


THE MYTH OF INDEPENDENCE

HOW CONGRESS GOVERNS THE FEDERAL RESERVE



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MOTIVATING QUESTIONS

- Why do we call Fed independence a “myth”?
- What makes Congress and the Fed “**inter-dependent**” institutions?
- How does inter-dependence undergird the evolution of the Fed’s mission and governance?



CONVENTIONAL WISDOM

- Lawmakers create independent central banks to insulate themselves from inflationary temptations
- The Fed independently makes monetary policy, free from short-term political influence

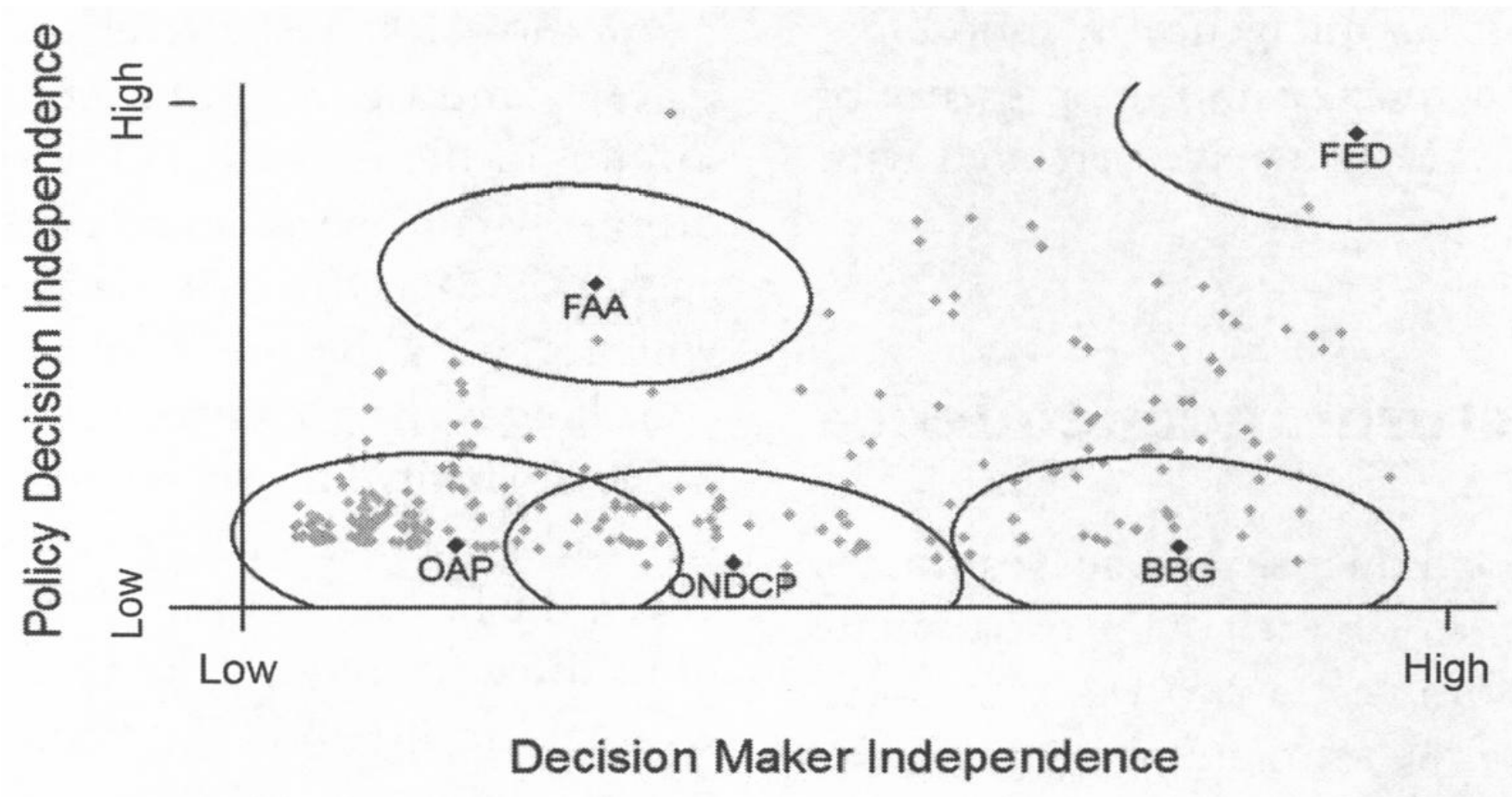


LIMITS OF CONVENTIONAL WISDOM

- Time bound
 - Theory shaped by central banks' focus on fighting inflation (1970s-80s)
 - Historically, deflation more often the challenge
 - Overlooks role of financial crisis in shaping origins and evolution of the Fed
- Apolitical
 - Overestimates lawmakers' commitment to "independence"
 - Underappreciates the partisan context in which Fed pursues its Congressional mandate

SIDE BAR: STRUCTURAL INDEPENDENCE

FIGURE 3 Five Highlighted Agencies



Source: Selin, AJPS 2015

INTER-DEPENDENCE OF CONGRESS AND FED

- Why does the Fed need Congress?
 - “Congress is our boss”
 - Fed power depends on Congress’s political support
- Why does Congress need the Fed?
 - Speed in crisis
 - Target for blame



POLITICAL-ECONOMIC CYCLE OF REFORM

- Onset of crisis
- Congress blames Fed
- Opens the Act
 - Empower the Fed
 - Demand transparency



WILLIAM MCCHESENEY MARTIN (1951-1970)



“Now, we do bear the slings and arrow of the public. You are in the position of being able to blame us if it goes wrong. We are certainly not asking for your applause if it goes right, but to say that if things collapsed we would not bear the brunt of the public opprobrium I do not think is quite a fair approach to it. I think we will bear the opprobrium of the people if things go wrong, and we have to, this is part of our responsibility.”

-- January 1964 (testimony to Congress)



CORE FINDINGS

- Counter-cyclical Congress
 - Lawmakers threaten and reform the Fed after economic downturns
- Politically dependent Fed
 - Fed typically seeks political support for major governance and policy changes

