Critical Dialogue

The Myth of Independence: How Congress Governs the Federal Reserve. By Sarah Binder and Mark Spindel. Princeton: Princeton University Press, 2017. 296p. $35.00 cloth.
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— Desmond King, *University of Oxford*

The Great Recession of 2008–9 rendered America's central bank, the Federal Reserve System, an improbable hot new scholarly subject. On the one hand, the Fed was hailed as the savior of the world's global financial system because of its rapid injection of liquid resources into the U.S. and, thereby, global financial markets as credit froze (under the direction of Fed Chair Ben Bernanke, whose economic studies of the 1930s pinpointed tight credit as a key factor in that crisis). On the other hand, it was denounced by its critics for propping up the very banks that caused the fiscal implosion and whose sloppy regulation by the same Fed permitted the crisis to unfold in the first place.

Hero or scoundrel? Heroic or complicit? Few commentators lacked an opinion one way or the other about the Fed.

Leading political scientist Sarah Binder, a distinguished scholar of Congress among other topics, takes on these competing interpretations to advance a new framework for understanding the place and powers of the Fed in the U.S. polity. With her coauthor Mark Spindel (an investment manager), Binder uses historical analysis, archival and other primary sources including testimony in Congress, and an inventory of the 879 bills introduced by 333 House and Senate members between 1947 and 2014 to reach a disarmingly uncontroversial thesis: The Fed and Congress need each other politically and economically.

Congress members can blame the Fed as the manipulator of monetary policy (particularly through interest rate setting), which affects not just the vast sums earned by billionaire hedge fund managers but also the mortgage and credit rates encountered by millions of ordinary Americans on a daily basis. Conversely, the Fed accrues power quietly during periods of economic growth when its Federal Open Market Committee (FOMC) decisions are below the radar screen of most voters, though closely watched by the financial institutions it regulates on Wall Street. When the political heat of disgruntled voters during a recession heats up, lawmakers engage in some reform of the Fed, but invariably of a modest form.

Binder and Spindel call this framework the "interdependence" model: "[I]nterdependence—rather than independence—best characterizes the Fed's position within the broader political system" (p. 236). They add that "legislators' interest in monetary policy is reactive and countercyclical. *But episodic interest does not create an independent Federal Reserve*. Because Fed credibility is vulnerable to congressional-led cycles of blame and reform, Fed success in managing an inherently cyclical economy depends directly on maintaining political support" (p. 232; emphasis added). Blaming the Fed helps Congress members to insulate themselves from blame for the economic hardships raining down on their constituency voters, as congressional response to the Great Recession illustrates, according to the authors (pp. 229–31). *The Myth of Independence* complements an older form of analysis by economists that traced the responses of the Fed to congressional hearings.

This argument is buttressed by a detailed account of the historical evolution of the Federal Reserve, from its founding legislation in 1913 through significant iterations in the 1930s, 1950s, and 1970s in which 18 new laws and various amendments redefined, usually broadening, the powers of the Fed. These periods of major reform of the Fed by Congress, according to Binder and Spindel, are closely associated with the pressures boiling up on lawmakers from voters affected by recessions, but the balance between initiatives that weaken the central bank versus enhancing its capacities are roughly evenly matched. They cite Dodd-Frank's concurrent expansion of Fed regulatory powers, with its new restrictions on the Fed's emergency lending powers, as an instance of this dual approach to accountability.

This is a major work of scholarship, and Binder and Spindel deserve to be congratulated for the achievement. The authors offer a highly readable narrative of the Fed's development over the century from its founding, and although this history has been the subject of existing scholarship—notably studies by Donald Kettl, John Woolley, and Allan Meltzer—the originality of Binder and Spindel is a keen focus on the Fed as a function of congressional creation and maintenance. But a number of lines of the argument can be challenged.

The authors have immersed themselves deeply in the world of the Fed and Congress, and this leads to an undeveloped critical perspective. They frequently recite the arguments of reformers (including statements from non-U.S. central bankers, such as the Bank of England's Paul Tucker [p. 231]) without considering how these claims are self-serving. Many critics of the Fed would conclude that the institution's egregious record in failing to regulate the mortgage industry and other financial institutions before 2008 exposed the Fed's ludicrously sutured rather than independent relationship with finance; it willingly sacrificed the autonomy necessary to be an effective regulator. Binder and Spindel report this regulatory sloppiness but do not invoke it in the analysis. They approvingly cite Ben Bernanke's mantra that the Fed needs to be embedded in (or "have roots in") Wall Street, rather than interrogating this view as self-serving for the Fed and indeed for finance. The authors do not pay much attention to what the economic sociologist Greta Krippner calls "financialization" since the 1990s (driven in part by massive post-1990 deregulation of the financial sector) and how it has created the Fed's structural dependence on finance, which necessarily denudes the central bank of its regulatory powers. The bitter experiences of many mortgage holders and workers in 2008 and the years after certainly invite such a reflexive commentary.

