ULYSSES AND THE PUNCH BOWL: THE GOVERNANCE, ACCOUNTABILITY, AND INDEPENDENCE OF THE FEDERAL RESERVE

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> We must examine the system on which these great masses of money are manipulated, and assure ourselves that it is safe and right.
>
> *Walter Bagehot, 1873*

INTRODUCTION

In the United States or any other country, one would be hard pressed to identify a governmental institution whose power is more out of sync with the public's level of understanding of it than the U.S. Federal Reserve System. Even as the Fed influences the economic decisions of individuals and institutions the world over, it operates shrouded in mystery, cultivating a "peculiar mystique" that even experts mischaracterize and miscomprehend. A central part of that mystique is its curious location within government itself. Citizens do not interact with the Fed in the same way they do with other political institutions, so it can be difficult to put the Fed, its policies, and its power into our usual frames of discussion.

We are given a reason for this difference. The Fed is "above politics," as President Obama has said,[1] protected by statute from the rough-and-tumble of our political process. It is, in a word, independent.

That word: *independent*. For administrative lawyers and central bankers alike, it's a familiar term. For historical reasons, though, the two groups of scholars and practitioners don't generally have much to do with each other. The Federal Reserve is the central bank; the rest of the independent administrative state entities are bureaucracies. And while both groups of scholars—economists, mostly, for central banks, lawyers and political scientists, mostly, for the administrative state—have thought seriously about independence in institutional design, they have largely not done so in conversation with each other.

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[1] *See* PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE 1 (2016) (quoting President Barack Obama).

What follows in this essay is an attempt to think through independence in central banking design by bringing these two literatures into better dialogue. In the process, I will unpack the troubling and incomplete assumptions that scholars, practitioners, and the general public make about where the Federal Reserve sits within government, and what set of values "independence" serves when we think about institutional design for central banking in particular and in the administrative state more generally. I conclude by asking whether the Fed's institutional design has appropriately optimized the desirable outcome of maintaining monetary policy with some measure of insulation from the day-to-day of electoral politics with the democratic requirement of accountability to that political process.

Given the symposium volume's focus on the administrative state, two notes of emphasis are useful to navigate the pages ahead. First, the Fed is part of the administrative state. Scholars of central banking aren't always accustomed to viewing it as such, but there is no denying that the Fed is a bureaucracy.[2] It can be—it must be—analyzed as an exercise of governmental authority over social and economic activity, private and public.

Second, the Fed's very idiosyncrasies—its distinctive governance, its unique budgetary structure, the diversity of its missions—make it a useful test case for exploring what we mean by agency independence generally. In this short essay, while I focus almost exclusively on the Fed, I make a few notes about where we might ponder similar questions for other administrative agencies.

I. THE ULYSSES/PUNCH-BOWL CONCEPTION OF CENTRAL BANK INDEPENDENCE

In economics and to a lesser extent political science, the concept of central bank independence has been so extensively studied as to earn its own acronym: CBI.[3] In 2004, Alan Blinder, an academic and former central banker, called the study of central bank independence a "growth industry," and the growth has only accelerated in the years since.[4] Although there are about as many precise definitions of central bank independence as there are authors who describe it, in reference to the Federal Reserve, we can gather from these studies a rough consensus of what central bank independence means.

[2] *See, e.g.*, Neil T. Skaggs, *A Theory of the Bureaucratic Value of Federal Reserve Operating Procedures*, 43 PUB. CHOICE 65, 66–67 (1984).

[3] CONTI-BROWN, *supra* note 1, at 2. *See also* ALAN S. BLINDER, THE QUIET REVOLUTION: CENTRAL BANKING GOES MODERN (2004).

[4] BLINDER, *supra* note 3, at 1.

That rough consensus goes something like this: Fed independence is the separation, by statute, of the central bankers (usually the Fed chair) and the politicians (usually the President) for purposes of maintaining low inflation.[5] The idea is that people—or more specifically, voters—naturally prefer a prosperous economy. In a democracy, politicians please us by giving us that prosperity, or at least trying to take credit for it. But when there is no prosperity to be had, politicians will resort to goosing the economy artificially by running the printing presses to provide enough money and credit for all. The short-term result is reelection for the politicians. The long-term result is worthless money that wreaks havoc on our economic, social, and political institutions.

The widely invoked metaphors of central banking come tumbling forth from here. In the Homeric epic the *Odyssey*, when Odysseus—referred to in central banking circles by his Latin name Ulysses, for reasons that are unclear—ventured with his men close to the seductive and vexing sirens, he devised a scheme to allow his men to guide their ship past their seduction in safety, while he experienced the short-term joys of hearing their songs.[6] Central bank independence is our Ulysses contract. We write central banking laws that lash us (and our politicians) to the mast and stuff bees wax in the ears of our central bankers. We enjoy the ride while the technocratic central bankers guide the ship of the economy to the land of prosperity and low inflation. (We are, by the way, the sirens in this metaphor, too.)

The other commonly invoked metaphor is even more colorful. In the oft-repeated words of William McChesney Martin, the longest serving Fed chair in history, the Federal Reserve is "in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up."[7] The subjects of the metaphors differ by millennia, but the idea is the same: the partygoers and Ulysses alike

[5] CONTI-BROWN, *supra* note 1, at 2.

