US Presidents ★★★ *and the* ★★★ Federal Reserve

By Peter C. Earle

In late August 2019, Bill Dudley, former President of the Federal Reserve Bank of New York and Vice Chairman of the Federal Reserve Open Market Committee, wrote an unprecedented editorial in *Bloomberg Magazine*. In it, he took to task President Donald Trump's badgering of central bank officials via Twitter and urged current Fed Chairman Jerome Powell not to "enable" the President's policies.

A former Fed official taking the Chief Executive to task is extraordinary, but the circumstances under which it occurred seems equally so. Since April 2019, Trump has made no less than 37 tweets criticizing the Fed's implementation of monetary policy and has made numerous other comments via the media.

The New York Times has decried Trump's media attacks on the Fed as "highly unusual." *USA Today* has said that in directing comments at the Fed regarding their policies, Trump has "br[oken] long-standing taboo[s]." And the *Washington Post* laments that the 45th US President had "violate[d] another Presidential norm."

In fact, the current President's comments only qualify as unusual on account of their directness and don't (really) break any long-standing codes of conduct. Instead, they call attention to one of the most sturdily-held shibboleths of American domestic policy: the independence of the United States Federal Reserve Bank.

While it ostensibly "make[s] monetary policy independently of short-term political influence," the Fed—by virtue of its structure, mission creep and the nature of its particular "policy lever"—is inevitably thrust into the political sphere.

Going back to the 1920s, American Presidents have both explicitly and implicitly requested, cajoled and even threatened the central bank's officials. At times, Fed officials have resisted those overtures, and at other times they seem to have acceded to those demands.

A Labyrinthine Organizational Structure

The Fed's very organizational structure—initially designed and modified over time to placate various public and private interests—subjects it to regular engagement with political and private interests.

- Fed officials are appointed by the Executive Branch and confirmed by Congress; many rise to prominence through positions at the US Treasury or on the Council of Economic Advisors;
- Private meetings between the Fed Chairman and Presidents are a long-standing fixture of economic policy coordination and implementation;
- The Fed Chairman and other Fed officials testify publicly before Congress twice every year, which includes a sometimes-contentious question-and-answer session;
- Leadership at the 12 regional Federal Reserve Banks are made up of appointees of the member banks which essentially own them; not by the President or Congress, but by regional bankers and business executives. (Historically, they tend to be more hawkish than the seven governors of the Federal Reserve, who are appointed by the President and confirmed by the Senate);
- In times of war, disaster or under other unusual circumstances, the Fed is expected to work closely with the US Treasury and other government agencies to coordinate monetary, fiscal and other policy initiatives.

Even with this mixed private-public structure, the Federal Reserve was partially immune to the full range of political manipulation for its first six decades by virtue of the gold standard: with the gold price pegged amid the international system of fixed exchange rates, Fed control of the growth of the money supply was bound. But with the end of the dollar's convertibility to gold in 1971, and thus the end of exposure to market discipline, the way was paved for the potential politicization of the Federal Reserve.

A Century of Mission Creep

Upon its founding in 1913, the Federal Reserve's exclusive mandate was to prevent financial panics and bank runs. This was the case until 1946 when, inspired by both the Great Depression experience and millions of veterans returning to the workforce from foreign battlefields, Congress passed the Employment Act.

This added to the Fed's mandate the requirement that monetary policy be conducted in a way that promotes "conditions under which there will be afforded useful employment opportunities…and to promote maximum employment, production and purchasing power."

The 1978 Full Employment and Balanced Growth Act ("Humphrey-Hawkins") added "reasonable price stability" to the Fed's mandate, additionally requiring that the Board of Governors conduct monetary policy in a way that "maintains long-run growth," that they transmit a monetary policy report to Congress twice a year and that they conduct monetary policy in conjunction with, and in support of, the economic policy and goals of the Executive Branch. (It has been suggested that the addition of financial stability to the Fed's

Left: President Barack Obama announces Janet Yellen as his choice to chair the Federal Reserve, October 9, 2013. *(Credit: Win McNamee)*

Right: President Ronald Reagan announces that Alan Greenspan will replace Paul Volcker as Federal Reserve Chairman at a press conference on June 1, 1987, as Treasury Secretary James A. Baker III looks on. *(Credit: Diana Walker)*

duties in the wake of the 2008 financial crisis effectively constitutes a third mandate.)

As the Fed's mandate has expanded into the macroeconomic realm, it has necessarily been tied increasingly to elected officials. Add in the unique characteristics of monetary policy—that unlike fiscal policy, it can be implemented effectively immediately, affects the economy generally and requires neither deal making within or the approval of the Legislative Branch—and the litany of incentives for exerting political influence upon Fed officials is clear.

