

## **CHAPTER 8**

### **RECOVERY**

#### **1986 – 1995**

Over time, the *threats* to the Fed's independence have lessened: that is, from 1986 to 1995, restrictive legislation had much less chance of passing than it did in earlier periods. The debate over the Fed's legitimacy, though, did not end in 1986. In some quarters, its legitimacy continued to be attacked, sometimes in very important ways. And whether restrictive legislation was likely to pass or not, my dissertation examines the public argument—so attacks, even if they were a purely rhetorical phenomenon, remain important to my study.

From 1986 to 1995, unlike earlier periods, much of the debate over the Fed's legitimacy focused on issues at the margins of the institution's power. Some elected officials were concerned, for instance, about when the FOMC's decisions were released. Because these decisions are so important, they should be released immediately, some argued. Some elected officials were concerned, too, to discover that the FOMC had maintained minutes of its meetings, even though Fed officials led Congress to believe no such minutes existed. These controversies raise legitimacy questions, since the underlying issue is the role of governmental secrecy in a democratic society. Should administrative agencies deliberate in private, reach decisions the public hears nothing about for almost two months, and maintain secret minutes the public never sees? These are real concerns. But the people expressing them, quite often, presumed the Fed itself had a right to govern—and if they did not accept its appropriateness for a constitutional democracy like ours, they often believed it could become a legitimate agency with a few changes around the edges.

#### **PAUL VOLCKER: THE END OF A CHAIRMANSHIP & REFLECTIONS ON THE FED'S LEGITIMACY**

Paul Volcker's term as Chairman expired on August 6, 1987. Two months earlier, on June 3, 1987, President Reagan announced the appointment of Alan Greenspan to replace Volcker. On June 1, 1987, he wrote a letter, in which he announced he was resigning from the Board and explained why he was leaving. "After eight years as chairman, a natural time has now come for me to return to private life as soon as reasonably convenient and consistent with an orderly transition" (Moore 1990 p. 165).

Although Reagan would have reappointed Volcker, if the Chairman had wanted him to, many believed the President and other administration officials *really wanted a new person at the helm*. In *Volcker: Portrait of the Money Man*, William R. Neikirk discussed the rumors circulating in 1985 and 1986, which said that Chief of Staff Regan "had extracted a promise from Reagan that Volcker would not be reappointed to a third term." After the Iran-contra scandal of late 1986 and Regan's resignation in early 1987, however, the rumors changed. Volcker, they began to say, would be reappointed after all (Neikirk 1987 p. 211).

After Volcker decided he did not want a third term, the new Chief of Staff—Howard Baker, who had frequently “criticized Volcker in the past,” though he “respected the Fed chief”—asked him to reconsider. Yet in a meeting with the President, Howard Baker, and Jim Baker, Volcker insisted he wanted to leave. In response, President Reagan “did not try to dissuade him and said he respected the chairman’s decision” (Neikirk 1987 p. 213).

Most people acknowledged the legacy Volcker left. Adam Smith, who hosted PBS’s “Money World,” argued that the Fed “basks in the success of the Volcker years, a central bank that did what central banks are supposed to do: preserve the currency and maintain the system” (Smith 1988 p. 73).

Throughout his years as Chairman, Volcker insisted that the Fed must be able to govern independently of the executive branch. In his 1992 book *Changing Fortunes*, which he co-wrote with Toyoo Gyohten, Volcker attacked the “extreme monetarists, who had long carried on an intellectual crusade against the Federal Reserve” and wanted to “end our independence, if not the institution.” In Volcker’s view, Arthur Burns—even after retiring from the Fed—was helpful in tempering the Fed’s enemies: His “intellectual stature, his public standing, and his old friendships were brought to bear to keep the wilder views of some of his Republican friends at bay” (Volcker & Gyohten 1992 p. 174).

As for Volcker’s relationship with the Reagan administration, he admitted it was difficult sometimes. In the early years, Reagan’s economic advisors made policy statements about reducing money growth by 1% a year for several years. As Volcker knew, such reductions “in the real world” could not be achieved with “precision.” Besides, even if they were achievable, pronouncements like that made it “look like the administration was trying to order the Fed.”

I somehow succeeded in talking them out of that kind of language on the basis that they would only invite conflict and antagonism on *matters that, after all, the law made amply clear were for us to decide*. Certainly, we got lots of advice from the administration. Later on, much of the advice was passed on via the press, sometimes by unidentified White House officials with vaguely ominous threats, often more openly by Donald Regan, who would recurrently refer to mysterious studies of the independence of the Federal Reserve [my emphasis] (Volcker & Gyohten 1992 p. 175).

Regarding Reagan himself, Volcker “never saw him often, as I had Mr. Carter, nor did I ever feel able to develop much personal rapport or indeed much influence with him.” Nonetheless, Volcker was well aware that Reagan accepted the Fed’s legitimacy. The President realized, on his end, that “it wasn’t a good idea to tamper with the independence of the Federal Reserve” (Volcker & Gyohten 1992 p. 175).

After his term was over, Volcker discussed his views of the Fed's legitimacy in "The Triumph of Central Banking?," which was delivered as the 1990 Per Jacobsson Lecture. To accomplish the nation's economic objectives, an "effective central bank" is necessary. This central bank, he believed, must "be a strong central bank, with substantial autonomy in its operations and with insulation from partisan and passing political pressures" (Volcker 1990 p. 17). To this end, Volcker insisted that he was "a strong advocate of the independence of central banks *within government*" [my emphasis]. But a central bank's "ability to reach independent judgments about monetary policy must not imply isolation." Quite the contrary: in a democratic political system, a central bank must "develop and sustain its basic policies within some broad range of public understanding and acceptability" (Volcker 1990 p. 17).

### **ALAN GREENSPAN: THE NEW FED CHAIRMAN**

After Reagan announced Greenspan's appointment, some were concerned about the new Chairman's political connections. Greenspan, like Arthur Burns before him, had had an active political life before coming to the Fed. He had been Chairman of Ford's Council of Economic Advisors; he had been Chairman of a Social Security Commission; he had been "one of the architects" of Reagan's economic speech in 1980, when the candidate promised tax cuts, spending cuts, defense increases, and balanced budgets—all within four years. As an activist in Republican politics, many critics of the appointment were concerned that Greenspan "would not be as tough as Volcker when the White House put the pressure on him." In an election year, these critics suggested, he may "expand the money supply to take care of whoever the Republican presidential nominee" was (Neikirk 1987 p. 215).

After Greenspan's nomination but before his confirmation, he acknowledged that the Fed "is, despite its independence, a political institution." As a result, Fed officials are aware of how "the Congress and/or the presidency is reacting" to them. To perform its legitimate role in American government, the Fed must "swing policy within the range of certain parameters." That the Fed under Volcker's leadership, Greenspan argued, was "attacked by both sides" shows it had "skillfully maintained—at least from a political point of view—a policy which is not perceived as going outside the consensus of the analysts in the world" (Neikirk 1987 p. 217).

Despite the concerns about Greenspan's political connections, the Senate confirmed him—91 voted for him, while only 2 voted against him (*New York Times* August 4, 1987 p. D1). During the recession of 1991, the *U.S. News and World Report* observed that America lacked "a national fiscal strategy," so "Greenspan's Fed is George Bush's domestic policy," at least on economic issues. The magazine reported further:

And chairing an institution whose decisions on interest rates can make or break political careers is tricky business, particularly for a man with a partisan past. "You're the guy who controls the game. Are you going to keep this [economy] going through November?," a GOP

operative asked Greenspan the Republican at a reception before the 1990 midterm elections. The chairman smiled. “Don’t you worry” (*U.S. News and World Report* 1991 p. 53).

In the early 1990s, some questioned “Greenspan’s independence as a central banker.” Treasury Secretary Nicholas Brady, for example, was unable to “persuade the finance ministers of large industrial countries to lower interest rates together.” Days later, the Fed cut the discount rate, leading some to attack the “collusion between the Fed and the Treasury.” As Fed officials argued, however, this criticism was inaccurate, since lowering the discount rate was a “long-planned move.” The critics, in fact, were exactly wrong. If Fed officials had refused to do what they had planned, all because of Brady’s failed plea to the finance ministers, “political appearances *would have* been setting policy” [my emphasis] (*U.S. News and World Report* 1991 p. 53). So lowering the discount rate, far from being a “collusion” with the Treasury, did not compromise the Fed’s independence at all.

Other events in the Bush Administration were important as well. Although the Bush Administration supported the Fed’s legitimacy, the President (like Nixon and Carter) hoped to use his appointment power to influence the Fed. In 1991, most believed that Bush would reappoint Greenspan, but the President was stalling—and he was doing so, commentators believed, “to keep pressure on the Fed to lower interest rates and thereby give the nascent recovery a gentle nudge.” Earlier in 1991, Bush claimed that he was in “no hurry” to announce who he was appointing as Chairman.

