A Century of Accommodation:
An Anecdotal History of Federal Reserve Independence

Peter J. Boettke[†] Daniel J. Smith[‡]

Abstract Even when compared to the faulty National Banking System, the Federal Reserve has failed to achieve macroeconomic stability over its centennial existence. Either the Federal Reserve has failed to zero in on an operational monetary policy rule despite a century of technical refinement, or, it has failed to remain independent of political pressures. Despite substantial theoretical and empirical evidence that the Federal Reserve has been susceptible to political and bureaucratic pressures–likely engendered by the epistemic difficulties inherent in conducting monetary policy–the concerns of political economy are not accounted for in monetary structures, models, and policy prescriptions. The existing empirical literature on Federal Reserve independence fails to capture the varied, varying, and interacting pressures exerted on the Federal Reserve. We make the case for the broader inclusion of the concerns of political economy in monetary expositions by supplementing the existing theoretical and empirical literature with an anecdotal history of Federal Reserve independence in order to inform future empirical investigations.

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[†] Department of Economics, Mercatus Center at George Mason University, Email: PBoettke@GMU.edu.
[‡] Manuel H. Johnson Center for Political Economy at Troy University, Email: DJSmith@Troy.edu.

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 FOMC to make monetary policy decisions based solely on the longer-term needs of the economy, not in response to short-term political pressures. Considerable evidence supports the view that countries with independent central banks enjoy better economic performance over time.
-Ben S. Bernanke, 2011a

…a principal point of the gold standard was to control governments, and we have not become sufficiently modern to come up with a satisfactory substitute (although governments have perhaps become more adept at eliminating these constraints).
-Robert J. Barro, 1982, 104

1 Introduction

The Federal Reserve was explicated designed to be independent of political, bureaucratic, and special interest group influence when it was created in 1913, and again at its major reorganization in 1935 (Clifford 1965, 21; Greenspan 2007, 110; Greider 1987, 280-1; Kettl 1986, 20; Price 1962, 154; Timberlake 1978, 187 & 1993, 214 & 316; Woolley 1984, 11).[1] The Federal Reserve was even granted its own independent and self-financing budget to prevent political pressures from being exerted through budgetary means (Greider 1987, 50; Toma 1982; Reagan 1961, 74).[2] Bernanke (2010a) argues that not only was the Federal Reserve founded as an independent central bank, but that the "…effective degree of independence has gradually increased over time."

Yet, after a century of operation and refinement of monetary policy, the Federal Reserve's performance record has failed to improve upon pre-Fed monetary arrangements (Romer 1986; Romer and Miron 1990; Davis 2004 & 2005; Hogan 2013; Hogan & Smith 2013).

[1] Despite this goal, the Secretary of the Treasury and the Comptroller of Congress were included on the Board of Governors until 1935 by law (Clifford 1965, 75).
The Federal Reserve Act was signed into law December 23, 2013. The 12 Federal Reserve Banks were opened by November 16, 2014.
[2] The Federal Reserve finances itself through the interest it receives from its portfolio of government securities, the sale of government securities, and service fees it receives for providing various banking services to private banks.

Indeed, Selgin, Lastrapes, and White (2012), find that the Federal Reserve has failed to achieve its goal of macroeconomic stability in comparison to even the National Banking System.[3] Either the economics profession has failed to zero in on an operational monetary policy rule, or, the Federal Reserve's monetary policy rules prove nonoperational in a contemporary political democracy. More precisely, the Federal Reserve's record indicates that our monetary structures have not been robust to the motivational and epistemic realities of political economy.

Likely, the inescapable epistemic complexities associated with conducting monetary policy engender the ensuing motivational problems.[4] The inability of the Federal Reserve to even adhere to the established monetary policy rule leading up to the financial crisis suggests that the Federal Reserve has failed to operate independently of political and bureaucratic influence (Taylor 2009).

In the quest for fine-tuning the proper monetary policy course, the concerns for political economy often only appear as afterthoughts to technical models, rather than as fundamental parameters. Perhaps this is due to the shortcomings of the current body of empirical work on Federal Reserve independence. While Boettke and Smith (2013) find substantial evidence that the Federal Reserve has been influenced by political and bureaucratic pressures, they also find substantial shortcomings in the empirical work. Measuring the extent of Federal Reserve accommodation of Treasury debt is extremely difficult (Thornton 2010; Williams 1990, 771). Just looking at the amount of money being printed fails to account for changes in the demand for

[3] For a critical comment on Selgin, Lastrapes, and White (2012), see Miron (2012).
[4] For some of the epistemic problems associated with conducting monetary policy see: Axilrod (2011, 31), Beck (1987, 202), Butos (1986), Feldstein (1982), Goldfeld and Blinder (1972), Havrilesky (1971 & 1977), Havrilesky, Sapp, and Schweitzer (1975), Horwitz (2000, Chapter 7), Johnson and Keleher (1996, Chapter 2 & 3), Karamouzis and Lombra (1989), Khoury (1993), Lombra and Karamouzis (1993), Lombra and Moran (1980), Lucas (1976), Morgenstern (1963), Reifschneider et al. (1997), Romer and Romer (1989), Selgin and White (1994), Taleb (2010 & 2012), and Toma (1991).

money, which is not related to federal deficits (Hein 1981; Havrilesky, Sapp, and Schweitzer 1975; Horwitz 1990, 468). As Bradley (1985, 411) argues,

> …the reduced-form money-growth equation cannot determine if the money supply response to an increase in federal debt comes from the private sector or from the monetary authority. Money growth which is generated from the accommodation of increased money demand has a different set of consequences than money growth which is initiated by the monetary authority.

Furthermore, assumptions such as a constant or policy invariant real interest rate, the choice of variables, the specification of models, estimating the perceived lag and reaction function at the time a specific monetary action was undertaken, other concurrent economic and political events that could divert the attention of influential political actors towards or away from monetary policy, the origins of deficits, the transition of key political leaders and monetary officials in and out of office, and tax rates can all significantly complicate empirical investigations (Abrams, Froyen, and Waud 1980; Beck 1987, 202; Caporale and Grier 1998, 423-4; Caporale and Grier 2000; Feldstein 1982, 161; Goldfeld and Blinder 1972; Grier and Nieman 1987; Havrilesky and Gildea 1992; Havrilesky, Sapp, and Schweitzer 1975, 467; Khoury 1993; Lombra and Torto 1973; Hamburger 1971; Meltzer 1966; Niskanen 1978). Additionally, many empirical investigations narrowly focus on only one or a few channels of influence, failing to incorporate the reality that the type of influence, its specific operation, and its interaction with other channels of influence are all apt to vary over different political and economic environments. Given these complexities, there is, understandably, a high degree of variance over the choice of date range, time period metric, monetary aggregate measures, deficit measures, and channels of influence employed in empirical investigations of Federal Reserve independence.

Because of the complexities involved in these empirical studies, Meiselman (1986) calls for anecdotal work to better understand the independence of the Federal Reserve:

> …if a central bank acts in a predictable way, it has little or no effect on financial or real variables. Only the price level is permanently changed. This means that monetary uncertainty and the inability to forecast and predict Fed behavior is a necessary condition for the Fed to alter financial markets, output, and employment that influence voters or serve other ends, including economic stabilization. In turn, it also means that the usual search for empirical regularities related to actual (not unanticipated) changes in the stock of money, including the testing of hypotheses using measured and actual monetary magnitudes, may not be appropriate—precisely because the Fed cannot act dependably on average if it wishes to be effective in specific circumstances. Thus, analyzing only actual monetary phenomena in different elections using standard statistical tests may not represent an operational of meaningful test of intended or actual Fed intervention directed to election results. Even if from time to time, the Fed, in fact, tries to use its monetary powers for political ends, 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.

As Grier (1987, 481) stresses, "[n]o amount of regression analysis can ever prove that the Fed is politically controlled."[5] This paper seeks to provide an anecdotal history of Federal Reserve independence to contextualize, support, and inform future empirical investigations. [6]

2 World War I

While the Federal Reserve was ostensibly given the independence to refuse to finance the Federal Government, the Federal Reserve was in existence only a few years before it sacrificed its independence in order to finance World War I (Bach 1950, 142; Bach 1971, 64; Brown 2013, 21; Clifford 1965, 99; Friedman and Schwartz 1963, 216; Greider 1987, 322; Hanna 1936a, 623; Harding 1925[1970], 145 & Appendix A; Herren 1992, 229; Kubik 1992, 357; Nussbaum 1967, 165; Timberlake 1993, 258). The Federal Reserve Act was amended in 1916 to allow "…Federal Reserve notes to be issued against Treasury security collateral" at below market interest rates in order to help finance WWI, violating one of the fundamental principles the Federal Reserve was

[5] See also Grier (1989, 388).
[6] For a defense of the 'narrative approach' in monetary economics, see Romer and Romer (1989), Summers (1991), and Morris (2002, 123). For a broader defense of the narrative approach in economics see Bates, Greif, Levi, Rosenthal, and Weingast (1998 & 2000) and Boettke (2000).

founded upon (Mehrling 2011, 37). With this advantage over private borrowers, Federal debt jumped from $1 billion in 1917 to approximately $25 billion in 1919 (Mehrling 2011, 37; Meltzer 2003, 89). Friedman and Schwartz (1963, 216) claim that, "[t]he Federal Reserve became to all intents and purposes the bond-selling window of the Treasury, using its monetary powers almost exclusively to that end." Mehrling (2011, 38) records,

> During the war, the Fed acted both to maintain liquidity in the Treasury bond market and to put a floor under the price of the bonds so that the Treasury could continue to borrow cheaply. After the war, the price floor was relaxed and the discount rate was raised, but the practice of liquidity support continued.

In total, "[u]nder this act $40,000,000,000 of liquid money was created to finance the World War. It financed not only the United States but financed to the extent of billions of dollars Great Britain, France, Italy, and their allies" (Owen 1939). Meltzer (2003, 85) records that "[i]ndependence was sacrificed to maintain interest rates that lowered the Treasury's cost of debt finance. The system became subservient to the Treasury's perceived needs." This sacrifice of independence included giving up the penalty rate which was yet another "…one of the main principles on which it [the Federal Reserve] was founded" (Meltzer 2003, 67 & 86).[7] Eichengreen (1992, 114), reflecting on WWI, wrote "[i]n retrospect, policymakers should have foreseen the consequences of interest-rate pegging…This reckless policy would seem indefensible. Yet so long as government budgets remained in deficit, little choice existed."

