed Paul Volcker. He took the Oath of Office on August 6, 1979, becoming the new Chairman of the Board of Governors (Neikirk 1987 p. 12).

WHAT PAUL VOLCKER’S NOMINATION TELLS US ABOUT ADMINISTRATIVE LEADERSHIP AND ADMINISTRATIVE LEGITIMACY

While examining the arguments over Paul Volcker’s appointment, we see how important *leadership* is to public administration generally and administrative legitimacy specifically. Scholars of public administration, of course, have long recognized the importance of leadership. Recently, however, scholars are emphasizing its importance more than ever before, with several important works published in the 1990s. In *Administrators as Conservators*, for example, Larry Terry analyzes the role administrative leadership plays within public agencies as well as democratic politics. For now, I want to discuss a recent article by Robert Behn entitled, “What Right Do Public Managers Have to Lead?,” which was published in *Public Administration Review*.

In Behn’s view, public managers not only have a right to lead; they have an obligation to do so as well. Behn connects the public administrator’s right to lead, quite interestingly, to the *imperfections* of our political system. By leading, he claims, public administrators “help correct some of the imperfections” (Behn 1998 p. 209).

And these imperfections are serious. According to Behn, the American system of government produces seven failures: organizational, analytical, executive, legislative, political, civic, and judicial. For my study of the Fed, the executive and the legislative failures are the most important, so I will discuss them briefly.

Traditionally, public administration has been conceptualized as a top-down process. Even today, many scholars believe that “when the elected chief executive gives an order, the public manager ought to salute.” In his critique of reinventing government, to cite just one important case, Ronald Moe argues that it “is the constitutional responsibility of the President and his duly appointed and approved subordinates to see that these laws [enacted by Congress], wise and unwise, are implemented” (Behn 1998 p. 213). In an article co-authored with Robert Gilmour, Moe extends his critique of reinvention, advocating an “accountable executive model of organization” with “clear lines of authority and accountability” (Behn 1998 p. 214).

But such arguments, Behn observes, embody the *fallacy of executive comprehensiveness*. Unfortunately, they assume that “the elected chief executive . . . is actively engaged in the task of ensuring that *all* the laws are faithfully executed.” It is humanly impossible, however, for one person to have that much influence or to exercise that much control. Indeed, elected chief executives usually provide “either ambiguous or contradictory” directives, if they provide any at all.

We might all like to think that the chief elected executive is omnipresent and omnipotent—actively engaged in using the *full* authority of the executive to ensure the faithful execution of *all* the laws. Realistically, however, we know that no elected chief executive can (Behn 1998 p. 214).

Even elected chief executives who are actively involved concentrate on a few areas, so they attempt to neither influence nor control all administrative agencies. As Behn observes, senior Governors routinely advise those who have just been elected to “limit your agenda.” What good Governors focus on is “a few priorities and ignore the rest of state government.” Similarly, at the federal level, Presidents can only focus on a few priorities. They have to leave the rest of government to public administrators, whether political appointees or career executives.

How, if at all, does Behn’s view apply to the Fed? In one sense, it does not apply at all, as the President has no authority over the Fed. In yet another sense, *that* is precisely the point. The traditional view of public administration—that is, the executive centered one—*applies even less to the Fed than to other agencies*. Even if the President wanted to “expand his agenda” to include the Fed, he could not do it. From the institution’s very beginning, legislators recognized that there are serious limits to what one President, one person, can achieve. Implicitly, then, they recognized the fallacy of executive comprehensiveness. Even more important, they believed that the President *should not have control over the Fed*, even if he had the time or the ability.

Legislatures fail too, according to Behn, but scholars often ignore this fact—with Moe & Gilmour arguing that the first principle of public administration is for agency managers to “implement the laws passed by Congress as elected representatives of the people.” As Behn understands it, this first principle embodies the *fallacy of legislative clarity*. Because Congress enacts ambiguous laws, administrative agencies serve “as a convenient lightning rod for public frustration and a convenient whipping boy for congressmen” (Behn 1998 p. 214).