[6] *Id.*; HOMER, THE ODYSSEY 85–87 (William Lucas Collins, ed. 1870).

[7] William McChesney Martin, Jr., Chairman, Bd. of Governors of the Fed. Reserve Sys., Address before the New York Group of the Investment Bankers Association (Oct. 19, 1955) ("The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up."); *see also* Thomas J. Brennan & Andrew W. Lo*, Dynamic Loss Probabilities and Implications for Financial Regulation*, 31 YALE J. ON REG. 667, 669–70 (2014) (providing a more recent example of the punch bowl metaphor). Interestingly, nearly every scholar to reference the metaphor does not source it. *See, e.g.*, ROBERT P. BREMNER, CHAIRMAN OF THE FED: WILLIAM MCCHESNEY MARTIN JR. AND THE CREATION OF THE MODERN AMERICAN FINANCIAL SYSTEM 276 (2004); 2 ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE 474 (2009). Martin himself purports to cite someone else (although he, too, does not source his quote).

want something in the near term that their best selves know is bad for them in the long term. Central bank independence is the solution.[8]

This conception of Fed independence, which I call the Ulysses/punch-bowl model, implies roughly five features. First, law does the work of separation—the lashes and beeswax are written into the Fed's charter, the Federal Reserve Act of 1913, the chaperone's authority stems from that statutory authorization.[9] Second, the Fed is a singular entity, even a single person: the Fed chair. In most discussions of Fed independence, little attention is paid to the internal governance of the rest of the Federal Reserve System and how that governance structure shapes the way the Fed engages in its policymaking process.[10] Third, the outside audience interested in influencing the Fed is a political one, usually the President, the only politician facing a national electorate.[11] We seldom analyze which other actors, beyond politicians, attempt to shape Fed policy beyond the politicians. Fourth, the reason for an independent central bank is to keep politicians away from the temptation to use the printing press to win reelection on the cheap.[12] Fifth and finally, the reason the Fed can accomplish this task is because its work is technocratic: it requires special training but not the exercise of value judgments or ideology.[13]

[8] Finn Kydland and Edward Prescott's paper established central bank independence, though they do not refer to the Ulysses contract as such. *See* Finn E. Kydland & Edward C. Prescott, *Rules Rather than Discretion: The Inconsistency of Optimal Plans*, 85 J. OF POL. ECON. 473, 473–74 (1977). Jon Elster provides the theoretical link between the Ulysses contract conception and central bank independence, one followed by, among others, William Roberts Clark and Guido Tabellini. JON ELSTER, ULYSSES UNBOUND: STUDIES IN RATIONALITY, PRECOMMITMENT, AND CONSTRAINTS 150–53 (2000); *see also* William Roberts Clark, *Partisan and Electoral Motivations and the Choice of Monetary Institutions Under Fully Mobile Capital*, 56 INT'L ORG. 725, 743 (2002); Jon Elster, *Ulysses and the Sirens: A Theory of Imperfect Rationality*, 16 SOC. SCI. INFO. 469, 484–85 (1977); Guido Tabellini, *Finn Kydland and Edward Prescott's Contribution to the Theory of Macroeconomic Policy*, 107 SCANDINAVIAN J. OF ECON. 203, 209–10 (2005). Martin's quip and especially the Ulysses-contract view of Fed independence provide the theoretical and empirical underpinnings of central bank independence.

[9] Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 251, 12 U.S.C. § 226 (2012).

[10] CONTI-BROWN, *supra* note 1, at 3.

[11] *Id.*

[12] *Id.*

[13] Kenneth Rogoff formalized the anti-inflationary benefits of the conservative central banker model, building on Finn Kydland and Edward Prescott and Barro and Gordon. *See generally* Kenneth Rogoff, *The Optimal Degree of Commitment to an Intermediate Monetary Target*, 100 Q.J. ECON. 1169 (1985); *see also* Robert J. Barro & David B. Gordon, *Rules, Discretion and Reputation in a Model of Monetary Policy*, 12 J. MONETARY ECON. 101 (1983); Kydland & Prescott, *supra* note 8.

By "structural," I mean to bring my conception of Fed independence into dialogue with two academic literatures: the "structure and process" theory in political science and the "state-structural" accounts of state power. In the structure-and-process approach, Jacob Gersen summarizes it, "[a]lthough the structure and process thesis now has many variants, its simplest form asserts that legislatures can control agency discretion (policy outcomes) by carefully delineating the process by which agency policy is formulated." Jacob E. Gersen, *Designing Agencies*, *in* RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC

Figure 1 presents the idea graphically.

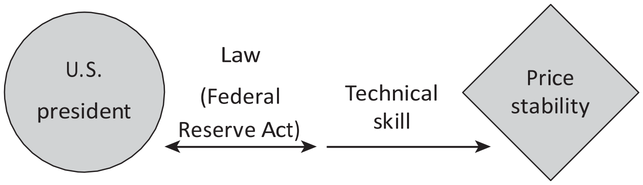

Figure 1. The Ulysses/punch-bowl account of Fed independence.