But the delay was starting to send shivers through financial markets, which have applauded Greenspan’s anti-inflationary policies and dread the idea of an unknown replacement. Even so, Bush’s subtle hint *may have* worked. In early July, Greenspan scored a point for economic stimulation by prevailing over anti-inflation zealots on the Fed who wanted to lower the targets for growth in the US money supply [my emphasis] (*Time* 1991 p. 50).

Over time, Greenspan has become accepted as Fed Chairman, with many viewing him as the epitome of a legitimate central banker. Nowadays, few people question his independence. His tenure, most importantly, has caused the Chairmanship to be more respected than ever before. As we all know, the Fed Chairman has long been described as “the second most powerful man in American.” But in a *Fortune* magazine poll of top business leaders, which was released nine years after Greenspan became Chairman, a full forty-percent of the respondents believed that the position he holds is *at least as important as the Presidency*. 19% believed that the Fed Chairman is “equally important” as the President, while 21% believed that “whoever is appointed to head the central bank is more important than who is elected President” (*Fortune* 1996 p. 43).

#### THE CLINTON ADMINISTRATION & GREENSPAN’S FED

The relationship between Alan Greenspan’s Fed and Bill Clinton’s White House is an interesting one to discuss, especially when studying the Fed’s administrative legitimacy.

On the campaign trail in 1992, Clinton promised an activist, progressive economic policy: “putting people first” was his central theme. But once he was elected, Clinton’s economic policies were very different, so different even the President himself worried that “we are all Eisenhower Republicans.” Not just outside observers, but White House officials as well, acknowledge that the Fed was at least partly responsible for this change.

When the transition from campaigning to governing began, Senator Lloyd Bentsen, who was appointed as Clinton’s first Treasury Secretary, told the President-elect how important it would be to “develop a relationship of trust with the chairman of the Federal Reserve, Alan Greenspan” (Woodward 1994 p. 61). Clinton took this advice seriously, meeting with Greenspan for more than two-and-a-half hours on December 3, 1992 at the Arkansas Governor’s Mansion. In that meeting, Greenspan told the President-elect the short-term interest rates were “at about the right level.” It was the long-term interest rates that were too high, but the best way to lower *them* was through substantial cuts in the federal deficit. Clinton’s economic plan, Greenspan emphasized, must be acceptable to the bond market—by implication, it must be acceptable to the Fed as well. “If Clinton’s economic plan was not credible with the bond market, an effort by the Federal Reserve to lower short-term interest rates would likely backfire, he said, and drive up long-term rates” (Woodward 1994 p. 70).

From Greenspan’s perspective, what is the proper relationship between the President and the Fed Chairman? According to Woodward’s *The Agenda: Inside the Clinton White House*, Greenspan believed that the Chairman should “work closely with the President while retaining the Fed’s independence,” which he recognized as a “tricky balancing act, even during the Republican administrations” (Woodward 1994 p. 68). Apparently, Greenspan was worried about working with a Democratic President, since Republicans in the Bush Administration had already attacked his policies. Although Bush officials did not challenge the Fed’s legitimacy—the administration accepted the institution’s right to govern, its appropriateness for a constitutional democracy like ours—they frequently “blamed Greenspan for Bush’s political demise.” Treasury Secretary Nicholas Brady, especially, believed the Fed could have pushed short-term interest rates lower during the recession, even though they already dropped 7 percentage points (from 10 to 3 percent). “If he couldn’t coordinate strategy with Republicans, how was he going to work with Clinton, a Democrat, in the White House?” (Woodward 1994 p. 65).

It was Bill Clinton, though, who ended up courting Alan Greenspan, not the other way around. At one point in January 1993, Clinton even acknowledged that “if we do all this [tax increases and deficit cuts] and bleed all over the floor, and Greenspan doesn’t help, we’re screwed” (Woodward 1994 p. 95). In his autobiography *Locked in the Cabinet*, Robert Reich, the Labor Secretary during Clinton’s first term, repeatedly referred to Greenspan as “the most powerful man in America.” In many of the early budget meetings between top administration officials, Greenspan’s name was not mentioned directly, but he “haunt[ed] every budget meeting” (Reich 1997 p. 64). To further develop a cooperative relationship with Greenspan, Clinton made a dramatic move. He placed Greenspan in the front row, sitting between Hillary Clinton and Tipper Gore, for his speech to the Joint Session of Congress, which he gave on February 17, 1993. Although

initially surprised, Greenspan did not mind occupying such a prominent position. Justices of the Supreme Court could remain neutral while participating in these events, so he should be able to too, he believed (Woodward 1994 p. 135).

Greenspan was never one to shy away from a social event at the center of the action. In this case it was where he belonged. After all, going back to his December 1992 meeting with Clinton in Little Rock, he had been privately advising the White House and Bentsen of his views. *The chairman of the Federal Reserve was in some ways the ghostwriter of the Clinton plan* [my emphasis] (Woodward 1994 p. 135).

Top officials in the Clinton Administration were impressed with the Fed's power, its control over monetary policy. But this was not all: they seem to have been impressed, too, by *its image*. At the very least, if Clinton officials were not *impressed* by the institution's image, they recognized that Fed officials used it to legitimate themselves and their institution. As an institution, the Fed has a refined, sophisticated, urbane, cultured image—which contrasts sharply with that of most other federal agencies. This carefully cultivated image, I think, supports the arguments the Fed's officials make in support of the institution's legitimacy. Robert Reich, who visited the Fed several times while Secretary of Labor, described this image in his autobiography. The building itself is “suitably dignified and obscure”; once inside, it is “a hive of furtive activity.”

Men and women in conservative dark suits, carrying black briefcases, walking briskly and purposefully to clandestine destinations. No greetings, no banter. It is very serious here (Reich 1997 p. 79).

Compared to the Fed, according to Reich, agencies in the executive branch have an image of “egalitarian zealotry.” At the Fed, the Chairman has a private dining room on the top floor, decorated with “an antique clock, a Louis XIV sideboard, fresh cut flowers.” From that private dining room, he has a “spectacular” view of the Washington mall. When Reich arrived for a lunch meeting with the Chairman, he was escorted to the dining room by “an older man who resembles an English butler in a murder mystery” (Reich 1997 p. 79).

#### “CENTRAL BANKING IN THEORY AND PRACTICE”: ALAN BLINDER'S CONCEPTUALIZATION OF THE FED'S LEGITIMACY

Alan Blinder was appointed as Vice Chairman of the Board of Governors during the Clinton Administration. After leaving office, he delivered the 1996 Lionel Robbins Lecture entitled, “Central Banking in Theory and Practice.” Later published as a book, this lecture shows how Blinder legitimated the Fed, so I discuss it here.

From the beginning, Blinder discussed the concept of central bank independence. This term means, in his view, not only that the central bank “has freedom to decide *how* to pursue its goals,” but also that “its decisions are very hard for any other branch of government to reverse” [my emphasis]. Consider, first, what Blinder said about the central bank's pursuit of goals: the bank does not “select the goals by itself.” In a

democratic political system, rather, “it seems entirely appropriate for the political authorities to set the goals and then instruct the central bank to pursue them.”

If it is to be independent, the bank must have a great deal of discretion over how to use its instruments to pursue its legislated objectives. But it need not have the authority to set the goals itself and, indeed, I would argue that giving the bank such authority would be an inappropriately broad grant of power. *The elected representatives of the people should make such decisions. The central bank should then serve the public will* [my emphasis] (Blinder 1998 p. 54).

Examining the statutes relating to the Federal Reserve, we find that the institution has a dual mandate. On the one hand, it is supposed to promote “maximum employment.” On the other hand, it is supposed to promote “stable prices.” These two policy objectives, as Blinder understands, are “sufficiently imprecise that they require considerable interpretation by the central bank.” Because the Fed has to interpret this mandate, determining which should take precedence at which time, its “*de facto* power” is increased.

“Near irreversibility”: this is the other “hallmark of independence” in Blinder’s view. In America, the FOMC’s monetary policy decisions are “for all practical purposes, immune from reversal.” Neither the Supreme Court nor the President can reverse the FOMC’s decisions. Technically, Congress could do so, but this would not be easy. Legislation would have to be passed by both the House and the Senate, then signed by the President—or failing that, his veto overridden by a 2/3 majority.

Why should the Fed (or any other central bank), Blinder asked, be independent? As an answer, Blinder presented what he saw as a “disarmingly simple” theory. Because monetary policy “requires a long time horizon,” unelected officials—insulated from the daily pressure of politics—must be responsible for it. The costs of responsible monetary policy are paid early; the benefits are reaped later.