Monetary Versus Fiscal Policy

The inclination to influence the Fed has essentially everything to do with the separate and distinct attributes of the federal government's two means of impacting the domestic economy: fiscal policy and monetary policy.

Fiscal policy targets spending levels (consumption) via taxation and stimulus measures; it is enacted by Congress. Monetary policy, enacted by the Fed, involves influencing the money supply and interest rates. Not only is the monetary policy route faster-acting, cheaper (no debt is incurred) and arguably more powerful (money "touches" everything), it additionally doesn't require the sort of horse-trading and lengthy negotiation that legislative efforts take. Monetary policy measures can be implemented in a very short amount of time (hours) and via the decisions of a mere handful of top people.

A Brief History of Jawboning

There's little doubt that in an age of social media, it has become easier to rally public opinion in favor of Fed action. But Presidents attempting to influence the Fed did not start (and probably will not end) with the current Chief Executive. With specific reference to direct, public jawboning of the type which the current President has been taken to task for, a partial list of previous examples bear listing.

Harry S. Truman, in early 1951, summoned the FOMC to a meeting at the White House in which he insisted that they continue to support Treasury bond prices.

Lyndon Johnson, in his 1967 State of the Union address, made the following statement:

> "Monetary conditions are also easing. Most interest rates have retreated from their earlier peaks. More money now seems to be available. Given the cooperation of the Federal Reserve System, which I so earnestly seek, I am confident that this movement can continue. I pledge the American people that I will do everything in a President's power to lower interest rates and to ease money in this country…toward easier credit and toward lower interest rates."

The Nixon tapes hold copious evidence of direct and indirect attempts to influence the Fed. Publicly, Richard Nixon had this to say upon appointing Arthur Burns to the Fed Chairman position in 1970:

> "Ladies and gentlemen, as all of you know, the Federal Reserve is independent, certainly independent of the President, although the Congress would suggest that it is not independent of the Congress. I respect that independence. On the other hand, I do have the opportunity as President to convey my views to the Chairman of the Federal Reserve in meetings with … the Secretary of the Treasury and the Chairman of the Council of Economic Advisers …
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> I have some very strong views on some of these economic matters and I can assure you that I will convey them…I respect his independence. However, I hope that independently he will conclude that my views are the ones that should be followed."

And in a later phone call between Nixon and Burns (via transcript):

> Nixon: "Arthur, [garbled]. You're independent! [Burns laughs]. Independent! You get it up. I don't want any more nasty letters from people about it. OK?"
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> Burns: "That [no more nasty letters], I can't guarantee."
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> Later,
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> Nixon: "The whole point is, get it [the money supply] up. You know, fair enough? Kick it!"

With skyrocketing inflation in the late 1970s, the Fed under Chairman Paul Volcker began a grueling interest rate hiking campaign. Knowing that the continuation of continually higher rates would be politically damaging with an election a few months away—and under pressure from both certain sectors of Congress and organized labor—Jimmy Carter announced the following alternative, a restraint on the growth of credit, during a televised broadcast in 1980, despite the Fed's opposition:

"The traditional tools used by the Federal Reserve to control money and credit expansion are a basic part of the fight against inflation. But in present circumstances, these tools need to be reinforced so that effective constraint can be achieved in ways that spread the burden reasonably and fairly. I'm therefore using my power under the Credit Control Act of 1969 to authorize the Federal Reserve to impose new restraints on the growth of credit on a limited and on a carefully targeted basis. Under this authority the Federal Reserve will first establish controls for credit cards and other unsecured loans but not for secured loans on homes, automobiles, and other durable goods, and second, to restrain credit extensions by commercial banks that are not members of the Federal Reserve System and also by certain other money market lenders."

Ronald Reagan's first State of the Union address in 1981:

"The final aspect of our plan requires a national monetary policy which does not allow money growth to increase consistently faster than the growth of goods and services. In order to curb inflation, we need to slow the growth in our money supply. Now, we fully recognize the independence of the Federal Reserve System and will do nothing to interfere with or undermine that independence. We will consult regularly with the Federal Reserve Board on all aspects of our economic program and will vigorously pursue budget policies that'll make their job easier in reducing monetary growth."

George H.W. Bush speaking to *The New York Times* in 1992:

"I'd like to see another lowering of interest rates. I think there's room to do that. I can understand people worrying about inflation. But I don't think that's the big problem now…I think inflation appears to be pretty well under control. I don't think the argument that lowering the rates will stimulate the long-term—shoot the long-term rates up—is valid anymore. And so, yes, I'd like to see it come down."