Fig. 1

The Ulysses/punch-bowl model of Fed independence has taught us a lot about central banks and their institutional design, and it looks like some previous conceptions of agency independence in administrative law.[14] It has also motivated an extraordinary rise of a specific kind of central bank throughout the world since roughly the 1980s.[15] There is much insight to be gained by studying central banks and their legal relationships to politicians for the purposes of combating inflation along the lines of this model.

A. *A New Model: The Power and Independence of Central Banks*

Despite the insights we gain from focusing on how law separates the Fed chair from the President so that she can do the expert work of managing price stability, there's a problem: The standard account of Fed independence—the story of Ulysses and the sirens, of the dance hall and the spiked punch bowl—doesn't work. It doesn't work when politicians whip up popular sentiment in favor of taking away the punch bowl—precisely the opposite of what we expect in a democracy. It doesn't work when the central bankers make headlines not for being boring chaperones but for bailing out the financial system. It

LAW 333, 339 (Daniel A. Farber & Anne Joseph O'Connell eds., 2010). Here, I am interested in the relationship between the political actors and the Fed, but also the influence of nonpolitical external actors and the internal institutional variety on the central bank. For representative work, in structure and process, see Matthew McCubbins's article. Matthew D. McCubbins et al., *Administrative Procedures as Instruments of Political Control*, 3 J.L. ECON & ORG. 243 (1987).

In this sense, it is similar to Hall's state-structural accounts, or those that "emphasize the impact on policy of the state's structure and its actions, but [that] are less inclined to insist on the autonomy of the state vis-à-vis societal pressure. Instead, they accord interest groups, political parties, and other actors outside the state an important role in the policy process. Their main point is that the structure and past activities of the state often affect the nature or force of the demands that these actors articulate." Peter A. Hall, *Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain*, 25 COMP. POL. 275, 276 (1993) (footnote omitted).

[14] *See, e.g.*, Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 522 (2010) (Breyer, J., dissenting).

[15] *See generally* Susanne Lohmann, *Optimal Commitment in Monetary Policy: Credibility versus Flexibility*, 82 AM. ECON. L. REV. 273 (1992).

doesn't work when the creaky, hundred-year-old Federal Reserve Act leaves a governance structure that makes it so we barely even know who the chaperone is supposed to be.

Instead, each of the five elements of that standard account—that it is law that creates Fed independence; that the Fed is a monolithic "it," or more often an all-powerful "he" or "she"; that only politicians attempt to influence Fed policy; that the Fed's only relevant mission is price stability; and that the Fed makes purely technocratic decisions, devoid of ideology or value judgments—is wrong. To understand why, we must refocus our gaze not on one narrow feature of institutional design, but on the Federal Reserve as it actually is. The metaphor, then, is spatial. We must understand the space within which the Fed operates. This space reflects a different orientation depending on the issue before it (inflation or not); the internal actor making the decision (Fed chair or not); the external actor interested in the outcome (the President or not); the tools Fed officials use to accomplish their goals (legal or not); and the values that inform their policymaking decisions (technocratic or not). This structural, geographic account allows the exercise of Fed power to tell its own story, even if—especially if—that story has little to do with the Ulysses/punchbowl narrative. Figure 2 illustrates the argument.[16]

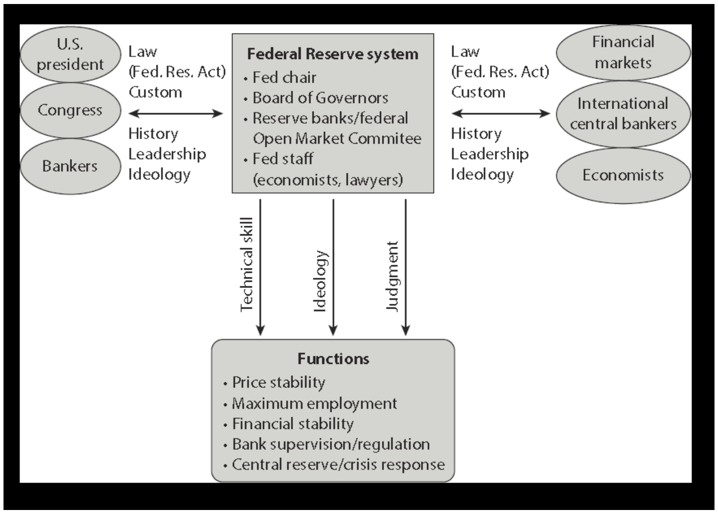
U.S. president
Congress
Bankers
Law
(Fed. Res. Act)
Custom
History
Leadership
Ideology
Federal Reserve system
• Fed chair
• Board of Governors
• Reserve banks/federal Open Market Commitee
• Fed staff (economists, lawyers)
Law
(Fed. Res. Act)
Custom
History
Leadership
Ideology
Financial markets
International central bankers
Economists
Technical skill
Ideology
Judgment
Functions
• Price stability
• Maximum employment
• Financial stability
• Bank supervision/regulation
• Central reserve/crisis response

Fig. 2

More specifically, the geographic view of the Federal Reserve breaks down into five arguments.