Binder and Spindel are curiously uninterested in the sociology of professionalization that imbues the Fed with one of its great strengths, reputational power rooted in a claim to expertise. When they discuss the shifting influences of Keynesianism and then monetarism on the Fed's decision making, they reproduce the standard economists' justifications of these frameworks and why they change. Neglected in the analysis is the many millions of dollars that are funneled to researchers and journal editors responsible for "independent" research on Fed policy—a similar practice in medicine is barred by multiple checks against conflicts of interest.

To sustain the proposition that Fed independence is a "myth," readers will anticipate a robust demonstration of congressional powers of accountability. But here, *The Myth of Independence* is disappointing in a number of respects. First, as Sarah Binder herself documents in other important scholarly work, Congress is "dysfunctional" and largely incapable of efficacious policymaking. How does this "broken branch," in Thomas Mann and Norman Ornstein's phrase, muster the political will and bipartisan strength to regulate the Fed and hold it accountable? Indeed, both in this book and one of the most important previous studies of the Fed—Donald Kettl's *Leadership at the Fed* (1986)—encounters between wily Fed officials and blustering members of Congress reveal how the former elide reform and distract the latter with lip-service changes. Consider the watering down of Senator Christopher Dodd's (D-CT) initial efforts to hold the Fed accountable after its part in the Great Recession. Dodd had concluded that the scale of Fed regulatory failure before 2008 was grounds to weaken the central bankers' regulatory powers; these efforts were substantially defeated in the wake of lobbying by the Fed and its well-heeled supporters in the financial sector. (Ditto to the Warren-Vitter reform proposals in 2015 [pp. 222–24]). In fact, Binder and Spindel's reporting of this outcome acknowledges the influence of bankers and banking associations in preventing the change (pp. 235–36), but the implications of this influence are not incorporated into the overall analysis and conclusions. Instead, the authors admire the adroit dancing steps of Bernanke and Janet Yellen to defend their institution's powers.

In addition, at times the book retreats to a troubling form of argument about an "intuitive" (p. 237) sense that the Fed is dependent on Congress, rather than a cogent demonstration of this proposition. But the complexity of modern financial systems and their keen interaction with monetary systems does not automatically free the Fed from political significance and calculations. The Fed is calculating in its use of obfuscation and complexity to conceal its most consequential actions—a pattern that the authors do not pursue analytically.

The book then offers an excellent account of core aspects of the Federal Reserve and its relationship with Congress. But there are omissions. Two stand out. First, the authors focus on interest rates and the Fed's responsiveness to congressional complaints about monetary policy. But interest rates were near zero or quite low during the past decade. Instead of catering to Congress, the Fed seized the power of lawmakers over fiscal policy during this period and used a series of unilateral unorthodox policies to boost the supply of money. Little about this unilateral and unaccountable action by the Fed appears in this work. Distributional consequences is another blind spot. Eight decades ago, Harold Lasswell reminded us that "Politics is who gets what, when, how" (*Politics: Who Gets What, When, How*, 1936). This imperative to political science is missing in *The Myth of Independence*. Undeniably, the Fed's interventions after the 2008 Great Recession to prevent a collapse of the financial system in the United States and globally spared many from job loss and misery. But, following Lasswell's dictum, it is important to avoid a false equivalency between the gains for finance and those for the general public. The Fed's policies delivered lopsided and often concealed benefits for finance, the top 1%, and the institutional interests of the Federal Reserve Bank that enjoys more power and autonomy than at any time in its 100-year history. Over the past decade, the most affluent acquired sharper gains and enjoyed greater protection against lasting deep losses than did most Americans who gained less and suffered bigger and more lasting harm.

Response to Desmond King's review of *The Myth of Independence: How Congress Governs the Federal Reserve*

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— Sarah Binder and Mark Spindel

The Federal Reserve is often blamed for financial crisis and economic distress. That tendency to blame the Fed scaffolds the central argument of our book: A cycle of crisis, blame, and reform led Congress to write the Federal Reserve Act in 1913 and continues to drive the Fed's evolution a century later. We argue in *The Myth of Independence* that Congress's power to rewrite the Act—in ways both welcomed and opposed by the Fed—creates two inter-dependent institutions. Congress depends on the Fed to absorb public blame for economic downturns and financial panics. And the Fed depends on Congress as the source of its goals, powers, and tools. By bringing Congress back into the study of the Fed, we sought to question claims that the Fed is an autonomous, apolitical institution. Desmond King challenges our account in several ways.