Many early Board members actually held the opinion that the Federal Reserve was just "...an adjunct of the Treasury Department rather than an independent body" after this encroachment of their independence (Kettl 1986, 25). In fact, the Federal Reserve Board meetings were actually held in the Treasury Department and the Secretary of Treasury was the

[7] The penalty discount rate is imposed so that there is penalty for banks borrowing money from the Federal Reserve so they have the incentive to only borrow money when they are in dire financial distress. If the discount rate is set below market interest rates, eliminating the penalty, then banks can profitably lend out money it has borrowed from the Federal.

Chairman of the Board by right of office until the Banking Act of 1935 (Havrilesky 1995a, 44; Kettl 1986, 24). Yet, in the words of Benjamin Strong–the head of the New York Federal Reserve Bank at that time–if the Federal Reserve did not deliver the desired Treasury support, it would have been "…an invitation to Congress to have their power modified – a perfectly unthinkable and most dangerous possibility" (as quoted in Kettl 1986, 27).[8]

Pressures from the executive branch, legislative branch, and the Treasury were all exerted on the Federal Reserve to provide easy monetary policy following WWI. The Treasury used its positions on the Board of Governors to ensure that the price of government bonds didn't fall (Clifford 1965, 114; Eichengreen 1992, 114; Friedman and Schwartz 1963, 223 & 228; Havrilesky 1995a, 44; Kettl 1986, 27). The Secretary of the Treasury, Carter Glass, even threatened to have Benjamin Strong removed from office by the President because Strong threatened to raise rates without the approval of the Board of Governors (Clifford 1965, 115). From the legislative branch, strong pressure from agricultural interests to keep interest rates low resulted in the introduction of an agricultural member on the Federal Reserve Board and the inclusion of nine month's agriculture paper in the rediscounting facilities of the Federal Reserve Banks (Hanna 1936a, 623; Meltzer 2003, 114). As Meltzer (2003, 132) summarizes, "Congressmen from agricultural areas, particularly in the South and West, were highly critical of the higher discount rates in those regions. Bills were introduced limiting the System's [Federal Reserve's] ability to increase rates. The Federal Reserve yielded to this political pressure by lowering discount rates." Pressure was also exerted on the Federal Reserve from the executive

[8] Also see Eichengreen (1992, 115).

branch in order to keep rates low in order to appease farmers (Friedman 1994, 157; Friedman & Schwartz 1963, 234; Havrileskey 1995a, 45; Meltzer 2003, 114).[9]

3 The Great Depression

The same pressures that were exerted following WWI remained in place leading up into the Great Depression (Meltzer 2003, 248 & 264). The Federal Reserve delivered, expanding the money supply by 34% in between June 1922 and June 1927, and another 10% in between June 1927 and December 1928 (White 2012, 69).

The Federal Reserve became even more malleable towards political pressures once the Great Depression hit (Bradford 1935, 662; Clifford 1965, 125; Friedman & Schwartz 1963, 322 & 363). George Harrison, the President of the Federal Reserve Bank of New York at the time, was being pressured to push the Federal Reserve to engage in monetary easement with the threat that if the Federal Reserve didn't act then "…Congress would approve 'inflationary' policies before the Federal Reserve" (Meltzer 2003, 360). A veteran's bonus bill intended to stimulate spending and to be funded by Federal Reserve banknotes collateralized by bonds sold to the Federal Reserve was under consideration in Congress. As Meltzer (2003, 360) records, "Senator Elmer Thomas, author of the bonus bill, told Harrison that 'if his bill is not favorably received, even more radical proposals will be forthcoming from Congress.'"

Pressure came from the executive branch as well. President Franklin D. Roosevelt told George Harrison that it was "imperative to get agricultural prices up before Congress meets and that if we did not, he was fearful of what Senator Thomas and the other inflationists might do" (Shlaes 2008, 169). As Meltzer (2003, 361) goes on to explain, "[p]olitical concerns

[9] For a more complete history about the early years of the Federal Reserve and pressures from the agricultural sector, see Harding (1925[1970]).

accomplished what economic disaster could not. The Thomas bill, and the threat of other legislation, aroused Harrison to action." Harrison told his directors, "[t]he only way to forestall some sort of radical financial legislation…is to go further and faster with our own program" (Friedman and Schwartz 1963, 384). Once Harrison succumbed to political threats from Senator Thomas, Senator Thomas pushed for even more action. Harrison reported that Senator Thomas told him that he "…might be satisfied not to press for congressional action if the system would proceed more vigorously" (as quoted in Meltzer 2003, 363). As Eichengreen (1992, 315) explains,

> …in an election year, Congress was not inclined to grant the Fed this leeway [to not engage in expansionary policy]…They [Congress] then applied direct pressure for the System to initiate expansionary open-market operations. The Board caved in to the pressure.

The Board added more than $1 billion of liquidity during February and June of 1932 under heavy pressure from congress (Eichengreen 1992, 315; Friedman and Schwartz 1963, 322 & 363; Marshall 1992, 220). With the depressed economy and the fiscal deficits being generated by President Roosevelt, the Federal Reserve was forced to accommodate the chosen course of fiscal policy to "…keep the government securities market 'orderly' so that the deficits would not bankrupt the government" (Timberlake 1993, 317). Havrilesky (1995a, 48) argues that in 1933 "…President Roosevelt effectively assumed responsibility for monetary policy," especially with the de facto dropping of the gold standard.[10] The Thomas Amendment of the Agricultural Adjustment Act of 1933, enacted in May of 1933, gave Roosevelt the power to stimulate inflation by increasing greenbacks, reducing the content of the dollar, or by coining silver if the Federal Reserve refused his instructions to purchase government securities (Bach 1971, 73; Clifford 1965, 142; Eichengreen 1992, 331; Hanna 1936a, 627; Nussbaum 1967, 181;

[10] Also see Eichengreen (1992, 231 & 342).

Timberlake 1993, 276; Toma 1985, 364). According to Bradford (1935, 661), the Thomas Amendment,

> …authorized the President, in his discretion, to direct the Secretary of the Treasury to enter into agreements with the federal reserve banks and the Federal Reserve Board, under which the reserve banks might buy up to $3,000,000,000 of additional government securities without incurring any penalty for deficiency in reserves resulting therefrom. The amendment also provided that if the Secretary of the Treasury "is unable to secure the assent of the several federal reserve banks and the Federal Reserve Board to the agreements authorized in this section," the President might direct the Secretary of the Treasury to cause to be issued United States notes up to $3,000,000,000 in amount. The Administration was accordingly provided with a club to hold over the reserve authorities. If they refused to enter into the open-markets agreements, it would be possible to offset the effects of their refusal by the issuance of United States notes. Moreover, although the amendment provided that the Federal Reserve Board might raise of lower existing reserve requirements, to prevent injurious credit expansion or contraction, such authority might be granted only with the approval of the President.

In May of 1933 President Roosevelt appointed Eugene Black to be the chairmen of the Federal Reserve, reportedly due to Black's reputation at the Atlanta Federal Reserve bank for being a staunch advocate of expansionary monetary policy (Meltzer 2003, 296; Richardson and Troost 2009, 1039).[11] The Banking Act of 1933 was passed in June, which created the Federal Deposit Insurance Corporation and brought about significant changes in the structure of the Federal Reserve, in particular the establishment of the Federal Open Market Committee (FOMC), comprised of a representative from each reserve bank (Hanna 1936a). Where previously open market operations were undertaken at the discretion of the individual reserve banks to prevent undue influence and centralization of the policies chosen, the Banking Act of 1933 brought these operations under the control of the Federal Reserve Board with the "obvious purpose…to subject open market operations to Reserve Board policy" (Hanna 1936b, 773). According to Hanna (1936a, 635),

[11] Black resigned in 1933 to return to the Atlanta Fed, reportedly due to its higher compensation (Hyman 1976, 154).

> The two chief characteristics of the Act of 1933 in its relation to the Federal Reserve Board were its enhancement of the power of the Board over the reserve and the member banks, and the subjection of the Board itself to the influence of the federal government.

In January of 1934, the Gold Reserve Act was passed, which put the Secretary of the Treasury–with the approval of the president–in control of the use and flow of gold (Bradford 1935, 662; Silber 2012, 37; Toma 1985, 364). This meant that any purchases of gold in the pursuit of settling international balances by the individual Federal Reserve banks had to be approved by the Secretary of the Treasury. In addition, it established a stabilization fund in the amount of $2 billion in the Treasury. Funds not necessary for exchange stabilization could be used to purchase government debt, which allowed the Secretary of the Treasury substantial leeway to offset market operations undertaken by the Federal Reserve (Bradford 1935, 662; Toma 1985, 365). The Gold Reserve Act also gave the President the ability to devalue the dollar by reducing the gold redemption value of the dollar (Toma 1985, 365). President Roosevelt immediately took advantage of the new power and created $3 billion in profits for the Treasury by devaluing the dollar the day after the Gold Reserve Act passed (Toma 1985, 365).[12] John M. Keynes was reportedly responsible for the strategy employed by the Treasury (Wapshott 2012, 163).