[16] I paraphrase Kenneth Shepsle's original and influential description of Congress. *See* Kenneth A. Shepsle, *Congress is a "They," Not an 'It': Legislative Intent as Oxymoron*, 12 INT'L J.L. AND ECON. 239 (1992), *reprinted in* PUBLIC CHOICE AND PUBLIC Law 427 (Daniel A. Farber, ed., 2007).

First, the Fed is a "they," not an "it." While we fixate on the Fed chair—Alan Greenspan or Ben Bernanke or Janet Yellen—in fact the Fed is organized as a series of interlocking committees that all participate in various ways to make Fed policy.[17] Putting these many and varied internal actors in their context is crucial to understanding how this policymaking process occurs.[18]

Scholars in administrative law often treat administrative agencies as singular entities, but this tradition has been profitably challenged.[19] To understand how agencies exercise their significant authority, we need theories and experience from deep within them, and not merely from the perspective of those who have spent a short stint in an agency's general counsel office. Staffers below an agency's upper echelon wield significant power, a point the example of the Federal Reserve illustrates well.

Second, we cannot understand the Federal Reserve System's structure without a close, historically sensitive reading of the Federal Reserve Act of 1913 as it has been amended over the last hundred years. Too few people who study the central bank take on this task. At the same time, the statute is also not enough. Law in practice differs in sometimes surprising, contradictory ways from law in the books. The argument is not that law is irrelevant; it is that the law is incomplete. As Rosa Lastra—a pioneer in the legal study of central banks—has written, "[c]entral banks have traditionally inhabited a 'world of

[17] *See* Alfred C. Aman, Jr., *Bargaining for Justice: An Examination of the Use and Limits of Conditions by the Federal Reserve Board*, 74 IOWA L. REV. 837, 845–51 (1989).

[18] Rosa M. Lastra orients her discussion of CBI around mechanisms of independence—she refers to them as "safeguards"—that come in three varieties: "organic, functional, and professional." ROSA MARÍA LASTRA, CENTRAL BANKING AND BANKING REGULATION 12 (1996). Organic and functional safeguards echo the legal separations that form the basis of economists' empirical models of CBI; organic safeguards refer to "the legal safeguards directed towards the organization of the central bank and to its institutional relationships with the government" and include mechanisms such as appointment, terms of office, dismissal, salary, prohibitions on central bankers while in office, prohibitions on central bankers after they leave office, and liaisons with the Treasury. *Id.* at 12, 27–36. Functional safeguards refer to legislative restrictions on "the functions of the central bank and the scope of the powers entrusted to it." *Id.* at 12 (footnote omitted). "Professional" safeguards are part of what Lastra calls "de facto" independence and are "determined by the personalities of the governor and the minister of finance (and in some countries of other high officials), the political and economic circumstances (e.g., economic expansion or recession); the history and national priorities of the country concerned; the depth and quality of monetary analysis; the rate of turnover of central bank governors and other factors." *Id.*(footnote omitted). Similarly, Alex Cukierman was a leader among the empiricists in studying central bank independence to distinguish between "legal independence" and "actual independence," sometimes distinguished between de facto and de jure independence. See ALEX CUKIERMAN, CENTRAL BANK STRATEGY, CREDIBILITY, AND INDEPENDENCE: THEORY AND EVIDENCE 371–72 (1992); *see also* José Fernández-Albertos, *The Politics of Central Bank Independence*, 18 ANN. REV. POL. SCI. 217 (2015) (containing a more recent discussion of these and related issues).

[19] *See, e.g.*, Elizabeth Magill & Adrian Vermeule, *Allocating Power Within Agencies*, 120 YALE L.J. 1032 (2011).

policy.' This does not mean there is no law. It means that the law has generally played a limited role in central bank operations."[20]

[20] ROSA MARÍA LASTRA, INTERNATIONAL FINANCIAL AND MONETARY LAW 30 (2d ed. 2015). I am not the first lawyer to take the Fed seriously as a subject of scholarly inquiry. The most important is the work of Lastra herself, who has focused on international central banking coordination generally for twenty years. *See* ROSA M. LASTRA, LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY (2006); LASTRA, *supra* note 18. Erik Gerding puts central banks in the context of political economic cycles of regulation and deregulation. *See* Erik F Gerding, *The Next Epidemic: Bubbles and the Growth and Decay of Securities Regulation*, 38 CONN. L. REV. 393 (2006). Colleen Baker analyzes the Fed's legal responses to various aspects of the 2008 financial crisis, including its use of international swap lines and in new approaches to the classic lender of last resort function. *See* Colleen Baker, *The Federal Reserve's Use of International Swap Lines*, 55 ARIZ. L. REV. 603, 606–07 (2013); Colleen Baker, *The Federal Reserve as Last Resort*, 46 U. MICH. J.L. REFORM 69, 71–72 (2012). Robert Hockett and Saule Omarova discuss the government as a market actor, which includes engagement with the Federal Reserve System. *See* Robert C. Hockett & Saule T. Omarova, *"Private" Means to "Public" Ends: Governments as Market Actors*,15 THEORETICAL INQ. L. 53, 54–55 (2014). Most recently, see Philip Wallach's 2015 article in Brookings for the most comprehensive assessment of the Fed's and Treasury's legal response to the crisis. Philip Wallach, *Minimizing Debt Ceiling Crises: Principles and Practical Advice*, BROOKINGS INST. (Oct. 2015), https://www.brookings.edu/wp-content/uploads/2016/06/debt_ceiling.pdf. See Timothy A. Canova for a sustained critique of central bank independence from a partially legal perspective. Timothy A. Canova, *Black Swans and Black Elephants in Plain Sight: An Empirical Review of Central Bank Independence*, 14 CHAP. L. REV. 237 (2011). For an excellent, though dated, overview of the Federal Open Market Committee, see Mark F. Bernstein, Note: *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111 (1989).

