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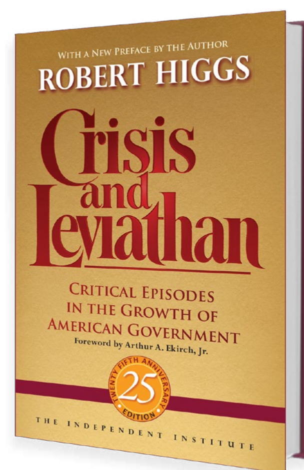

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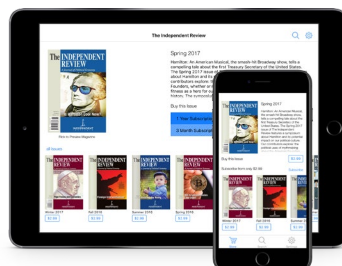

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An Episodic History of Modern Fed Independence

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DANIEL J. SMITH AND PETER J. BOETTKE

> The Congress established the Federal Reserve, set its monetary policy objectives, and provided it with operational independence to pursue those objectives. The Federal Reserve's operational independence is critical, as it allows the [Federal Open Market Committee] to make monetary policy decisions based solely on the longer-term needs of the economy, not in response to short-term political pressures.
>
> —Ben S. Bernanke, *Semiannual Monetary Policy Report to the Congress* (2011)

This paper contextualizes, supports, and informs previous empirical studies on the independence of the Federal Reserve (Fed) with an episodic history of modern Fed independence. At the Fed's founding, its independence was considered necessary to separate monetary policy from the influence of electorally focused politicians and special-interest groups (Kettl 1986, 3; Morris 2002, 4–5; Bernanke 2010a). According to C. W. Barron, at its founding, Fed independence meant that "[i]f the new Federal Reserve Board is of the desired quality and character it will be the most unpopular board that ever sat in Washington. It will turn deaf ears to all political and sectional considerations. The greater the clamor for cheap money the tighter it will hold the reserves" (1914, 13).

With these concerns in mind, the structure of the Fed was designed to turn "monetary policy over to a small group of people selected so as to balance the

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The Independent Review, v. 20, n. 1, Summer 2015, ISSN 1086–1653, Copyright © 2015, pp. 99–120.

interests for and against inflation" (Faust 1996, 268). Although the Fed is an agency of Congress and responsible to Congress, the need for an independent Fed to "make monetary policy independently of short-term political influence" (Bernanke 2010a) has been recognized since the Fed's inception.

Despite early efforts to create an independent Fed, its independence was quickly undermined during the tumultuous political and economic periods of World War I, the Great Depression, and World War II (Havrilesky 1995b; Meltzer 2003). Some economists hold that structural tweaks and greater transparency have ensured, according to Ben Bernanke, that the "effective degree of independence [at the Fed] has gradually increased over time" (2010a). However, empirical studies measuring the degree of Fed independence have found, even in modern times, evidence of substantially compromised Fed independence (Boettke and Smith 2013).

This paper seeks to understand how the modern Fed, despite the many steps taken since its founding to ensure independence, still succumbs to political influence. We examine the postwar period to focus on the modern Fed's independence following the 1951 Accord between the U.S. Department of the Treasury and the Fed, which, according to Robert Hetzel and Ralph Leach, "marked the start of the modern Federal Reserve System" (2001b, 53–54). Michael Munger and Brian Roberts also indicate that following the 1951 Accord the Fed had a mandate to "lean against the wind, implying an unprecedented discretionary choice of how much monetary growth was too much, and how little was too little" (1993, 90). Our episodic history finds that even an increasingly sheltered Fed, primarily under the control of economists with increasingly refined monetary models, has failed to remain independent of political pressures. Although the Fed has at times been able to assert its independence, it is clear that at times it has also succumbed to political pressure.

We use an anecdotal approach to supplement the existing empirical approaches because, as David Meiselman argues, "*a convincing test or proof* may require more detailed and explicit information about explicit intentions on a more micro level, including who said and did what to whom" (1986, 571, emphasis in original) and, as Kevin Grier stresses, "No amount of regression analysis can ever prove that the Fed is politically controlled" (1987, 481; see also Grier 1989, 388). Historical context is necessary to supplement the existing empirical investigations to understand when these separate influences were operational and the mechanism of their operation. Anecdotal work, such as our episodic history, can corroborate the existing empirical literature and inform future empirical investigations.[1]

We analyze the history of modern Fed independence by the tenure of each Fed chairperson, starting with William Martin and ending with Ben Bernanke. Even these modern Fed chairs, utilizing refined economic models and bolstered

1. For a defense of the "narrative approach" in monetary economics, see Romer and Romer 1989, Summers 1991, and Morris 2002, 123.

by modern structural tweaks and greater transparency, have succumbed to political pressures in different ways and to varying degrees.

William Martin (1951–1970)

William Martin was appointed chairperson of the Fed in 1951 by President Harry Truman after he played an important role in negotiating the 1951 Accord as the assistant secretary of the Treasury. Under Martin, the role of the modern Fed came to be one of macroeconomic stabilization (his famous "leaning against the wind" policies) and price-level stability (Hetzel and Leach 2001a, 2001b). However, even with its newfound independence from the Treasury, for the Fed under Martin

> [i]ndependence no longer excluded consultations and exchange of information. Martin's interpretation of the 1951 Accord went further. He [Martin], and most others in the System, believed that the Federal Reserve had a responsibility to assure that Treasury bond issues did not fail. He reasoned that Congress voted the budget that the Treasury had to finance. The Federal Reserve had an obligation to help make the issues succeed in the market, provided the Treasury priced its issues at market rates. It should not refuse to accept the fiscal decision or refuse to assist in financing. Help took two forms: preventing failure of new issues and refundings, and maintaining even keel policy during Treasury operations. Even keel meant that the Federal Reserve supplied enough reserves to permit banks to purchase their share of the issue. This seems a narrow meaning of independence. When budget deficits became large and frequent, independence was severely restricted. (Meltzer 2009a, 261)

Martin was reportedly under some pressure to provide accommodating monetary policy throughout the 1950s (Havrilesky 1995b, 54) and met frequently with President Dwight Eisenhower, the Treasury secretary, and the chairperson of the Council of Economic Advisors (CEA) to discuss the economy (Bach 1971, 91; Meltzer 2009a, 261).