Once Eccles was appointed Chairman of the Federal Reserve in 1934, his accommodative policies played a vital role in Roosevelt's New Deal policies (Kettl 1986, 53). Upon his appointment, Eccles reportedly told George Harrison, still the Chairman of the Federal Reserve Bank of New York, that he [Eccles] had "…accepted the post of Governor primarily for the purpose of carrying out an important legislative program, which you in all probability, are going

[12] Even before the Gold Reserve Act of 1934 passed, President Roosevelt was already 'experimenting' with the price of gold, deciding in October 1933 that he would raise the price of gold 21 cents, reportedly because 21 was a "…lucky number…" (Shlaes 2007, 148).

to oppose" (Hyman 1976, 167). According to Meltzer (2003, 490), "…the Federal Reserve was less independent of the administration from 1934 to 1941 than in any other peacetime period."[13]

Lacuhlin Currie–one of Roosevelt's economic advisors, working with Marriner Eccles, an earlier proponent of stimulus spending who was reportedly promised the job of the Chairman of the Federal Reserve–set out to change the objective of the Federal Reserve from one of accommodating growth to actively creating economic growth (Kettl 1986, 48; Meltzer 2003, 467; Timberlake 1993, 282).[14] This required a drastic change in the structure of the Federal Reserve–a change that would require a Federal Reserve that was accommodating to the needs of the administration, especially when it came to the planned New Deal policies which would require extensive monetary accommodation (Kettl 1986, 49). In particular, it was obvious that the approval of Roosevelt's public works programs by congress would require Federal Reserve action to provide the banking system with the credit and financing, and that under the existing decentralized system individual Reserve banks could block the required financing (Eccles 1951, 187; Hyman 1976, 165). As Currie argued, "[t]here is no economic problem more important than achieving and maintaining prosperity, and since the actions of the monetary authority have a direct bearing upon the strength of business activity they must be subject to the control of the Administration" (as quoted in Kettl 1986, 49).

Eccles and Currie's plan, which restructured the Federal Reserve in pursuit of this goal, was passed through Congress as the Banking Act of 1935, but with some minor curtailments of their desired plan (Barber 1992, 85; Blum 1959, VIII.3; Clifford 1965, 128; Eccles 1966, 166; Greider 1987, 310; Havrilesky 1995a, 49; Hyman 1976, Ch. 17; Kettl 1986, 52). One of the main advantages of the bill for the Roosevelt administration was that it concentrated power in

[13] See also Bach (1971, 76) and Kettl (1986, 53).
[14] John Kenneth Galbraith suggested that under the leadership of Eccles, the Federal Reserve became "…the center of Keynesian evangelism in Washington" (as quoted in Greider 1987, 310).

Washington by limiting the power of the individual reserve banks (Bach 1971, 34 & 72; Barber 1992, 85; Bradford 1935, 666; Eccles 1966, 166; Eichengreen 1992, 11; Friedman and Schwartz 1963, 447; Greider 1987, 312; Hanna 1936b, 761; Nussbaum 1967, 196; Timberlake 1993, 282 & 416). The Banking Act of 1935 eliminated the position of Federal Reserve Agent and assistant agent for the Federal Reserve banks, and instead delegated their responsibilities to a president and vice-president to be elected every five years by the Federal Reserve banks boards of directors, with approval of the Federal Reserve Board–the name of which would be changed to the Board of Governors of the Federal Reserve System (Hanna 1936b). Rather than being responsible to the board of directors of the bank (consisting of nine members, three of whom were appointed by the Federal Reserve Bank) as was previously the case, the employees and officers became responsible to the president of the bank. The Act reduced the number of the representatives on the Board of Governors from eight to seven, removed the Secretary of the Treasury and the Comptroller of the Currency as ex officio members, and granted the President the power to appoint the chairman and the vice chairman of the Board of Governors. In addition, the Banking Act of 1935 rounded out the FOMC, created with the Banking Act of 1933, with five representatives from the Reserve banks, and required Reserve banks to engage in operations as dictated by the FOMC (Hanna 1936b; G. F. W., Jr. 1936, 340).

In order to ensure the passage of the Banking Act of 1935, Roosevelt reportedly orchestrated the addition of three new board members to the Senate Banking Committee with known allegiances to his administration (Hyman 1976, 173). As Timberlake (1993, 283) says of the act,

> The rule of men thus spread to the Fed. But the men in charge were not the men in the Federal Reserve System. They were the men in the Executive administration; the Fed simply became their monetary handmaiden.

When Roosevelt (1937, 1062) dedicated the Federal Reserve's new building in 1937 he said,

> To this public body [the Federal Reserve] Congress has entrusted broad powers which enable it to affect the volume and the cost of money, thus exerting a powerful influence upon the expansion and contraction in the flow of money through the channels of agriculture, trade and industry…By their nature these important powers are of public concern and the responsibility for their exercise is properly vested in a public body… To be effective in performing their function, they must be closely coordinated with the other major powers and policies of government which influence the country's economic life. I dedicate this building to progress toward the ideal of an America in which every worker will be able to provide his family at all times with an ever-increasing standard of comfort.[15]

When Eccles did step out of line with what the administration wanted, and tried to tighten monetary policy, Roosevelt played the Treasury off against the Federal Reserve by encouraging the Treasury to use its newly established Exchange Stabilization Fund to counter the Federal Reserve's tightening (Bach 1971, 75; Blum 1959, 343; Eccles 1951, 292; Hetzel 2008, 27; Hyman 1976, 228 & 275; Meltzer 2003, 511; Timberalke 1993, 295). This allowed the Treasury to keep interest rates low for its bond issues (Bach 1949, 138; Havrilesky 1995a, 50; Meltzer 2003, 513; Kettl 1986, 56). In order to maintain their control over the money supply, the Federal Reserve caved in, accommodating the Treasury with their desired monetary policy in exchange for the Treasury halting its stabilization program (Bach 1971, 75; Havrilesky 1995a, 50; Meltzer 2003, 513). If the Federal Reserve was at odds with the Treasury, and the Treasury had the power to intervene in market operations, Eccles knew that "[i]n any serious dispute with the Treasury…he would have to fight the president as well, and that was one battle he could not win" (Kettl 1986, 56).

[15] Since the Federal Reserve claimed to be independent, and not a government entity, the District of Columbia sent the Federal Reserve a property tax bill (Greider 1987, 49). The Federal Reserve objected and refused to pay the tax bill, resulting in the District of Columbia even scheduling a public auction of the Federal Reserve building. The Federal Reserve avoided the auction by making the case that the Federal Reserve, in fact, was part of the federal government.

In 1937, the Federal Reserve, for the "…first time as a major policy objective," purchased long-term government securities specifically to prevent a decline in their price (Chandler 1949, 405). In April 1938, when Roosevelt sent a new push for massive spending in the form of the Works Progress Administration, Farm Security, the National Youth Administration, and the Civilian Conservation Corps to Congress for approval, it was also announced that the Treasury would desterilize gold while the Federal Reserve would reduce reserve requirements in order to provide the necessary credit (Hyman 1976, 248).

4 World War II

The Federal Reserve again provided accommodating monetary policy when it came to World War II (Bernanke 2013, 30; Chandler 1949; Friedman and Schwartz 1963, 562; Greider 1987, 322; Hyman 1976, 293; Kettl 1986, 59; Timberlake 1993, 304 & 317; Thornton 2010). In fact, Eccles had agreed to Roosevelt and Morgenthau–Roosevelt's Secretary of Treasury–ahead of time that he would follow an easy monetary policy if the U.S. got involved in the war (Thornborrow 1992, 175-6; Eccles 1951, 327; Hyman 1976, 272; Meltzer 2003, 551).

With pegged below-market interest rates on Treasury debt offered by the Federal Reserve, and an unlimited offer by the Federal Reserve to purchase any securities the Treasury did not sell, government debt went from $48 billion in 1941 to $235 billion in 1945 (Havrilesky 1995a, 51; Kettl 1986, 56; Mehrling 2011, 46; Meltzer 2003, 580). Eccles recalled, "[t]he pattern of war finance had been firmly established by the Treasury; The Federal Reserve merely executed Treasury decisions" (as quoted in Timberlake 1993, 309). As Meltzer (2003, 579) summarizes the period, "[o]nce again the Federal Reserve put itself at the service of the wartime Treasury, and once again it had difficulty extricating itself from the Treasury's grasp after the

war. And again it took almost as much time to free postwar monetary policy as to fight the war." The Board of Governors on December 8th, 1941, "assured the public…that the Federal Reserve could and would see that the Treasury was supplied with all the money that it needed for war finance" (Chandler 1949, 407). An associate economist at the Federal Reserve and Harvard economist, John Williams wrote in 1942, "[a] restrictive monetary policy is not feasible or desirable so long as the government is the principal borrower…" (as quoted in Timberlake 1993, 309). The Treasury continued to exert pressure on the Board of Governors anytime they felt they weren't accommodating Treasury issues sufficiently. As Hyman (1976, 284) records of 1942,

> The Treasury, however, was unrelenting in its insistence that the Federal Reserve should toe the market that had been set. It sent the board a weekly chart showing the agreed-upon pattern of rates and those which actually prevailed in the market. More than that, even on an hour-by-hour basis, when trading in the government security market was a little weak and interest rates rose close to the pegged pattern, Treasury officials would call Federal Reserve Board members into an emergency meeting to remind them of their commitment and to find out what had gone wrong.

The entry of the United States into WWII had "…curbed the legal independence of the Federal Reserve, and had made it a junior partner subordinate to the Treasury" (Hyman 1976, 284). The accommodative policy continued even when Eccles began to worry about drastic inflation (Hyman 1976, 299). A directive sent out in 1943 by Roosevelt to all federal department heads warned that any disagreements between agency heads that were publicly aired would be unacceptable and thus should be accompanied by a letter of resignation (Hyman 1976, 299).

5 The Postwar Period

Harry S. Truman continued Roosevelt's record when he became president in 1945. The Full Employment Act of 1946 was particularly detrimental to the Federal Reserve's already

compromised independence. The Full Employment Act was used as a guide to Federal Reserve policy as soon as it was enacted, despite the fact that it wasn't officially adherent to it until 1978 ("A Primer on Money" 1964, 102-3; Bach 1971, 21; Clifford 1965, 227 & 319; Hyman 1976, 188; Meltzer 2009a, 252; Reagan 1961, 73; Timberlake 1993, 345). While the initial Federal Reserve Act set up the Federal Reserve explicitly as a "…'cooperative enterprise' among bankers for the purpose of increasing the security of banks and providing them with a reservoir of emergency resources," with no mention of any goal of acting to stabilize the national economy, stabilization of the national economy quickly become its primary objective (Reagan 1961, 65). More than before, this transition of goals forced the Federal Reserve into the political world, further compromising its independence. As Reagan (1961, 66) wrote concerning this transition,

> With this shift, the operation of the Federal Reserve System necessarily moved into the political mainstream, for the goal of stabilization requires making choices among alternatives that have important and visible consequences for substantial interests and community values. Once macro-economic policy had become the primary raison d'être of the System, the breadth of interests involved became coterminous with the nation, not just with the bankers; and monetary policy, as well as depositors' safety, became a public concern rather than a private convenience.