As one of the most important pieces of legislation to come out of the Progressive Era, it is unsurprising that the Fed's founding has attracted attention from that era's historians. For arguments that the Federal Reserve Act represents basically a business-friendly conservatism, see Gabriel Kolko and Robert Wiebe. GABRIEL KOLKO, THE TRIUMPH OF CONSERVATISM: A REINTERPRETATION OF AMERICAN HISTORY, 1900–1916 (1963); ROBERT H. WIEBE, BUSINESSMAN AND REFORM: A STUDY OF THE PROGRESSIVE MOVEMENT (1962). For a similar argument from a Marxian lens of class consciousness among bankers and capitalists, see JAMES LIVINGSTON, ORIGINS OF THE FEDERAL SYSTEM (1989). Elizabeth Sanders makes the counter argument, that the farmers and populists had more to say about the Fed than the previous consensus had allowed. ELIZABETH SANDERS, ROOTS OF REFORM: FARMERS, WORKERS, AND THE AMERICAN STATE 1877-1917 (1999). In a historically grounded work in political science that challenges the almost obdurately domestic focus of the previous work, J. Lawrence Broz argues that the Fed's primary purpose was not simply the alleviation of domestic monetary concerns, but the opening up of international markets to American finance (and, therefore, business). J. LAWRENCE BROZ, THE INTERNATIONAL ORIGINS OF THE FEDERAL RESERVE SYSTEM (1997).

Appropriately to their methodological considerations, the histories of the Fed by economists reflect their concerns about theoretical debates important to economists. In their classic history of the Fed's first fifty years, Milton Friedman and Anna Jacobson Schwartz make sophisticated use of vast primary resources, but the focus is on developing a theory of monetarism that explains the macroeconomic consequences of Fed action and inaction. MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES: 1867-1960 (1963). Meltzer's sprawling two-volume history of the Fed is in a similar vein. Meltzer's history is a seminal reference work for scholars. ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE (2003). As this essay's notes indicate, I and every other Fed historian are indebted to him. But Meltzer's is not a useful narrative history for nonspecialists given its long excursions into monetarism and explanations for why the Fed's failures to adhere to the doctrine's dictates have had harmful policy consequences. This is not to criticize Meltzer's magisterial work—the erudition and care taken to produce this 2,100-page history make it a defining achievement in Federal

Here, again, we're on a frontier in assessing the "conventions of agency independence," in Vermeule's term.[21] Institutional design is not a function of legal form alone, or sometimes even at all. Gaining insight into those conventions—their origins, their malleability, their future—is essential to understanding independence generally.

Third, nearsighted presidents anxious to inflate away their electoral problems aren't the only outsiders interested in influencing the Fed's policies, even among politicians. Members of Congress, bankers, economists, international central bankers, and others all influence the shape of the space within which the system operates. How and to what effect they succeed are essential questions for understanding the Federal Reserve. Scholars have conducted detailed analyses of the "epistemic communities" that surround other administrative agencies.[22]

Fourth, the Fed's policymakers have, over the last hundred years, become much more than defenders against inflation. They are also, by statute and practice, recession fighters, bankers, financial regulators, bank supervisors, and protectors of financial stability. A theory of independence that accounts for but one function (price stability) among so many others is not a very good theory.

Fifth, these many missions are not the bailiwick of technocrats and mathematicians alone. The Fed's policymakers are people. They have values and ideologies, like all people. And the policies they formulate and implement require the exercise of value judgments under uncertainty.

In this reconceptualization, "independence" fails to capture where the Fed, or any other agency, fits within government, how it exercises its authority, and to what end. The Fed doesn't glow green with independence or red with political domination. Political scientist John Goodman got close to this proposition when he wrote that "[i]ndependence is a continuous, not dichotomous, variable. In other words, there are degrees of central bank independence."[23]

I would go further still: independence is difficult to quantify at all. It is more of a sleight of hand that reveals only a narrow slice of Fed policymaking at the expense of a broader, more explanatory context where Fed insiders and interested outsiders form relationships us-

Reserve historiography. It is to say that the style and viewpoint will prevent it from a wide readership, even among scholars specializing in the field. An accessible, single-volume narrative history of the Federal Reserve has yet to be written.

[21] Adrian Vermeule, *Conventions of Agency Independence*, 113 COLUM. L. REV. 1163, 1163 (2013).