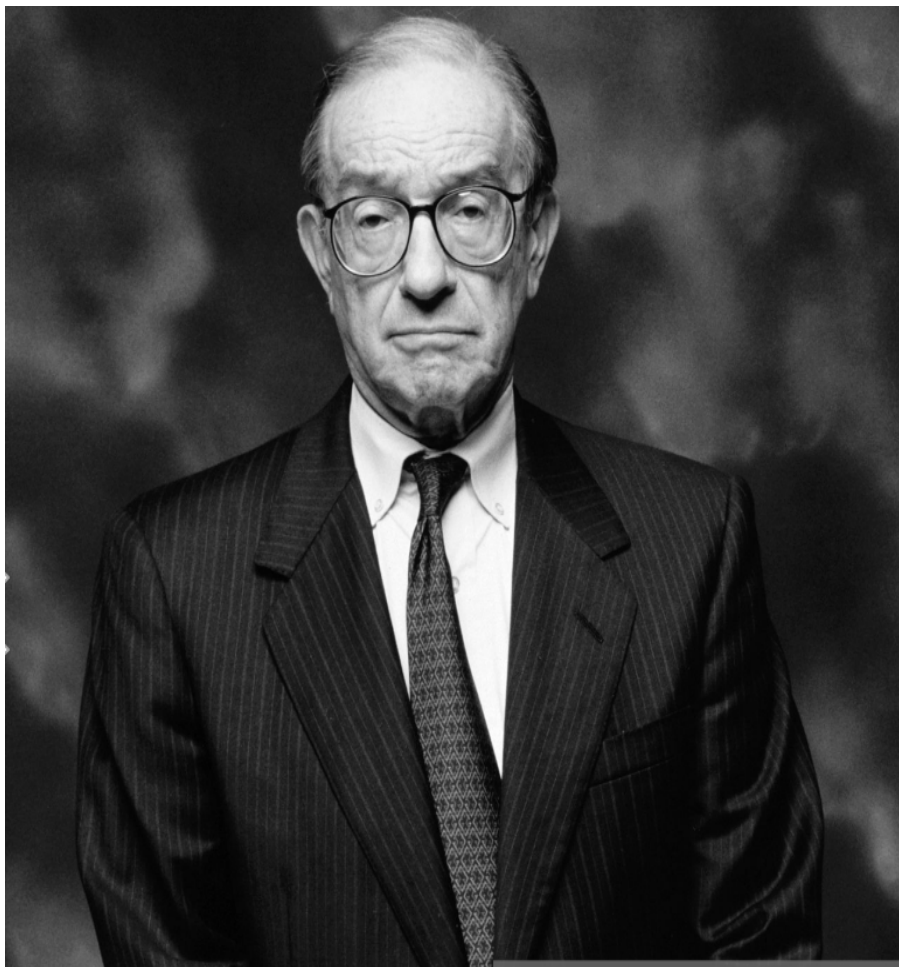


POLITICAL DEPENDENCE OF THE FED

- Historical counterfactuals are hard
 - How would the Fed have acted in the absence of political pressure?
- Case study approach
 - The Volcker Fed slays inflation
 - The Fed adopts an inflation target



ADOPTING THE INFLATION TARGET

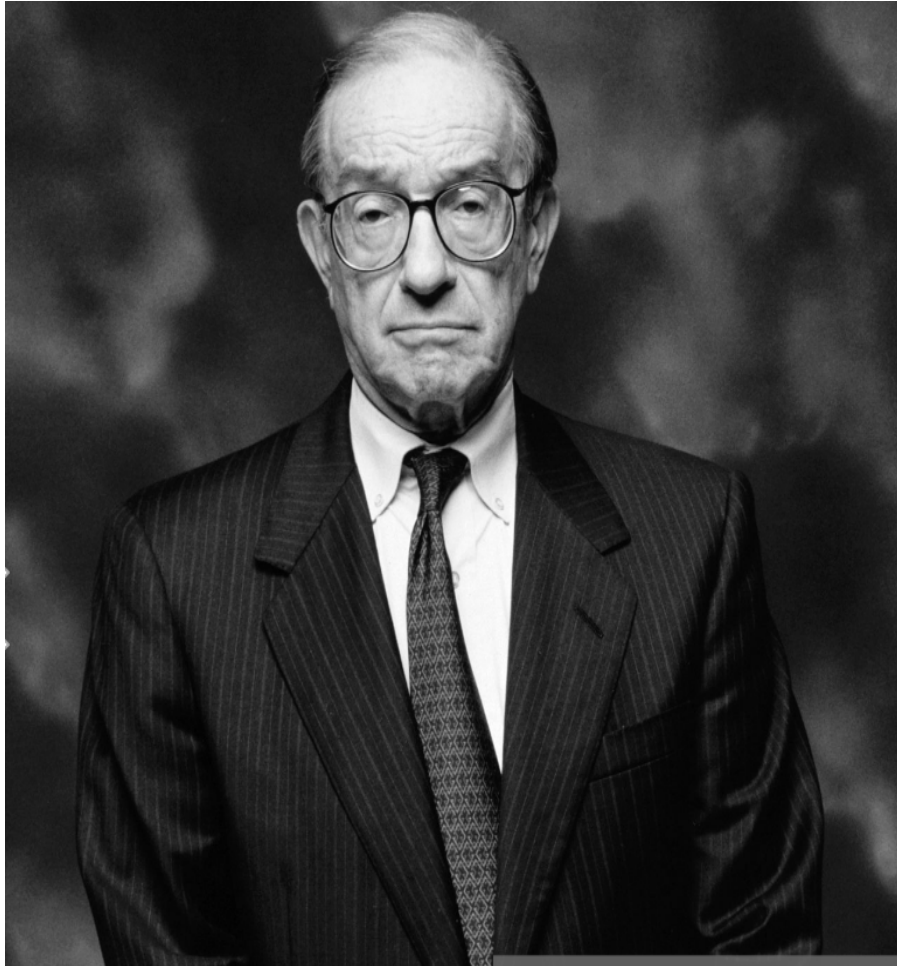


1996 FOMC transcript (Greenspan)

"I will tell you that if the 2 percent inflation target gets out of this room, it is going to make more problems for us than I think any of you might anticipate."



ADOPTING THE INFLATION TARGET

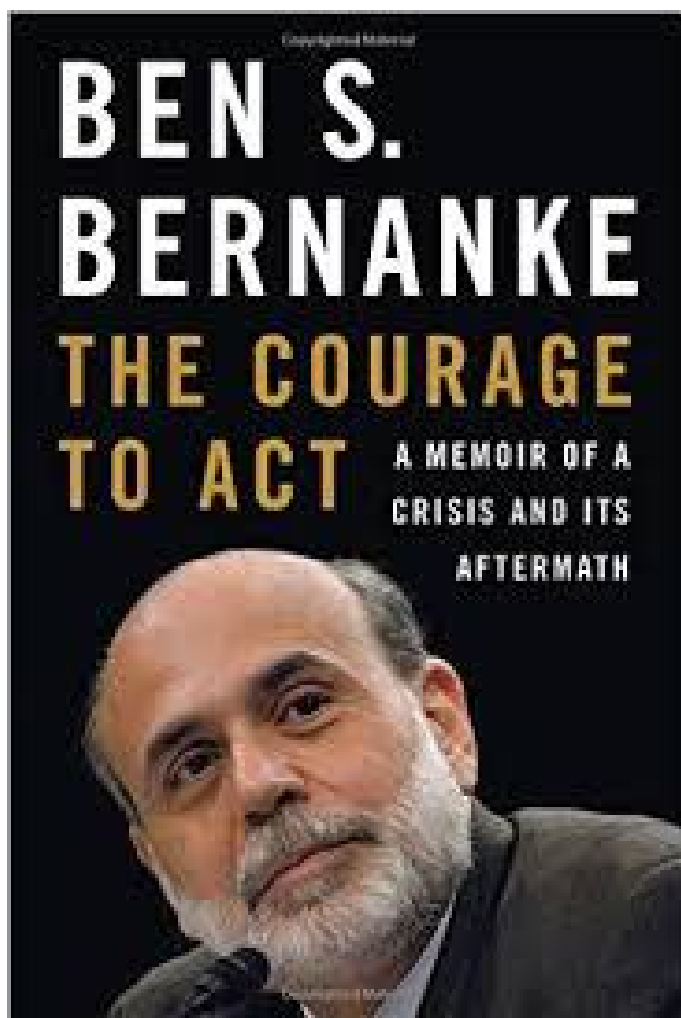


1996 FOMC transcript (Greenspan)

"I think the type of choice is so fundamental to a society that in a democratic society we as unelected officials do not have the right to make that decision. Indeed, if we tried to, we would find that our mandate would get remarkably altered."



