POLITICS SYMPOSIUM

Clarifying How the Fed Is Political

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With good reason, *TIME Magazine* named Ben Bernanke its "Person of the Year" in 2009. In November 2008—just weeks after the collapse of Lehman Brothers brought world finance to the edge of disintegration—the Federal Reserve began purchasing approximately $100 billion every month in mortgage-backed securities from government-sponsored entities such as Fannie Mae and Freddie Mac (as well as continuing to buy Treasury securities). The total assets held by the Federal Reserve quickly jumped from approximately $1 trillion to slightly more than $2 trillion. This program, which lasted 17 months and became known colloquially as QE1 (after the first of three rounds of "quantitative easing"), drove down the corporate bond rate and mortgage rates. Early in 2009, the stock market began a modest recovery (Heard 2013; Irwin 2013; 2014; Williamson 2017).

To be sure, the American economy was still in trouble. Also, the Fed used a wide range of short- and long-term approaches to address the crisis, not only so-called quantitative easing (QE) (Bernanke 2009; 2010). Stabilizing the economy further required many participants besides the Federal Reserve. Congress enacted the Troubled Asset Relief Program in early October 2008 at the behest of Treasury Secretary Henry Paulson. Congress essentially gave him a $700-billion blank check. The Keynesian stimulus of early 2009 (i.e., the $787 billion Recovery Act) also helped to block the Great Recession of 2007–2009 from morphing into a dreadful 1930s replay (Matthews 2011; Webel 2013).

However, the National Bureau of Economic Research Business Cycle Dating Committee concluded in September 2010 that the Great Recession ended in—wait for it—June 2009 (National Bureau of Economic Research 2010). The significant points are that the federal government had the capacity to prevent serious and long-lasting economic damage—and that a decisive part of such power was the Federal Reserve's competence. Christopher Adolph titled his contribution to this symposium, "The Missing Politics of Central Banks." What about the missing meltdown?

Indeed, we have gotten an "Obama expansion" (Matthews 2016). Unemployment (as I write) is just under 4% (i.e., full employment). Black unemployment is the lowest it has been in 45 years (Baker 2018). To be sure, a tight labor market today differs from previous episodes. The rate reveals nothing about the types of jobs people have today and whether they receive decent raises. Considering the caveats, however, we must concede the strength of the current labor market's condition (Bureau of Labor Statistics 2018; Casselman 2018). Much of this macroeconomic record can be chalked up to the continuously good leadership of the two Fed chairs who served during Obama's presidency: Ben Bernanke and Janet Yellen (Bell 2018).

Yet, there is a gap between how consequential the Fed is, on the one hand, and the attention, on the other, that political scientists have given it. Reviewing Bernanke's (2015b) memoir, *The Courage to Act*, Kinsley (2015), vividly wrote:

> The Federal Reserve System is hard to justify in democratic terms. Except for a few cranks and obsessives, almost nobody can even explain how it works, let alone develop an informed opinion about the policies that emerge from it. Ben Bernanke fought for more openness at the Fed.…But what good is transparency if almost everyone is looking the other way?

Kinsley, of course, referred (correctly) to citizens, not political scientists (Motel 2014). Perhaps "the shoe fits" more than we might like to think, though. As Jacobs and King point out in their contribution, and as Binder and Spindel also suggest in theirs, there simply are not enough political scientists truly conversant with the institution. Few PhD programs in political science have a Fed specialist on the faculty. The only program with depth in central-bank politics is offered at the University of Washington, where Christopher Adolph teaches along with Caitlin Ainsley, who has similar expertise.

"PUZZLING" AND "POWERING"

The basic problem is that monetary policy is not "in-your-face" political. Yes, as Adolph states, the Fed sits at the heart of a "mono-cultural epistemic community" with a highly technical language and discourse. This suggests a certain mystification that disguises the power of "shadow principals." However, ordinary people also must be shadow principals if there is a 3.9% unemployment rate. My view is that it is difficult to argue that one set of players dominates monetary policy and consistently acquires advantage at the expense of other actors, interests, and social forces. The Fed instead is rooted in a complex and often ambiguous web of principal–agent relationships. This is, indeed, a central theme in the work of the marquee authors of this symposium: Adolph, Binder and Spindel, and Jacobs and King.

The Fed, to be sure, has made terrible mistakes. To this day, it is not clear whether it acted pro-cyclically or counter-cyclically during the Hoover administration. In other words, it performed hardly as well as it did in 2008–2009 under Bernanke's leadership. In the early 1980s, Paul Volcker exhibited a Melvillean determination to "break the back" of inflation by imposing severe austerity (Spross 2016). This prompted a notable journalistic effort to understand what the Fed meant for actual people: Greider's (1989) *Secrets of the Temple*. Finally, we all paid dearly—economically and politically—for Alan Greenspan's denial of systemic risk before the Great Recession. On the other hand, mistakes—big and small—are certain to

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result from the bounded rationality that shadows the administrative state's executives.