But politicians in democratic—and even undemocratic—countries are not known for either patience or long time horizons. Neither is the mass media or the public. And none of these constituencies have much understanding of the long lags in monetary policy. So, if politicians made monetary policy on a day-to-day basis, the temptation to reach for short-term gains at the expense of the future (that is, to inflate too much) would be hard to resist. Knowing this, many governments wisely try to depoliticize monetary policy by, e.g., putting it in the hands of unelected technocrats with long terms of office and insulation from the hurly-burly of politics (Blinder 1998 pp. 55 – 56).

Blinder recognized that his “disarmingly simple” justification for central bank independence raises “a deep philosophical question.” By making the central bank “independent of political control,” have we not created an anti-democratic institution, one

that cannot be squared with a democratic political system? In a democratic political system, Blinder believed, the legitimacy of an independent central bank can be defended in six ways. First, even in democratic systems, some decisions are “reserved to . . . the constitutional stage”; they are not decided by elected officials, particularly legislators. Because the Fed is independent, monetary policy is similar to decisions made at the constitutional stage. Elected officials who realized the nation needed a responsible monetary policy “made a once-and-for-all decision to limit their own in this way just as, for example, the Constitution made it difficult to change the length of the President’s term of office” (Blinder 1998 p. 67).

Second, officials at the Fed do not choose their own goals. Instead, elected officials decide what the central bank’s goals will be, so the institution does not serve its own purposes. As a practical matter, Blinder discussed his experience as Vice Chairman. While serving in that position, some citizens “suggested to me that the Fed should be content with 3% inflation.” He explained, in response, that the Federal Reserve Act “calls for ‘stable prices,’ not ‘pretty low inflation.’” If citizens disagree with the Act, they “should get the law changed.”

Third, Fed officials should be honest with the public about their goals and their policies, as this is what they owe “the body politic” in return for their “broad grant of power.”

A central bank that dissembles or is imperiously silent is, in my view, behaving in a profoundly anti-democratic manner. So are those who would cloak central bank actions in misleading rhetoric (Blinder 1998 p. 67).

Fourth, members of the Board of Governors are politically appointed, just as any legitimate central bank’s top officials should be. Arriving at the Fed in 1994 along with another Clinton appointee, he “joined five other men and women who had been appointed by Presidents Reagan and Bush.” As he acknowledged, none of these officials had “ever been elected to anything,” but the people who appointed them—Ronald Reagan, George Bush, and Bill Clinton—had been. In fact, each of them had been elected President of the United States.

We obtained our political legitimacy from the men who appointed us; and they, in turn, got it the old-fashioned way: directly from the voters. That is how it should be. Central banks should not be self-perpetuating oligarchies (Blinder 1998 p. 68).

Fifth, elected officials can reverse the Fed’s decisions—though this is, admittedly, difficult for them to do. Because the Fed’s decisions *can be* reversed, however, the institution is appropriate for a constitutional democracy like ours (Blinder 1998 p. 68).

And, finally, the Fed is (or should be) accountable and open. Blinder spends a great deal of time discussing this issue; I do not want to go into much detail here. Suffice it to say, he believes the Fed, like other central banks, should be more open and accountable than it



is. In a democratic political system, Fed officials should explain to citizens what they are doing, why they are doing it, and what they hope to accomplish. Unfortunately, “greater openness is not a popular cause in central banking circles,” which often believe “mystery . . . [is] essential to effective monetary policy.” Blinder rejects such sentiments, arguing that public accountability “is a moral corollary of central bank independence.” Because the Fed is free to make policy decisions for the whole population, its officials have “an *obligation*” to explain themselves to the public [his emphasis]. “Independence and accountability,” as Blinder understands the concepts, are “symbiotic, not in conflict” (Blinder 1998 p. 69).

Nor, by the way, do I accept the claim that more openness and accountability will harm the central bank—as long as it is independent. If the central bank makes good decisions, it should have no trouble explaining and defending them in public. If it cannot articulate a coherent rationale for its actions, perhaps its decisions are not as good as it thinks. *Remember—and this is critical—I am talking only about explaining the decisions, not putting them to a vote* [my emphasis] (Blinder 1998 p. 70).

## **CONGRESS & THE FEDERAL RESERVE**

Although threats to the Fed were much less serious during this period, Congress did debate its legitimacy in several important ways. First, I discuss the “secret tapes” controversy, which raises questions about the role of government secrecy in a democratic polity. Second, I examine Alan Greenspan’s and David Mullin’s testimony against the Federal Reserve Accountability Act, legislation that would have required the FOMC to release its decisions and an unedited transcript immediately. Third, I show how the 1994 Congressional elections—when the Republicans gained control of both the House and the Senate—made it virtually impossible for Henry Gonzalez and other left-liberals to restrict the Fed’s independence.

### **THE SECRET TAPES**

In the Fall of 1976, the FOMC announced that it “was halting its decades-old practice of keeping detailed minutes of its proceedings.” Most *Fed watchers*, as they are called, believed the institution was responding to a federal court ruling, which “made portions of the minutes subject to prompt disclosure under the Freedom of Information Act (FOIA).” Before this ruling, the Fed had released the minutes—but only after five years had passed (Starobin 1993 p. 2984).

For completely understandable reasons, Congress believed no detailed record of FOMC minutes existed from 1977 on. What Congress was unaware of, however, was that the FOMC was now audiotaping its meetings; from the audiotapes, unedited transcripts were produced. So a record existed, one Congress knew nothing about.

In the Fall of 1993, Congress became aware of the secret tapes and the unedited transcripts because Rep. Gonzalez, always ready to attack the Fed, asked Greenspan to “report to me the existence of any records of FOMC meetings including unedited transcripts.” In a letter to Gonzalez, which was sent on October 26, 1993, Greenspan

acknowledged that the Fed had unedited transcripts; these dated to 1976, a full seventeen years back (Starobin 1993 p. 2989).

After this disclosure, Fed critics mounted an attack—once again, they claimed, the central bank had shown how secretive and anti-democratic it was. Fed officials, for their part, attempted to minimize the issue. According to Joseph R. Coyne, the Fed’s public affairs officer, the whole matter was nothing more than a “minor affair.” In his statements on the issue, Coyne argued that “no conspiracy” existed to keep the tapes secret. True, Congress knew nothing about them, but only because “nobody asked for them.” (This argument, I believe, is particularly disingenuous: people do not ask for transcripts when they have no idea such records exist.) Paul Starobin, who analyzed the issue for the *National Journal*, was skeptical of Fed officials’ arguments.

In its efforts to control the dissemination of information about its deliberations, the Fed has gone *well beyond* its imperative to prevent premature disclosure of its policy actions. Decisions to release information about FOMC proceedings have been guided as much by *political and public relations considerations as by other factors* [my emphasis] (Starobin 1993 pp. 2984 – 2985).

Academics agreed. Donald Kettl, for example, argued that the issue “tarnishes some of the special images that the Fed has spent 80 years trying to create”—namely, a perception that it has “a sense of integrity about how it goes about its business” (Starobin 1993 p. 2985). Anna Schwartz, co-author of *A Monetary History of the United States* with Milton Friedman, claimed that the Fed was “an institution that isn’t open, that doesn’t want to discuss what it’s up to and why it does what it does” (Starobin 1993 p. 2989).

Some Members of Congress were even more concerned. Rep. Hinchey, a member of the House Banking Committee, argued that “these people think they are not part of the government.” As expected, Rep. Gonzalez used the issue to promote his anti-Fed agenda, which included a GAO audit and Presidential appointment and Senate confirmation of Reserve Bank Presidents, among others. Even Rep. Leach, a member of the House Banking Committee who usually defended the Fed, reported that though the institution “was designed to be set up with the public spotlight once removed,” its officials “prefer twice removed.” In Leach’s view, the Fed was being “too insular” (Starobin 1993 p. 2989).

At least one former Fed official believed the institution should not be so secretive. By acting so secretly, former Cleveland President W. Lee Hoskins observed, the Fed “tends to attract suspicions.” “By being more open, the Federal Reserve probably strengthens its position as an independent institution” (Starobin 1993 p. 2985).

In a *Washington Monthly* article, William Greider, author of *Secrets of the Temple*, connected the Fed’s secrecy to the economic power it possesses. Like everyone else, Fed officials can make mistakes, so the people have a right to know what they believe and what they plan to do.