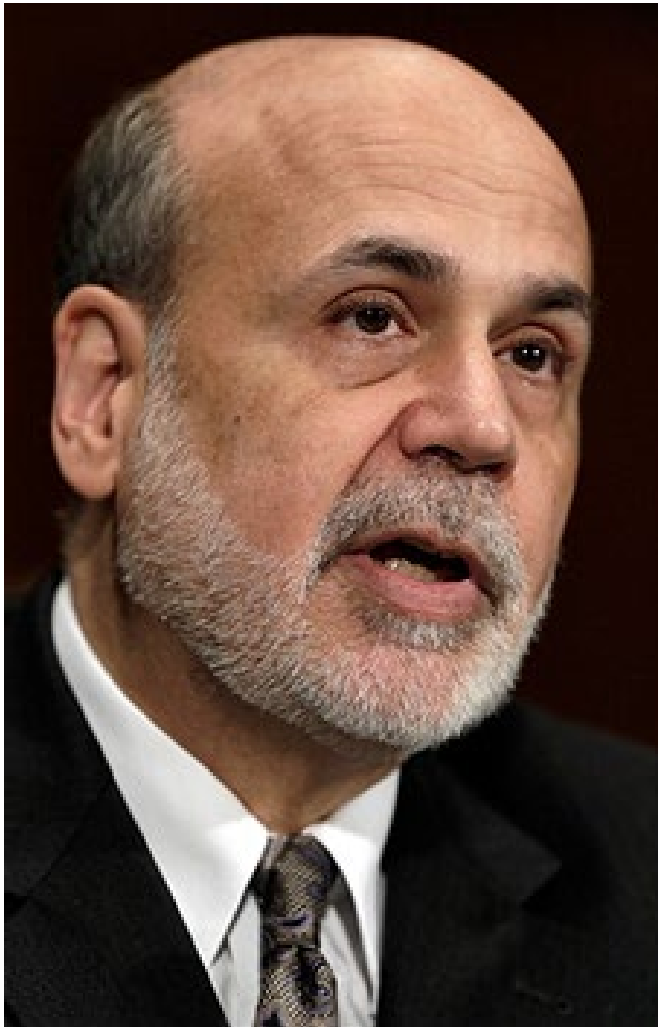
ADOPTING THE INFLATION TARGET



2009 (from *Courage to Act*)

[Barney Frank] thought that the middle of a recession was the wrong time to risk giving the impression, by setting a target for inflation but not employment, that the Fed didn't care about jobs."

ADOPTING THE INFLATION TARGET

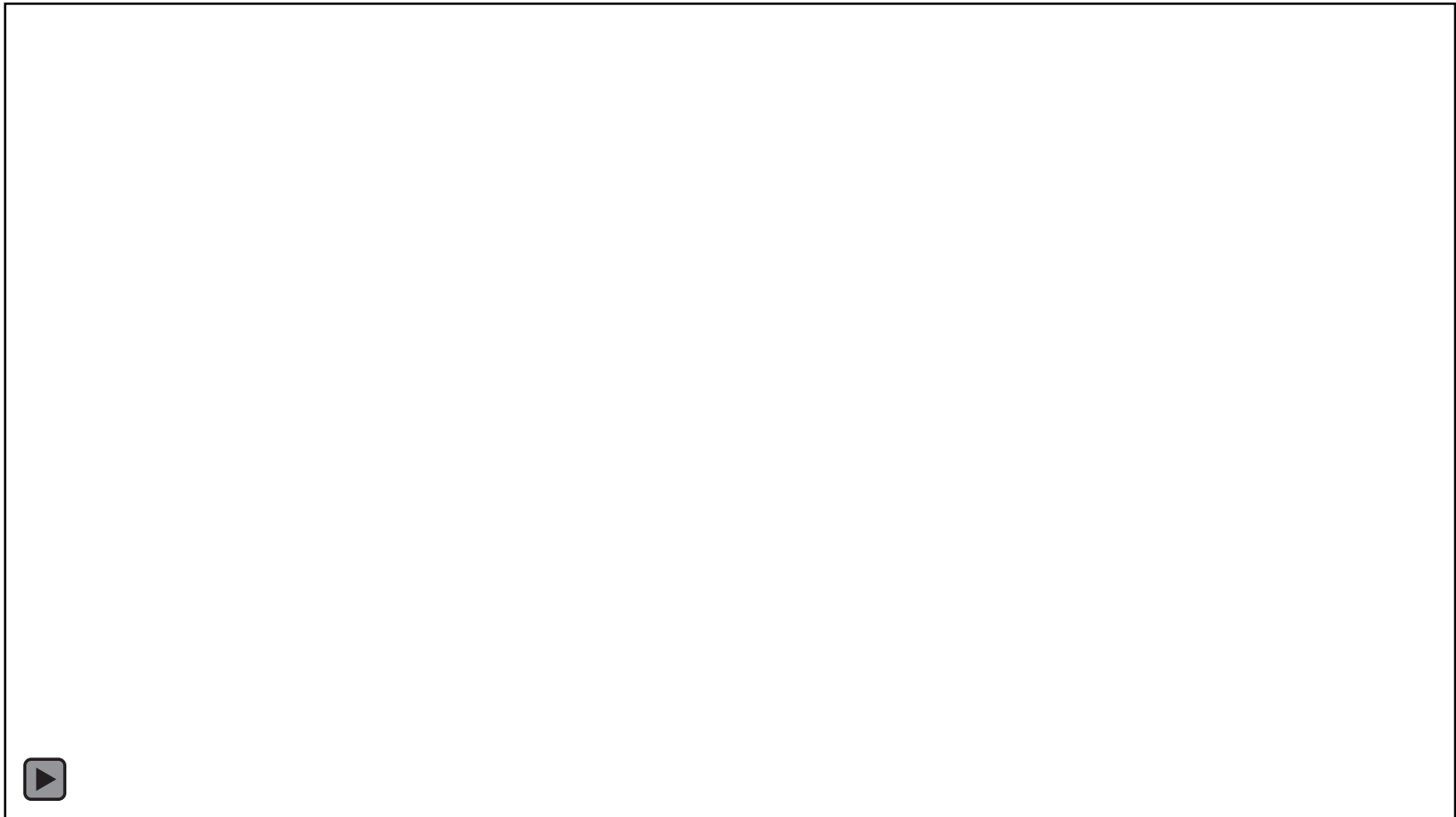


2010 (December FOMC)

One of the main issues has been whether we could succeed politically in creating an inflation target or whether there would be pushback from Congress, etc. I think we are actually at a moment where if we wanted to do something like that, it would actually be welcomed by the political world.

