POLITICS SYMPOSIUM

American Oligarchy? The Concealed Politics of the Federal Reserve Bank

The Fed's Political Economy

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Why study the Federal Reserve Bank? Political scientists analyzing US politics, with only a few notable exceptions, have largely ignored the question. The result is that we know precious little about the Fed even as it becomes an increasingly consequential feature of contemporary American politics amid rising economic inequality.

This symposium is innovative in two respects. First, it treats the Fed as a political institution instead of adopting the common assumption among many of its observers that the central bank is a neutral technocracy. Second, this symposium introduces the study of power and political economy to the analysis of the Fed.

The core of the symposium consists of three articles by authors of recent books on the Fed and central banks—Lawrence Jacobs and Desmond King, Sarah Binder and Mark Spindel, and Christopher Adolph. The articles develop unique approaches to studying the Fed and to articulating its importance for US politics. These articles are the subject of three probing commentaries from distinct perspectives: Jonas Pontusson situates the Fed and its political economy within comparative politics; Rick Valelly applies his expertise in American political development; and Alexander Hertel-Fernandez reveals the centrality of power to the Fed's operations.

The study of inequality by political scientists has neglected capital and its facilitator and guardian: the Federal Reserve Bank. We take a new direction in the study of inequality by focusing on the Fed and its interventions in capital markets. We push back against the presumption that the Fed is a public steward impartially serving the national interest through its technocratic expertise. The defining features of the Fed's operations are its structural dependence on finance, its institutional interests in expanding its capacity and independence, and its supportive policy coalition. The Fed's institutional and fiscal interests predispose it toward policies that produce winners and losers. Studying the political economy of the Fed and its distributional effects within the United States is an urgent real-world priority as inequality and biases in political representation intensify (Jacobs and King 2016; Pontusson 2005).

IS POLITICAL SCIENCE ASLEEP AT THE WHEEL?

The Federal Reserve is a potent government influence on the economy and, yet, political science has nearly ignored it (with notable exceptions, including participants in this symposium). In 2008–2009, the financial system nearly collapsed and the Fed unilaterally reacted by committing loans and guarantees that amounted to *half* of the value of everything produced in the United States in 2009. Since then, about one article per year referenced the Fed or central banks in the *American Political Science Review*.[1]

The neglect of the Fed and its impact on rising inequality results, in part, from its secrecy. It also stems from the tendency of political scientists who study inequality to concentrate on government spending and taxation. The deservedly influential *Winner-Take-All Politics* by Hacker and Pierson (2010) traced the rise of inequality to fiscal and regulatory policies but largely ignored the Fed's role.

The inattention of political science to inequality's connection to capital markets and the Fed is out of step not only with the tradition of political economy (Marshall 1977; Marx and Engels 1893) but also with the contemporary concentration of income among the top 1%—that is, the 250,000 who run businesses, big banks, and Wall Street and doubled their share of total annual income in the past 35 years. Piketty, Saez, and Zucman (2016) reported that capital markets and the returns on equity and bonds are the "primary driver of the upsurge of top incomes…since 2000." Compared to the mid-twentieth century (1940–1970s), finance doubled as a proportion of GDP to 7% in 2016 and its profitability as a share of corporate profits increased nearly six-fold. It generated the highest-paying jobs in the country; in 2014, salaries for investment bankers and those in the securities industry were five times greater than workers outside of this sector (Irwin 2015; Surane 2016). These sobering measures of income disparities stand out even though they may not include lucrative equity deals for finance executives (Smith 2016).

THE FALSE EQUIVALENCY OF FED POLICIES

The Fed portrays itself—as do those sympathetic to its operations—as benefiting "society at large" (Blinder 1997; Broz 1999). This promotion of the Fed as a "benevolent social planner" is used to justify extraordinary independence and technical capacity to perform two functions: (1) intervene as a "last resort" when financial crisis strikes, and (2) adjust the supply of money and credit to avoid inflation and help employment. In the United States the exercise of government power commonly faces numerous checks. The Fed is an exception. It wields unrivaled autonomy in domestic affairs—researchers

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and the public are regularly informed—to insulate its decisions from untrustworthy elected officials and protect the credibility of government debt. Without the Fed's independence, politicians are expected to promise low inflation to attract loans from private markets and later diminish its real value by printing money to boost employment and please lobbyists and voters (Kydland and Prescott 1977).