In the 1953–54 recession, Eisenhower, to ensure that he fulfilled a 1952 campaign pledge that he would prevent another depression, wrote in his diary that he "talked to the secretary of the Treasury in order to develop real pressure on the Federal Reserve Board for loosening credit still further. . . . Secretary Humphrey agreed with me and promised to put the utmost pressure on Chairman Martin of the Federal Reserve Board in order to get a greater money supply throughout the country" (Eisenhower 1981, 278). When Martin refused to provide accommodating policy, Eisenhower pressured him to resign or comply; Martin ended up making a "promise to ease credit if the economy slowed" (Meltzer 2009a, 135). The Fed

ultimately "could not buck a direct plea from the White House" and accommodated Eisenhower (Kettl 1986, 88).

In November 1955, the Treasury had difficulty issuing securities on the market, so the Federal Open Market Committee (FOMC) supported the debt issue (Clifford 1965, 313; Bach 1971, 95). Looking at this period, Jerome Clifford observes: "Such quick and strong cooperative action showed that there was indeed a 'revolving door' in the 'fence' between the independent agencies, the Treasury and the Federal Reserve. Perhaps it could be said that really the fence was invisible and that the neighbors cultivated a common garden, but each with his own tools" (1965, 321). The stagnating state of the economy in 1956 was a cause of concern for the Eisenhower administration during an election year, so Eisenhower encouraged Arthur Burns, then on the CEA, to push the Fed toward monetary easement (Meltzer 2009a, 135). A *Fortune* writer summarized the views of a young Alan Greenspan at the time: "The Fed . . . has recently been boxed in by a huge and partially monetized federal debt, which tends to produce an addition to the money supply, whose size is unrelated to the needs of private business" (Burck 1959, 201).

The pressure for favorable monetary policy in the 1960s started immediately with the election of John Kennedy (Havrilesky 1995b, 55–58; Meltzer 2009a, 262). Martin caved in to pressure for monetary expansion from Kennedy, the Treasury secretary, and the budget director, reversing his previous policy stance (Kettl 1986, 93, 98–99; Havrilesky 1995b, 56; Meltzer 2009a, 269, 317, 323). Kennedy successfully pressured Martin to cater monetary policy to Operation Twist, a plan by the Kennedy administration to invert the yield curve, despite the Fed's opposition to the policy (Vencill 1992, 203; Havrilesky 1995b, 57).[2] Under Kennedy, Allan Meltzer records, the independence of the Fed was supplanted by the coordination of fiscal and monetary policy (2009a, 283, 287, 316, 417). Meltzer observes that in one particular episode "there is no denying administration involvement in the discount rate increase. Even if [Martin] did not make a formal commitment, the change had been discussed with administration officials as part of a package before it was brought to the bank presidents" (2009a, 418).

When Lyndon Johnson took office in 1963, he vastly expanded spending to undertake his Great Society programs and the Vietnam War. He immediately started pressing for accommodating monetary policy (Newton 1983, 70; Havrilesky 1995b, 58–59; Hetzel 2008, 69; Meltzer 2009a, 262, 443–45, 456–57).[3] During this time, the Fed was explicitly catering monetary policy to the Treasury's needs (Bach 1971, 124). The FOMC's Records of Policy Actions reveal that targets were always qualified with the phrase "to the extent permitted by Treasury financing" (Timberlake

2. They would attempt to do this by selling short-term securities to increase short-term interest rates and then buying long-term securities to decrease long-term interest rates (Havrilesky 1995b, 57).

3. Donald Kettl dissents and reports that Johnson "largely ignored Martin and the Fed for his first year in office" (1986, 102).

1993, 338). Although Martin was able to withstand such pressure in some instances, the pressure appears to have been successful in others (Kettl 1986, 93; Havrilesky 1995b, 60). Robert Hetzel reports that "Martin confronted a president and Congress united in their hostility to interest rate increases. The situation was untenable for the Fed because it raised the possibility of a political consensus to alter the Federal Reserve Act to limit Fed independence. . . . Martin deferred a rate rise" (2008, 70). A report produced by the House Committee on Banking and Currency, chaired by Wright Patman (D–Tex.), argued:

> What does high interest mean to the taxpayers? High interest means that the Federal Government, as well as the State and local governments, have to pay out more money in interest costs. In one way or another this is money which must come from the taxpayers. The interest costs for carrying the Federal debt is particularly sensitive to a change in interest rates. A large portion of outstanding Government securities is constantly coming due and the Treasury is constantly "paying" these off by issuing new securities. In a period when interest rates are being raised, the Treasury is replacing securities issued at low interest rates with new securities bearing higher rates. (U.S. House of Representatives 1964, 12)[4]

Martin clearly did not believe that the Fed should finance deficits for the Vietnam War, but he faced "a political system hostile to interest rate increases" (Hetzel 2008, 71). During his meetings with President Johnson, he worked out an agreement to refrain from increasing interest rates in exchange for Johnson's support for tax increases (Hetzel 2008, 71–73). Despite growing concern about inflation, the Fed submitted to pressure from the Johnson administration, allowing a surge in the monetary base (Meltzer 2009a, 443; Bernanke 2013, 33). In fact, the Great Inflation, beginning in 1965, occurred precisely because of the Fed's financing of the administration's large fiscal deficits, which prevented it from maintaining price stability (Meltzer 2005, 2009a, 670; Weise 2012).