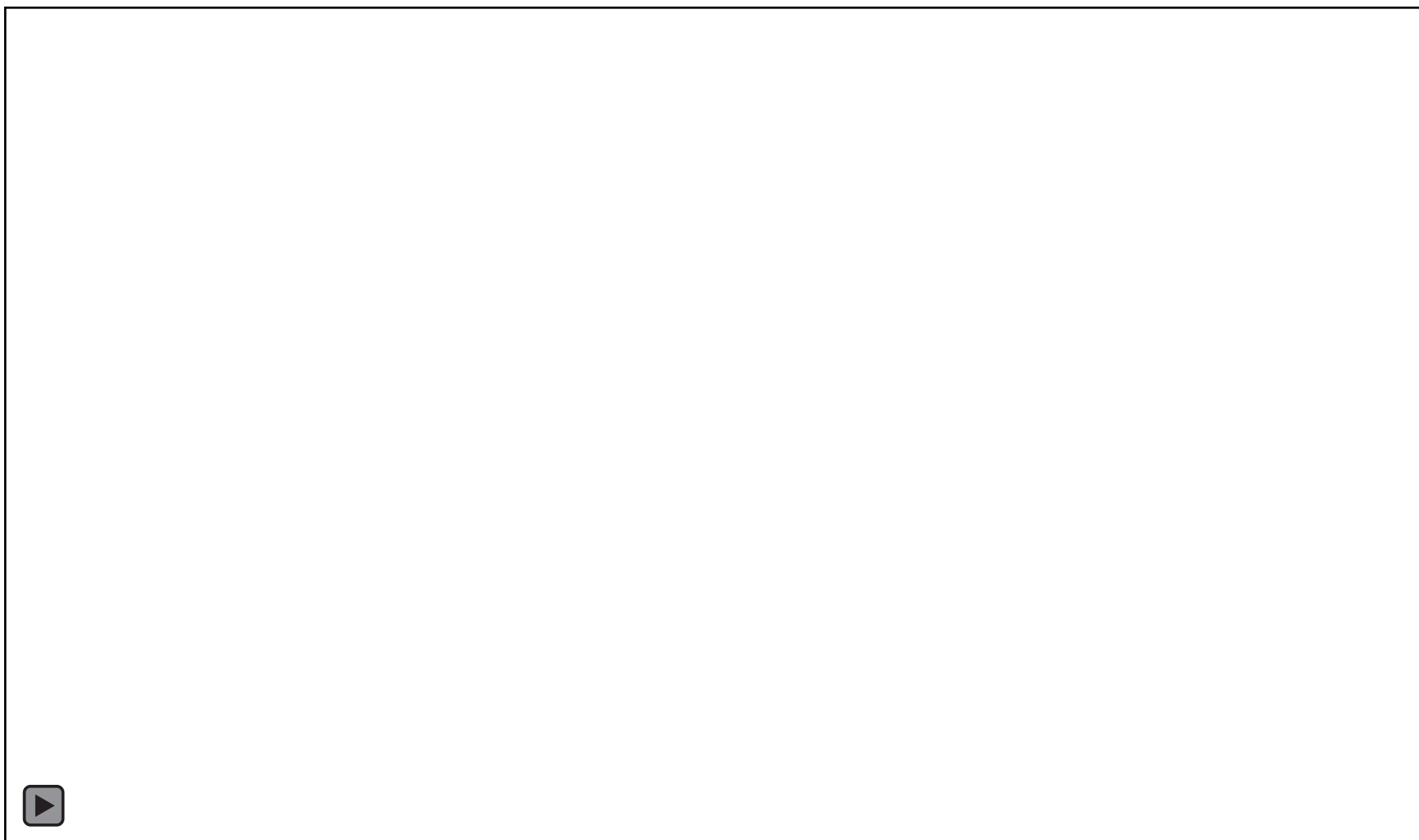


ADOPTING THE INFLATION TARGET



July, 2017 Semi-annual Monetary Policy Report

ADOPTING THE INFLATION TARGET



February 2018: Brookings Institution (Janet Yellen talking to Ben Bernanke)



PANDEMIC CRISIS FUELS INTER-DEPENDENCE

- Congress tells Fed to lend beyond Wall Street
 - Corporate America (even junk bonds!)
 - Main Street and small businesses
 - State and local governments
- Democrats want Fed to address racial equity and climate change
- Republicans force Congress to end CARES lending and block Biden Fed nominee over climate views



INFLATION COMPLICATES INTER-DEPENDENCE

- Salient to voters (and political elite)
- Fed toolkit is well stocked, but can be politically costly when employment slows
- Converts dovish presidents to hawks
- Increases electoral incentives to blame the Fed— precisely when Fed most needs political support to take away the punch bowl

INFLATION COMPLICATES INTER-DEPENDENCE



March 2022: The Semiannual Monetary Policy Report to the Congress



THE MYTH OF INDEPENDENCE

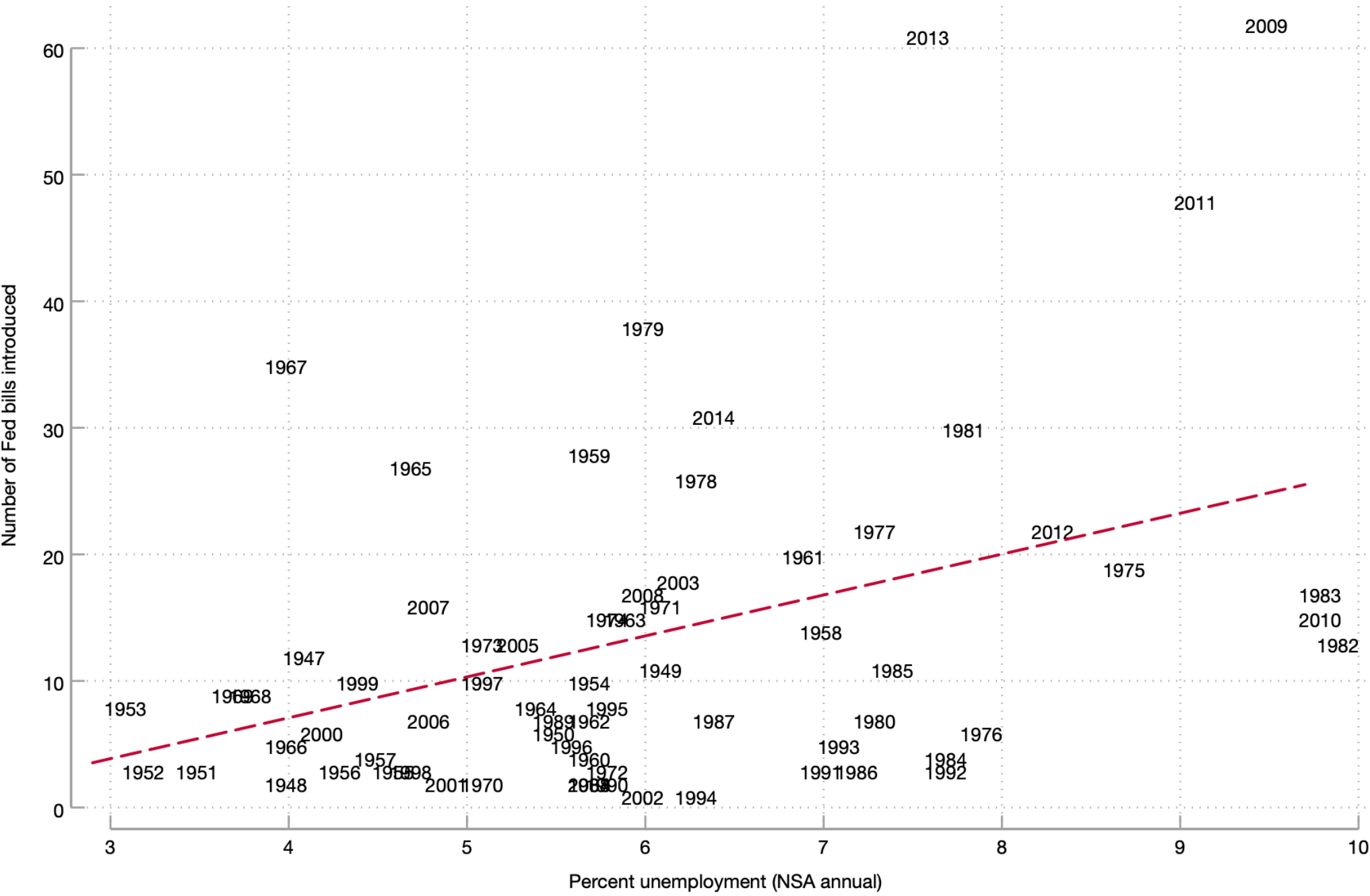
- Tested across broad range of economic and political environments
- Crises demand cooperation (if not coordination) between fiscal and monetary policymakers
- Central bankers need political support to succeed
- Polarized politics complicates search for support
 - Magnifies blame game, keeps Fed in partisan cross-hairs
 - Heightens political risk for the Fed