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The Fed's technocratic claim—like many other expert-based accounts—is belied by its track record. The nonpartisan Financial Crisis Inquiry Commission on the 2008 crisis singled out the Fed as one of the "sentries…not at their posts," sharing blame for the "widespread failures in financial regulation and supervision" (FCIC 2011, xviii-ixx). Its mistakes prompted former Fed Chair Alan Greenspan to declare his "shocked disbelief" as financial markets melted down in October 2008 (Jacobs and King 2016).

In addition to failing to deliver on the promise of expert solutions, the 'public-good' account of the Fed poses a false equivalency between the gains for finance and for the general public. When the country is spared financial disaster, many gain. However, finance and the Fed enjoy lopsided and often concealed benefits. The political-economy approach focuses on the unequal rates of return.

THE FED'S POLITICAL ECONOMY

Studies of government policies (i.e., from foreign policy and national defense to social policies and trade) use a diverse range of frameworks to pinpoint the interests and influence of domestic actors who use lobbying, campaign contributions, and other tactics to curry favor and secure selective benefits from government authority and resources (Esping-Andersen 1990; Gourevitch 1986; Keohane and Milner 1996; Pontusson 2005; Skocpol and Hertel-Fernandez 2016; Valelly 1989). The Fed has been given a pass by political science.

The Fed's political economy rests on three critical components that we outline here and developed in *Fed Power: How Finance Wins* (Jacobs and King 2016).

The Fed as an Institution with Interests

The institutional turn in political science in the past generation led to sustained attention to the rules, norms, agency, authority, and administrative capacity of Congress; the executive branch; and established programs (North 1990; Skocpol 1985). This sea change has yet to register in political science analysis of the Fed; the result is that the Fed's institutional interests are often omitted.

Far from being guided passively by expert analysis, the Fed is a strategic and ambitious actor committed to expanding its institutional position and power. It is equipped with a strong sense of mission, comparatively well-trained staff, and clear lines of authority that spare it from the degree of infighting and external interference that saps other agencies. No other domestic institution rivals the Fed's autonomy and capacity.

The Fed's Structural Dependence on Finance

Unlike other government agencies, the Fed 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. The returns cover the Fed's expenses (i.e., more than $1 billion in 2014) and those of the 12 regional banks (i.e., $3.6 billion in 2014), as well as a 6% dividend paid to the more than 2,900 private banks that are members of the Fed's 12 regional banks. After covering these costs, the Fed transfers to the Treasury the remaining revenues: $98.7 billion in 2014 and about $500 billion from 2008 to 2014.

Fiscal independence frees the Fed from the scrutiny and accountability that accompanies the appropriations process.[2] The flipside is the Fed's structural dependence on the operation and health of financial markets. The Fed advances its own institutional position and resources when it protects and stabilizes finance. The Fed's structural interests and internal sense of mission to safeguard finance are mutually reinforcing.

Our account of the Fed's structural dependence on finance differs from claims that special interests consistently dictate the Fed's policies through the "revolving door" between industry and the Bank or through literal or "cultural" capture. Our review of the career trajectories of Fed officials found that certain authoritative decision makers have worked in finance. However, their numbers were limited and it was difficult to persistently attribute a consistent pattern of decisions to these individuals—a finding echoed by Carpenter and Moss (2014).