In the 1967 State of the Union Address, Johnson pledged to "do everything in the President's power to lower interest rates and to ease money" (qtd. in Hazlitt 1978, 118). Meltzer concludes of the relationship Martin had with Johnson that "[p]olicy coordination ensnared Martin in administration policy. He willingly sacrificed part of the Federal Reserve's independence for the opportunity to be part of the economic 'team,' make his views known to the president, and coordinate policy actions" (2009a, 445). Maxwell Newton observes that "[i]t was obvious in 1968, even from the published statements of the Council of Economic Advisers, that the

4. The report argued that the most important reason for keeping interest rates artificially low via the Fed was the need to remain competitive against the Communist world, especially the Soviet Union (U.S. House of Representatives 1964, 12).

administration and the Federal Reserve System were acting totally in concert" (1983, 113).

Arthur Burns (1970–1978)

In 1970, Richard Nixon appointed Arthur Burns as Fed chairperson. Burns was Nixon's close associate and personal counselor and thus someone who could be trusted to provide accommodating policy to the administration (Wells 1994, 26, 42; Meltzer 2009a, 583; Silber 2012, 71). Nixon apparently blamed Martin for his failed presidential bid in 1960 as well as for the 1969 recession and was eager to replace him (Greider 1987, 340; Wapshott 2011, 242). The day of Burns's appointment, Nixon joked, "I hope that independently he will conclude that my views are the ones that should be followed" (qtd. in Havrilesky 1995b, 61), and told Burns, "Dr. Burns, please give us more money!" (qtd. in Newton 1983, 158). Privately, Nixon urged Burns, "You see to it: no recession" (qtd. in Wells 1994, 42).

Burns took immediate control of the Fed, creating new precedents in centralizing its power under the chair. For instance, he actively shaped FOMC members' views to fit his own and spent less time allowing the other members to present their opinion (Wells 1994, 44). He also insisted that any reports to the press from the Fed go through him. Burns went to extreme measures to punish governors who refused to abide by these strictures, including bringing in the FBI and even attempting to get Nixon to replace a deviant governor by appointing that governor as an ambassador (Wells 1994, 49).

With the advent of stagflation in 1970, Burns, despite being concerned about inflation, agreed to follow an expansionary monetary policy in exchange for Nixon's passing of wage-and-price controls (Wells 1994, chaps. 4 and 5; Silber 2012, 74).[5] Nixon told an aide that Burns would "get it right in the chops" if he didn't cooperate and asked, "Should I give the Fed a good kick now?" (qtd. in Wells 1994, 62–63). Nixon was even quoted in the *Wall Street Journal* in 1970 as saying that he had a firm "commitment" from Burns for easy monetary policy, and he even threatened to "unleash" Congressman Patman, a strong critic of the Fed and still chairman of the House Committee on Banking and Currency, if Burns did not follow through with his commitment (Havrilesky 1995b, 61) and, in a separate instance, to "take the Fed on publicly" (qtd. in Wells 1994, 55). Burns, in turn, reportedly brought Fed Board members who cast dissenting votes into his office and lectured them on the importance of consensus voting (Silber 2012, 127). When Alfred Hayes, the president of the New York Fed, continued to dissent, Burns reportedly questioned the New York Fed's travel budget, used the FBI to investigate media

5. This agreement, although never substantiated, was referred to as the "Accord of 1970" when the press discovered it (Silber 2012, 74).

leaks, and made it known that he was searching to replace Hayes a year out from his retirement (Meltzer 2009a, 584; Silber 2012, 127).

As the new chairperson, Burns started catering monetary policy to the Nixon administration (Greider 1987, 341). Donald Kettl reports that "[d]espite his constant squabbles . . . Burns's policy was rarely far out of step with the Nixon administration. He largely delivered the expansive policies the president and his advisers wanted . . . and his relationship with the White House was close" (1986, 130). Meltzer writes, "Burns was unwilling to use the independence of the Federal Reserve for its intended purpose" (2009a, 583–84).

In 1971, after many years of devaluing the dollar, Nixon dropped the gold standard and the international system of fixed exchange rates, effectively eliminating a major constraint on the Fed's influence and opening the door to more political control of the Fed's actions (Barro 1982, 104; Buchanan and Wagner [1977] 2000, 126).[6] Robert Barro, looking at the consequences of this policy, concludes: "Since . . . the complete divorce of United States monetary management from the objective of a pegged gold price, it is clear that the nominal anchor for the monetary system—weak as it was earlier—is now entirely absent. Future monetary growth and long-run inflation appear now to depend entirely on the year-to-year 'discretion' of the monetary authority, that is, the Federal Reserve" (1982, 105). Meltzer (2009a, 630) reports that Nixon repeatedly questioned Burns's commitment to the administration and threatened Burns if he did not indicate a willingness to cater monetary policy to the administration's desires. Burns reportedly submitted to pressure to engage in monetary easement to aid Nixon's reelection bid in 1972 (Kane 1974, 751; Rose 1974; Woolley 1984, chap. 8; Abrams 2006; Wapshott 2011, 255).[7] Burns even moved up the FOMC's January 1972 meeting because Nixon told him they needed to expand monetary policy by February: Burns understood that it took six to nine months for monetary easing to show up in the economy, which would help ensure that any action undertaken in February would have results in time for the November election (Meltzer 2009b, 799). Nixon reportedly told his chief of staff, H. R. Haldeman, that for the election year they "can't afford to risk a downturn, no matter how much inflation" (qtd. in Silber 2012, 73).