An historical perspective helps one to see why today's politics of monetary policy is so hard to identify and characterize. Over a century ago, monetary politics was in the air and everyone knew (or thought they knew) who won, who lost, and for what to fight. In the 1870s, 1880s, and 1890s, countless Americans—particularly farmers—had active ideas that they talked and read about every week concerning the best way to run US monetary policy. Their self-education and radicalization set the stage for the epic 1896 contest between William Jennings Bryan and William McKinley. The Bryan–McKinley standoff was the culmination of grassroots efforts to forge a durable, cross-sectional, farmer–labor coalition. First the Greenback Labor Party and then the People's Party of 1892 racked up state-level and congressional victories. The People's Party—one of American history's great "might-have-beens"—meant to create the world's first mixed economy based in key part on novel approaches to the democratic allocation of credit. Its leaders thought that the economic downturn of the 1890s would open the way for them to implement their ideas.

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However, Populist defeat in 1896 swept their broadly democratic approach to monetary policy off the table. This happened not so much because—after the dust settled—ordinary people grasped their foolishness. It happened because their badly rattled opponents rewrote the rules of the game. Outside of the South, this meant "fusion bans"—Bryan was the last multistate "fusion" candidate. Within the ex-Confederacy, Democrats accelerated suffrage restriction, shut down party competition, and instituted one-party regimes. Rebellious white farmers never again would make common cause with black Southerners.

What came next was the Progressive pass at monetary politics. The Progressive solution was a private–public partnership regulated by experts. In his October 17, 1914 "Message to Congress Expressing Appreciation for Legislative Work," Woodrow Wilson—who signed the Federal Reserve Act in late December 1913—proposed to Congress that the Act banished politics from monetary policy:

> [t]he power to direct this system…is put into the hands of a public board of disinterested officers of the Government itself….No group of bankers anywhere can get control; not one part of the country can concentrate the advantages and conveniences of the system upon itself for its own selfish advantage." (Wilson 1914)

Wilson, it turned out, had a clear crystal ball. As Binder and Spindel show in their contribution, Congress was involved in perpetuating Wilson's vision, regularly enhancing its capacities and its policy portfolio. Indeed, the current match between President Wilson's intuition, on the one hand, and important (although hardly all) accounts of the Fed, on the other, is quite striking.

Consider *The Power and Independence of the Federal Reserve*, the 2016 descriptive study by Peter Conti-Brown, a Fed historian at the Wharton School. A particular virtue of the book is that Conti-Brown treats the Fed as a "they" and not an "it," to borrow Shepsle's (1992) famous formulation about Congress. Conti-Brown disaggregates the Fed institutionally and takes seriously the "federalism" of the Federal Reserve. It turns out that the most that Conti-Brown can muster by way of serious political controversy is arguing that the constitutionality of the regional reserve banks is not clear (Conti-Brown is a JD as well as an historian).

Reading the excellent but bloodless memoir by Stephen Axilrod of his years as a high-level Fed staffer, *Inside the Fed*, we find that Woodrow Wilson's vision matches his own experience (Axilrod 2011). Axilrod wrote of "disinterested officers" who engaged in what Hugh Heclo famously dubbed "puzzling." In an oft-quoted passage, Heclo distinguished between "powering" and "puzzling": "Governments not only 'power'…they also puzzle. Policy-making is a form of collective puzzlement on society's behalf; it entails both deciding and knowing" (Heclo 1974, 305–6; see also Hall 1993). Axilrod wrote page after page of such "puzzling" as Donald Kettl did as well in his classic 1986 study of the Fed, *Leadership at the Fed*.

Thinking of the Fed as a "puzzling" agency par excellence makes it easier to see other accomplishments in addition to the "Obama expansion." Think, for instance, of what the Fed helped to deliver during the "Clinton expansion": low inflation, low unemployment, higher labor-force participation, and surprisingly high GDP growth (Matthews 2012). The tight labor market, in particular, was highly unusual (Katz and Krueger 1999). During the course of two presidential terms, the Fed stood aside as unemployment drifted well below what most economists previously considered the natural rate of unemployment. It was down to 4% in 2000, the lowest rate since 1969 (Federal Reserve Bank of St. Louis n.d.). Not all of the explanation for the tight labor market was benign—that is, mass incarceration had a role in it. However, it was no longer possible to assert that a tight labor market guaranteed hyperinflation. Greenspan demonstrated a surprising willingness to ignore economic orthodoxy.

BEYOND LEADERSHIP AND PUZZLING

Is that all the "politics" there is—that is, leadership, bounded rationality, puzzling, and testing orthodoxy? Not by a long shot. Turn to how the marquee authors of this symposium ingeniously succeed in finding other types of Fed politics.