[22] *See generally, e.g.*, DANIEL CARPENTER, REPUTATION AND POWER: ORGANIZATIONAL IMAGE AND PHARMACEUTICAL REGULATION AT THE FDA (2010).

[23] John B. Goodman, *The Politics of Central Bank Independence*, 23 COMP. POL. 329, 330 (1991).

ing law and other tools to implement a wide variety of specific policies. To understand more, we need to specify the insider, the outsider, the mechanism of influence, and the policy goal.

II. THE STRUCTURE OF FED (AND AGENCY) INDEPENDENCE

Looking at the power, governance, and purpose of the Federal Reserve, as with administrative agencies generally, in these terms, a new theme emerges. Rather than the site of a constant battle between populists and technocrats, the Fed's policymaking space becomes a balance between democratic accountability, technocratic expertise, and the influence of ideology. Independence as an all-or-nothing proposition rings false. Instead, we see central bankers that are deeply embedded in their legal, historical, social, ideological, and political contexts. Pure separation from the political process was never a possibility, whatever the law said or says. And in the century since the Fed's founding, it has become only more embedded in a set of traditions all its own.

Once we have this view of Fed policymaking, a view better informed by law, history, and practice, we will have an easier time finding a common frame for debating any question about administrative agencies past and present, even when we disagree about what we would hope for an agency's future. As Walter Bagehot said of his own central bank, it is our duty to "examine the system on which these great masses of money are manipulated, and assure ourselves that it is safe and right."[24] Settling on a more coherent and authentic frame for analyzing central bank and agency independence is the first step.[25]

To reach the goal of providing that understanding, the book from which this essay is derived focuses on the following questions about central banks, each of which can be repurposed for administrative agencies generally. What do we mean by the Fed, and how did it take the shape it has taken? What does the Fed do? Who influences the Fed's policies? And is the Fed we have the Fed we want?[26]

In the interest of space (and book sales), I'll only briefly summarize these arguments, each of which can and should be repurposed when thinking through the experiences of other agencies.[27]

[24] WALTER BAGEHOT, LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET 9 (1979).

[25] *See id.* at 11–15.

[26] *See* CONTI-BROWN, *supra* note 1 at 1–3.

[27] *See* Sam Halabi, *Conti-Brown's "Independence" and Institutional Design: Lessons from and for the FDA*, YALE J. REG.: NOTICE AND COMMENT (Apr. 5, 2016), http://yalejreg.com/nc/conti-brown-s-independence-and-institutional-design-lessons-from-and-for-the-fda-by-sam-halabi/ (applying this framework on Fed independence to other agency contexts).

A. *Agencies Are a 'They,' Not an 'It'*

When people describe the Fed, they usually do so in one of two ways: as a single monolith ("the Fed announces a change in interest rates," or "the Federal Reserve bails out AIG") or as the institutional shadow of a single individual ("Yellen announces a change in interest rates" or "Bernanke bails out AIG.").[28] The common assumption is that the Fed chair equals the Federal Reserve, and the Federal Reserve is an indivisible whole. This assumption is false. The Fed is not a single individual, and the view that the Fed's power is concentrated into the hands of one is not correct.

In fact, the Fed is one of the most organizationally complex entities in the federal government and has been from the very beginning. The first step in understanding the power and independence of the Fed is to understand its history, including the ways the Fed has grown, institutionally, over time. I focus particularly on three signature events in Fed history, what I call the "three foundings" of the Federal Reserve: the statutory beginning in 1913, the Fed's reformulation in 1935, and the Fed-Treasury Accord of 1951.[29]

My argument that the Fed is a "they," not an "it," can be exaggerated. Not all actors within the Fed are equal. The influence of Fed chairs, especially in the second half of its history, has been important, often decisive. Part of the Fed's institutional change occurs through the exercise of individual leadership by Fed chairs, even though the Federal Reserve Act gives them no particular legal claim for that authority.

But even when the Fed chairs influence the Fed's institutional design, the Fed remains a complicated, multidimensional institution. We must look beyond the chair to these other features of the Fed's governance and analyze the role of the Fed's two powerful committees: the seven-person Board of Governors, consisting of presidential appointments (confirmed by the Senate),[30] and the Federal Open Market Committee, consisting of the Board of Governors plus the Presidents of the twelve regional Federal Reserve Banks (only five of whom vote at a given time), who are appointed through a convoluted process almost completely outside the public eye.[31] The President of the Federal Reserve Bank of New York is a permanent member of the committee; the other eleven

[28] CONTI-BROWN, *supra* note 1, at 7–8.

[29] *Id.* at 15–16.

[30] *Id.* at 8; *see also The Structure and Functions of the Federal Reserve System*, FED. RESERVE EDUCATION.ORG, https://www.federalreserveeducation.org/about-the-fed/structure-and-functions.

[31] CONTI-BROWN, *supra* note 1, at 8; *see also* FED. RESERVE, THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS 15–16 (10th ed. 2016), https://www.federalreserve.gov/pf/pdf/pf_complete.pdf.