Bill Clinton strongly signaled that his relationship with the Fed would be prominent going forward by his placement of Fed Chairman Alan Greenspan at his first State of the Union address in January 1993:

"Tongues began to wag when Federal Reserve Chairman Alan Greenspan appeared at President Clinton's State of the Union address sitting between Hillary Rodham Clinton and Tipper Gore. What on earth was the conservative, Republican, inflation-fighting Chairman of the nation's central bank doing sitting next to the wife of the liberal, Democratic, growth-boosting President? Startled financial analysts and even some Fed officials wondered why Greenspan would send such a dramatic signal that he was making common cause with Clinton. Simply by sitting there, he appeared to be sacrificing a slice of the Fed's vaunted independence…In early December, when Clinton invited the Fed Chairman to fly to Little Rock, Arkansas, to discuss economic policy issues, the scheduled hour long session stretched to 2½ hours and included lunch. They clearly had hit it off."

George W. Bush, arriving in Washington, DC after his contentious election, similarly signaled the pivotal nature of the Fed in his administration's plans by making his first stop a breakfast with then-Chairman Alan Greenspan.

"Mr. Greenspan, who was welcoming the fourth President to pass through during his 13-year tenure, briefed Mr. Bush on the state of the economy. He may also have indicated whether, as the stock market expects, he will announce a loosening of the Fed's monetary policy by reducing interest rates today. Mr. Bush was forthright in his admiration for Mr. Greenspan, who took the key job in 1987. He said, laying his hand on the Chairman's shoulder: 'I talked with a good man right here. We had a very strong discussion about my confidence in his abilities…' For part of their breakfast the two men were alone together, later being joined by Vice President-elect Dick Cheney and members of the new administration's prospective economic team."

Barack Obama's public record shows little by way of comments directed at Federal Reserve officials or pertaining to Fed policies, which seems surprising and somewhat refreshing. In fact, though, circumstances precluded his doing so: with the Fed Funds rate target set below 0.5%

Left: President George W. Bush announces the nomination of Ben Bernanke as the new Federal Reserve Chairman at a press conference on October 24, 2005, as current Federal Reserve Chairman Alan Greenspan looks on. *(Credit: Jim Watson)*

Right: Federal Reserve Board Chairman Alan Greenspan speaks to the press after being reappointed by President George H.W. Bush to a second four-year term. *(Credit: Bettmann)*

for the duration of his presidency, the effective zero boundary precluded action other than a return to higher rates. In short, there was nothing to say: the only way for rates to move was "up."

Expect More of the Same

The entire exercise of introducing evidence that the Fed isn't politically independent is moot from the start, though. For despite what numerous media outlets have taken the President to task for, the Q&A section of the Richmond Fed website asserts that, in fact, "the Federal Reserve can be more accurately described as 'independent within the government' rather than 'independent of government.'"

The Fed is independent within the government, in part, because it is self-financed and does not depend on Congressional appropriations or Presidential recommendations for its funding. By the same token, neither the President or Congress can bully the Fed by cutting its budget. That's not the case with most other federal regulatory agencies, or even the IRS.

Consider what incontestable political independence would actually require: at the very least, every one of the Fed's political ties—appointments, testimony, the ability to expand or reduce their mandate, etc.—would have to be severed. To inoculate them from indirect political pressure, the identity of Fed officials would have to be essentially secret.

As currently structured, and considering both the raft of directives that it labors under and the unique attributes of monetary policy, it is cogent to expect elected officials to attempt to sway Fed actions. It was going on for decades before the current President took office and, barring changes, will continue to do so. That any institution exercising as tremendous a mandate as managing the money supply of the world's largest economy (and the world's reserve currency, to boot) would go unheeded in the corridors of political power is unrealistic at best.

In that sense, the Federal Reserve is something of an embodiment of the Hayekian adage: a reminder that, at times, economics is a constant lesson in letting people know what they cannot design. $

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Left: President Richard Nixon confers with his monetary advisors at the White House. From left to right: John D. Erlichman, Domestic Council; Arthur Burns, soon to become Chairman of the Federal Reserve; President Nixon; and Budget Director Robert P. Mayo. *(Credit: Bettmann)*

Right: Federal Reserve Chairman Alan Greenspan speaks to the media in the Oval Office of the White House beside President Bill Clinton, January 4, 2000. *(Credit: Mario Tama)*