By statute, the National Park Service is expected to both “promote public use of the parks” and “preserve the parks.” Obviously, each is a worthy goal; taken together, they conflict. Rather than decide which priority takes precedence or which should be promoted in a certain instance, Congress has left it to the National Park Service to decide. At the same time, many agencies are “charged with promoting or helping one interest while preserving or protecting another.” New York’s Department of Juvenile Justice, for example, is responsible for “help[ing] the juveniles in custody while protecting the general public” (Behn 1998 p. 214).

At the Fed, officials are forced to reconcile two contradictory objectives—maximum employment with minimum inflation. At some point, increasing employment leads to increasing inflation: more workers working adds to consumer demand. At some point, too, decreasing inflation leads to decreasing employment, with consumer demand becoming lower. Nevertheless, the Humphrey-Hawkins Act of 1978 (and before that, the Full Employment Act of 1948) requires the Fed to promote full employment and price stability simultaneously. By leading, Fed officials respond to this legislative imperfection, deciding which of these contradictory objectives should predominate at a particular time.

By leading, in fact, public administrators in all government agencies respond to such legislative imperfections. Yet some wonder why unelected officials have a *right* to lead. In the traditional view, citizens elect legislators—who then give certain responsibilities to public administrators. If citizens do not like what their elected officials are doing, they can replace them. They have fewer options for replacing public administrators, which is why these unelected officials must be strictly subordinate to elected leaders (Behn 1998 p. 215).

Although this may be reasonable in theory, government does not work that way in practice, since a “legislature’s directives to public managers may not, in fact, reflect the popular will.” In addition to the “paradox of voting,” other problems emerge: the problem of interpreting legislation, the problem of legislatures not behaving democratically, the problem of Senatorial privilege, and the problem of legislative organization (Behn 1998 p. 216). Due to these problems, legislative bodies—whether at the federal or the state or the local level—must “be checked and balanced.” At the Constitutional level, elected chief executives and judges are able to restrain the legislature. But no matter how much checking and balancing the elected executives and appointed judges may do, public administrators still face legislative failures, some of

which may “create large, adverse consequences for an individual agency.” As a result, public administrators must check and balance the legislative branch, according to Behn.

This is the public manager’s responsibility. He or she needs to exercise leadership, to seek out remedies for the legislative failure. If the elected chief executive takes a pass, the public manager ought to respond. This is not optional; it is obligatory (Behn 1998 p. 217).

STILL ATTACKING THE FEDERAL OPEN MARKET COMMITTEE

From 1976 to 1980, the Federal Open Market Committee (FOMC) continued to be controversial. In 1976, Representative Reuss filed a federal suit challenging the FOMC’s composition as unconstitutional. In this suit, Reuss claimed that the five Reserve Bank Presidents—who are appointed by their Boards, subject to approval by the Board of Governors—could not serve on the FOMC. Speaking in favor of Reuss’s suit, Representative LaFalce argued that “the exercise of such power by private citizens is unconstitutional” (*Congressional Record* July 21, 1976 p. 23222). Ultimately, his suit was dismissed for lack of standing, but the arguments that supporters and opponents advanced remain important.

In a *Washington Post* article entitled, “Small Group of Men, in Secret, Controls Our Bankrolls,” John Holusha analyzed the FOMC’s power and Reuss’s suit. The FOMC, as Holusha described it, is a “small group of powerful men” who “meet in secret.” During these secret meetings, which are “unobserved and unregulated,” the FOMC makes decisions that affect the lives of “millions of Americans within a few months” (*Congressional Record* July 21, 1976 p. 23222).

Holusha interviewed Reuss, who told him “if the board of the regional banks had appointed nothing but Albert Schweitzers, it is still unconstitutional to have the powers of government exercised by anyone but government officials.” In addition to the constitutional problems, the FOMC raises political ones as well. The bankers, much more so than the general public, are concerned about inflation—and Dr. James Pierce, formerly an economist with the Fed, reports that the Reserve Bank Presidents “work with bankers and tend to identify with bankers’ interests.”