Using evidence from the Nixon tapes, Burton Abrams (2006) details how Nixon repeatedly pressured and cajoled Burns into providing accommodating monetary policy (see also Wells 1994, chap. 4). Meltzer quotes Nixon as saying in

6. Meltzer argues that at Camp David in 1971, where closing the gold window was discussed, Nixon's "main concern was to lower the unemployment rate before the election" (2009b, 764–65).

7. Havrilesky (1995b, 35) does acknowledge that this occurrence is disputed by John Cullity (1992, 41) and others (also see Wells 1994, 100–101). Kettl details the episode, concluding that Burns did cave in to Nixon and offered easy money, but only in exchange for a system of wage-and-price controls to keep down inflation (1986, 127–29, 114). Meltzer suggests that an alternative explanation for the expansive policy in 1972 might be that it occurred because Nixon appointed Burns to be the chairperson of the Committee on Interest and Dividends, which also included three cabinet members—an appointment that created a rather obvious conflict of interest for the Fed chairperson (2009b, 767).

a meeting with Burns in 1971, "I don't want to have a runaway inflation . . . [but many elections] have been lost on the issue of unemployment. None has been lost on the issue of inflation. . . . Unemployment is always a bigger issue than inflation" (2009b, 791). A tape from earlier in 1971 exposes Burns telling Nixon, "I have done everything in my power, as I see it, to help you as President, your reputation and standing in American life and history" (qtd. in Meltzer 2009b, 792).[8] In a separate meeting, Burns told Nixon that he had trouble getting the FOMC to agree to the policies that Nixon wanted, so he "kept them there until four o'clock to get what I want." Nixon replied, "You're independent (laughter), independent (laughter). Get it [the money growth rate] up! I don't want any more angry letters from people. . . . The whole point is, get it up!" (both qtd. in Meltzer 2009b, 796). Haldeman instructed Nixon's speechwriter, William Safire, to make three points clear to Burns in a 1971 meeting:

1. The President is saddened by the degree of public disagreement with his policy made by the Chairman in recent months.
2. The Chairman's criticism works against rising public confidence and harms economic recovery.
3. The Chairman must not expect his criticism to go unchallenged and cannot be surprised when others suggest ways to bring monetary policy in line with the national economic policy set by elected officials. (Safire 1975, 493)

When Sherman Maisel, a member of the Fed Board at this time, dissented, Nixon wrote Burns a private letter promising to replace Maisel with someone who would "follow your leadership." In the letter, Nixon also praised Burns's attempts to increase monetary growth and threatened a "major attack on the independence of the Fed" if the Fed did not provide the desired monetary policy (qtd. in Meltzer 2009b, 799–800). Meltzer reports that the board members chosen as replacements between 1971 and 1973 were appointed because they supported Burns's or Nixon's position. In fact, at one point in 1971 Nixon's administration even floated the idea of packing the board with additional accommodating governors (Safire 1975, 493). Burns also used the board power of approving appointees to the presidency of the Reserve Banks to influence who was selected (Meltzer 2009b, 830). He expanded this power by requiring the directors of the Reserve Banks to submit several names, rather than just one, to the board as candidates (Meltzer 2009b, 830).

Although the pressure on the Fed from Nixon declined after the election, it soon picked up again because both Nixon and Congress desired an expansionary monetary policy for Nixon's New Economic Policy. The Fed once again delivered (Wells 1994, chap. 6; Meltzer 2009b, 790). According to Hetzel, because Burns held macroeconomic beliefs that required support from Nixon and Congress, Burns

8. See Meltzer 2009b, 794–802, for more details on Burns's catering of Federal Reserve policy under pressure from Nixon.

made only minor increases to the funds rate (2008, 89). In 1973, the U.S. economy saw inflation soar (Newton 1983, 117; Meltzer 2009b, 850). Although prevailing belief at that time held that the inflation was due to price increases by the Organization of Petroleum Exporting Countries (OPEC), Hetzel argues that the expansionary monetary policy followed by the Fed had already resulted in inflation before the OPEC price increases (2008, 94). Meltzer argues that although economists blamed theoretical errors and misinformation for the inflation, political pressure was also an important factor (2009b, 844, 856–59).

Arthur Burns recalled from his experience in serving two terms as Fed chairperson, “Mr. Nixon tried to interfere with the Federal Reserve both in ways that were fair and in ways that by almost any standard, were unfair” (qtd. in Meltzer 2009a, 584).

When Gerald Ford came to office in 1974, his administration took a largely hands-off approach to the Fed. Thomas Havrilesky suggests that this was because at that time Republican presidents had appointed every single member of the board and because Ford had an anti-inflation attitude (1995b, 63).[9] It may have also been due to Ford’s close relationship with Chairman Burns, as well as with Vice Chairman Stephen Gardner (Havrilesky 1995a). When Ford came into office, Burns “met with Ford more often and over a broader range of issues than had any other chairman in the Fed’s history” (Kettl 1986, 135). With rampant inflation in the first year of Ford’s presidency, agreeing on policy goals was not that difficult (Kettl 1986, 132; Hetzel 2008, 108–10; Meltzer 2009b, 846).