EXTRA SLIDES

Pages	Subject
23-25	Threats
26-27	List of FRA changes and model estimates
28	Audit the Fed bills
29-30	Volcker
31-36	Trump tweets

LEGISLATIVE THREATS RISE WITH UNEMPLOYMENT



MORE THREATS AFTER FED HIKE RATES

INDEPENDENT VARIABLES	COEF. (STD ERROR)
Quarterly change in U-Rate	.40 (.21)*
FOMC rate hike	-.19 (.17)
FOMC rate hike (lagged)	.47 (.16) **
# of bills (lagged)	.18 (.03)***
Constant	1.56 (.17)**
N	143
Dependent variable: # of Fed-bills introduced per quarter (1973-2014)	*p<.05, **p>.01, ***p<.001 (one tailed tests)

MORE THREATS AFTER FED HIKE RATES

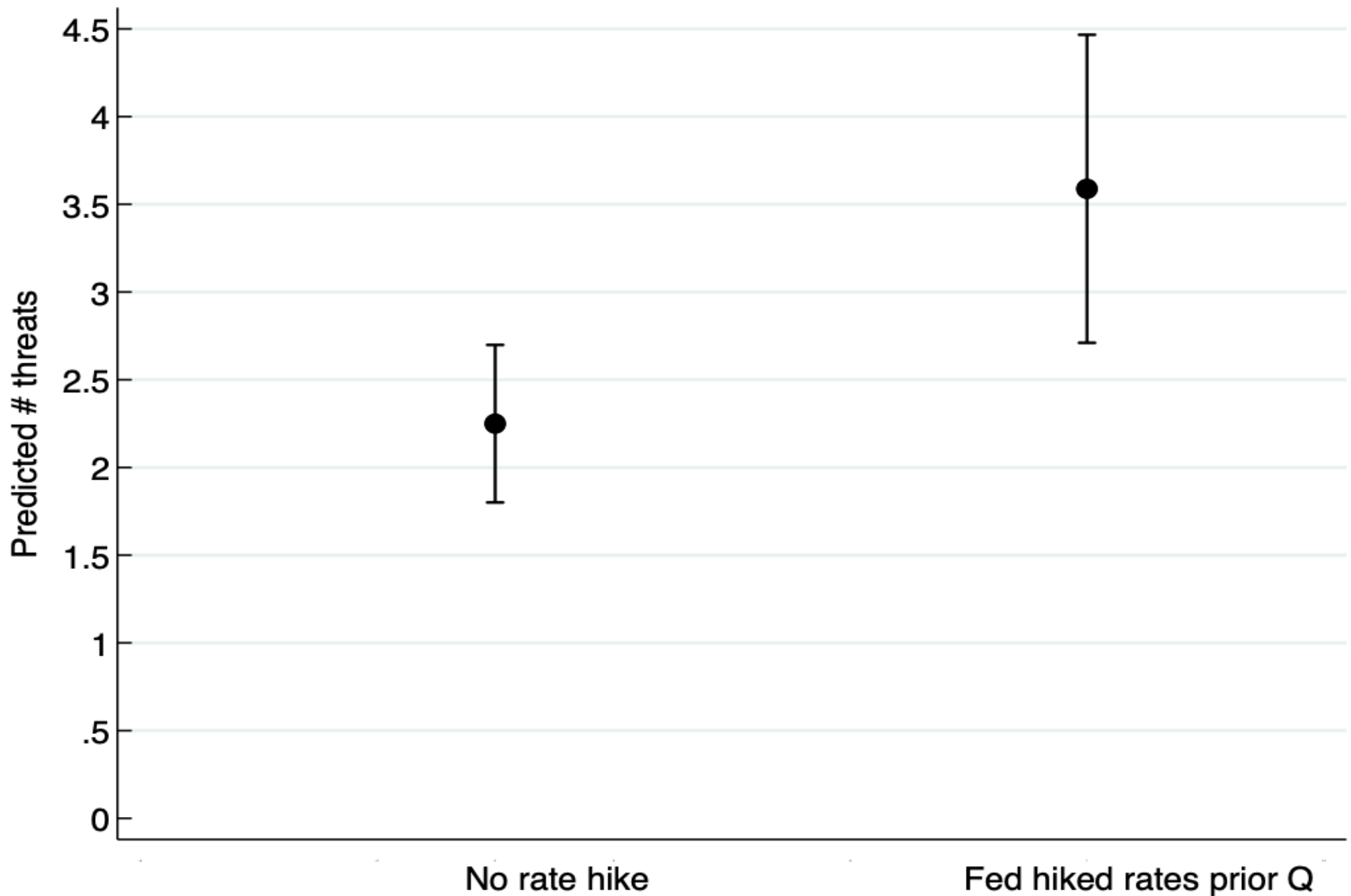


TABLE 1.1. Key Episodes of Congressional Reform of the Fed, 1913–2015

Year	Reform
1913	Federal Reserve Act adopted
1917	First and Second Liberty Bond Acts
1922	Addition of agricultural seat to Federal Reserve Board
1923	Agricultural Credits Act of 1923
1927	McFadden Act
1932	Glass-Steagall Act (February) and Emergency Relief and Construction Act (July)
1933	Emergency Banking Act (March), Thomas Amendment (1933), and Banking Act (June)
1934	Gold Reserve Act of 1934
1935	Banking Act of 1935
1942	Second War Powers Act of 1942
1946	Employment Act of 1946
1951	Treasury-Fed Accord (nonlegislative)
1956	Bank Holding Company Act
1975	House Concurrent Resolution 133 (new reporting requirements)
1977	Federal Reserve Act Amendments
1978	Humphrey-Hawkins Full Employment Act
1980	Monetary Control Act
1991	Federal Deposit Insurance Corporation Improvement Act
2006	Financial Services Regulatory Relief Act
2010	Dodd-Frank Wall Street Reform and Consumer Protection Act