For this reason, liberal critics like Holusha and Reuss attack the “potential power of unelected businessmen.” The Presidents, according to Reuss, must make policy acceptable to their banker-dominated boards, at least so long as they wish to retain “jobs that pay incomparably better than any federal job other than the President himself” (*Congressional Record* July 21, 1976 p. 23223). Reuss has a point: the Boards determine how much their Presidents will make, which has three major implications. First, the salaries are not uniform. While the President of the Richmond Reserve Bank made \$52,500 in 1976, the President of the New York Reserve Bank made \$95,000. Second, by having the power to set salaries, the boards may influence the Presidents’ policies on the FOMC. Lastly, *all* of the Reserve Bank Presidents are paid more than the Board of Governors (*Congressional Record* July 21, 1976 p. 23223).

Supporters of the Reserve Bank Presidents' participation, however, mounted a defense. It is important, some argued, to have a regional focus—as one banker argued, “things might be fine in Kansas” even though “there’s a recession in the Northeast.” By having regional representation, therefore, the FOMC receives “a variety of inputs.” Others like J. Rex Duwe, the President of the American Bankers Association, argued that the system has worked well so far. “Why tamper with something that works,” he asked rhetorically. Moreover, Chairman Burns believed that the Reserve Bank Presidents must continue serving on the FOMC. As he saw it, allowing the President of the United States to appoint the Presidents of the Reserve Banks would “turn these offices into political plums.” In the process, an “atmosphere of partisanship” would be “injected into the formulation of monetary policy” (*Congressional Record* July 21, 1976 p. 23223).

CONCLUSION

While summing up, I want to review the major issues raised in this chapter. First, I examined Burns's commencement address, “The Independence of the Federal Reserve System,” where he presented a comprehensive defense of the institution's legitimacy. In this defense of the Fed, he raised several issues. He tried to show how the flexibility of monetary policy depends on an independent administrative institution; the way the Fed fulfills its Founders' expectations; how the “concept of independence” fits within the American Constitutional framework; and why it is better for the Fed to exercise the monetary authority than the White House staff. For all these reasons, Burns believed that the Fed has a right to govern, and it is appropriate for a constitutional democracy like ours.

Second, I discussed the Carter Administration's attitude toward the Fed. During the 1976 campaign, Carter seemed to challenge the ability of the Fed Chairman to govern independently of the President. To this end, he argued that the Chairman's term should be concurrent with the President's, so the elected chief executive could “have a Chairman . . . whose economic views are compatible with his” (*Congressional Record* May 10, 1976 p. 13086). But once he became President, Carter's attitude changed. At no point did he pursue this campaign proposal. Nor did he attack the Fed's legitimacy in other ways. In the final stages of the 1980 campaign, when everyone realized the poor economy had virtually doomed Carter's reelection effort, the President challenged the Fed's policies. While doing so, though, he affirmed its legitimacy.

Third, I examined Congressional controversies over the Fed, seeing what they tell us about the Fed's legitimacy. Representative Reuss, who emerged as one of the main challengers of the Fed, introduced the Federal Reserve Reform Act—which not only would have increased the Fed's accountability to Congress, but also would have expanded the President's authority over the institution. In this legislation and in speeches throughout this period, Reuss charged that the Fed was unrepresentative, providing representation to the bankers and the big businesses rather than our ordinary citizens.

While discussing Congressional controversies, too, I was especially concerned about the Fed's leadership. From 1976 to 1980, the Fed had three Chairmen: Arthur Burns, G. William Miller, and Paul Volcker. After Burns left office, Miller became Chairman, but

he was very weak in that position. Eventually, Carter moved Miller to the Treasury Department, then appointed Volcker as Chairman of the Fed. At the White House, some were concerned about appointing Volcker, the New York Reserve Bank President with a reputation for independence. Unlike Miller, Volcker did not believe he was part of the President's "team"—and influential people inside as well as outside the White House knew this would be so. In Congress, however, Volcker's appointment was praised, with the institution's supporters believing he signified the Fed's independence from the President. Only by having strong leadership, they believed, could the Fed govern without encroachment from the White House. And Volcker was nothing if not independent.

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