First, King argues that our analytical focus on Congress's relationship with the Federal Reserve leaves us insufficiently critical of the Fed's close ties to financial institutions. According to King, those ties led the Fed to favor Wall Street and the wealthy in the wake of the global financial crisis a decade ago. As we document in Chapter 7, the Fed's weak supervision of banks surely contributed to the onset of crisis. (Congress was also asleep at the wheel.) But the ways in which legislative politics shape the Fed's conduct of monetary policy lead us to dispute arguments that the Fed is fully subjugated to financial interests. Congress authorizes the Fed to make emergency loans to banks—not to steer aid directly to homeowners. In a crisis, monetary policy can affect the real economy by pumping credit through the clogged plumbing of the financial system. And evidence from progressive economists suggests that the Fed's unconventional bond purchases reduced mortgage rates, making working- and middle-class Americans better-off.

Second, King suggests that legislators' threats to hold the Fed accountable ring hollow in today's gridlocked Congress. Over the course of Fed history, however, we find ample evidence that the Fed pays a price for failure: Congress and the president typically revamp Fed tools and responsibilities in the wake of crisis. And since the 1970s, Congress has repeatedly imposed more transparency on the Fed—each time over the objections of Fed leaders. Counterfactuals are difficult to establish. But we argue that requiring greater transparency forces the central bank to balance its own views against the policies it believes that Congress and the broader public will support.

Finally, King charges that we largely ignore the Fed's seizure of fiscal policy in the long, sluggish, postcrisis recovery. But we document in Chapters 7 and 8 how the Fed pushed its legal limits when a divided Congress failed to provide additional fiscal stimulus. Republicans at least saw political upside to inaction—thus leaving monetary policy the only game in town. The Fed's activism worked: Recent record improvements in labor markets are directly attributable to postcrisis monetary policy. Why is the Fed so focused on employment? Because Congress—as early as the 1940s—directed the Fed to care about both jobs and inflation. That unusual dual mandate seems to have paid off, even for cohorts often left behind in an economic recovery. To be sure, the Fed makes mistakes. But explaining the course of American central banking demands scrutinizing Congress and monetary politics as well.

Fed Power: How Finance Wins. By Lawrence R. Jacobs and Desmond King. New York: Oxford University Press, 2016. 264p. $24.95 cloth, $18.95 paper.

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— Sarah Binder, *George Washington University and The Brookings Institution*

— Mark Spindel, *Potomac River Capital, LLC*

Monetary policy has always been political. Key conflicts have pitted coalitions at odds over the availability of money, credit, and jobs: bankers versus borrowers, Washington versus Wall Street, urban versus rural, and so on. Despite the consequences of such conflicts for the health of American households and the national economy, few political scientists have studied the U.S. Federal Reserve—the key political institution whose policy choices are central to the paths and outcomes of such debates.

Enter Lawrence Jacobs and Desmond King, whose *Fed Power* shines an important light on the Federal Reserve as an inherently political institution. Given the depth of the last recession and the Fed's implementation of controversial, unconventional monetary policies in the wake of the financial panic, it is perhaps no surprise that the central bank has been caught in political crosshairs. As such, Jacobs and King's critique of the Fed's role in the broader political system arrives at a particularly opportune time.

Analysis of central banking flourishes within comparative politics and international political economy. But scholars of American politics have paid relatively little attention to the Fed. This book makes a bold contribution to emerging debates. Aiming for a broad readership, Jacobs and King write in an accessible style, move swiftly over a broad swath of Fed history, dig deep into monetary politics during and after the financial crisis, and offer comparative examples to argue why and how the Fed went astray and how it could have done better. The result is a strong critique of the biases that the authors perceive in the Fed as a political institution and the preeminent economic policymaker in the world. The central argument of *Fed Power* is threefold.

First, according to Jacobs and King, the Federal Reserve is a democratically unaccountable institution. They suggest that over the course of Fed history, the Fed's budgetary autonomy from Congress and its intimate-by-design relationship with banks empowered the central bank and the financial sector. Moreover, the authors argue that the Fed can act stealthily—without public debate or congressional hearings. As a result, its power grows because the Fed is untethered to elected officials who might otherwise attempt to rein it in. Exhibit A in their account is the Fed's behavior during the global financial crisis. They argue that the Fed designed policies intended to favor banking and investment industries at the expense of individual homeowners hardest hit when the housing bubble burst. As a result, Wall Street recovered relatively quickly from the crisis; Main Street did not.