[The] Fed’s mistakes can have devastating impact on the lives and fortunes of millions. It can sink viable business enterprises, force debtors to the wall, and put millions of people out of jobs. It can reward some investors and punish others. It can literally reverse the tide of economic growth or, in other circumstances, ignite the economic energies of the nation, not the mention the world (Greider 1993 p. 37).

Because the Fed is so powerful, it makes no sense to claim it “can somehow be insulated from politics.” Working in a political institution, Fed officials have “private and semi-private dialogues surrounding monetary policy” with “financial markets, banks and brokerages, and other major players, both foreign and domestic.” But the most important stakeholders are “left out of this conversation”: the American people and their elected officials (Greider 1993 pp. 37 – 38).

Rep. Gonzalez wanted to require the FOMC to release a full transcript “two months after its meetings.” According to Greider, this is “not an unreasonable standard.” Actually, it is one that virtually “every other institution of government,” with the exception of the CIA, has to comply with. Executive branch agencies, for example, provide “exhaustive documentation and rationale for decisions.” By doing so, these agencies are accountable to the people in a way the Fed is not.

Gonzalez’s bill is actually quite modest in scope. It does not compromise the Federal Reserve’s established independence in any way. It does not try to change the institutional structure of the Federal Reserve System. It simply asks a very basic question of a powerful government agency: Tell us what happened at your meeting. Let us hear what you said in plain English. Let us see why you made these decisions, what you thought you would achieve, what the economic conditions looked like to you at the time. Given that information, then we might be able to judge more coherently whether you are doing a good job or not . . . (Greider 1993 pp. 39 – 40).

#### THE FEDERAL RESERVE ACCOUNTABILITY ACT OF 1993

In 1993, the House Banking Committee held hearings on the Federal Reserve Accountability Act. Had this legislation passed, it would have required the Fed to disclose FOMC discussions and decisions *immediately*. So this bill was more stringent than Gonzalez’s—which would have required the release of a transcript too, but only after two months (U.S. House Banking Committee p. 1107).

In response to this legislation, many Fed officials testified: the Chairman, the Vice Chairman, and several Reserve Bank Presidents. All of them opposed it, as we would expect. In my view, the most important testimony came from Alan Greenspan and David Mullins (the Vice Chairman), for these officials were so aware of the challenge that secrecy posed to democratic theory and democratic institutions.

According to Greenspan, the Congress and the Fed must strike a “balance” between “the public’s right to know and the need for effective policymaking and implementation.” In a democratic political system, he recognized, decisions about public policy “should be in the open, except when exposure impedes the primary function assigned to an institution by law” (US House Banking Committee 1993 p. 1107). Greenspan’s testimony continued:

Accordingly, the Federal Reserve makes its decisions public immediately, except when doing so could undercut the efficacy of policy or compromise the integrity of the policy process. When we change the discount rate or reserve requirements, those decisions are announced at once. When we establish new ranges for money growth and credit growth, those ranges are set forth promptly in our reports to the Congress. Moreover, we publish our balance sheet every week with just a one-day lag, enabling analysts to review our operations in considerable detail (US House Banking Committee 1993 p. 1107).

What, then, does the Fed *not* release right away? As Greenspan explained, the Fed does not disclose the “implementing decisions with respect to our open market operations” immediately. After the next regular FOMC meeting, however, the Fed not only releases these decisions, but also publishes an *edited set of “minutes”* that present “a comprehensive record of the economic factors and analysis and alternative policy approaches considered in reaching our decisions” (US House Banking Committee 1993 p. 1107). Although Greenspan’s testimony referred to these as “minutes,” they are far less than that. At best, this record is equivalent to an economic policy analysis. This analysis, no doubt, helps us determine why the FOMC acted a certain way—but it is not in anyway the unedited transcript Congress was seeking.

When David Mullins testified, he presented similar views, emphasizing three points. When public officials deliberate, Mullins argued first, they are often “thinking out loud.” As a member of the FOMC, for example, Mullins engages in dialogue “with others concerned with the nation’s interest. By so doing, Mullins (like the other FOMC members) exchanges “views on possible policy options,” plans for potential crises, and contemplates “the market’s reaction to what we might do” (US House Banking Committee 1993 p. 1110).

[According to Mullins,] [m]uch of the job of a central banker involves worrying about events that have a small probability of occurrence but would impose large costs on the financial system and the economy were they to occur. Unfortunately, the public release of such discussions would only serve to focus attention on the sensational—the differences in opinion, the fears about individual institutions, and the concerns about worst-case scenarios—that normally have little consequence on net to the setting of policy and that would distract people from more fundamental issues, almost certainly heightening market volatility (US House Banking Committee 1997 p. 1110).

Here, I believe, Mullins is appealing not only to the importance of professionalism, but also to the differences between administrative discourse and political discourse. In the world of politics, we *expect* to focus “attention on the sensational.” We expect, for instance, to find Senator X attacking Senator Y (so long as it is not a personal attack on the Senate floor). We expect to find Democrats bashing Republicans, whether rightly or wrongly. We expect to listen to “doomsayer” policy analysts—many of whom base their arguments on unreasonable assumptions, while using analysis as just another ideological weapon. This “warfare” aspect of politics is what attracts many people to the enterprise; it is certainly what the newsmedia focuses on.

I think Mullins, in effect, is saying we should expect this in the political world. But in the administrative world, we need to “get real,” acting like professionals who use cold, hard logic to make the policy of the present and consider the possibilities for the future. Because political discourse is so oriented toward the sensational, administrative discourse often must be kept away from the political arena—at least for a time.

The “prospect of detailed and complete exposure,” Mullins argued next, “tends to cast a chill on some proceedings.” If unedited versions of FOMC proceedings were published, its officials would no longer “speak to each other.” Instead, they would be speaking “to the record,” so creative solutions to the nation’s economic problems may not be explored. Taken to an extreme, the danger of such a “chill” is that it allows officials to settle “too quickly on the status quo” (US House Banking Committee 1993 p. 1110).

The “monetary policy process,” Mullins argued last, is “open where it counts.” Although the deliberation may count for something, it is the *decision* that matters most. By acting in certain ways, the Fed influences “interest rates and the economy, and those actions are made public immediately.” Even the Fed’s open market operations, which the institution guards so zealously, can be discovered: “Changes in reserve conditions are transparent to the market by 11:30 am on the day of the change in the open forum of the financial market” (US House Banking Committee 1993 p. 1110).

#### THE IMPACT OF THE 1994 CONGRESSIONAL ELECTIONS

James K. Galbraith, professor of economics at the University of Texas, wrote a chapter on the Fed in *Reclaiming Prosperity: A Blueprint for Progressive Economic Reform*, which the Economic Policy Institute published in 1996. This chapter, “The Federal Reserve: Give It Till Sunset,” first discussed the impact of the 1994 elections, then presented a proposal for reform. Galbraith, it is important to recognize, was once Chief of Staff of the Joint Economic Committee, so he spoke not just as an academic, but as an insider in the world of Congressional politics.

Before 1994, as we know, the Democrats controlled both the House and Senate. In the House, the party’s control seemed virtually impregnable. The last time the Republicans gained a majority was in 1952, even then holding on to it for just two years. In the Senate, by contrast, the party’s control was not as certain, since the Republicans had had a majority from 1980 to 1986. From Galbraith’s perspective, the Congressional elections

of 1994—when the Republicans gained a majority in the House as well as the Senate—harmed the efforts of those, like himself, who wanted to reform the Fed.

On November 8, 1994, those who would reform the Federal Reserve found themselves in . . . trouble. The election brought the turnover of both congressional banking committees to Republicans, the defeat of Senator Jim Sasser, one of the leading voices in the Senate for monetary reform, and the destruction of many Democratic staffs in Congress. Ships and stores lost, the Fed remains untouched, and its hold on interest rates and on the well-being of American families remains as strong as ever (Galbraith 1996).

Before the 1994 elections, Galbraith had worked with the House Banking Committee—then chaired by Henry Gonzalez, that implacable opponent of the Fed. Along with Gonzalez, he worked to develop a “not-so-bold program” to promote “structural reform of the Federal Reserve, wherein its system of appointments and decision making would be opened up to more democratic scrutiny and accountability” (Galbraith 1996). After the 1994 elections, the reformers assumed, this legislation could be addressed, and they thought it might pass. Due to the Democrats’ defeat, however, “circumstances have changed radically, and so must we,” he said, with we referring to would-be reformers of the Fed.

Before the 1994 elections, the Fed’s opponents had a long-term goal to “reform the structure of the Federal Reserve System.”

It can be said without fear of contradiction that the Federal Reserve is the most ridiculous of all government agencies, the platypus of institutions, a bureaucracy designed by a committee, governed by an odd hybrid of public governors and private presidents, the latter spread out along the lines of economic and political power (four on the East Coast, three in the Upper Midwest, two in Missouri, and one each in the South, Southwest, and West) prevailing in 1913 at the climax of the Railroad Age (Galbraith 1996).