COUNTER-CYCLICAL CONGRESS

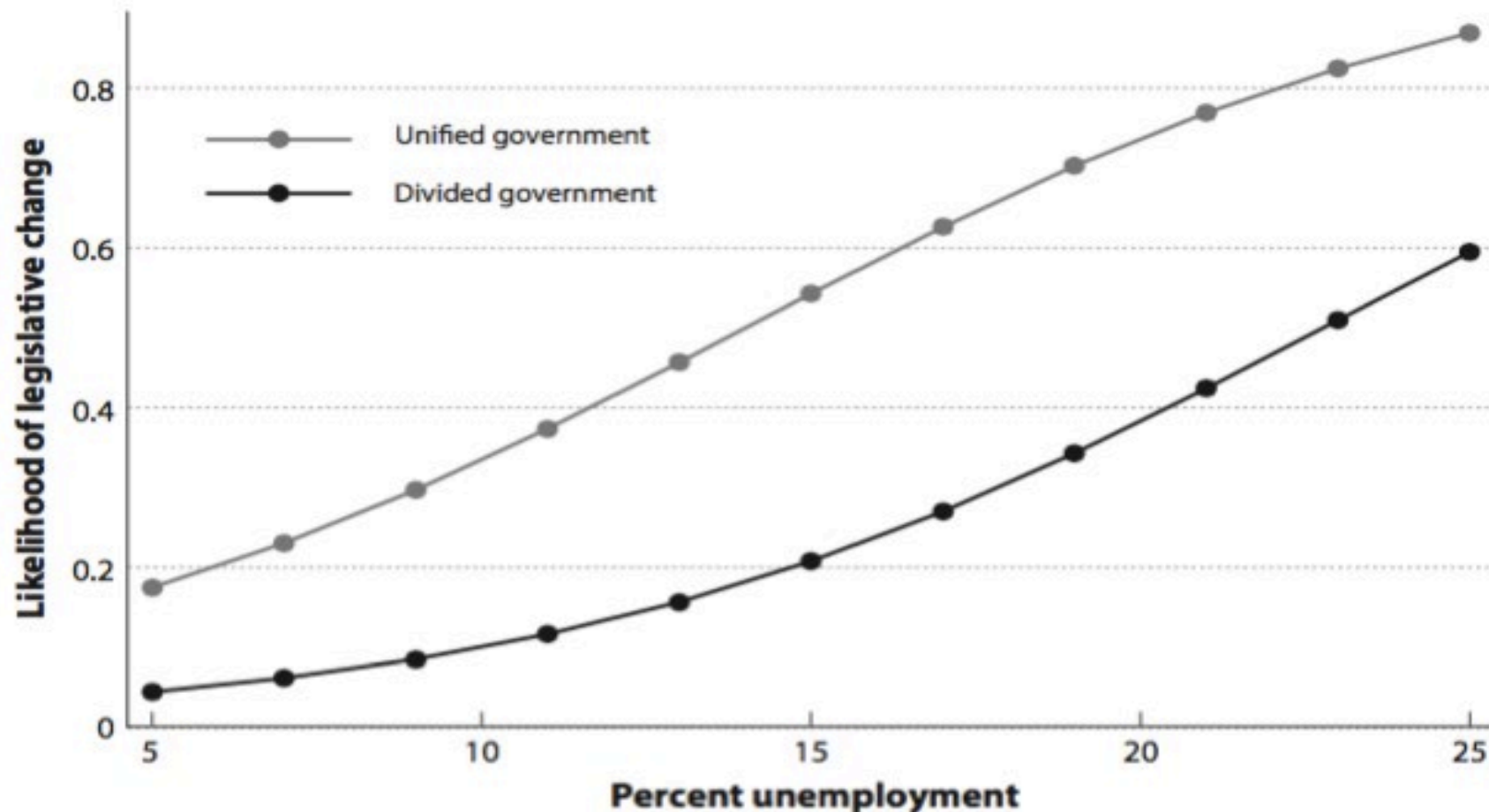
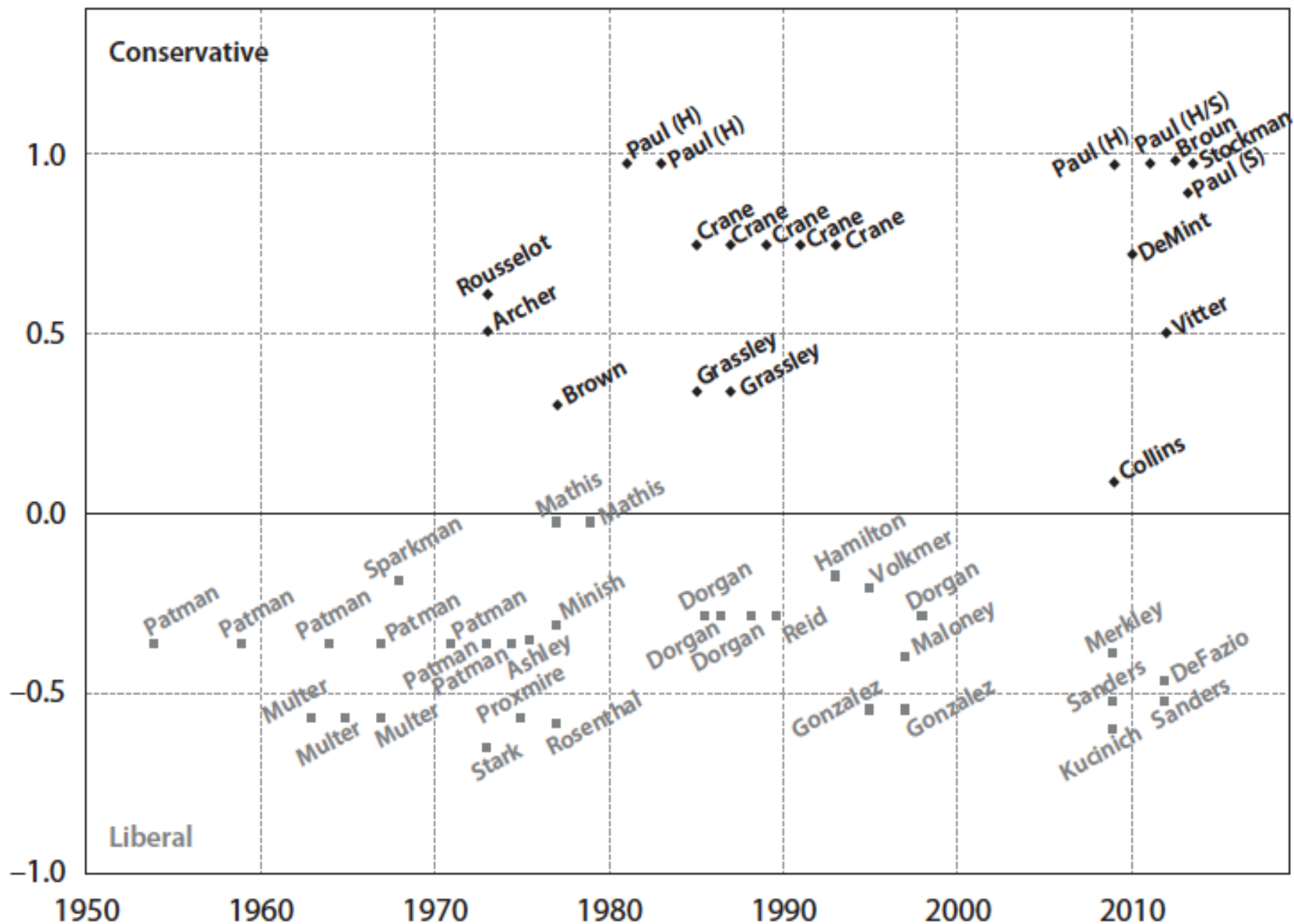


FIGURE 2.9. Likelihood of changes to Federal Reserve Act, 1913–2014. The figure shows the simulated likelihood of legislative action, conditional on economic and political forces (as described in the text). The model controls for unemployment and inflation rates, the number of months the economy was in recession in any given year, and whether the president's party appointed the sitting Fed chair. The results for the underlying model are available from the authors.