The wartime peg of interest rates for the Treasury remained in effect even after the war, and "…robbed the Fed of its operating flexibility" because it had to support the Treasury's market by keeping interest rates low to keep the government's interest cost of the national debt low ("A Primer on Money" 1964, 102; Adams 1992, 169; Bach 1971, 79; Bernanke 2013, 30; Chandler 1949, 411; Clifford 1965, 163; Friedman 1982, 104; Friedman and Schwartz 1963, 577; Greider 1987, 325-6; Hetzel 2008, 35; Hyman 1976, 323; Kettl 1986, 64). At the close of 1947, then Secretary of Treasury John Wesley Synder sent Chairman Eccles a Christmas note, "[t]he fine understanding between the Federal Reserve System and the Treasury Department, which has

made possible such a splendid record of cooperation during the past year, is a source of much gratification to me" (Hyman 1976, 333).

Any attempt by the Federal Reserve to assert independence was met with swift action. A Presidential assistant to Truman, John Steelman, reported that Truman choose not to reappoint Eccles to be Chairman of the Board when his third term expired in 1948 precisely because Truman did not think Eccles would continue to support the Treasury with accommodative monetary policy and would "…not cooperative enough with the White House" (as quoted in Kettl 1986, 63).[16] Thomas McCabe was appointed to the Board of Governors and as the Chairman of the Federal Reserve in 1948 and was immediately pressured into providing accommodative policy.[17] A June 28, 1949, press release by the Federal Reserve announced that,

> …after consultation with the Treasury…a view to increasing the supply of funds available in the market to meet the needs of commerce, business, and agriculture it will be the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve Banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market, and the confidence of investors in Government bonds will be continued. Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.[18]

Bach (1949, 1174), writing in 1949, wrote of the pressure that Chairman McCabe faced,

> The current setting for monetary policy formation is so well known that detailed repetition would be pointless. In essence, traditional Federal Reserve control mechanisms (reserve requirements, open-market operations, rediscount rates) have become largely useless against inflation because a huge volume of government securities is outstanding in the hands of the commercial banks and the non-banking public, and because both Federal Reserve and Treasury authorities are committed (at least temporarily) to maintaining a low rate on long securities. Practically, this involves Federal Reserve support of the whole rate structure in governments when necessary, and in effect guarantees monetization of outstanding governments at the option of the banks and the public.

[16] Also see Adams (1992, 168), Havrilesky (1995a, 51), Hyman (1976, 338), and Timberlake (1993, 313).
[17] Eccles elected to ignore pressures to resign and remained on the Board of Governors (Hyman 1976, 338).
[18] Federal Reserve Bulletin July 1949: http://fraser.stlouisfed.org/docs/publications/FRB/1940s/frb_071949.pdf

The interest cost of the debt from World War II, the New Deal, and the need to issue new bonds for the Korean War in 1950 meant that the interest rate peg, that mandated a low interest rate for the Treasury, needed to be kept in place (Adams 1992, 170; Clifford 1965, Ch. VII; Friedman 1982, 104; Hetzel 2008, 40 & 49; Kettl 1986, 68; Timberlake 1993, 317).

In 1951, then Treasury Secretary John Synder announced at a talk before the New York Board of Trade that "the 2½ percent long-term rate is fair and equitable to the investor, and that market stability is essential, the Treasury Department has concluded, after joint conferences with President Truman and Chairman McCabe of the Federal Reserve Board, that the refunding of new money issues will be financed within the pattern of that rate" (as quoted in Hyman 1976, 342).[19] Announcements of this nature should have been the prerogative of the Board of Governors, but McCabe reportedly had no prior knowledge of the announcement (Hyman 1976, 342). The chief financial writer for the New York Times, Edward Collins, wrote of the occasion (as quoted in Hyman 1976, 342),

> Central banks in their general policies may from time to time make concessions to the temporary needs of the Exchequer, but when and if they do they announce the fact themselves. In the opinion of this writer, last Thursday constituted the first occasion in history on which the head of the Exchequer of a great nation had either the effrontery or the ineptitude, or both, to deliver a public address in which he has so far usurped the function of the central bank as to tell the country what kind of monetary policy it was going to be subjected to.

After Eccles joined in and publicly critiqued this effrontery, including in testimony before Congress, President Truman called a meeting with the FOMC to get Federal Reserve support for monetary accommodation to aid with the expected fiscal deficits related to the Korean War ("A Primer on Money" 1964, 104; Adams 1992, 170; Bach 1971, 82; Clifford 1965, 243; Hyman 1976, 343; Kettl 1986, 70; Timberlake 1993, 313). Truman made sure that the FOMC members

[19] See also: "A Primer on Money" (1964, 102-3), Adams (1992, 170), and Chandler (1949).

understood that this meant that he wanted their assurance that they would fully support the financing of the Korean War by accommodating the Treasury's bonds with policies that maintained low interest rates (Kettl 1986, 72). The FOMC decided to write a memorandum for the record–that Eccles publicly released without informing the committee shortly after–stating that Truman had ended the meeting by stressing that "…he wanted us to do everything possible to maintain confidence in the credit of the Government and in the Government securities market and to support the President of the United States in achieving this end" (as quoted in Hyman 1976, 344). Eccles called this meeting "…an extraordinary event in the history of relations between the Treasury and Federal Reserve" (as quoted in Timberlake 1993, 313). Timberlake (1993, 313) describes it as "…an attempt by the Truman administration to bring direct pressure to bear on Federal Reserve policy by means of face-to-face confrontation…" After the meeting, the White House released a follow-up letter to Chairman McCabe to the press, in which Truman (1951) wrote,

> Your assurance that you would fully support the Treasury defense financing program, both as to refunding and new issues, is of vital importance to me. As I understand it, I have your assurance that the market on Government securities will be stabilized and maintained at present levels in order to assure the successful financing requirements and to establish in the minds of the people confidence concerning government credit. I wish you to convey to all the members of your group my warm appreciation of their cooperative attitude.

McCabe's attempts to fight Truman and the Treasury by refusing to engage in accommodative policy quickly led to his forced resignation in 1951, on the basis that Truman found McCabe's performance unsatisfactory (Adams 1992, 171). As Truman (as quoted in Kettl 1986, 75) later explained "McCabe was informed that his services were no longer satisfactory, and he quit."[20] As McCabe was forced out, the Federal Reserve worked out a deal with the Treasury, which

[20] See also "A Primer on Money" (1964, 104-5). Eccles, who was still serving as a Governor, also resigned (Bach 1971, 83; Barber 1992, 85; Clifford 1965, 267).

became known as the 1951 Accord, for the Federal Reserve to accommodate the war time debt in exchange for the elimination of the pegged interest rates (Clifford 1965, Ch. VIII; Friedman 1982, 104; Havrilesky 1995a, 52; Kettl 1986, 74; Meltzer 2003, 712).[21] It essentially wasn't until 1953 that, due to outside pressures, the Federal Reserve finally ended the pegged interest rate policy. Friedman (1982, 104) notes that there wasn't "…any valid intellectual argument presented in favor of the policy" over the eleven years it was enacted. Timberlake (1993, 311), summarizing this period, "[t]he Federal Reserve System in the immediate postwar economy was hardly more than a department of the Treasury that held the government security-reserves of the commercial banks."

6 William Martin

Truman replaced McCabe in 1951 with a more accommodating Chairman, William Martin (Bach 1971, 83; Clifford 1965, 268). Martin explained what he considered to be the limits of Federal Reserve independence when it came to assisting the Federal Government in paying off large debts from WWII (as quoted in Meltzer 2009a, 85),

> Congress appropriates the money; they levy the taxes; they determine whether or not there should be deficit financing. The Treasury then is charged with the responsibility of raising whatever funds the Government needs to meet its requirements…I do not believe it is consistent to have an agent [the Federal Reserve] so independent that it can undertake, if it chooses, to defeat the financing of a large deficit, which is a policy of the Congress.

William Martin "…said repeatedly that the Federal Reserve could not refuse to finance a deficit that Congress approved" (Meltzer 2009a, 85).[22] Martin was quoted in a newspaper saying "[w]e have no obligation to finance the Treasury at just any rate, arbitrarily chosen. But we do have an

[21] Under this Accord, the Treasury lost the ability to issue money. Since then, the Treasury merely fulfills the Federal Reserve's orders for printing currency and coins through the Bureau of Engraving and Printing (Auerbach 2008, 5).
[22] See also: Vencill (1992, 201-2).

obligation to see that the expenditures which are authorized by the Congress are met" (as quoted in Meltzer 2009a, 85).[23] As Meltzer (2009, 85) explains,

> He [William Martin] made it clear that to him independence did not permit the Federal Reserve to prevent inflation if the administration and Congress ran large budget deficits. His was a very narrow definition of independence. He could not prevent inflation if the deficit remained large, so he could not meet the primary responsibility of an independence central bank – to maintain money's purchasing power.

In another speech, Chairman Martin (as quoted in Meltzer 2009a, 86) said,

> The Federal Reserve's task of managing the money supply must be conducted with recognition of the Treasury's requirements, for two reasons: One, the Federal Reserve has a duty to prevent financial panics, and a panic surely would follow if the Government, which represents the people as a whole, could not pay its bills; second, it would be the height of absurdity if the Federal Reserve were to say in effect that it didn't think Congress was acting properly in authorizing expenditures, and therefore it wouldn't help enable the Treasury to finance them.

Martin's extremely accommodating nature towards the Truman administration and the Treasury caused Senator Douglas to fight for congressional influence. In a hearing, Senator Douglas told Martin, "I have typed out this little sentence which is a quotation from you: 'The Federal Reserve Board is an agency of the Congress.' I will furnish you with scotch tape and ask you to place it on your mirror where you can see it as you shave each morning…" (Kettl 1986, 84; Vencill 1992, 201).

Pressure for accommodating monetary policy continued throughout the 1950s (Havrilesky 1995a, 54). Eisenhower met frequently with Martin, the Treasury Secretary, and the Chairman of the Council of Economic Advisors to discuss the economy (Bach 1971, 91; Kettl 1986, 92; Meltzer 2009a, 261). Meltzer (2009a, 261), describes the new role the Federal Reserve assumed,

> Independence no longer excluded consultations and exchange of information…He [Martin], and most others in the System, believed that the Federal Reserve had a

[23] See also Axilrod (2011, 39).