Like many others who challenge the Fed’s legitimacy, Galbraith insisted that the FOMC “is flagrantly unconstitutional” because the Reserve Bank Presidents are not “‘appointed by the President with the advice and consent of the Senate,’ as the Constitution requires.” Drawing on yet another theme of Fed opponents—the one attacking it for being unrepresentative—Galbraith argued that the institution is “an insular white male club.” Even worse, perhaps, it is “responsive to no constituency below the top 1% of the income distribution” (Galbraith 1996).

In the short-run, the left-liberal members of the House Banking Committee (and their staff of activists) made some “modest proposals.” First, the reformers hoped to abolish the FOMC, placing the Reserve Bank Presidents on an Open Market Advisory Committee—where they would, of course, have no real power, as they could not vote.

Second, the reformers hoped to “place the system under the budget.” Third, the reformers hoped to “broaden its base of appointees.” And, finally, the reformers hoped to “expose its internal debates to external review.” None of this, however, seemed to have much effect on the Fed itself.

In contrast to the summer of 1982, when congressional restiveness truly did disturb the institutional slumber on Constitution Avenue, what happened in 1994 evidently did not. Indeed, all agreed that the moment of a real test would come later, in the 104<sup>th</sup> Congress, when reformer Sarbanes in the Senate and reformer Henry Gonzalez in the House would both chair their respective banking committees. But the 104<sup>th</sup> turned out to be less promising than previously expected (Galbraith 1996).

So what should opponents of the Fed’s legitimacy do next? Galbraith is skeptical. Not only is it impossible to “will Congress into action on this issue,” but the Fed itself has shown, too, it will not “administer a policy that runs counter to the heart of its political and bureaucratic culture.” In Galbraith’s view, the only real answer is a sunset review, a federal statute similar to the ones many states have adopted. Under sunset laws, government agencies must undergo periodic review by legislators and receive public comments from citizens. For a given government agency to continue to exist, its enabling statute(s) must be reauthorized every few years (how frequently depends on the sunset law itself).

The advantage of such a process, as Galbraith saw it, is that it “provides a powerful lever for agency modernization and for consolidation and elimination of redundant functions.” Just as important, the sunset process takes on a life of its own—so it operates “with some independence from the gridlock of interests” normally found in legislative committee structures. As for applying sunset to the Fed, Galbraith believed there was never “an agency more in need of this process than the Federal Reserve and its associated bank regulatory systems” (Galbraith 1996).

### **THE FEDERAL RESERVE BANKS**

From 1986 to 1995, like the previous periods, the Reserve Banks defended the Fed’s legitimacy. The Federal Reserve Bank of Dallas, it seems to me, mounted the most important of these defenses; I discuss two of its arguments here.

#### **TWO KINDS OF PAPER**

In its 1990 annual report, the Federal Reserve Bank of Dallas published an article entitled, “Two Types of Paper: the Case for Federal Reserve Independence.” Essentially, the Reserve Bank contended that the “*power to spend money* and the *power to print money* must be separate and independent powers within government” (Federal Reserve Bank of Dallas 1990 p. 7).

We believe that the separation of money-spending and money-printing powers within government is essential to the efficient production and

allocation of resources in society. The principal point is that in order to continue to control inflation in the United States, the independence of the Federal Reserve must be preserved (Federal Reserve Bank of Dallas 1990 p. 7).

The Reserve Bank's argument is worth exploring in more detail. The Reserve Bank, first, connected the need to separate the spending and printing powers to the fiscal climate of the 1980s and early 1990s. Over time, federal budget deficits were getting larger: from 1948 to 1970, they averaged less than \$1 billion a year; by the 1970s, they averaged \$30 billion; by the 1980s, they averaged \$142 billion. In the early 1990s, they were projected to be "more than \$300 billion in the near-term fiscal years." Because of these deficits, "central bank independence is more important today than at any time in history" (Federal Reserve Bank of Dallas 1990 p. 6).

Somehow the government must finance these deficits, and it can do so in two ways. It can either use "interest-bearing paper," which is government debt issued by the Treasury Department, *or* print money. Obviously, printing money is "the cheapest way to finance deficits from a government fiscal standpoint because currency does not bear interest." If the government finances its deficits that way, however, it can cause inflation, thereby transferring "resources involuntarily from the private sector to the federal government" (Federal Reserve Bank of Dallas 1990 p. 6).

The Reserve Bank, second, argued that governments benefit from the inflation caused by printing money. If inflation increases, the "real value of outstanding government debt" decreases. If a dependent central bank—that is, one unable to govern independently of the executive branch—must "monetize" the debt by purchasing government securities, the "government's net interest obligation . . . [is] lower." After all, the "interest on government debt purchased by the central bank is returned to the government." At the same time, when a dependent central bank must purchase the government's debt, it "lower[s] the real interest rates at which this debt is financed."

In other countries, central banks do not "set money growth so as to have no inflation" because they are "often obliged or even pressured—directly or indirectly—to help solve the government's fiscal problem."

Such pressures can be exhibited in a variety of ways: through legislation or constitutional provisions that mandate the pursuit of fiscal objectives by the central bank, through participation of fiscal agents in monetary policy-making at the central bank, or through such subtle means as the central bank attempting to hold down interest rates in the face of a rising public debt (Federal Reserve Bank of Dallas 1990 p. 14).

During the 1980s, when the federal government was running massive fiscal deficits year after year, the independent Fed prevented "sustained double-digit inflation" (Federal Reserve Bank of Dallas 1990 p. 14). To control inflation, therefore, the nation needs an



independent central bank. Within the government, the agency responsible for printing dollars must not be the same one responsible for creating budgets. “The people who print money and those who spend it must not be the same, and institutional arrangements must be carefully constructed to keep both groups at arm’s length” (Federal Reserve Bank of Dallas 1990 p. 17).

#### WHY FIX WHAT IS NOT BROKEN?

Harvey Rosenblum, the Senior Vice President and Director of Research at the Federal Reserve Bank of Dallas, published an article in *Business Economics* entitled, “It’s Not Broke, So Don’t Fix It: Why the Federal Reserve Should Not Be Reformed.” In that article, Rosenblum assessed proposals for reforming the Fed—some of them serious challenges to its ability to govern, others mere adjustments to the way the institution conducts itself.<sup>1</sup> For my study, I want to discuss the challenges to the Fed’s independence, only one of five areas Rosenblum analyzes.

To begin with, Rosenblum used business-terminology to describe the Fed’s structure. As an operational goal, the Fed should “maximize the return and value” of the institution “to its shareholders,” who are the 260 million or so American citizens. Like a corporation, the Fed has “outside directors” and a “governance board,” which is the Congress and the Administration.

Like a private sector board of directors, they choose the Fed’s chief executive officer, the Chairman of the Federal Reserve Board. And like the board of directors of many not-for-profit institutions, the President and Congress select many of the members of the Fed’s most senior management ranks, namely, the six [other] governors on the Federal Reserve Board. The Congress, like any governance board, sets the Fed’s goals and broad policy guidelines, and then monitors the compliance and performance against these goals and guidelines (Rosenblum 1994 p. 38).

Over the years, the Fed’s opponents have attacked the Reserve Bank Presidents’ membership on the FOMC, perhaps the most popular of all their challenges to the Fed’s structural features. To address this issue, Senator Sarbanes introduced a typical piece of legislation—which, if passed, would remove the Presidents from the FOMC entirely. The twelve Reserve Bank Presidents, under Sarbanes’s proposal, would become a Federal Open Market Advisory Committee. In that capacity, they could advise the FOMC, but not vote. Rosenblum was especially critical of this proposal:

Anybody who has been in Washington recognizes that advice without a vote is the same thing as having no input at all. It would eliminate the

---

<sup>1</sup> The five areas Rosenblum discusses are the conduct of monetary policy, the Fed’s role in bank regulation, the Fed’s independence, the Fed’s role in handling systemic risk, and the Fed’s role in the payments system. For the most part, these other areas deal with technical questions of economics, so I see no need to discuss them here.

diversity of views, research, and regional input that are so critical in the making of monetary policy. It would be analogous to the Congress having to rely solely on the Administration's economic forecasts and budget projections without being allowed independent analysis of its own (Rosenblum 1994 p. 40).