Durable Policy Coalitions

An enduring coalition of the Fed, presidents, and congressional committees with ostensible oversight responsibilities for the Fed (i.e., the House Finance Services Committee and the Senate Banking Committee) supports and defends the central bank's prerogatives and accommodation of finance (Hertel-Fernandez 2016). Presidents are motivated primarily by the need to sustain a stable financial system and to create favorable conditions for the reelection of themselves and their party (Galvin 2014). Legislators—along with presidents—are drawn to campaign contributions from finance as well as to lucrative jobs and speaking fees after they leave office (Skocpol and Hertel-Fernandez 2016). For their part, the finance industry and lobbyists working for banks, realtors, and others seek access to Fed policy makers as well as targeted benefits.

The Fed stands at the vortex as both beneficiary and selective distributor of benefits. The Fed commits its institutional capacities to sustain finance by granting tangible assistance,

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information, and access to decision makers. In turn, the Fed receives revenue from vigorous capital markets as well as political support from allied lawmakers and the lobbyists hired by finance to protect and expand its core authority.

Lawmakers occasionally dispute Fed policy. However, these contests typically occur on nested policy questions—principally, the setting of interest rates—and may prompt the Fed to adjust policy. Undergirding even these disputes is the shared commitment of the enduring policy coalition for capital-market stability and deference to the Fed to facilitate and, if it decides, to intervene to stabilize financial markets by unilaterally supplying exorbitant loans and guarantees. Congressional proposals to strip Fed authority or threaten finance (as was the case in 2009) collide with this policy accord and face an onslaught of opposition until they are watered down or defeated.

DIFFUSE AND TARGETED BENEFITS

The confluence of the Fed's institutional interests, structural dependence on finance, and alliance with the finance-policy coalition predispose the central bank to distribute selective benefits to its allies. Three stand out.

Ushering in Financialization

The process of "financialization" accelerated the growth of finance and the outsized gains it delivers to the top 1% by further expanding global capital markets and reducing national regulations. In the United States beginning in the 1980s, the Fed's Alan Greenspan became a champion of "private-market regulation" in place of government regulations. By 1999, Bill Clinton and Congress repealed the Glass–Steagall Act, which cleared the way for investment banking to expand and mingle with commercial banking for the first time since the Great Depression (Krippner 2011). As part of the economic restructuring, banks and other financial institutions changed their business models from seeking yields on credit for the production of goods and services to funding and investing in consumer lending, as well as developing and trading securities. These changes, in turn, launched derivatives, credit swaps, and the packaging of traditional securities (e.g., home mortgages). The most notorious version of "securitization" was the bundling of subprime loans for home mortgages and other consumer credit into packages that were then resold in financial markets, which contributed to the 2008 crisis.

The Fed facilitated financialization and securitization by granting leeway to US capital markets and their "innovation." This deference cleared the way for finance to reap enormous profits. It also introduced enormous risks.

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Privatizing Gain, Socializing Risk

The Fed abandoned its passivity toward securitization when growing numbers of subprime mortgages failed to make payments in 2007 and 2008. The result was a chain reaction. Investors discovered that the sellers of the credit-default swaps were unable to pay them for the defaults of toxic securities. Credit markets froze. The Fed intervened—without congressional or presidential authorization—to invent nine "facilities" in 2007–2009 that delivered concrete payoffs to finance—and itself. The facilities extended loans and guarantees that were 10 times the size of the government bailout known as the Troubled Asset Relief Program (TARP), supplying an incalculable benefit to recipients: credit when credit markets were frozen.

The Fed's intervention revived finance, ratified its disproportionate place in the US economy, and restored the concentration of wealth and income among the richest. The loans and guarantees for banks and non-banks were unavailable for the 13 million homes put into foreclosure proceedings from 2008 to 2013—about one of every 100 homes. The result is that the Great Recession depleted the savings and assets of millions of Americans, many of whom still have not recovered their losses. Meanwhile, finance and the top 1% bounced back. Research by Montecino and Epstein (2014) demonstrated that the Fed's facilities "increased bank profits" and they concluded that the "Federal Reserve undertook these policies, at least in part, to increase the profitability of their main constituency: the large banks."

Our account of the Fed's structural dependence on finance differs from claims that special interests consistently dictate the Fed's policies through the "revolving door" between industry and the Bank or through literal or "cultural" capture.