Perhaps the lack of presidential pressure on the Fed while Nixon was occupied with attempting to stay in office, the confusion as Ford entered office, and the Fed’s failure to control inflation explains why in 1974 Congress threatened the Fed to move to a more expansionary policy (Woolley 1984, 144–53; Wells 1994, 132, chap. 7). Congress held hearings that threatened what Munger and Roberts describe as “statutory emasculation” if the Fed did not provide the desired monetary policy (1993, 91; see also Kettl 1986, 143). Congressmen Patman threatened a bill requiring Government Accounting Office audits of the Fed, subjecting the Fed’s budget to congressional appropriations, putting a ceiling on Fed spending, requiring Senate confirmation of Reserve Bank presidents, and requiring the representation of labor and commercial interests among the Fed Board members (Wells 1994, chaps. 6 and 7; Meltzer 2009b, 875). Congress eventually passed House Concurrent Resolution 133 in 1975, mandating that Fed officials provide Congress with monetary-growth projections that were consistent with national economic policy throughout the year (Volcker 1978; Munger and Roberts 1993, 91; Meltzer 2009b, 890).[10] In addition,

9. See also Havrilesky 1995b, 62; Hetzel 2008, 108; and Meltzer 2009b, 846.

10. House Concurrent Resolution 133 was later made binding in 1977 with the passage of the Federal Reserve Reform Act and in 1978 with the passage of the Humphrey–Hawkins Act (Volcker 1978, 329; Munger and Roberts 1993, 91; Wells 1994, 199; Hetzel 2008, 118; Meltzer 2009b, 890). James Pierce (1978) and Milton Friedman (1982, 108) argue that this congressional episode did not result in a compromise of Fed independence.

the resolution gave Congress the authority to mandate that the Fed report to it for any departure from the objectives outlined (Friedman 1982, 107–8).

Burns met regularly with Ford and had a standing invitation to the administration's economic policy meetings (Wells 1994, 146). Milton Friedman summarized the Fed's policy under Burns in a column in *Newsweek* at the time: "We, the public, have been asking Congress to provide us with ever more goodies—yet not to raise our taxes. Congress has obliged, enlisting inflation as a hidden tax to finance the difference (and surreptitiously raise taxes by pushing more and more income into higher tax brackets). The Fed has cooperated—except when the public outcry against inflation has overcome Congressional pressure" (1978).

G. William Miller (1978–1979)

Throughout his presidential campaign, Jimmy Carter stressed the need for greater coordination between monetary and fiscal policy and thus for less Fed independence (Wells 1994, 204). Carter was displeased with Burns's refusal to provide additional monetary accommodation to subdue fears of rising deficits as well as with Burns's critique of Carter's economic policies (Cullity 1992, 44; Wells 1994, chap. 9; Meltzer 2009b, 904–5, 910, 922).[11] An administration official reportedly warned Burns, "This isn't the way to get reappointed" (qtd. in Wells 1994, 206). The administration followed through with the warning when in 1977 Carter replaced Burns with G. William Miller, an outspoken proponent of monetary easement (Kettl 1986, 169; Wells 1994, chap. 9; Havrilesky 1995b, 63–64; Meltzer 2009b, 848, 923; Axilrod 2011, 76). Alan Greenspan observes that the Fed under Burns and Miller, despite being ostensibly independent under the Carter administration, seemed to "mirror Carter's indecisiveness" (2007, 83). Carter signed into law the Humphrey–Hawkins Full Employment Act in 1978, giving the Fed the mandate of maintaining full employment in the nation (Wapshott 2011, 245).

Miller's tenure was short. In what Kettl describes as the "only episode in the Fed's history in which administration officials pressured the Fed for tighter, rather than easier, money" (1986, 170), the Carter administration, especially through CEA chairperson Charles Schultze and Treasury secretary Michael Blumenthal, began pressuring Miller for tighter monetary policy. When Miller proved uncooperative, Carter offered Miller the position of Treasury secretary in order to replace him at the Fed with a more cooperative chairperson, Paul Volcker (Havrilesky 1995b, 65; Wapshott 2011, 246).[12]

11. A Carter campaign paper on monetary policy read, "It is important that throughout a President's term he have a chairman of the Fed whose economic views are compatible with his own" (qtd. in Kettl 1986, 167).

12. William Greider portrays Miller as having been a "team-player" with the Carter administration rather than having been uncooperative (1987, 20, 35).

Paul Volcker (1979–1987)

Paul Volcker, appointed in 1979, provided the desired monetary tightening with the help of Carter's appointment of Frederick Schultz to the board. Schultz had close ties to Carter and called for even tighter monetary policy (Claypool 1992, 293–94).

In the run-up to his reelection bid in 1980, Carter changed course and even publicly criticized Volcker for maintaining a tight monetary policy (Timberlake 1993, 356–57; Havrilesky 1995b, 64–65; Silber 2012, 190). Carter hoped that the Fed would decrease interest rates to "help me politically and obviously help our nation economically" (qtd. in Greider 1987, 217). He increased fiscal expenditures over this period and may have been successful in delaying tighter monetary policy (Meltzer 2009b, 1064–65).

Ronald Reagan was elected in 1980 on the campaign promise that he would balance the budget and rein in inflation. In fact, in his campaign Reagan accused Carter of making the Fed his "whipping boy" (qtd. in Greider 1987, 217). Thus, monetary policy was the linchpin of the Reagan administration's policies (Kettl 1986, 179–80; Timberlake 1993, 379; Meltzer 2009b, 1035). A memo to President-elect Reagan, prepared by his Coordinating Committee on Economic Policy (which included Arthur Burns, George Shultz, Milton Friedman, and Alan Greenspan, among others), recommended that Reagan "[i]mprove the procedures for coordinating Federal Reserve monetary policy with the economic policies of the Administration and the Congress and support Congressional efforts to monitor the Fed's performance and to recommend changes in the procedures that could improve performance" (Burns et al. 1980; see also Silber 2012, 194). Reagan set out to forge a relationship with Volcker to coordinate their efforts. Despite Volcker's initial reluctance, Reagan convinced him to have a meeting as long as it was held on neutral ground at the Treasury. Greenspan reports that at the meeting Reagan made it clear that the "Federal Reserve Act was subject to change" (2007, 93–94). By April 1981, Volcker had overcome his initial reluctance when Reagan reportedly called him over to a meeting in the White House and asked, "Do you intend to control the money of America?" (Newton 1983, 15). Although Volcker was already following a tight monetary policy, Reagan continually pressed him for even more monetary contraction to fight inflation early on in his administration (Greider 1987, 542; Havrilesky 1995b, 66; Auerbach 2008, 151–52). Volcker, in turn, knew he had to accommodate Reagan if he wanted to be reappointed in 1983 (Timberlake 1993, 356).