In yet another piece of legislation, this one introduced by Rep. Gonzalez, the President of the United States would appoint the Presidents of the Reserve Banks, subject to Senate confirmation. If this Bill passed, the “governance role of the quasi-private sector board of directors of the Reserve Banks would be diminished in that they would no longer choose the chief executive officer of each Reserve Bank.” Why, Rosenblum asks, do Gonzalez and others want to do such a thing—and so consistently? “In the minds of the sponsors, such a reform would be more in keeping with *their* interpretation of the U.S. Constitution” [his emphasis] (Rosenblum 1994 p. 40).

Rosenblum evaluated this proposal—its consequences, its assumptions—and decided it should not be adopted. First, as a constitutional matter, the federal courts have rejected challenges to the FOMC's makeup. In *Melcher v. Federal Open Market Committee*, Judge Harold H. Greene argued that “while the composition of the Federal Open Market Committee may be unusual, it is not unconstitutional” (664 F. Supp. 510 D.D.C. 1986). The Judge noted, furthermore, that this structure resulted from an “exquisite balance” struck between public and private interests. Rosenblum argued, furthermore, that the appointment process is “based on a long historical precedent,” as the Fed is “modeled after the First Bank of the United States.”

Many of the same people who wrote the U.S. Constitution participated in writing or approving the legislation that founded the First Bank of the United States. If this private-public blend was deemed to be constitutionally correct in the eyes of our Founding Fathers, why should we doubt the constitutional legitimacy of the Fed president appointment process two centuries later?

Then, too, the Gonzalez legislation would “largely disenfranchise the boards of directors of the Federal Reserve Banks.” If the Directors could no longer appoint and reappoint their Presidents, they would have little influence over these officials—their own CEOs. In the process, the Directors would become nothing more than an “advisory committee, whose advice and counsel could be largely ignored by a political appointee” (Rosenblum 1994 p. 40). Why would anyone want to serve on such a Board? Why should such weak Boards exist in the first place?

As for Fed independence and openness *per se*, Rosenblum observed that the international trend is toward more central bank independence, not less. “Many of the recent attempts to reform the Fed,” however, would “undermine the Fed's independence in subtle, and perhaps, unintentional ways.” Retaining the Fed's structure as it is now, he believed, is necessary to prevent rising inflation. The United States has a \$4 trillion debt, but

inflation has not gotten out of control, largely because of “Fed credibility” (Rosenblum 1994 p. 41).

The financial markets understand this very well, and they react warily whenever the Fed’s independence is threatened. Rising inflationary expectations, and its corollary, high interest rates, will come back if the firewall between the Fed and the rest of government continues to be undermined (Rosenblum 1994 p. 41).

Considering specific proposals, Rosenblum rejected the idea of videotaping FOMC meetings. This is, in his opinion, an “over-reaction to the perceived lack of openness” of the Fed. If adopted, it would “reduce the Fed’s independence by making every member of Congress, in effect, an ex-officio member of the FOMC” (Rosenblum 1994 p. 41). Although videotaping “would destroy the deliberative process,” Rosenblum did believe the FOMC should release its policy decisions earlier. Because he did not say when these decisions should be released (what does “earlier” mean?) we are left to wonder exactly when he thinks the public should learn of them.

### **ACADEMIC & POLITICAL COMMENTARY**

During this period, both academic and political commentary was offered about the Federal Reserve, the most important of which I discuss here.

#### THE DIFFERENCE BETWEEN THEORY AND PRACTICE

In an interesting *New Republic* article, “Monetary Democracy,” Michael Kinsley argued that the Fed is “indefensible in theory and indispensable in practice.” As he described the institution, “twelve unelected people”—the FOMC members—have “their collective finger on the second most important button in America,” the money supply. By 1989, when Kinsley was writing, fiscal policy had stagnated, as the federal government was running huge deficits. For this reason, neither the Congress nor the President had much power to stimulate the economy.<sup>2</sup>

Seven of the 12, the Federal Reserve governors, are appointed by the President to virtually uncurtailable 14-year terms. The other five, regional Federal Reserve Bank presidents, are appointed by people appointed by the first seven. Their decisions are made in secret and kept secret for six weeks. They probably affect your life more than the Supreme Court. How many of them can you even name? (Kinsley 1989 p. 4).

---

<sup>2</sup> Even the “automatic stabilizers” built into federal programs, through which the national government automatically runs a larger deficit when the economy is in recession, reduces the influence of elected officials in the here and now. As today’s elected officials are well aware, these policies were established by their predecessors, not themselves. Although these policies can be changed, elected officials can do so only by going through a time-consuming, often difficult legislative process. Consequently, these stabilizers vary very little over time.

To those who believe, as many do, that the Supreme Court is a metaphor worth pursuing, Kinsley showed how that institution differs from the Fed: the Court is in the Constitution; the central bank is not. The Fed, according to Kinsley, is “merely a conceit of Congress and wasn’t fully vested with its current authority until 1935.” As for the Court, it may seem anti-democratic, but really it is not that way at all. Democratic theories, at least all worthy of the name, recognize the need to protect “individuals and minorities against the tyranny of the majority.” That is the function of the Court. What about the Fed? “The best that can be said of the Fed along those lines is that it protects the majority against itself—a dubious democratic safeguard” (Kinsley 1989 p. 4).

So the Fed is indefensible in theory, according to Kinsley. Still, it is *indispensable in practice* because elected officials cannot be trusted with such an important economic task. When considering the Fed’s independence in “the current state of American politics,” “no sane person would want it in any other way.” As an example of how important the Fed is in practice, Kinsley discussed the Fed’s decision—which its officials made on October 6, 1979—to target the money supply rather than interest rates. To rid the nation’s economy of inflation, Volcker was “willing to put the country through high interest rates,” something few elected officials would be willing to do. With an independent Fed, the nation’s elected officials deflected blame for high interest rates: “It’s the Fed, not us,” they said. The nation’s economy, meanwhile, was the beneficiary, over the long-term at least.

In Kinsley’s opinion, the American political system has deteriorated since 1979, becoming “more self-indulgent and shortsighted” than ever:

Reagan and Bush taught the country to believe that no short-term sacrifice, however small, is necessary for any long-term benefit, however large. It is laughable to suppose that the President and Congress, who are now busy cooking up yet another tax cut in the face of a \$140 billion deficit, could be trusted with the power to create a short-term rush of prosperity anytime they wanted, at the cost of future inflation and decay (Kinsley 1989 p. 2).

In sum, an independent Fed is legitimate because it constrains the power of politicians and promotes the public interest. As the Fed exists now, it allows “politicians to complain about monetary discipline without doing anything about it.” And that, in Kinsley’s view, is how it should be (Kinsley 1989 p. 2).

#### THE FED’S “INDEPENDENCE”: A BIG MYTH?

In a 1990 article in *The Nation* entitled, “The Myth of an Independent Fed,” Bernard D. Nossiter attacked the institution’s legitimacy. Although he placed his attack in the context of the economic recession the nation was then facing, his argument applies regardless of how strongly (or how weakly) the economy is performing.

As an institution, the Fed serves one “critical constituency,” the nation’s large commercial banks. From the very year the institution was established, 1913, its officials

have recognized that “their allegiance is to the big commercial banks, the giants like Chase, Citibank, and Manufacturers Hanover.” From the Fed, these banks receive security they would not have otherwise—because the institution is the “lender-of-last-resort,” the large banks realize that “no matter how badly they behave,” their actions will cost them little, if anything. Suppose, for instance, that these banks are careless in their lending practices, lending money (when they should not do so) in Latin America, to the American real estate market, and so on. To protect the banks from bad lending decisions, the Fed will, before long, be “turning on its money spigot to rescue them, if not the economy” (Nossiter 1990 p. 2).

Since members of the Board of Governors serve fourteen-year terms, elected Presidents cannot “interfere with anything so important as the creation and liquidation of money.” How, though, do the *commercial banks* maintain control of the Fed, as Nossiter alleged? In his mind, the banks “maintain their grip” through their influence on the FOMC, where the five Reserve Bank Presidents serve along with the seven Governors. Even though these Presidents are not a majority, he asserted, the seven Governors “mostly echo the commercial bank view.” So no matter how the FOMC *appears*, it is captured by the commercial banks.

Admittedly, other regulatory agencies are captured—but the Fed “is in a serious business,” for no other agency “is more powerful in the economic life of the country.”

The central bank, with appropriate support from taxes and government spending, can literally determine prosperity or misery, inflation or deflation, boom or slump. Flood the banks with the Fed’s high-powered money reserves, and a boom is triggered, even inflation and high employment. Starve the banks, as the Fed in its wisdom did at the bottom of the Great Depression, and business, incomes, and jobs wither (Nossiter 1990 p. 2).