Reserve Banks rotate as voting members in the other four seats.[32] All twelve of the Reserve Bank presidents are in the room for FOMC meetings, though, and can make their views heard without restriction.[33] By statute, the FOMC determines the Fed's monetary policies; the Board of Governors determines the rest.[34] Figure 3 presents a graphical display of these committees.

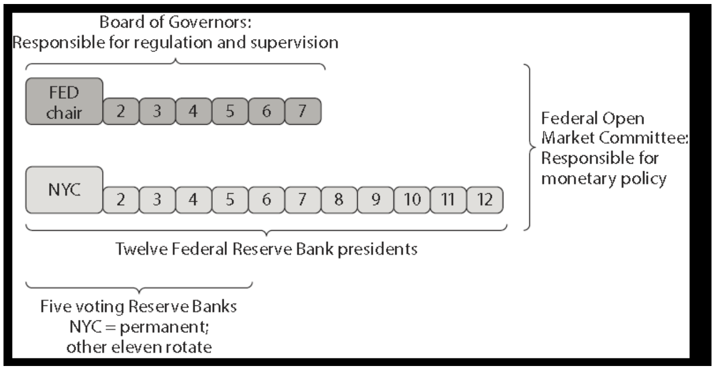
Board of Governors:
Responsible for regulation and supervision
FED chair
2
3
4
5
6
7
Federal Open Market Committee: Responsible for monetary policy
NYC
2
3
4
5
6
7
8
9
10
11
12
Twelve Federal Reserve Bank presidents
Five voting Reserve Banks
NYC = permanent;
other eleven rotate

Fig. 3

In getting a sense of the Fed as a multifaceted institution, we must not stop at the committee level. We must also confront the expansive influence that two other sets of actors have on the Fed's policymaking space: the Fed staff (especially economists and lawyers) and the twelve regional Federal Reserve Banks.[35] The banks are perhaps the most controversial and least defensible aspect of the Fed's governance structure. They present a seat at the table for private bankers' representatives to make essential economic policy decisions.[36] There are policy, constitutional, and governance problems with the Reserve Banks and not enough value to justify those serious costs.[37]

A better, deeper understanding of the "they" of the Federal Reserve is only the first step. We must then turn to the question of what the Fed does.

[32] CONTI-BROWN, *supra* note 1, at 8.

[33] *Id.*

[34] *Id.*

[35] *Id.* at 9.

[36] *Id.*

[37] *Id.*

B. *The Fed as a Regulator: Monetary Policy, Systemic Risk, and Administrative Law*

The logic of the Ulysses/punch-bowl view of the Federal Reserve depends on the idea that politicians will mismanage a nation's currency with an undesirable inflationary bias. The story of the development of that understanding is fascinating and important in its own right but suffers from two weaknesses: the politics of money and inflation are not so straightforward, and the Fed is not now and never has been exclusively concerned with managing price stability.[38] An alternative to the Ulysses/punch-bowl view must thus look at the Fed's varied missions by asking and answering the surprisingly difficult question: What does the Federal Reserve do? The answer: many things beyond controlling inflation. The Ulysses/punch-bowl theory of Fed independence doesn't hold up for most of them.

Given the focus of this symposium on administrative law and regulation, it is worth pausing to consider what the Ulysses/punch-bowl conception of Fed independence means for these other factors. The Fed's missions—originally and, especially, as they have changed over time—have come to include a large array of banking, supervisory, and regulatory activities that have little to do with punch bowls and mast ties.[39] Indeed, we can divide the Fed's other functions into two broad categories.

The first category considers the Fed as a *bank*, with a focus on the Fed's classic role as a "lender of last resort" to the banking system, the complementary role of supervising the banks within its system, and its oversight of the payment system (meaning the clearing of checks, credit cards, and cash: the plumbing of the financial system).[40] This is the kind of service-oriented work that we see elsewhere in government, functions that are at the core of what we might call microadministrative law. When the Fed approves a loan, charges for check clearing, or makes sure that individual banks are complying with bank regulation, it looks an awful lot like the Department of Health and Human Services and the Centers for Medicare and Medicaid Services that oversee the government's substantial investments in supervising Medicare and Medicaid.[41]

Put aside for a moment whether government should be in this kind of business at all. For our purposes, what is the kind of independence that an agency should have when providing these services? The specific answers of institutional design will vary, but the idea that we need to separate such services from electoral politics via Ulysses-type constraints makes no sense.

[38] CONTI-BROWN, *supra* note 1, at 9.

[39] *See* Peter Conti-Brown, *To Fear the Fed or Not*, WHARTON MAG., Feb. 10, 2016, http://whartonmagazine.com/issues/winter-2016/to-fear-the-fed-or-not/.

[40] FED. RESERVE, *supra* note 31, at 9.

[41] *See id.* at 14–15.

There is no time inconsistency problem to resolve, no early consistent indulgence that unchecked will lead to a long-term hangover.

The second category considers the Fed as a financial regulator, including responsibility for broad prudential banking regulation and systemic risk regulation.[42] The Fed shares this financial regulatory authority with many other agencies of government, including the new Financial Stability Oversight Council, of which the Fed is but one of fifteen members.[43] That such deep overlap occurs tells us that the Fed's unique institutional design—including complete budgetary autonomy, a private-public model with respect to the Federal Reserve Banks, and other features—isn't intended for some of the Fed's key functions.[44] But that design isn't perfectly tailored to reflect that reality. When you pick up one end of the Fed stick, you pick up the other.