> 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.

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 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" (Ferrell 1981, 278). When Martin refused to provide accommodating policy, Eisenhower pressured him towards resignation or compliance; Martin ended up making a "…promise to ease credit if the economy slowed…" (Meltzer 2009a, 135). The Federal Reserve "…could not buck a direct plea from the White House" and accommodated Eisenhower, albeit, perhaps in a weak semblance of defiance, with a different monetary instrument than the one Eisenhower requested (Kettl 1986, 88). In November of 1955, the Treasury needed to issue securities which were not being purchased on the market so the FOMC took swift action to support their debt issue (Bach 1971, 95; Clifford 1965, 313). Looking at this period, Clifford (1965, 321) 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.

The initial slow growth in 1956 was a cause of concern for the Eisenhower administration during an election year, and he encouraged Arthur Burns, then on the Council of Economic Advisors, to

push the Federal Reserve towards monetary easement (Meltzer 2009a, 135). A *Fortune* writer summarized the views of a young Alan Greenspan (Burck 1959, 201), "[t]he 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."

The pressure for favorable monetary policy in the 1960s started immediately with the election of Kennedy, who was quickly converted to Keynesianism by his Council of Economic Advisors (Havrilesky 1995a, 55; Kettl 1986, 97; Meltzer 2009a, 262). With pressures from President Kennedy, the Treasury Secretary, and the Budget Director, Chairman Martin again caved into pressures for monetary expansion (Havrilesky 1995a, 56; Kettl 1986, 93 & 98; Meltzer 2009a, 269, 317, 323 & 417). Kennedy successfully pressured Chairman Martin to cater monetary policy to 'Operation Twist,' a plan by the Kennedy administration to invert the yield curve, despite the Federal Reserve's opposition to the policy (Havrilesky 1995a, 57; Kettl 1986, 99; Vencill 1992, 203).[24] Under Kennedy's administration, Meltzer (2009a, 283 & 287) records, the independence of the Federal Reserve was supplanted by the coordination of fiscal and monetary policy. In one particular episode, when the Federal Reserve gave into pressure from Kennedy to increase the discount rate, because he was worried about the balance of payments, Meltzer (2009a, 418) says that "…there is no denying administration involvement in the discount rate increase. Even if he [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."

When Lyndon Johnson took office in 1963, he vastly expanded Federal Government spending to undertake his Great Society programs and the Vietnam War. He immediately started

[24] 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, a policy that fails to take into consideration expectations (Havrilesky 1995a, 57).

pressing for accommodating monetary policy (Greider 1987, 331; Havrilesky 1995a, 59; Hetzel 2008, 69; Meltzer 2009a, 262; Newton 1983, 70).[25] Bach (1971, 124) and Timberlake (1993, 338) found that the Federal Reserve was explicitly catering monetary policy to the Treasury's needs. In examining the FOMC's Records of Policy Actions, Timberlake (1993, 338) finds that targets were always qualified with 'to the extent permitted by Treasury financing'. While Martin was able to fight off some of these pressures, the pressure appears to have been successful in some cases (Havrilesky 1995a, 60; Kettl 1986, 93). Hetzel (2008, 70) reports,

> 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.

A House of Representatives Committee on Banking and Currency Report ("A Primer on Money" 1964, 11), chaired by Wright Patnam 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.[26]

When it came to the financing the Vietnam War's deficits, Martin clearly did not believe that the Federal Reserve should finance them, but he faced a "…political system hostile to interest rate increases" (Hetzel 2008, 71). During his meetings with President Johnson, Martin worked out an agreement to refrain from increasing interest rates in exchange for the suspension of the

[25] Kettl (1986, 102) dissents and reports that Johnson ignored Martin and the Federal Reserve during his first year in office.

[26] The report argued that the most important reason for keeping interest rates artificially low via the Federal Reserve was the need to remain competitive against the communist world, especially the Soviet Union ("A Primer on Money" 1964, 12).

investment tax credit and for Johnson pushing through tax increases (Hetzel 2008, 72; Meltzer 2009a, 434).

Despite their increasing concern about inflation, the Federal Reserve submitted to pressure from the Johnson administration, allowing a surge in the monetary base (Bernanke 2013, 33; Meltzer 2009a, 443). Barro (1982, 104) calls Johnson's removal of silver from most US coins after 1964 one of his "…most significant policy moves," and that it should be viewed "…as a continuation of the well-established tendency of all unrestrained monarchs to secure revenue by debasing the currency." In fact, the Great Inflation starting in 1965 occurred precisely because of the Federal Reserve's financing of large fiscal deficits which were inspired by the Keynesian models prevailing at that time (Meltzer 2005; Weise 2012).[27]

In Johnson's 1967 State of the Union Address, he pledged to "…do everything in the President's power to lower interest rates and to ease money" (as quoted in Hazlitt 1978, 118). Meltzer (2009a, 445) concludes of the relationship Martin had with Johnson, "[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." Newton (1983, 113) observes that "[i]t was obvious in 1968, even from the published statements of the Council of Economic Advisers, that the administration and the Federal Reserve System were acting totally in concert…"

7 Arthur Burns

In 1970, Nixon appointed Arthur Burns, a close associate and personal counselor, and someone who could be trusted to provide accommodating policy to the Administration, to be the Chairman of the Federal Reserve (Kettl 1986, 115; Meltzer 2009a, 583; Silber 2012, 71; Wells

[27] Also see Meltzer (2009a, 670).

1994, 26 & 42). Nixon apparently blamed Martin for his [Nixon's] failed presidential bid as well as for the 1969 recession and was eager to replace Martin (Greider 1987, 340; Wapshott 2011, 242). The day of the appointment Nixon joked, "I hope that independently he will conclude that my views are the ones that should be followed" (as quoted in Havrilesky 1995a, 61), and told Burns, "Dr. Burns, please give us more money!" (as quoted in Newton 1983, 158). In private Nixon told Burns, "[y]ou see to it: no recession" (Wells 1994, 42). Burns delivered the desired policy (Greider 1987, 341).

Burns took immediate control of the Federal Reserve, creating new precedents centralizing the power of the Federal Reserve under the chairmanship. For instance, Burns spent less time allowing the other FOMC members to present their opinion, and instead actively shaped the views of the committee towards his own views (Wells 1994, 44). He also insisted that any reports to the press from the Federal Reserve go through him. When governors refused to abide by this, he went to extreme measures to punish them, 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, concerned about inflation, agreed to follow an expansionary monetary policy in exchange for Nixon passing wage and price controls (Silber 2012, 74; Wells 1994, Ch.s 4 & 5).[28] Nixon was even quoted in the *Wall Street Journal* in 1970 saying that he had a firm commitment from Burns for continued ease, and even threated to unleash Congressman Patman, a strong critic of the Federal Reserve, if Burns did not comply with his commitment (Havrilesky 1995a, 61) and, in a separate instance, to "take the Fed on publicly" (as quoted in Wells 1994, 55). Burns, in turn, reportedly brought Federal Reserve

[28] This agreement, while never substantiated, was referred to as the Accord of 1970 when discovered by the press (Silber 2012, 74).

Board members who casted 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 Federal Reserve Bank continued to dissent, Burns reportedly questioned the travel budgets of the New York Fed, used the FBI to investigate media leaks, and even began searching for a replacement for Hayes a year before his scheduled retirement (Meltzer 2009, 584; Silber 2012, 127). Shortly after becoming the Chairman, Burns started delivering the desired easy monetary policy of the Nixon Administration (Silber 2012, 72). Kettl (1986, 130) reports that "[d]espite his constant squabbles, however, Burn'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…" Meltzer (2009a, 583), writes, "Burns was unwilling to use the independence of the Federal Reserve for its intended purpose…Martin worked with the administration to coordinate monetary and fiscal policy…" In addition, Burns maintained close ties with commercial bankers, reportedly calling the chairman of the Morgan Guarantee Trust weekly (Wells 1994, 50).

In 1971, after many years of devaluing the dollar, the gold standard and the international system of fixed exchange rates was dropped by Nixon, effectively eliminating a major constraint on the influence of the Federal Reserve, opening the door to more political control of the Federal Reserve's actions (Barro 1982, 104; Buchanan and Wagner 1977[2000], 126; Greider 1987, 68; Havrilesky 1995a, 61).[29] Barro (1982, 105), looking at the consequences of this policy, concludes,

> Since the move in 1971 toward flexible exchange rates and 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

[29] At the Camp David in 1971 where closing the gold window was discussed, Meltzer (2009b, 764) argues that Nixon's main concern was lowering unemployment before the election.

> now to depend entirely on the year-to-year "discretion" of the monetary authority, that is, the Federal Reserve. Not surprisingly, inflationary expectations and their reflection in nominal interest rates and hence in short-run inflation rates have all become more volatile.

Meltzer (2009a, 630) reports that Nixon repeatedly was questioning Burn's commitment to the administration and making threatening statements if Burns did not indicate a willingness to cater monetary policy to his administration's desires. Arthur Burns reportedly submitted to pressures to engage in monetary easement to aid the reelection bid of Nixon in 1972 (Abrams 2006; Greider 1987, 67 & 342-3; Havrilesky 1995a, 35; Kane 1974, 750; Kettl 1986, 113; Meltzer 2009b, 788; Newton 1983, 117; Rose 1974; Silber 2012, 73; Wapshott 2011, 255; Woolley 1984, Ch. 8).[30] Burns even moved up the January 1971 meeting of the FOMC because Nixon told him the cutoff date for expanding monetary policy was February, because most studies at that time agreed that it took 6 to 9 months for monetary easing to show up in the economy, which would ensure that any action undertaken would be active in time for the November election (Meltzer 2009b, 799). Nixon reportedly told his White Chief of Staff, Harry Haldeman, that for the election year they "…can't afford to risk a downturn, no matter how much inflation" (as quoted in Silber 2012, 73).