Although Fed officials claim they simply respond to the nation’s economic needs, Nossiter did not believe this is the case. Over and over, Fed Chairman attempt to “direct the economy,” *even interfering with the Congressional budget process*. In 1990, to cite just one instance, Greenspan urged Congress to adopt “deflationary cuts . . . in return for some easing of credit.” In popular mythology, the Fed prevents “monetary excess,” but Nossiter believes it really “executes the narrow agenda of the commercial bankers.” It is the bankers, he argued, who have a bias against strong economic growth—slower economic growth means lower inflation, which is what they are concerned about most. Bankers “always favor curbing credit, cutting government spending, and resisting expansion, regardless of whether the economy is in a boom or a slump” (Nossiter 1990 p. 2).

As Nossiter understood it, the nation needed to end the rule of the commercial banks and the (so-called) “independence” of the Federal Reserve. What the nation must do is establish “some kind of democratic governing of money.” With the way the Fed is structured today, the nation’s elected officials have simply guaranteed that “the central

bank is a handmaiden of the banking industry.” These private bankers, in turn, are deflationists—and control by them is “far less preferable than control by elected politicians” (Nossiter 1990 p. 2).

The Fed, as it exists now, should be abolished. After abolishing the institution, the Congress should give its “money-creating tasks to an office in the Treasury or some other agency in the Cabinet.” This is the reform Nossiter favored—if some see it as too radical, however, he would favor retaining the Board of Governors *so long as they “serve at the pleasure of the President”* [my emphasis] (Nossiter 1990 p. 2). Although he recognized that the various reforms would allow economic policy to “be fixed by a triad” (the Council of Economic Advisors, the US Department of the Treasury, and the Office of Management and Budget), this is preferable to the Fed. Almost anything, in fact, would be.

These are not populist bodies, but, unlike the Federal Reserve Board, their members owe their jobs to the President and they are charged with executing the President’s policy. Apart from trading quips with Congressional committees, the Fed chair reports to no one. His constituents, the commercial banks, neither know enough nor are infused with enough public spirit to run anything. It is time to admit that the seventy-seven year experiment has failed (Nossiter 1990 p. 2).

Here Nossiter presents a Presidential view of public administration, a perspective we have seen time and again. What is really interesting, though, is how he connects this view to a populist-progressive perspective. In theory, populists should align themselves with legislatures, for they are the majoritarian bodies. In American history, however, populists and progressives have often aligned themselves with like-minded Presidents—beginning with the Presidency of Andrew Jackson, the first “Man of the People” to hold that office. In the twentieth century, populist-progressives aligned themselves with Woodrow Wilson, who signed the Federal Reserve Act of 1913. During the New Deal, they generally supported Franklin Roosevelt, though many on the far-left supported Huey Long. In the 1960s, they aligned themselves with Lyndon Johnson’s Great Society, until the Vietnam War ruptured the alliance. By 1990, Nossiter seems to have resigned himself to the Presidential perspective. He does not think it is a great solution, just the only one available.

As a rhetorical strategy, furthermore, Nossiter challenged the definition of central bank “independence.” In his view, the Fed is controlled by the commercial banks—so while the institution is independent of elected officials, it is captured by private interests who wish to use the government for their own purposes. *If* this is true (that is, if the commercial banks control the Fed’s policy), it is a major challenge to the institution’s legitimacy. When defending the Fed’s legitimacy, many supporters claim that it promotes the public interest. If the institution is captured by commercial banks, however, that cannot be true. (Why should the Fed continue to exist if it simply does the bidding of commercial banks? Would it not be better for elected officials to make monetary policy?)

#### AN ACADEMIC ATTACK ON THE FEDERAL OPEN MARKET COMMITTEE (FOMC)

In 1989, the *Virginia Law Review* published Mark Bernstein's academic critique of the Federal Open Market Committee (FOMC) entitled, "The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens." From the beginning, Bernstein acknowledged that Congress frequently delegates power to administrative agencies, a practice he does not take issue with. It may do so, he believed, because administrative agencies have "technical expertise" that legislators lack. Or it may do so "for reasons of political expediency." By the late eighties, when Bernstein was writing, the "delegation of governmental authority is accepted as indispensable, despite debates about when and where it is necessary." Unfortunately, neither elected officials nor scholars have carefully examined "the question of *who* may exercise delegated power" [my emphasis] (Bernstein 1989 p. 111).

At first glance, the idea that Congress could perhaps deputize the CEOs of the Fortune 500 companies to cast additional votes on a new Clean Air bill, or invite the Brookings Institution to determine and implement mandatory budget cuts under Gramm-Rudman seems ridiculous. But the sharing of control over the nation's monetary policy within the FOMC between the Board of Governors of the Federal Reserve System and representatives of the Reserve banks is a similar situation (Bernstein 1989 p. 152).

Five of the twelve FOMC members are not appointed by the President and confirmed by the Senate. Instead, they are "selected by members of the banking community—the very constituents the FOMC is supposed to regulate." Because of the way the FOMC is composed, it raises the most serious "questions about the accountability of those responsible for monetary policy." "The problems raised by a delegation to private individuals . . . suggest the need for closer scrutiny of the status of the FOMC's privately appointed members" (Bernstein 1989 p. 112).

Although inconsistent in its application, the Supreme Court has permitted broad delegations of power when Congress or the President has exercised some control over the recipients of that power, whether by oversight, appointment, or removal . . . [T]he private citizens who serve as Reserve Bank representatives to the FOMC are subject to no such control. Their presence is a violation of the appointment clause of the Constitution, and the present structure of the FOMC should be altered to resolve the tension between the need for an expert and independent open market committee and the constitutional requirements of governmental control over delegated authority (Bernstein 1989 p. 112).

Part of Bernstein's article discusses the "delegation doctrine" and the separation of powers, where he shows how contemporary practice differs from classical liberal philosophy. Traditionally, delegation of powers was "rejected . . . out of hand." John Locke, one of the most important liberal thinkers of the 1700s, argued that the legislature

“cannot transfer power of making laws to any other hands,” since the people had delegated the legislative authority to it. As a social contract theorist, Locke assumed that the government “derives its legitimacy from the consent of the governed,” and delegation makes no sense in that framework. The Framers of the Constitution, for their part, seem to have “accepted the Lockean view of electoral accountability as the theoretical foundation of their new system of government.” James Madison, the father of the Constitution, contended that “the people are the only legitimate foundation of power.” Only because the people have delegated their power to the three branches do their officials have a right to exercise it (Bernstein 1989 p. 125).

If the nondelegation doctrine was ever a realistic component of democratic government, it became less so over time. As Congress began to establish independent regulatory commissions, for example, it challenged “this view of a government of rigidly separated powers whose legitimacy is derived from its accountability to the governed.” Today, for the most part, “broad delegations of legislative authority are accepted as a necessary part of the federal system” (Bernstein 1989 p. 124). Elected officials have neither the time nor the expertise to make all decisions about public policy. When administrative agencies—as repositories of expertise, institutions with long-time frames, specialists in one area of public policy—make these decisions, the public is better off.

Returning to the FOMC, the “sharing of monetary policymaking authority with private interests has been described both as a unique affirmation of democracy and as a dangerous concentration of power.” Private interests, some argue, have always been an important part of the American polity, and they should continue to be. By providing representation to the commercial banks, the FOMC ensures that diverse interests—both public and private—are considered. And even though the Reserve Bank Presidents serve on the FOMC, the majority of its members are Governors, officials appointed by the President and confirmed by the Senate. The Subcommittee on Economic Stabilization had this to say about the Reserve Bank Presidents’ presence:

It exemplifies the unceasing search of the American democracy for forms of organization that combine centralized direction with decentralized control, that provide ample opportunity for hearing to the private interest but that function in the public interest, that are governmental and yet are screened from certain governmental and political pressures since even these may be against the long-run public interest (Bernstein 1989 pp. 126 – 127).

According to Bernstein, however, the questions about delegation of power are even more acute in this situation. Anytime administrative agencies share “power . . . with private interests,” they force us to question “the recipients’ conflict of interest and accountability.” They force us, too, to consider the possibility of agency capture. “The risk is not only that power will be concentrated, but that it potentially may be concentrated in those unaccountable for their actions” (Bernstein 1989 p. 127).



Bernstein cites some case law to support his contentions about the FOMC. In *Carter v. Carter Coal Company*, which was decided in 1936, the Supreme Court rejected the Bituminous Coal Conservation Act of 1935 as unconstitutional.<sup>3</sup> Under that statute, coal companies elected district boards, and their members “set minimum prices for each district.” Similarly, the industry’s largest employers were able to establish “industry-wide wages and working hours.” If mine owners refused to participate in this arrangement, they were fined. Delegating power to private interests, the Court held, was “legislative delegation in its most obnoxious form” (Bernstein 1989 p. 130).