Yet markets were skeptical of Reagan's campaign promise to balance the budget and thus his ability to rein in inflation (Meltzer 2009b, 1065). As Robert Lucas wrote in the *New York Times,* "Can a resolutely 'monetarist' central bank, restraining monetary growth no matter what else is happening, insulate the economy from the effects of this fiscal dishonesty? . . . Certainly, the Federal Reserve can peg the growth rate of monetary aggregates for a couple of years, more or less independent

of fiscal policy. But it is not within the abilities of any central bank to make things work out right in a society that insists that the real resources spent by its government can exceed, on a sustained basis, the resources that government extracts from the private sector via taxes" (1981).

In addition to the pressure to accommodate deficits, pressure was also coming from the legislative branch for monetary easement before the 1982 elections (Kettle 1986, 181–82; Greider 1987, 376). Volcker's refusal to bend to these pressures led to the threat of congressional challenges to the Fed's authority (Havrilesky 1995b, 112, 136; see also Fuerbringer 1982 and Kettl 1986, 181–82). The White House was also concerned about the elections, and "[t]he prospect that the administration might support one of Congress's proposals was a significant threat" to the Fed (Meltzer 2009b, 1109). Havrilesky comments that "one might argue that under Volcker during the 1979–1984 period the Federal Reserve was more or less forced to surrender to executive branch signaling because of Congressional challenges to its institutional powers. . . . [T]he overall pattern of responsiveness suggests a dominant role for personal, partisan, and ideological allegiances" (1995b, 174). Senator Lawton Chiles (D–Fla.) warned in a Senate Budget Committee meeting that the committee was more prepared to "cut the head off the Federal Reserve System" than to make budget cuts (qtd. in Silber 2012, 207). Senator Edward Kennedy (D–Mass.) even threatened to make the Fed part of the Treasury (Clymer 1982).[13]

Pressures for monetary easement were also coming from the White House despite Reagan's initial goal to rein in inflation (Greider 1987, 426–28, 478, 490). Although there is mixed evidence whether the pressure came directly from Reagan or not, it definitely came from Reagan's administration.[14] White House chief of staff James Baker pressured Volcker for easy monetary policy to aid in the 1982 elections (Greider 1987, 541–42). Meltzer records that Baker "dropped hints about legislation reducing System independence" and, as noted, that there was a possibility that the administration might unite with Congress in anti–Fed independence legislation (2009b, 1109). The Fed, "[c]aught between the two positions—political pressures, legislator threats, and fear of a crisis on one side and concern about their credibility

13. Senator Kennedy accused Chairperson Volcker of "only doing the Reagan Administration's dirty work" (Clymer 1982).

14. Meltzer argues that although Reagan was under pressure to direct Volcker to ease monetary policy for the 1982 election, he successfully resisted these pressures (2009b, 1088). Kettl claims that Reagan had a far more hands-off relationship with the Fed than Nixon, Ford, and Carter (1986, 186). Despite the recorded incidents of influence, Silber argues that Volcker is widely acknowledged to have successfully resisted pressures and to have tackled inflation (Silber 2012, 269). Friedman gives credit to Reagan: "We got out of that mess because in 1980 to 1982, newly elected President Reagan supported the Federal Reserve in following a policy of slowing down sharply the rate of monetary growth. No other president in the twentieth century in my opinion would have stood by without trying to prevent the Fed from doing what it was doing, because the only way you could get out of that inflation was by suffering a recession. And the contractionary policy of the Fed from 1980 to 1982 led to a very severe recession, triggered by a later Chairperson of the Fed, Paul Volcker. And Reagan's courage . . . was to back him. At the time, at the depth of the depression in 1982, Reagan's poll standings had gone way down. Every other president, in my opinion, would have brought pressure on Volcker to reverse policy. Reagan did not do so" (2000).

and the need to maintain the appearance of independence on the other . . . made a first small change in policy to lower rates" (Meltzer 2009b, 1111–12). One of the proposed changes to the structure of the Fed being advanced was to reinstate the secretary of the Treasury on the board (Greider 1987, 490–91). Another proposed change came in the form of the Balanced Monetary Policy Act of 1982 sponsored by Senator Robert Byrd (D–W.Va.), which sought to give Congress the authority to force the Fed to lower interest rates (Greider 1987, 512). Senator Byrd reportedly told Volcker that "[a]s long as interest rates are coming down, we're not going to push it [the Balanced Monetary Policy Act of 1982]" (qtd. in Greider 1987, 514).

Thus, under pressure from both the executive and the legislative branches to accommodate deficit spending, Volcker delivered easy monetary policy leading up to the 1982 congressional elections (Kettl 1986, 181–83). The *New York Times* quoted Meltzer, at that time chair of a private committee that critiqued the FOMC, as saying, "Here we go again. It used to be that we would have bulges in the money supply every Presidential election year, but now we're getting them every two years for the Congressional elections as well" (Farnsworth 1982).