Using evidence from the Nixon tapes, Abrams (2006) details how Nixon repeatedly pressured and cajoled Burns into providing accommodating monetary policy (see also: Wells 1994, Chapter 4). Meltzer (2009b, 791) transcribes Nixon in 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

[30] Havrilesky (1995a, 35) does acknowledge that this occurrence is disputed by Cullity (1992, 41) and other FOMC members (also see: Wells 1994, 100-1). Kettl (1986, 128) 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 (see also Kettl 1986, 114). Meltzer (2009b, 767) suggests that an alternative explanation for the expansive policy in 1972 might be that it occurred because Nixon appointed Burns to be the chairman of the Committee on Interest and Dividends, a position on a committee that had three cabinet members and a goal that created a rather obvious conflict of interest for the Chairman of the Federal Reserve. Woolley (1995) also reportedly provides an examination of this episode in an unpublished manuscript, but the author could not locate a copy of the manuscript.

unemployment. None has been lost on the issue of inflation …Unemployment is always a bigger issue than inflation." In an earlier tape in 1971, Burns told 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" (Meltzer 2009b, 792).[31] 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" (Meltzer 2009b, 796). Nixon replied back, "[y]ou're independent (laughter), independent (laughter). Get it up! I don't want any more angry letters from people…The whole point is, get it up!" (Meltzer 2009b, 796). Nixon's White House Chief of Staff, Bob Haldeman, instructed William Safire, Nixon's speechwriter, to make three points clear to Burns in a 1971 meeting (Safire 1975, 493),

> 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.

Maisel, a member or the Board of Governors at this time, discussed his view of independence, "…if the Congress and the President agree on the national economic goals then it seems clear that the Federal Reserve has to agree to furnish the necessary sums of money and credit…" (Meltzer 2009a, 634). In a private letter to Burns, Nixon, who was aware of Maisel's dissent, promised to replace Maisel with someone else who would "…follow your leadership" (Meltzer 2009b, 800). In the letter Nixon also praised Burns's efforts to increase monetary growth and threatened a "…major attack on the independence of the Fed" if the Federal Reserve did not provide the desired monetary policy. Meltzer (2009b, 830) reports that the three Board of

[31] See Meltzer (2009b, 794-802) for more details of Burns catering Federal Reserve policy under pressure from Nixon.

Governors members who were replaced in between 1971-1973 were all chosen because they supported Burn's position, and thus as oftentimes was the case, Nixon's position. In fact, Nixon's administration even floated around the idea of packing the Federal Reserve Board at one point in 1971, similar to Roosevelt's court-packing scheme (Safire 1975, 493). Burns also used the Board of Governors power of approving appointees to the presidency of the Federal Reserve Banks to influence who was selected, and even expanded this power by requiring the directors of the Federal Reserve Banks to submit several names to the Board of Governors as candidates, rather than just one (Meltzer 2009b, 830).

While the pressure on the Federal Reserve 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 Federal Reserve, once again, caved in and delivered (Hetzel 2008, 89; Meltzer 2009b, 790; Wells 1994, Ch. 6). According to Hetzel (2008, 89), because Burns held macroeconomic beliefs that required support from Nixon and Congress, he [Burns] only made minor increases to the funds rate. In 1973 the U.S. economy saw inflation soar (Meltzer 2009b, 850; Newton 1983, 117). While prevailing beliefs at that time held that the inflation was due to the OPEC price increases, Hetzel (2008, 94) argues that the expansionary monetary policy followed by the Federal Reserve had already resulted in inflation before the OPEC price increases. Meltzer (2009b, 844 & 856-9) argues the while economists blamed theoretical errors and misinformation for the inflation, that political pressure was also an important factor.

Arthur Burns recalled from his experience serving as two-term Federal Reserve Chairman (as quoted in Meltzer 2009a, 584),

> 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. Mr. Ford on the other hand

> was truly angelic. I met with President Ford frequently, alone in the privacy of his office…He never even remotely intimated what the Federal Reserve should be doing…

When Ford came to office in 1974, his administration took a largely hands off approach to the Federal Reserve. Havrilesky (1995a, 63) suggests that this was due to the fact that, at that time, the entire Federal Reserve Board had been appointed by Republican presidents, in addition to Ford's anti-inflation attitude (see also: Havrilesky 1995a, 62; Hetzel 2008, 108; Meltzer 2009b, 846 & 866; Wells 1992, 179). It may have also been due to his close relationship with Ford. When Ford came into office, Burns established a close relationship with him and "…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, 110).

Perhaps the lack of presidential pressure on the Federal Reserve while Nixon was occupied with attempting to stay in office, the confusion as Ford entered office, and the failure of the Federal Reserve to control inflation, explains why in 1974, Congress decided to start changing the rules of the Federal Reserve in order to threaten the Federal Reserve towards a more expansionary policy (Meltzer 2009b, 846 & 899; Woolley 1984, 144-153; Wells 1994, 132 & Ch. 7). Congress held hearings threatening what Munger and Roberts (1993, 91) describe as "…statutory emasculation," if the Federal Reserve did not provide the desired monetary policy.[32] Congressmen Patman threatened a bill requiring regular GAO audits of the Federal Reserve, subjecting the Federal Reserve's budget to congressional appropriations, putting a ceiling on Federal Reserve spending, requiring Senate confirmation of Federal Reserve Bank presidents, and requiring the President to represent labor and commercial interests in appointing members of the Board of Governors (Meltzer 2009b, 875; Wells 1994, Ch. 6). Congress eventually passed

[32] Also see Kettl (1986, 143).

House Concurrent Resolution 133 in 1975, mandating that the Federal Reserve officials provide Congress with monetary growth projections twice a year which must be defended as being consistent with national economic policy (Friedman 1982, 107; Hetzel 2008, 118; Kettl 1986, 145; Meltzer 2009b, 890; Munger and Roberts 1993, 91; Volcker 1978).[33] In addition, the resolution gave the authority to Congress to mandate that the Federal Reserve report to Congress for any departure from the objectives outlined (Friedman 1982, 107).

Burns met regularly with President Ford and had a standing invitation to the administration's economic policy meetings and met with Ford alone almost once a week (Wells 1994, 145-6). Especially since Burns had recruited his former student, Alan Greenspan, to be the CEA chairman and had Greenspan inform him, based on the agenda, when he [Burns] should show up (Wells 1994, 146). In 1976, President Ford altered the strong tradition of appointing a Vice Chairman from within the Federal Reserve System, instead hiring Stephen Gardner who had no Federal Reserve experience; it is no longer a tradition (Havrilesky 1993). When the election year in 1976 rolled around, the Federal Reserve again followed a path of monetary expansion (Greider 1987, 347; Newton 1983, 118).[34]

8 Miller and Volcker

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

[34] Wells (1994, 200), argues that the money supply grew slowly during the beginning of 1976 resulting in the Federal Reserve decision not to raise interest rates, and that the increase in monetary growth in the summer of 1976 was unexpected. Wells (1994, 201) does reveal that "Burns very much wanted Gerald Ford to win–he had developed considerable respect for the president and enjoyed an exceptionally close relationship with his administration. Prosperity would, of course, greatly help the Republican's chances. Moreover attacks on Burn's policies were a staple of Democratic campaign rhetoric. For instance, Sargent Shriver, who had been the vice-presidential candidate in 1972 and now aimed at the top place, said, 'If Arthur Burns won't reduce interest rates, then I will find some way to reduce him!'"

With his election in 1977, Jimmy Carter replaced Arthur Burns as Chairman at his first chance in 1978, despite Burns having lobbied for reappointment and having met with Carter (Axilrod 2011, 76; Greider 1987, 67 & 346-7; Wells 1994, Ch. 9).[35] Friedman (1978) summarized the Fed's policy under Burns in a column in Newsweek,

> 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…

The Carter administration was displeased with the refusal of Burns to provide even further monetary accommodation to quell their fears of rising deficits resulting in higher interest rates and Burns critique of the administration's economic policies (Cullity 1992, 44; Kettl 1986, 168; Havrilesky 1995a, 63; Meltzer 2009b, 905, 910 & 922; Timberlake 1993, 348; Wells 1994, Ch. 9).[36] One administration official reportedly warned Burns that "[t]his isn't the way to get reappointed" (Wells 1994, 206). President Carter replaced him with William Miller, an outspoken proponent of monetary easement, perhaps as a reward for working for Carter's campaign (Havrilesky 1995a, 63-4; Hetzel 2008, 123; Kettl 1986, 169; Meltzer 2009b, 848 & 923). Greenspan (2007, 83), observed that the Federal Reserve, under Burns and Miller, despite being ostensibly independent under the Carter administration, seemed to "…mirror Carter's indecisiveness." Carter also signed into law the Humphrey-Hawkins Full Employment Act in October of 1978, which gave the Federal Reserve the mandate of keeping Full Employment (Wapshott 2011, 245).

[35] Throughout his campaign, Carter had stressed the need for greater coordination between monetary and fiscal policy, and thus less Federal Reserve independence (Wells 1994, 204).

[36] A Carter campaign issue paper on the Federal Reserve read "It is important that throughout a President's term he have a chairman of the Federal Reserve whose economic views are compatible with his own" (as quoted in Kettl 1986, 167).

Miller's tenure was short. In what Kettl (1986, 170) describes as the "…only episode in the Fed's history in which administration officials pressured the Fed for tighter, rather than easier, money," the Carter Administration, especially through the Council of Economic Advisors Chairman 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 get a more accommodating Federal Reserve Chairman, Paul Volcker (Havrilesky 1995a, 65; Hetzel 2008, 125; Kettl 1986, 171; Meltzer 2009b, 1009; Wapshott 2011, 246).[37] Volcker provided the desired monetary tightening, with the help of Carter's appointment of Frederick Schultz, who had close ties to Carter, to the board and even called for more drastic tightening (Claypool 1992, 293-4).

In the spring of 1980, the Monetary Control Act was passed. Up until this act, member banks of the Federal Reserve were members voluntarily. In response to the increasing exit of commercial banks from its system, the Federal Reserve lobbied for legislation that would require all depository institutions, including non-member banks, to maintain reserves at the Federal Reserve (Greider 1987, 155-6; McNeill 1980, 444; Meltzer 2009, 1052). Sold to politicians as a necessity for controlling monetary aggregates, the legislation was a political move by the Federal Reserve System to maintain its monopoly (Greider 1987, 155-6; Meltzer 2009, 1052).