Defenders of the Fed insist that the generous and selective terms were necessary and that imposing conditions was impossible if the Fed was to be effective in rescuing finance. Yet, central banks in other Western countries were less deferential to finance. The Bank of England, for example, extended selective assistance to finance but demanded in exchange what the Fed would not require: that the rescued banks and

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investment firms work to relieve the freeze in credit facing homeowners and businesses (Jacobs and King 2016).

The Fed responded to the 2008 crisis by aiding finance; it also was an opportunity for the Fed to engage in institution building. Creating the facilities and sharply departing from the boundaries of monetary policy accelerated the Fed's century-long drive to establish unparalleled domestic authority, administrative capacity, and independence.

Privileging Capital Markets

Debate over health-care reform and its taxes, spending, and regulations has been intense, sustained, and highly public for almost a decade. Public conflict, congressional machinations, and struggles over the design of policy tools also characterize battles about reforming immigration, education, Social Security, and taxation.

What stands out about the Federal Reserve is its evasion of this Madisonian system of public conflict and institutional checking *before* policy is made. The Fed may commit more US assets than many legislative bills and oversee massive government interventions in the economy; yet, its decisions and selection of policy tools receive far less scrutiny. The spotlight does shine on the Fed but these occasions generally are rare, brief, and *after* it has formulated and implemented policy and chosen which information to release.

In addition to dodging accountability, the Fed advantages finance in other ways. Its selection of policy tools and capital markets as its arena of intervention inherently favors finance. By working through capital markets for equities, bonds, and other assets, the Fed operates in arenas in which the wealthy possess unique, cumulative advantages. In particular, access to enormous assets, extensive investor networks, and sophisticated knowledge of capital markets generate differential opportunities for either financial gain or mitigating losses.

Central banks control "monetary policy" by intervening in capital markets to change the money supply, thereby attempting to manage inflation and the economy. After the Fed reduced its interest rates to near zero beginning in 2007, it turned to the unorthodox approach of "quantitative easing" in which it bought financial assets from banks and other financial institutions to expand the money supply and offset the credit freeze. The Fed universally applied these policies of quantitative easing and interest-rate adjustments; however, individuals and institutions qualitatively differed in their capacities to respond and benefit.

In short, the Fed's reliance on the distinctive policy instrument of capital markets to modulate the supply of money is not "neutral" in its distributional effects. The super-rich acquire sharper gains and enjoy greater protection against lasting deep losses than most Americans who gain less and suffer more significant and lasting harm.

Western central-bank leaders acknowledge what political science research on inequality has neglected. The normally staid Bank of England (2012) reported that the policy effects of low interest rates and quantitative easing were "heavily skewed" to benefit the already well off who own most stocks and other investments. Mario Draghi (2016), president of the European Central Bank, similarly concluded that these policies "might exacerbate and worsen distributional effects" and equip "wealthier households [to] have benefitted relatively more."

BRINGING CAPITAL BACK IN

Barack Obama pursued generally progressive domestic policy—most clearly in his transformational health reform (Jacobs 2014; Jacobs and Skocpol 2015)—and yet economic and racial disparities persisted. The 117 million adults who comprise the bottom 50% of the income distribution lost ground even when the economy grew—falling from 20% of national income in 1980 to 12.5% in 2016 (Cohen 2016; Piketty, Saez, and Zucman 2016). Meanwhile, the Stock Market rose 438% from 1976 to January 2017. The share of total annual income of the top 1% increased from 9% in 1976 to 20% in 2011—a trend that accelerated during Obama's presidency.

Making sense of the widening of inequality even during a period of progressivism requires attention to capital markets and how Fed policy affects them. We need a political economy of finance and the Fed. ■

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NOTES

1. Only 14 of 498 articles referenced central banks or the Fed *in the text* from 2007 to 2016.
2. For the many—unsuccessful—efforts by members of Congress to rein in Fed powers, and the diluted compromises always reached favoring the Fed, see the account in Kettl (1988).

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