Reagan's ultimate failure to rein in deficit spending led to a "game of chicken" between the administration and the Fed (Greider 1987, chap. 15). Thomas Sargent wrote of the situation in the *New York Times*: "Neil Wallace, an economist, has observed that monetary and fiscal authorities seem to have been playing chicken over the past two and a half years. The Federal Reserve resolved to stick to a policy that is feasible only if the budget is approximately balanced, while Congress and the executive branch together have determined prospects for taxes and spending that are feasible only if the central bank eventually becomes passive and accommodating. With such mutually infeasible prospects, all that is certain is that one side or the other must eventually give in" (1983). Despite Volcker's attempts to fight inflation, Reagan had appointed enough members to the board to sway the February election-year vote against Volcker and toward monetary easement (Havrilesky and Katz 1992, 108; Winder 1992, 297–98; Woodward 2000, 18; Silber 2012, 256).[15]

Owing to Volcker's resistance to catering to the Reagan administration desires, Reagan chose not to reappointment him as Fed chairperson in 1987, instead seeking out someone more accommodating (Greider 1987, 542, 570–71).

Alan Greenspan (1987–2006)

Alan Greenspan, who had served as an unofficial adviser to Reagan for years, was appointed as the Fed chairperson in 1987 (Havrilesky 1995b, 69). Reagan put pressure on Greenspan as well. In 1988, under this pressure, Greenspan resorted to the media to get a top Treasury aide to stop trying to influence Fed policy (Gutfeld

15. Inexplicably, there are no transcripts for the FOMC telephone conference calls in the 1984 election year (Auerbach 2008, 44).

1988). Havrilesky argues that despite this outcry Greenspan largely catered Fed policy to the Reagan administration's desires (1995b, 174–76).[16] Rowland Evans and Robert Novak reported in the *Chicago-Sun Times* in 1989 that the FOMC eased monetary policy "[u]nder backstage pressure from the administration, foreign central banks and the business community."

Greenspan also maintained close ties with the Clinton administration, elected in 1992. Seeking protection from the current chairperson of the House Banking Committee, Henry Gonzalez, who was demanding more Fed accountability and seeking to have all the members of the FOMC be politically appointed, Greenspan flew out to Little Rock, Arkansas, to have a meeting with President-elect Bill Clinton (Woodward 2000, 95; Auerbach 2008, 154). Greenspan met frequently with the Treasury secretary, Robert Rubin, and deputy secretary, Lawrence Summers (Rubin and Weisberg 2004, 9; Greenspan 2007, 160). Although Greenspan reports meeting with Clinton infrequently, he does recall that they had "an easy, impromptu relationship" (2007, 161). He reportedly timed a needed interest rate hike so that its slowdown effect would occur in the year before Clinton's reelection bid in 1996 rather than during the election year itself (Woodward 2000, 118). Clinton, not understanding the need to lower interest rates at all, reportedly sought out more supportive Democrats to put on the Fed Board (Woodward 2000, 122–25).[17] Alan Blinder, appointed by Clinton, publically suggested that Greenspan was catering to Clinton (Jeremy Taylor 1996). The ensuing stock-market bubble in the 1990s can be attributed, at least in part, to the loose monetary policy the Federal Reserve provided (Woodward 2000; Friedman 2005; Auerbach 2008, 169; Sheehan 2010).

With a lack of politically feasible alternatives to Greenspan, Clinton reappointed him but explicitly sought out monetary doves for the other two openings on the Fed Board (Woodward 2000, chap. 9). Greenspan recalls Clinton making a statement to reporters at Greenspan's reappointment that wasn't "hard to read between the lines . . . he was asking for faster growth, higher wages, and new jobs," presumably with assistance from the Fed (2007, 163).

The housing bubble was fueled largely by the easy monetary policy from 2002 to 2005 in response to the 2001 recession (John Taylor 2009; Wessel 2009; Iacoviello and Neri 2010; Rajan 2010, 15, 108–17; Sheehan 2010; Stockman 2013, chaps. 16–21).[18]

16. Greenspan's record of independence under Reagan, especially during the 1987 stock-market crash, is difficult to determine because there are no transcripts of the FOMC telephone conference calls during this period (Auerbach 2008, 44).

17. Clinton reportedly asked Alan Blinder after a lecture, "You mean to tell me that the success of the program and my reelection hinges on the Federal Reserve and a bunch of f***ing bond traders?" (qtd. in Woodward 2000, 125–26).

18. Although we find these arguments compelling, there is still debate over the linkage between the low interest rates caused by an easy monetary policy and the housing boom. Bernanke (2010b) disputes this linkage, arguing that the widespread availability of alternative mortgage products "is likely a key explanation of the housing bubble." John Taylor (2010) critiques Bernanke. James Dokko and others (2009) and Kenneth Kuttner (2014) find that monetary policy was only modestly influential in creating the housing bubble.

In fact, the history of the modern Fed is replete with examples of the Fed taking action specifically to assist or grow the housing industry or both (see Meltzer 2009a, 386, 503, 505, 525, 527, 570, 576, 651, 675–76, and 2009b, 790, 900).[19] The federal funds rate had consistently been between 4.5 and 6.5 percent from 1994 to January 2001. By July 2003, it was pushed to 1 percent, its lowest rate in forty years, which fueled the housing bubble (Roberts 2010).

Ben Bernanke (2006–2014)

The recent financial crisis indicates that the political influence and monetary accommodation have continued at the Fed (John Taylor 2009; Wessel 2009; Kotlikoff 2010; Roberts 2010; Epstein and Carrick-Hagenbarth 2011; Barofsky 2012; Beckworth 2012; Horwitz 2012; Hummel 2013; Stockman 2013). Unprecedented levels and growth of gross public debt have been accommodated by unprecedented monetary easement, with more of the same expected in the future (Kotlikoff and Burns 2012, 4). Stephen Axilrod observes that "as shown in the Fed's use of the discount window for emergency loans to nonbanks during the great credit crisis, the support and participation of the U.S. Treasury seemed desirable to demonstrate political unity in programs that placed the U.S. budget at risk and raised major political and social issues of fairness and equity" (2011, 10).