Second, after detecting what they term a "consistent pattern of favoritism" (p. 101), Jacobs and King assert that the Fed could have adopted more effective policies, less tilted toward financial interests. In particular, they praise the approaches of the Banks of Canada and England. They argue that those two countries came through the crisis far better than did the United States—albeit recognizing the two countries' distinct political and banking systems.

Third, Jacobs and King contend that the Fed's choice of monetary policies fueled preexisting income inequality in the United States. By crafting policies that bolstered the bottom lines of "too big to fail" financial institutions, the Fed, according to the authors, enhanced the flow of riches to the top 1% at the expense of Middle America. Top earners and institutions rebounded smartly, they note. In contrast, few on Main Street were so lucky.

Jacobs and King draw provocative conclusions about the interdependency of the Fed and the financial industry, the Fed's responsibility for the onset of the financial crisis, and necessary reforms for the U.S. financial architecture. As such, their critique raises several questions for students of American political economy and institutions, all of which are open to competing interpretations.

First, is the Fed as unaccountable as the authors suggest? The Fed's structure, powers, and governance stem directly from political choices made by Congress. As such, it seems difficult to conceptualize the Fed as an entirely undemocratic and unaccountable institution. That Congress is its boss has an important implication for the book. When the Fed acted in the heat of the crisis—coming largely to the aid of financial institutions—it did so under legal authority granted by Congress. To be sure, Fed officials debated contemporaneously whether they were deploying their emergency powers as Congress had intended; some outside of the Fed later argued that the officials stretched their powers beyond the limit. But Congress was the source of such power.

After the crisis, lawmakers clipped those same emergency powers when they rewired the financial regulatory system—making the Fed pay a price for how it deployed its congressionally allocated policy tools. Granted, it took legislative and judicial action to force the Fed to reveal the recipients of its emergency loans. But those moves undercut charges that the Fed is unaccountable to public officials. None of this absolves the Fed of at least partial blame for causing the crisis in the first place, as the authors remind us. In light of Congress's actions before and after the crisis, however, it seems difficult to call the Fed a wholly unaccountable agency.

Second, were the Fed's unconventional policies as harmful to the polity as the authors suggest? Jacobs and King single out the Fed's unwillingness to directly help homeowners—suggesting, for example, that the Fed should have pursued "cram down" policies to reduce homeowner debt in bankruptcy court. But the Fed lacked legal authority to do so. A Democratic Congress in 2009 and 2010 debated, but stalemated, over empowering bankruptcy judges to write down homeowner mortgages. And the Fed lobbied Congress to use fiscal policy tools to help homeowners. All that said, the 2009 CNBC rant by Rick Santelli that gave rise to the Tea Party stemmed from an Obama White House proposal to forgive household debt. Even if the Fed had authority to directly aid homeowners, they would have faced partisan political fire no matter how they acted.

A related concern of the authors is appropriately the effect of the Fed's *large-scale asset purchase* program on economic inequality. Jacobs and King argue that the Fed's multi-trillion-dollar bond acquisition benefited the wealthy, exacerbating income inequality in the wake of the crisis. Although they cite former Fed Chair Ben S. Bernanke in support, he questioned such claims (Ben S. Bernanke, "Monetary Policy and Inequality," The Brookings Institution, June 1, 2015). And in the years since the crisis, Bernanke has been clear that the Fed's purchase of mortgage-backed securities and Treasury bonds lowered mortgage rates, boosted house prices, and helped to stabilize housing markets.

Fed policies increased stock prices to record levels, and stocks are held disproportionately by the wealthy. But boosting the equity market has broad benefits—for pension funds, private-sector employment, and capital investment—all of which can directly help the working or middle classes. Indeed, one postcrisis study from the left-leaning Economic Policy Institute showed that middle-class wealth is largely based on home equity, and so by capping mortgage rates, the Fed's bond buying likely dampened a decades-long movement toward greater inequality (Josh Bivens, "Gauging the Impact of the Fed on Inequality in the Great Recession," Hutchins Center Working Paper, June 1, 2015). Moreover, the Fed's dual mandate from Congress requires the Fed to maximize

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employment and stabilize prices. In concert with its asset purchases and to further assist the labor market, the Fed committed to keeping interest rates low during the recovery. Those strategies accrue benefits directly to working and middle classes in the form of remarkably low unemployment rates, even as inflation remained below the Fed's 2% target. In sum, it is likely that working-and middle-class Americans were made better-off with the Fed's bond buying than without it.