Because the FOMC’s actions affect everyone, its structure “presents a stronger case for invoking the delegation doctrine than did *Carter Coal*.” Even worse, the Federal Reserve Act of 1913 and the Banking Act of 1935 provide the FOMC with *broad grants of power*, requiring the body to make policy “with a view to accommodating commerce and business.” Nevertheless, Bernstein recognized that the federal courts are not likely to reject the FOMC’s composition. In the past, they have either dismissed suits entirely or upheld the FOMC’s constitutionality.<sup>4</sup>

Recognizing that the federal courts will not intervene on his cause’s behalf, Bernstein proposed a political solution:

The FOMC embodies a tension between, on the one hand, the need for monetary policy made independent of political considerations and with input from the financial community and, on the other hand, the requirement that some branch of government exercise control over governmental decisions that affect the national economy. Its current composition, however, is not necessary to effect the compromise. The independence of the FOMC and the contribution of the banking community can be retained while implementing greater control over the FOMC’s actions (Bernstein 1989 p. 150).

How could this be done? In Bernstein’s view, the FOMC appointment process should be reformed, with the banking community *recommending* appointments to the President, but not appointing them. Already, the Fed has a Federal Advisory Council, which consists of banking representatives. If the nation adopted Bernstein’s proposal, these representatives would recommend appointees for the five seats the Reserve Bank Presidents occupy now. After hearing the Advisory Council’s recommendations, the President would consider them carefully. These recommendations would not, however, bind the President. (During confirmation hearings for whoever was chosen, the Advisory Committee “could also be consulted,” thereby enhancing its influence.)

---

<sup>3</sup> Although *Carter* is remembered primarily as an interstate commerce case, it also dealt with the issue of delegation—recall that the Bituminous Coal Conservation Act raised questions not only about how far Congress’s power to regulate “interstate commerce” extended, but also about delegating government power to private citizens. This second issue is what Bernstein is most concerned with, and it is what has particular relevance for the FOMC.

<sup>4</sup> For a case history, see chapter six, footnote 5.

Once the FOMC members were appointed, they could not be removed except for cause, just as the Federal Reserve Act of 1913 requires today. So all FOMC members would have fourteen-year terms—which, in some ways, would strengthen their independence while increasing their accountability. By forcing all FOMC members to be appointed by the President and confirmed by the Senate, Bernstein believed, we could make certain that they all “are at some point subject to scrutiny by those whom the people have elected to run their government.”

## CONCLUSION

In this chapter, what have we learned about the Fed’s administrative legitimacy? What are the central themes? First, we saw that the threats to the Fed’s independence have lessened over time, with most of the debate addressing issues at the margins of the institution’s power. Elected officials and political activists were concerned, for example, about the FOMC’s secret tapes and unedited transcripts, which Congress was unaware of. Along the same lines, the House Banking Committee held hearings on the Federal Reserve Accountability Act. If that legislation had passed, the FOMC would have to not only release an unedited transcript of its meeting, but also inform the public immediately of any decisions it made. Fed officials, for their part, were skillful opponents of this legislation—as Alan Greenspan acknowledged, the issue was one of balance between the public’s right to know and the Fed’s need for “effective policymaking and implementation.”

Second, we saw that some originally questioned Alan Greenspan’s political connections, since the Chairmanship is supposed to be a nonpartisan position. As a long-time activist in Republican politics, some questioned whether he would be able to resist partisan pressures, especially during Presidential elections. Over time, however, Greenspan has become accepted as Fed Chairman. Now few question his independence; many view him as the epitome of a legitimate central banker. Not surprisingly, the Fed Chairmanship is more respected than ever, with many CEOs seeing it as a *more important position* than the Presidency itself.

Third, we saw that the Fed was largely responsible for major changes in President Clinton’s economic policies. In the 1992 campaign, Clinton promised to “put people first”—investing more in the public infrastructure, even if it required deficit spending, and reducing taxes on the middle class. Shortly after Clinton’s election, however, Greenspan met the President-elect at the Arkansas Governor’s Mansion. In that meeting, the Fed Chairman emphasized how important reducing the deficit was. Implicitly, Greenspan was telling Clinton that if he reduced the deficit, the Fed might reduce short-term interest rates.

In previous years, I think, Greenspan’s strong influence on the elected administration’s economic plan would have been attacked vigorously. No telling what would have been said if Arthur Burns, Chairman from 1970 to 1978, had had that kind of influence! Because the Fed’s legitimacy is more accepted now than ever, though, Greenspan’s influence was seen as prudent service to the public interest, not unwarranted intrusion into a President’s political prerogatives.

Fourth, we saw how officials at the Federal Reserve Bank of Dallas attempted to legitimate the institution. While doing so, we concentrated on an important article in its 1990 annual report, “Two Types of Paper: The Case for Federal Reserve Independence.” In America, we believe that governmental power must be dispersed, and the Reserve Bank used this theme in its argument. One agency, the Bank claimed, must have the power to spend money; another must have the power to print it. Because of its independent central bank, America has been able to avoid runaway inflation, so the Fed is legitimate because it promotes the public interest.

And, lastly, we examined some academic and political commentary. Michael Kinsley of *The New Republic*, for instance, argued that the Fed was indefensible in theory, but indispensable in practice. To him, elected officials could not be trusted to make monetary policy, so the Fed was legitimate by default. Bernard D. Nossiter reached a different conclusion, claiming that the Fed should be abolished, as it was captured by the commercial banks. In the academic world, Mark Bernstein offered a critique of the FOMC’s composition, which was published in the *Virginia Law Review*. Not nearly as rash as Nossiter, Bernstein’s proposed reform would allow the President to appoint five more members to the FOMC, though the appointment process itself would still be strongly influenced by the banking community. The Federal Advisory Council, composed of banking representatives, would be able to make recommendations to the President. During confirmation hearings, moreover, it could be consulted by Senate committees.

## REFERENCES

- Bernstein, Mark. (1989). The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens. Virginia Law Review, 75, pp. 111 – 152.
- Blinder, Alan S. (1998). Central Banking in Theory and Practice. Cambridge, MA: The MIT Press.
- Borger, Gloria. (1991). The Politician-Economist: Walking the Fine Line Between the Public White House and the Private Fed, Chairman Alan Greenspan Looks to the Numbers for Answers. US News and World Report, 111, 1, pp. 53 – 54.
- Federal Reserve Bank of Dallas. (1990). Two Types of Paper: The Case for Federal Reserve Independence. Federal Reserve Bank of Dallas Annual Report. Washington, DC: Government Printing Office.
- Galbraith, James K. (1996). The Federal Reserve: Give It Till Sunset. In Todd Schafer & Jeff Faux (Eds), Reclaiming Prosperity: A Blueprint for Progressive Economic Reform. Armonk, NY: ME Sharpe.
- Greenspan, Alan. (1993). Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the US House Committee on Banking, Finance, and Urban Affairs. Federal Reserve Bulletin, 79, 12, pp. 1107 – 1109.
- Greider, William. (1993). Why Alan Greenspan Should Show You His Hand: The public has a right to know what the Fed has up its sleeve. Washington Monthly, pp. 36 – 44.
- Kinsley, Michael. (1989). Monetary Democracy. The New Republic, pp. 4 – 5.
- Mullins, David W. (1993). Statement by David W. Mullins, Jr., Vice Chairman, Board of Governors of the Federal Reserve System, before the US House Committee on Banking, Finance, and Urban Affairs. Federal Reserve Bulletin, 79, 12, pp. 1110 – 1111.
- Neikirk, William R. (1987). Volcker: Portrait of the Money Man. New York: Congdon & Weed, Inc.
- Nossiter, Bernard D. (1990). The Myth of an Independent Fed. The Nation, pp. 837 – 838.
- Reich, Robert B. (1997). Locked in the Cabinet. New York: Alfred A. Knopf.
- Rosenblum, Harvey. (1994). It's Not Broke, So Don't Fix It: Why the Federal Reserve Should Not be Reformed. Business Economics, pp. 37 – 42.
- Smith, Adam. (1988). The Volcker Legacy. Esquire, pp. 71 – 73.

Starobin, Paul. (1993). The Fed Tapes. National Journal, pp. 2984 – 2989.

Volcker, Paul A. (1990). The Triumph of Central Banking? Washington, DC: Per Jacobsson Foundation.

Volcker, Paul A. (1992). Changing Fortunes: The World's Money and the Threat to American Leadership. New York: Random House, Inc.

Welsh, Tricia. (1996). CEOs: Greenspan by a Landslide. Fortune, 133, 5, p. 43.

Woodward, Bob. (1994). The Agenda: Inside the Clinton White House. New York: Simon & Schuster.