The close working relationship between Secretary of the Treasury Henry Paulson and Chairperson Ben Bernanke suggests a Fed decidedly not independent of the Treasury Department or of the administration (Sorkin 2009; Wessel 2009). In a paper in the Federal Reserve Bank of New York's journal *Current Issues in Economics and Finance,* Paul Santoro writes: "The U.S. Treasury and the Federal Reserve System have long enjoyed a close relationship, each helping the other to carry out certain statutory responsibilities. This relationship proved beneficial during the 2008–09 financial crisis, when the Treasury altered its cash management practices to facilitate the Fed's dramatic expansion of credit to banks, primary dealers, and foreign central banks" (2012, 1). Congress, attempting to exert its influence, developed threatening legislation that included a proposal to take away the votes of the presidents of the Reserve Banks in the FOMC and give them to presidential appointees (Mishkin 2011b). Fredric Mishkin, in explaining the global financial crisis, argues: "[P]urchase of long-term government bonds has raised concerns that the Fed is willing to accommodate profligate fiscal policy by monetizing government debt, and this does have the potential to cast inflation expectations adrift without an anchor, which could have inflationary consequences in the future" (2011a). Meltzer sums up his observations of the Fed during the financial crisis: "[U]nder

19. It is interesting to note that in 1931 the Fed initially refused to assist the housing industry and market by purchasing mortgages, which led to the establishment of the Federal National Mortgage Association (Fannie Mae) in 1937 (Meltzer 2009b, 1246).

Mr. Bernanke, the Fed has sacrificed its independence and become the monetary arm of the Treasury: bailing out A.I.G., taking on illiquid securities from Bear Stearns and promising to provide as much as $700 billion of reserves to buy mortgages. Independent central banks don't do what this Fed has done" (2009c; see also Wray 2012). John Taylor similarly claims that

> [w]hen Bernanke replaced Greenspan in 2006, and especially in the months immediately before, during, and after the financial crisis in 2008, we saw monetary activism as it never had been seen before in the United States. Bernanke used the Fed's resources in a highly discretionary way to bail out creditors of financial firms. He coordinated with the administration and the Treasury to a degree that made William McChesney Martin look like a piker as he coordinated with the Johnson administration in the late 1960s. Bernanke expanded the Fed's portfolio by unprecedented amounts. He purchased huge amounts of mortgage-backed securities and massive amounts of Treasury securities. (2012, 92)

During his first term, President Barack Obama appointed six of the seven current Fed Board members, with the approval of a Democratic Senate, all of which have voted for continued monetary easement (Bernstein 2012; Coy and Philips 2012).

Conclusion

The theoretical and empirical evidence, especially when corroborated by contextualized episodic evidence, suggests that Fed independence has been compromised. On the Fed's action during the Great Inflation, Meltzer writes, "[P]olitical concerns weakened whatever independence the Federal Reserve had just at the time when an independent central bank was most needed" (2009b, 839).[20] Modern reforms and the accession of economists to the Fed's helm have failed to ensure an independent Fed.

Compromised Fed independence cannot be viewed as a historical problem that is no longer of scholarly concern. The episodic evidence suggests that activity undertaken by the modern Fed has consistently been influenced by political pressure. This trend can be expected to continue in the wake of the financial crisis as more demands are placed on the Fed. As Athanasios Orphanides warns, "When other policies fail, when other policies are hard to implement, when other policies are politically challenging, it may be appealing to ask central banks to use monetary policy to achieve broader goals, to make up for the gaps in what other institutions and policies should do. The risk is that pursuing multiple objectives simultaneously brings

20. "At times of greatest inflationary danger, the Fed could expect insurmountable pressure to serve the Treasury's purposes and sacrifice its own goals" (Kettl 1986, 44).

the central bank back into the realm of politics. This can compromise its independence and risk losing sight of price stability" (2013).

Although one can find episodes in which the Fed has been able to assert its independence, under pressure that independence has been compromised. A system that depends on good people in favorable circumstances for its operation is not a robust or practical system (Friedman [1962] 2002, 50; Boettke and Leeson 2004). In light of the conclusion that the Federal Reserve has not lived up to its original promise of reducing monetary instability (Selgin, Lastrapes, and White 2012), perhaps a more drastic examination of our monetary structures is warranted. Future research on alternative monetary structures, such as constitutionalizing money (Buchanan 2010), turning monetary policy over to a computer ("Milton Friedman @ Rest" 2007), or even privatizing money (Hayek 1978), might shed light on the viability of such regimes. At the minimum, concern regarding political pressure and failed independence ought to be taken into consideration in monetary models. As John Woolley asserts, "The notion that such an important institution [the Fed] could *not* be involved in politics is simply a delusion" (1984, 180, emphasis in original).

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Acknowledgments: We thank Christopher Coyne, Thomas Duncan, Thomas Hogan, Steve Horwitz, Peter Leeson, George Selgin, Scott Sumner, Robert Whaples, Lawrence White, the attendees of the 2010 Southern Economic Association Annual Meeting session "Are There Public Choice Problems with Nominal Income Targeting?" and two anonymous referees for helpful comments on earlier drafts of this paper. We gratefully acknowledge generous research support from the Mercatus Center at George Mason University. We also thank Robin P. K. Aguiar-Hicks and Sean Alvarez for helpful research assistance and Lynann Henagan and Michelle Anderson for editing assistance.