Third, does Canada and its central bank offer an appropriate and superior model for managing a financial crisis and directing a recovery? True, Canada weathered parts of the global financial crisis better than the United States did. But overlooking Canada's early 1990s fiscal and financial crisis may unduly brighten the analysis. And a recent run-up in Canadian house prices and lending look suspiciously similar to precrisis events in the United States. Over a longer period, per capita economic growth in Canada has not kept up with the United States, and the painful 1990s restructuring of its public sector came after years of living beyond its means.

As the authors note, Canada also rationalized its banking sector by enabling mergers that resulted in a handful of very large financial institutions. In the United States, both parties have pushed to *downsize* American banks. The key point is that the Fed—by design—does not shoulder blame for the shape of the banking system. As Jacobs and King remind us, banking systems are deeply rooted in each country's political and institutional DNA. Canada's parliamentary democracy gives enormous, unified power to the ruling party. Its more monolithic central bank—with monetary control vested in a more omnipotent governor—still answers to Ottawa. Overlooking the extent to which a legislature creates and governs its central bank risks losing sight of the long arc of political and economic history.

Fed Power joins a growing body of work that examines the myth of a politically independent Fed. Jacobs and King's broad sweep of economic history and their deep dive into the 2007–8 crisis yield a provocative critique of the Fed and its recent, unconventional approach. To be sure, some readers may disagree with their conclusions about the extent and sources of the Fed's policy biases. But the book opens important avenues for studying monetary politics and the Federal Reserve.

Response to Sarah Binder and Mark Spindel's review of *Fed Power: How Finance Wins*

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— Lawrence R. Jacobs and Desmond King

Eight decades ago, Harold Lasswell reminded us that "politics is who gets what, when and how" (*Politics: Who Gets What, When, How*, 1936). This iconic guide to political science is often missing in the study of central banks, including the Federal Reserve. It defines the most significant point of disagreement our book has with *The Myth of Independence*. Sarah Binder and Mark Spindel view the Fed's actions as part of a dance with Congress that is largely silent about the winners and losers outside of Washington. By contrast, *Fed Power* puts the distributional consequences of the central bank's policy front and center, along with the politics that produces them. Our approach joins the dominant framework in the study of domestic and foreign policy: From Gosta Esping-Andersen, Jonas Pontusson, Theda Skocpol, and Ben Page to Peter Gourevitch and Robert Keohane and Helen Milner, scholars aim to pinpoint the interests and influence of lobbying, campaign contributions, and other tactics to curry favor and secure selective government benefits. *The Myth of Independence* gives the Federal Reserve a pass. *Fed Power* does not.

Here are four important areas of disagreement. First, *The Myth of Independence* breaks new ground by treating the Fed as a political organization but overstates its deference to Congress and under appreciates the Fed's will and capacity to evade legislative control. Building on scholarly economic and political research on institutions by Theda Skocpol, Douglass North and others, *Fed Power* defines the Fed as an institution that has developed over the past century considerable autonomy and extraordinary administrative capacity. Few students of modern executive politics will be startled to learn that evading Congress is built into the Fed's DNA as a strategic and ambitious actor with a robust sense of mission and the trained staff and clear lines of authority to pursue it.

Second, *The Myth of Independence* under appreciates the most important structural reality of the Fed—it is independent of the congressional budget appropriations process. The Fed's fiscal independence results from the massive returns on collecting interest on its investments and the revenue from buying and selling them on capital markets. Fiscal independence frees the Fed from the scrutiny that accompanies the appropriations process. This structural reality has enormous implications: The Fed is dependent on the operation and health of financial markets. The Fed advances its own institutional position and resources when it protects and stabilizes finance.

Third, the Fed is enmeshed not only in domestic politics but also in the fundamental global transformation known as "financialization," absent from *The Myth of Independence.* Since the 1980s, the business of banking shifted from making loans and collecting interest to reaping profits from markets for securities—including the infamous mortgage securities market responsible for the 2008 Great Recession. Narrowly focusing on congressional oversight misses the new scope and modalities of Fed activities and connections to finance in the United States and globally.

Fourth, the Fed's selective benefits for finance and the conduct of monetary policy produce clear winners among the most affluent. Juan Montecino and Gerald Epstein demonstrate that Fed interventions "increased bank profits." The Fed's unorthodox policies to expand the supply of money were mimicked in the UK where they produced (according to a recent Bank of England report) the "single biggest distribution of wealth in modern history."

Scholars should read *Fed Power* and *The Myth of Independence* for themselves and reach their own conclusions. Vibrant research fields thrive from discussion and respectful disagreement, as ours is. The Fed should be at the center of political science and public debates about democratic accountability and the impact of government policy in generating economic inequality. It is time for much more significant research on the Fed.

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