In the run-up to his reelection bid in 1980, Carter changed course and even publicly criticized Volcker for maintaining a stringent monetary policy (Greider 1987, 216-7; Havrilesky 1995a, 65; Meltzer 2009b, 1065; Newton 1983, 3, 15, 119 & 229; Silber 2012, 190; Timberlake 1993, 356-7). Carter hoped that the Federal Reserve would decrease interest rates in order to "…help me politically and obviously help our nation economically" (Greider 1987, 217). Carter

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

increased fiscal expenditures over this period and may have been successful in delaying tighter monetary policy (Meltzer 2009b, 1065).

President 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 had accused Carter of making the Federal Reserve his "…whipping boy…" (Greider 1987, 217). Thus, monetary policy was the linchpin of his administration's policies (Kettl 1986, 179-80; Meltzer 2009b, 1035; Newton 1983, 14-15; Timberlake 1993, 379). In a memo to President-elect Reagan, prepared by his Coordinating Committee on Economic Policy which included George Shultz, Arthur Burns, Milton Friedman, and Alan Greenspan among others, recommended that Reagan (Burns et al. 1980; Silber 2012, 194),

> Improve 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.

Reagan set out to forge a relationship with Volcker in order to coordinate their efforts. Despite Volcker's initial reluctance, Reagan convinced Volcker to have a meeting as long as it was held on neutral ground at the Treasury. At the meeting Greenspan (2007, 93-4) reports that Reagan made it clear that the "Federal Reserve Act was subject to change." By April 1981, Volcker had overcome his initial reluctance, as Reagan reportedly called him over to a meeting in the White House and asked, "[d]o you intend to control the money of America?" (Newton 1983, 15). While 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 (Auerbach 2008, 151-2; Havrilesky 1995a, 66; Greider 1987, 542). Volcker, in turn, knew he had to accommodate Reagan if he wanted to be reappointed Chairman in 1983 (Timberlake 1993, 356).

Yet markets were skeptical of Reagan's campaign promise to balance the budgets, and thus his ability to rein in inflation (Meltzer 2009b, 1065). As Robert Lucas (1981) 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? The Administration has boldly wagered all of Paul Volcker's chips on this possibility, but it is buying only time. 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.

In addition, to debt accommodation pressures, pressure was also coming from the legislative branch to ease up on monetary leading up to the 1982 elections (Greider 1987, 376; Kettle 1986, 181-2). Volcker's refusal to bend to these pressures led to "…a retaliatory wave of legislation sponsored by Congress which would restructure the Federal Reserve and limit its powers" (Havrilesky 1995a, 68).[38] Senator Lawton Chiles, in a Senate Budget Committee even threatened that they were more prepared to "…cut the head off the Federal Reserve System…," than to make budget cuts (as quoted in Silber 2012, 207). Senator Edward Kennedy even threatened to make the Federal Reserve part of the Treasury Department (Clymer 1982).[39]

Pressures for monetary easement were also coming from the White House despite Reagan's initial pressure to rein in inflation (Greider 1987, 426-8,478, & 490). While there is mixed evidence whether pressure came directly from Reagan or not, there was significant pressure coming from Reagan's administration.[40] White House Chief of Staff James Baker and

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[38] Also see: Fuerbringer (1982), Hetzel (2008, 182), and Kettl (1986, 181-2).

[39] Senator Kennedy accused Chairman Volcker of "only doing the Reagan Administration's dirty work" (Cylmer 1982).

[40] Meltzer (2009b, 1088) argues that Reagan was under severe pressure to direct Volcker to ease monetary policy for the 1982 election, but that Reagan successfully resisted these pressures. Kettl (1986, 186) argues that Reagan was far more hands-off towards the Federal Reserve than the Nixon, Ford, and Carter administrations. Despite the recorded incidents of influence, Silber (2012, 269) argues that Volcker is widely acknowledged to have successfully

his deputy, Richard Darman, pressured Volcker for easy monetary policy in order to aid in the 1982 elections (Greider 1987, 541-2). Meltzer (2009b, 1109) records that Baker "…dropped hints about legislation reducing System independence," and that "[t]he prospect that the administration might support one of Congress's proposals was a significant threat." The Federal Reserve, "[c]aught between the two positions – political pressures, legislator threats, and fear of a crisis on one side and concern about their credibility and the need to maintain the appearance of independence on the other…made a first small change in policy to lower rates" (Meltzer 2009b, 1111-2). One of the proposed changes to the structure of the Federal Reserve being advanced was to reinstate the Secretary of the Treasury on the Board of Governors (Greider 1987, 490). Another, the Balanced Monetary Act of 1982 sponsored by Senator Byrd, sought to give Congress the authority to force the Federal Reserve 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 Act of 1982]" (Greider 1987, 514).

Thus, under the pressure to accommodate deficit spending, and from the executive and legislative branch, Volcker delivered easy monetary policy leading up to the 1982 Congressional elections (Kettl 1986, 183). Meltzer, quoted in the *New York Times*, said, "[h]ere 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" (as quoted by Farnsworth 1982).

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resisted pressures and have tackled inflation (Silber 2012, 269). Friedman (2000) gives credit to Reagan, "[w]e 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 chairman of the Fed, Paul Volcker. And Reagan's courage in your judgment 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."

Reagan's ultimate failure to rein in deficit spending led to a 'game of chicken' between the administration and the Federal Reserve; a game the Federal Reserve historically always lost (Greider 1987, Ch. 15). Thomas Sargent (1983), writing in the *New York Times*, wrote of the situation,

> 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.

Despite Volcker's staunch advocacy for fighting inflation, by the run up to his 1986, Reagan had appointed enough members to the Board of Governors to swing the February vote towards monetary easement against the will of Volcker (Havrilesky and Katz 1992, 108; Meltzer 2009b, 1190; Silber 2012, 256; Winder 1992, 297-8; Woodward 2000, 18).[41]

Due to Volcker's resistance to catering to the Reagan administrations desires, Reagan chose not to reappointment Volcker as Chairman in 1987, instead seeking out a more accommodating Chairman (Greider 1987, 542 & 570-1).

9 Greenspan, Bernanke, and the Housing Bubble

Greenspan, who had served as an unofficial advisor to Reagan for years, was appointed as the Chairman in 1987 (Havrilesky 1995a, 69; Timberlake 1993, 390). Reagan tried to influence Greenspan as well. In 1988, Greenspan actually resorted to public appeal to get a top Treasury aide to stop trying to influence Fed policy (Gutfeld 1988). Despite this outcry, Havrilesky (1995b, 174-6) argues that Greenspan largely catered Federal Reserve policy to the Reagan

[41] All the FOMC telephone conference calls in the 1984 election year have, inexplicably, no transcripts (Auerbach 2008, 44).

administration's desires.[42] Evans and Novak (1989) reported in the Chicago-Sun Times in 1989 that, the FOMC loosened 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. Greenspan, seeking protection from the current Chairman of the House Banking Committee, Henry Gonzalez, who was demanding more Federal Reserve accountability and seeking to make all the members of the FOMC politically appointed, flew out to Little Rock, Arkansas to have a meeting with president-elect Clinton (Auerbach 2008, 154; Woodward 2000, 95). Greenspan met frequently with the Secretary of the Treasury (and former Clinton Assistant to the President for Economic Policy) Robert Rubin, and the Deputy Secretary of the Treasury Lawrence Simmers (Greenspan 2007, 160; Rubin and Weisberg 2004, 9). While Greenspan (2007, 161) reported meeting with Clinton infrequently, he does recall that they had "…an easy, impromptu relationship," where Clinton would "….pull me aside to see what was on my mind or to try out an idea." Greenspan reportedly timed a needed interest rate so that its slowdown effect would be in the year before Clinton's reelection bid in 1996, rather than during his election year (Woodward 2000, 118). Clinton, not understanding the need to lower interest rates at all, reportedly sought out more supportive democrats to put on the Federal Reserve's Board of Governors (Woodward 2000, 122-5).[43] Alan Blinder, appointed to by Clinton, openly suggested that Greenspan was catering to White House preferences (Taylor 1996). The ensuing stock-market bubble in the 1990s, can be attributed, at least in part, to the loose monetary policy the

[42] Greenspan's record of independence under Reagan, especially during the 1987 stock market crash, is difficult to determine because the FOMC telephone conference calls have, inexplicably, no transcripts during this period (Auerbach 2008, 44).
[43] 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 fucking bond traders?" (Woodward 2000, 126).

Federal Reserve provided (Auerbach 2008, 169; Friedman 2005; Sheehan 2010; Woodward 2000).

With a lack of political feasible alternatives to Greenspan, Clinton reappointed him, but explicitly sought out monetary doves for the other two openings on the Board of Governors (Woodward 2000, Ch. 9). At his reappointment, Greenspan (2007, 163) recalls President Clinton making a statement to reporters 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 Federal Reserve.

The housing bubble was largely fueled by the easy monetary policy from 2002-2005 in response to the 2001 recession (Ahrend et al. 2008; Boettke, Smith, and Snow 2011; Frame and White 2005; Iacoviello and Neri 2010; Maddaloni and Peydro 2010; Rajan 2010a, 15, 108-117; Rajan 2010b; Roberts 2010; Sheehan 2010; Stockman 2013, Ch. 16-21; J. B. Taylor 2009; Wessel 2009).[44] In fact, the history of the Federal Reserve is replete with examples of the Federal Reserve taking action specifically to assist and/or grow the housing industry (see: Meltzer 2009a, 386, 503, 505, 525, 527, 570, 576, 651, 675-6; Meltzer 2009b, 790, 900).[45] The Federal Funds Rate had been consistently between 4.5% and 6.5% since 1994, and stood at 6% in January of 2001. By July of 2003 the Federal Funds Rate was pushed to 1%, its lowest rate in 40 years.

[44] While 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 availability of alternative mortgage products is the key explanation for the housing bubble. J. B. Taylor (2010) critiques Bernanke (2010b). Shiller (2009), while admitting that monetary policy is an important factor in analyzing bubbles, argues that there is a psychological component behind the housing bubble. Boettke, Smith, and Snow (2011) agree that this is possible, but argue that without monetary easement, interest rates rise to act as a brake on psychologically spurred bubbles. Dokko et al. (2009) argue "…accommodative monetary policy was certainly supportive of macroeconomic activity and a source of strength in the housing market. Nonetheless, the simulation suggests that macroeconomic conditions did not drive the housing market developments in this period—at least not in a historically typical manner, as captured by the VAR." Kuttner (2012) argues that the housing bubble is only partly attributable to monetary policy. Edge et al. (2008) argue that monetary policy played only a modest role in the rise in housing investment.