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First, Jacobs and King remind us that it would be naïve to embrace wholeheartedly and uncritically the idea that the Fed is a "public board of disinterested officers"—one that *only* "puzzles" and never "powers." The iconoclasm of their contribution makes that perfectly clear. They emphasize, Niskanen style, that a primary goal of the Fed's top officials is perpetuating the prestige of its corps of policy mandarins. Because they run a self-funding agency, they keep banks happy; banks, in turn, provide the revenue base for one of the world's largest bureaucratic operations. Given that banking and finance have become much more macro-economically dangerous, Jacobs and King's portrait captures something uncomfortably close to a Faustian bargain at the expense of the general public.

Adolph, for his part, sketches a desirable non-Fed politics that might exist *without* a "public board" that knows what it is doing. The Fed, he suggests, structurally suppresses the legislative development of Keynesian capacities. More subtly, the Fed's macroeconomic competence can facilitate Beltway stalemate. Adolph thus asks us to appreciate the second-order consequences of state capacity for both Congress and partisan gridlock. In an elegant twist, he adds that the Fed's capacity to deflate an expansion augments the other forces that generate income inequality. The Fed, perversely, is too good at being countercyclical.

In their contribution, Binder and Spindel delve deeply into the surprising connections between Congress and Fed competence. They show that Congress *likes* competence: "[b]y centralizing power in the hands of the Fed, lawmakers can more credibly blame the Fed for poor economic outcomes, insulating themselves electorally and potentially diluting public anger at Congress" (Binder and Spindel 2017, 2). The Fed itself is not very political; the politics is on Capitol Hill.

Because the Fed is a self-funding agency, members of Congress cannot quickly or easily punish it for doing things that they decide they do not like. Nevertheless, if Congress does not have the "power of the purse," it still has the power to legislate. Congress is certainly willing, in a "blame–reform cycle" deftly analyzed by Binder and Spindel (2017), to alter the legislative–bureaucratic contract and to add new terms. Binder and Spindel stress, in other words, that Fed independence—qua ability to make discretionary policy first with the privilege of later explaining it to the public and Congress—is always on legislative loan. Periodically, Congress rewrites the terms as part of a long-running politics of deflecting blame for macroeconomic strains away from Congress toward the Fed (Weaver 1986).

DISSING DISCRETION

If there is a common goal among the authors of this symposium, it is to widen our angle of vision. They help us to see that the Fed—specifically, its Board of Governors and the Federal Open Market Committee (FOMC)—are embedded within a matrix of principal–agent relationships, formal and informal. This includes the regional reserve banks, the White House, Congress, the Treasury, financial firms, the Community Advisory Council (founded in 2015), elite economists including the Shadow Open Market Committee (see www.shadowfed.org), and the annual Jackson Hole Economic Symposium organized by the Kansas City Fed (Federal Reserve Bank of Kansas City n.d.).

Yes, the Fed's leaders have independence and discretion. Indeed, they celebrate its "origins" in the Treasury–Fed Accord of 1951 (Federal Reserve Bank of Richmond n.d.). However, those two properties of the institution—independence and policy discretion—are continuously negotiated within the larger system of principal–agent relationships.

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This brings us to one final question: Will there be fundamental change in the Fed's independence and discretion? The principal that is best organized to destabilize the independence and discretion, if it chooses, is Congress. Remarkably, a bid to contain the Fed is in the offing during this current 115th Congress.

In rolling back the Dodd–Frank Act in early June 2017—with passage of H.R. 10 on a straight party vote, the Financial CHOICE Act—Republicans also contained the Fed's independence (GovTrack 2017). Among other provisions that revamp the Fed, the House bill directs the FOMC to follow a variant of the "Taylor Rule" (after John Taylor, the Stanford economist who first wrote the rule). The Rule's various iterations are smart efforts to preprogram the timing and magnitude of policy adjustments. However, they put the Fed's operations on "autopilot" (Asso, Kahn, and Leeson 2007; Taylor 1999). Fed decision makers, like airplane pilots, can override the Taylor "flight plan"; Congress also receives immediate notice (Bennett 2017; Bernanke 2015a; 2016; Bernstein 2017).

As I write, a bipartisan restructuring of Dodd–Frank also is underway in the Senate (i.e., S.2155). It is far less comprehensive than H.R. 10 (US Senate Committee on Banking, Housing, and Urban Affairs 2017). The Fed-related provisions of H.R. 10 probably will not attract significant Senate support in the months ahead.

Nonetheless, something unusual has happened: a wing of one of the two major parties willed itself to explicitly legislate monetary policy by codifying a version of the Taylor Rule. Without a research program of elite interviews, it is not obvious how to interpret this turning point—and it certainly is not clear that it portends a politicization of monetary policy that would have an impact on partisan competition.

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I conclude with this, however, to highlight the significance and relevance of the invitation issued by this symposium's marquee authors (i.e., Adolph, Binder and Spindel, and Jacobs and King): Study the Fed; it is not only about macroeconomics and finance (although there is much of that). There has not been this much political science of the Fed in a long time. There should be more—and there very likely will be as a result of the fascinating insights and findings in their articles and their books behind them. ■

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