PROPOSALS TO AUDIT THE FED (1947-2014)



POLITICAL DEPENDENCE OF THE FED

- Why did Volcker succeed in slaying stagflation in the early 1980s after Burns had failed miserably in the 1970s?
- CW: Independent Fed prescribed tough medicine
- Alternative: Political support for Fed empowered Volcker to raise rates and bring on a recession

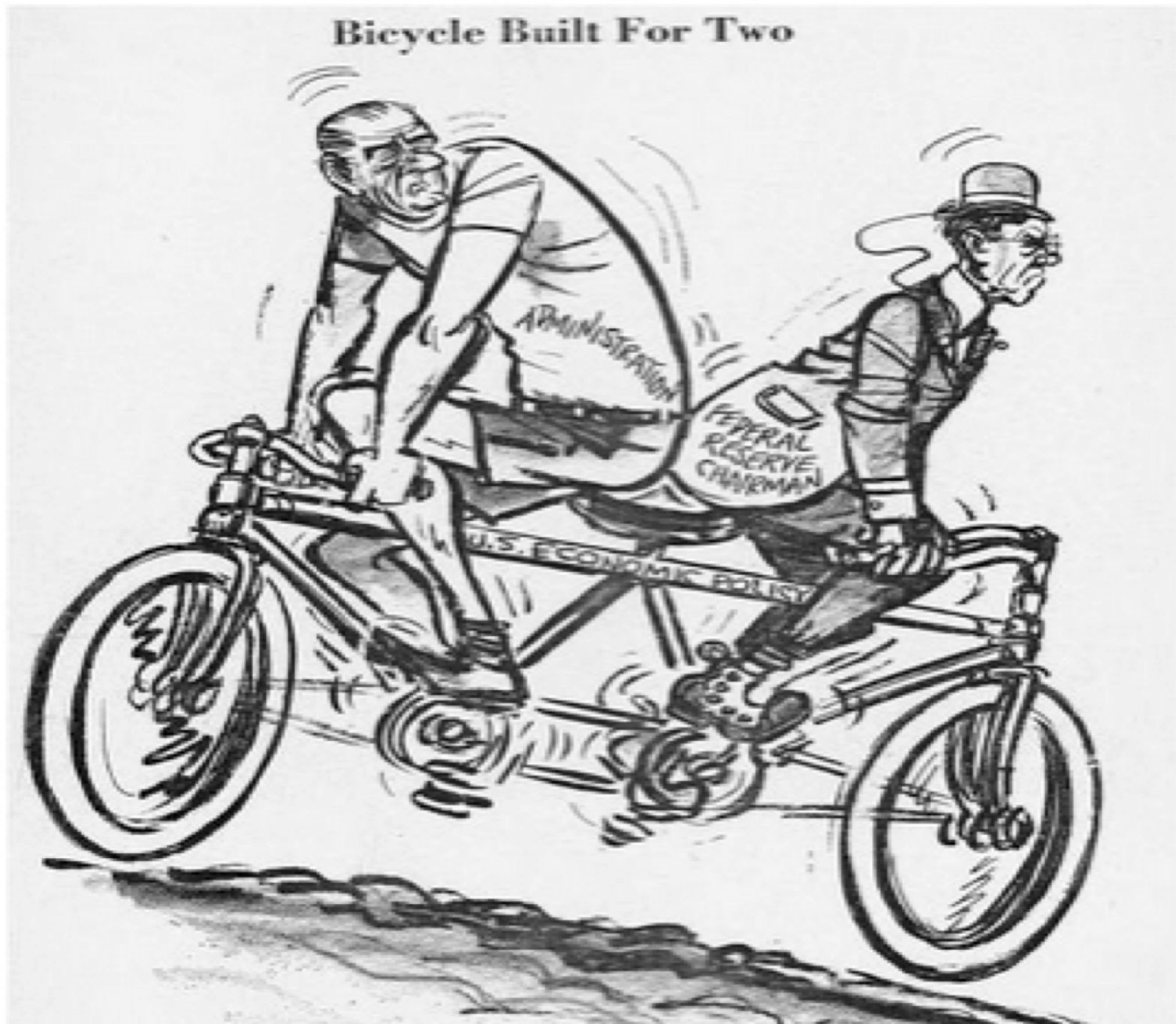


POLITICAL DEPENDENCE OF THE FED

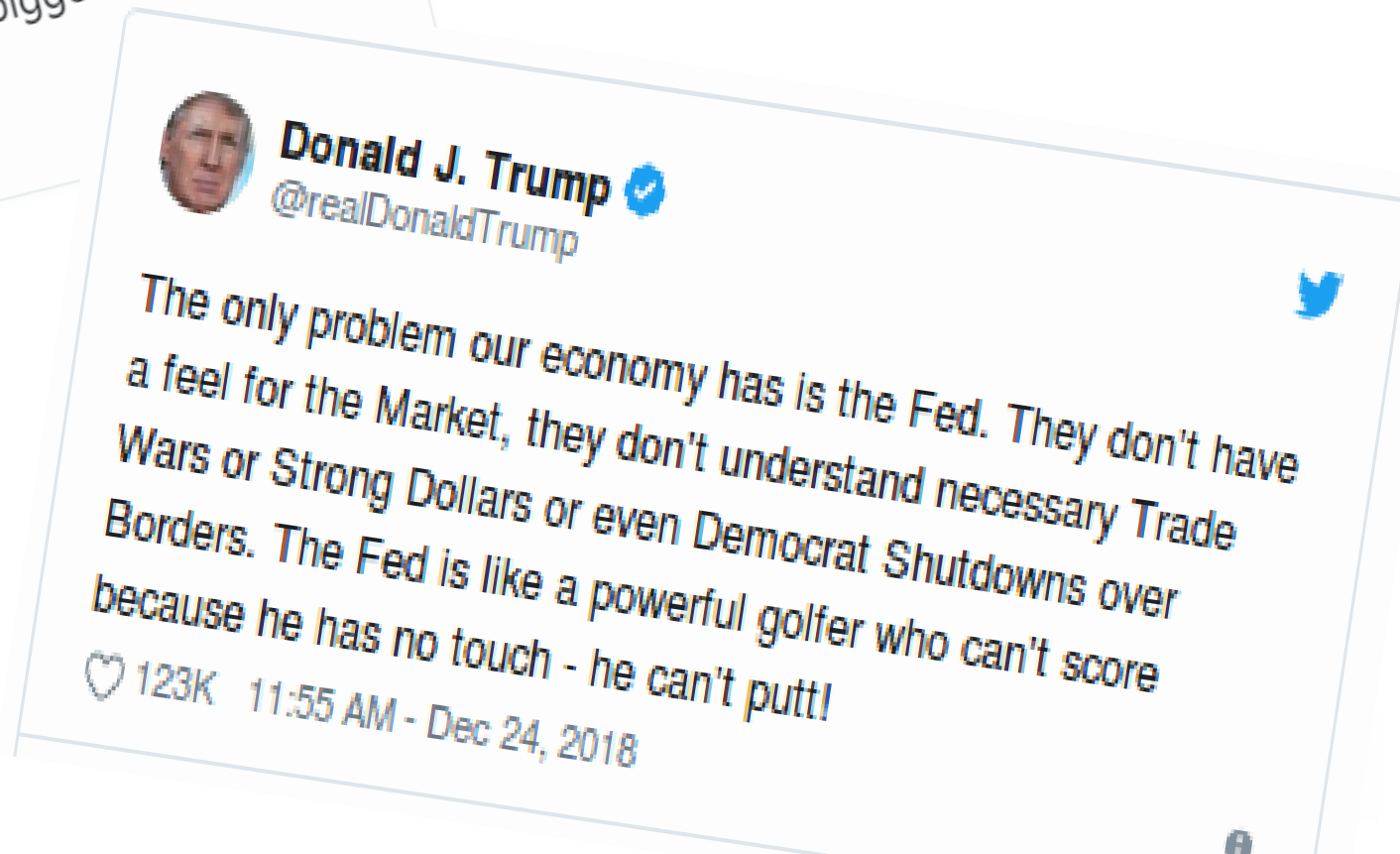
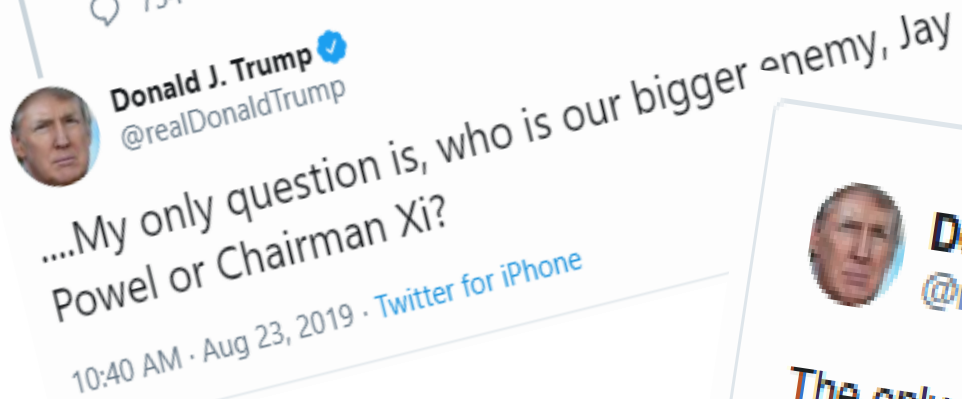
- 1979: **Volcker** “I have also told you that [the administration] is ready for a strong program.”
- 1980: **Volcker** “We have political support and understanding for what we have been doing.”