[45] It is interesting to note that in 1931 the Federal Reserve 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).

When adjusted for inflation these rates were at times even negative (Roberts 2010). Boettke, Smith, and Snow (2011) argue that accommodating monetary policy, when combined with government initiatives, such as Fannie Mae and Freddie Mac and the mortgage deduction tax that channeled inflation-induced investment towards the housing market, led to the housing bubble and collapse.[46] As Meltzer (2009b, 1246) records, "[b]etween 1980 and 2007, the volume of mortgages backed or supported by the three government-chartered agencies rose from $200 million to $4 trillion, an unsustainable compound growth rate of 36 percent a year." In addition, government's 'too big to fail' policy led banks to become too big and engage in riskier behavior; riskier behavior that would not have been undertaken without the 'too big to fail' policy and easy monetary policy that kept interest rates down (Boettke, Smith, and Snow 2011; Meltzer 2009b, 1248; Roberts 2010).

The current financial crisis indicates the political influence and monetary accommodation have continued at the Federal Reserve (Barofsky 2012; Beckworth 2012; Epstein and Carrick-Hagenbarth 2011; Horwitz 2012; Hummel 2013; Kotlikoff 2010 & 2013; Norberg 2009; Roberts 2010; J. B. Taylor 2009; Wessel 2009). Unprecedented levels and growth of gross public debt (**Figure 1**) have been accommodated by unprecedented monetary easement (**Figure 2**), with more of the same expected in the future (Kotlikoff and Burns 2012, 4). As Axilrod (2011, 10) observes, "…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."

The close working relationship between Secretary of the Treasury Paulson and Chairman Bernanke show a Federal Reserve decidedly not independent of the Treasury Department or the

[46] See also Meltzer (2009b, 1245).

administration (Sorkin 2009; Wessel 2009). In an abstract of a paper in the Federal Reserve Bank of New York's *Current Issues in Economics and Finance*, Santoro (2012) 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.

Congress, attempting to exert their influence, brought threatening legislation, including a proposal to take away the votes of the presidents of the Federal Reserve banks from the FOMC and give them to presidential appointees (Mishkin 2011a). In a testimony before the Senate Committee on the Budget, Bernanke (2011b) spelled out just how accommodating the Federal Reserve's monetary policy has been,

> In a situation in which unemployment is high and expected to remain so and inflation is unusually low, the FOMC would normally respond by reducing its target for the federal funds rate. However, the Federal Reserve's target for the federal funds rate has been close to zero since December 2008, leaving essentially no scope for further reductions. Consequently, for the past two years the FOMC has been using alternative tools to provide additional monetary accommodation. Notably, between December 2008 and March 2010, the FOMC purchased about $1.7 trillion in longer-term Treasury and agency-backed securities in the open market.

Governor Sarah Bloom Raskin (2012) more recently expressed the accommodative policy of the Federal Reserve,

> The highly accommodative monetary policy now in place is intended to provide the support needed to strengthen the economic expansion and, over time, return the economy to sustainable rates of output growth, unemployment, and inflation. While the Federal Reserve recognizes that the accommodative policy we have put in place to support the economic recovery may limit the financial returns to saving for a time…

Mishkin (2011b), in explaining the global financial crisis argues,

> … purchase 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.

Meltzer (2009c) sums up his observations of the Federal Reserve during the financial crisis "…under 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."[47] Similarly, J. B. Taylor (2012, 92) claims that,

> When 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.

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

10 Conclusion

The theoretical and empirical evidence, especially when corroborated with contextualized anecdotal evidence, suggests that the Federal Reserve has presided over a century of accommodation. Furthermore, it has swayed the furthest from independency during those times economic times when an independent Federal Reserve was most vitally needed.[48] While the

[47] See also: Wray (2012).

[48] "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). Meltzer (2009b, 839), on the Federal Reserve's action during the Great Inflation, wrote "…political concerns weakened whatever independence the Federal Reserve had just at the time when an independent central bank was most needed"

Federal Reserve was explicitly created with the intention of it operating as an independent body, it only took a few years for monetary officials at the Federal Reserve to cater their policy choices to the federal government. Throughout its history, the Federal Reserve's independence has been repeatedly compromised.

While, at times, the Federal Reserve has been able to assert its independence, these episodes pale in compassion to the drastic pressure that has been exerted on the Federal Reserve. A system that depends on its operation for good people, in favorable circumstances and with the right information to run it, isn't a robust or practical system (Friedman 1962[2002], 50). Combined with the conclusions of Selgin, Lastrapes, and White (2012) that the Federal Reserve has not lived up to its original promise, perhaps a more drastic examination of our monetary structures is warranted. Future research on alternative monetary structures, such as the constitutionalization of money (Buchanan 2009), turning monetary policy over to a computer (Friedman 2007), or even the privatization of money (Hayek 1978) could shed light on the viability of alternative monetary regimes. At the least, a deeper appreciation for the concerns of robust political economy is called for in the proffered monetary models and policy prescriptions of the economics profession.

FIGURE 1

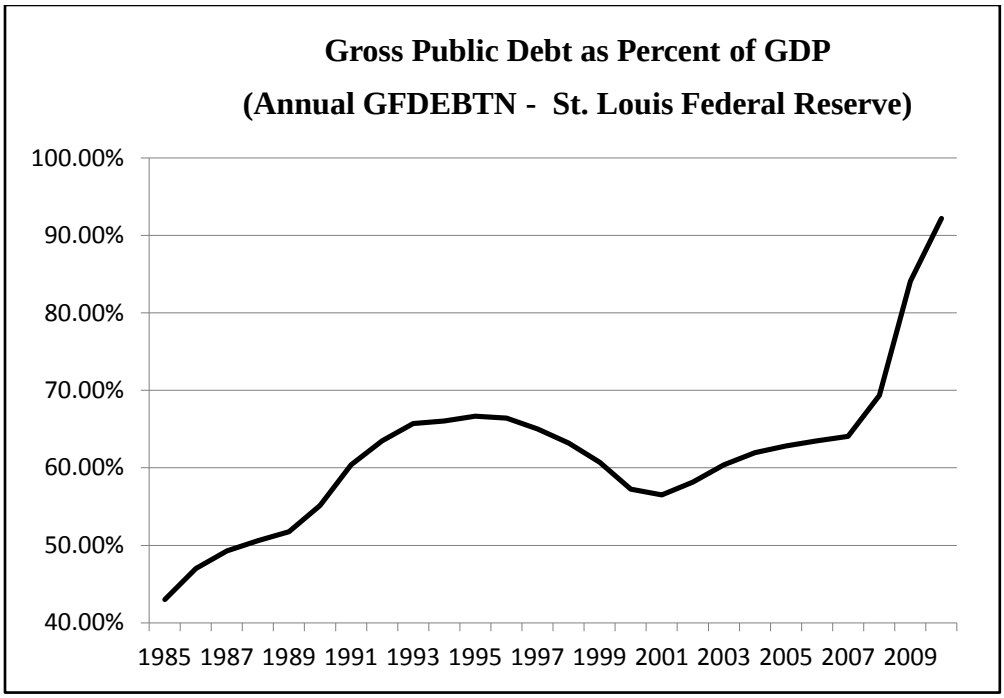
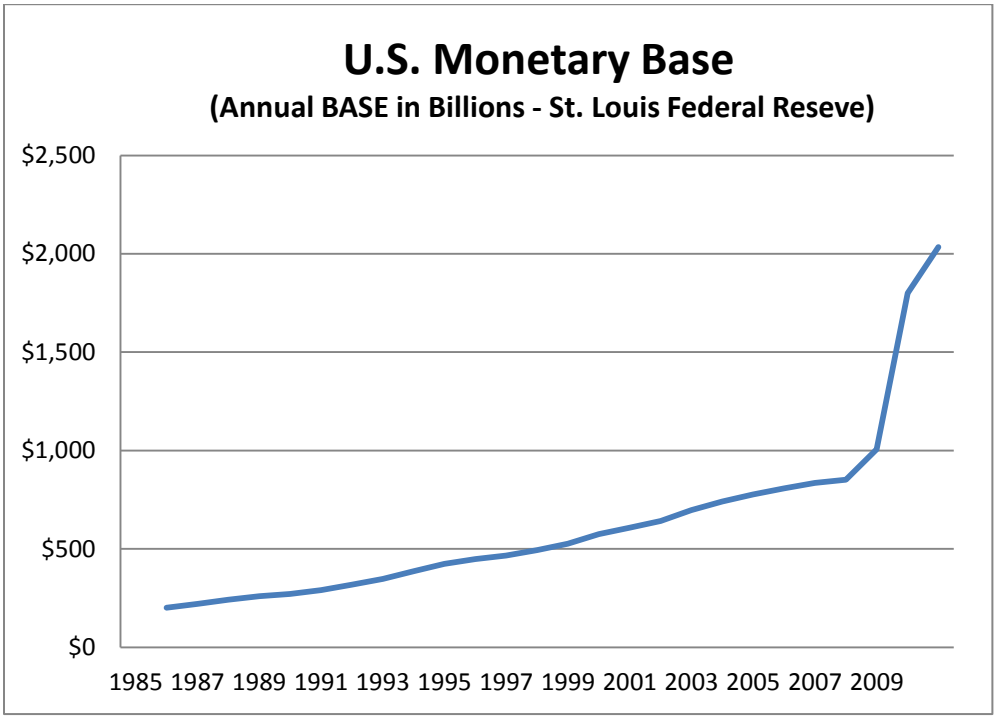

Gross Public Debt as Percent of GDP
(Annual GFDEBTN - St. Louis Federal Reserve)
100.00%
90.00%
80.00%
70.00%
60.00%
50.00%
40.00%
1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009

FIGURE 2


U.S. Monetary Base
(Annual BASE in Billions - St. Louis Federal Reseve)
$2,500
$2,000
$1,500
$1,000
$500
$0
1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009

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