- 1981: **Guffey** “For the first time ever we do have, for whatever length of time, the support of the Administration at least.”
- 1981: **Roos** “we have to think of our vulnerability from a public opinion point of view if the economy remains soft.”
- 1981: **Volcker** “I think the public patience for climbing up the hill very rapidly again may be extremely limited.”
- 1982: **Volcker** “If we get this one wrong, we are going to have legislation next year without a doubt.”

TRUMP TWEETS SLIDES

IMPLICATIONS: PRESIDENTIAL PRESSURE

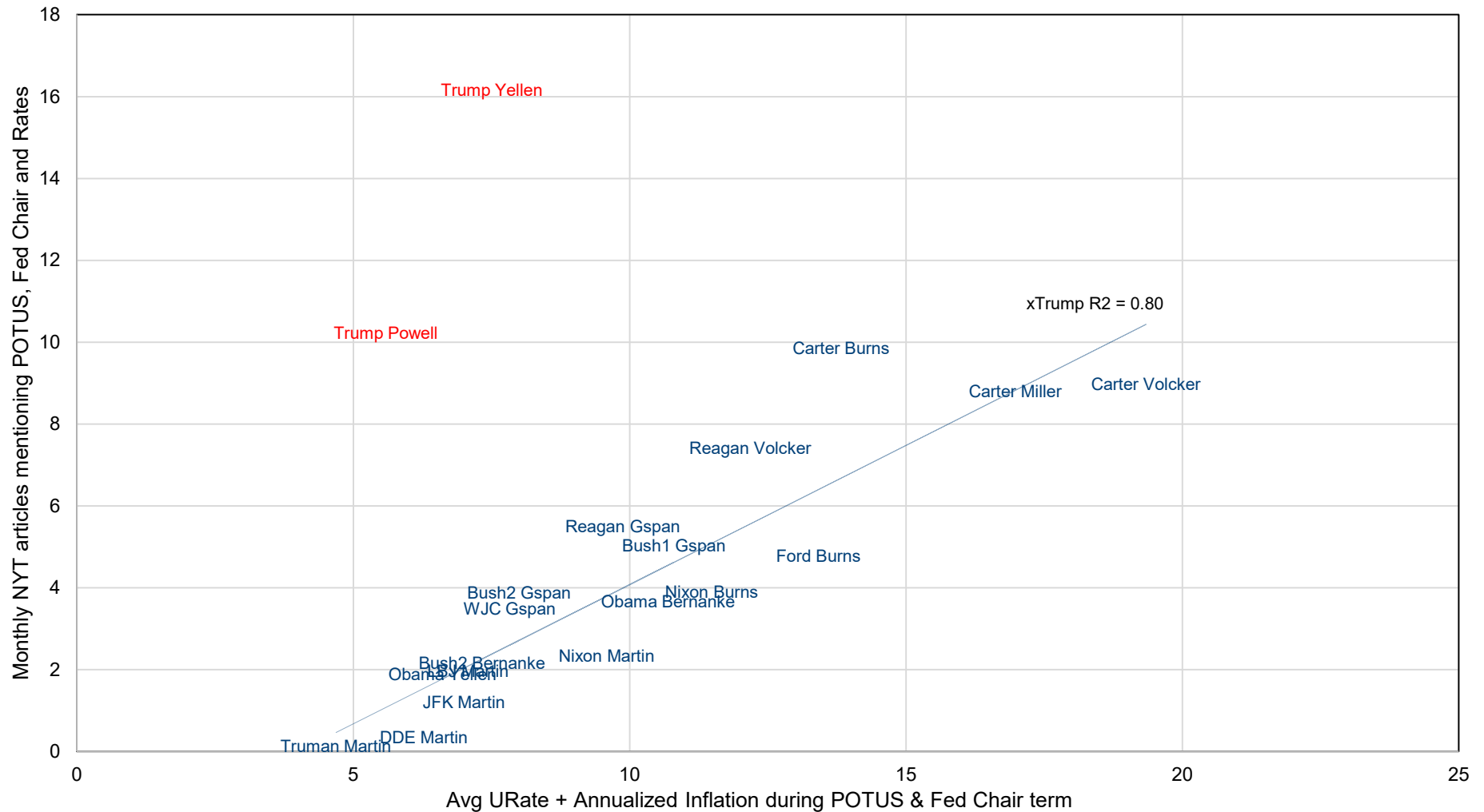


IMPLICATIONS: PRESIDENTIAL PRESSURE



PRESIDENTIAL PRESSURE *PRELIMINARY*

"Misery" vs POTUS/Fed Chair Mentions
('51 Accord thru 12/2018)



Source: Bloomberg, Binder/Spindel preliminary NYT dataset