Stanley Fisher, the Fed's Vice Chair, addressed this very concern in a speech in November 2015.[45] In discussing the Fed's independence, he said:

> I have heard foreign central bankers argue, "You can't be independent in one function (monetary policy) and not independent in another (financial stability), without the nonindependence with respect to financial stability seeping over to weaken the independence of monetary policy." I do not believe this is correct—as proof, I think each of us feels and is more independent in some of the decisions we make about our lives than in others. Thus, I think the Fed retains its monetary policy independence despite its nonindependence with respect to financial stability policy.[46]

Vice Chair Fischer is among the most important theorists and practitioners of central banking in recent memory. But he is wrong here. The problem is that independence is more than a feeling. It is part of the basic structure of the Fed's design. The Fed's budgetary autonomy goes to all of the Fed's functions, not just its monetary policy functions.[47] From the perspective of institutional design, the Fed's structure does not match its more variegated functions.

[42] *Id.* at 98–99.

[43] Financial Stability Oversight Council, Rules of Organization, TREASURY DEPT. §XXX.2(a)–(b), https://www.treasury.gov/initiatives/Documents/FSOCbylaws.pdf.

[44] *See generally* Peter Conti-Brown, *The Institutions of Federal Reserve Independence*, 32 YALE J. ON REG. 257 (2015) (tracing the history of the Federal Reserve's institutional design).

[45] Stanley Fischer, Vice Chairman of Bd. of Governors of the Fed. Reserve Sys., Remarks at the 2015 Herbert Stein Mem'l Lecture, Nat'l Economists Club (Nov. 4 2015), https://www.federalreserve.gov/newsevents/speech/fischer20151104a.pdf.

[46] *Id.* at 16.

[47] *See* Conti-Brown, *supra* note 44, at 285–86.

C. *The Outsiders: Who Tries to Influence Agency Effort?*

The next question is the external one: who on the outside seeks to influence Fed policies? The Ulysses/punch-bowl view of Fed independence focuses on the President, an appropriate first step. What is fascinating, though, is to see *how* the President seeks to manipulate the Fed. Some of that control is legal: the President gets to appoint members to the Board of Governors, including the chair, but is restricted in those appointments.[48] Fed practice, however, has led to the President exercising dramatic control over the Fed, in ways that the black letter law of the Federal Reserve Act does not anticipate.[49] Nor is the law the last word on presidential control. Presidents seek to control—or, in some interesting and undemocratic cases, curry favor with—Fed chairs in a variety of ways.[50]

After the President, the next destination for understanding external influence on the Fed is to look at Congress, an essential audience for influencing Fed policy. Individuals in Congress can have enormous influence in defining the Fed, outside the context of formal legislation.[51] What is even more interesting, though, is that Congress has ceded one of its most important authorities: Congress does not use its traditional spending power to control the Fed.[52] Instead, the Fed has that power on its own. It literally creates the money with which it funds itself.[53] What's more, this power is not directly authorized by statute.[54] Understanding Fed power and independence requires an exploration of the history and legal structure of the Fed's budgetary autonomy. Such an exploration also continues to develop one of the primary themes about the Fed: law as written in the Federal Reserve Act matters, but not in the way that scholars, politicians, central bankers, and even lawyers have assumed.

D. *Reforming the Fed*

This discussion raises the important question: so what? There is, in fact, a programmatic approach to reform that a more comprehensive, structural approach to the Fed can offer. That reform approach would focus on preserving the best of the Ulysses/punch-bowl account of Fed independence: we really do want a central bank that will protect the currency from the winds of electoral politics, without losing the benefits of democratic legitimacy and without indulging the myth that all central

[48] CONTI-BROWN, *supra* note 1, at 8.

[49] *Id.* at 181–84.

[50] *See id.*

[51] *Id.* at 6.

[52] *Id.* at 10.

[53] *Id.*

[54] CONTI-BROWN, *supra* note 1, at 10.

bank policy is purely technocratic. We can and should be comfortable with the reality that central bankers, like everyone else, are people whose life experiences—including their technical training—give them an ideological frame of reference through which they evaluate the world. The key to reforming the Fed is to know as much about the ideologies of those central bankers as possible.

The watchword in this pragmatic approach is *governance*. Governance refers to the institutional decisions about who inside the Fed gets to establish which policies. As it stands today, the Fed's governance is, simply put, a mess.[55] It can and should be clarified without sacrificing the essential tasks of regulating inflation and employment, free from the overwhelming influence of electoral politics. Consistent with these goals, it is worth highlighting a few positive recent developments in reforming the Fed (including the creation of a separate Consumer Financial Protection Bureau), even as we note a few new changes to the Fed's structure and governance (including the reform of the twelve Federal Reserve Banks) that could extend these governance benefits.[56]

This essay has necessarily only briefly highlighted the deficits of the Ulysses/punch-bowl approach to Fed independence and the benefits of the alternative. Two themes are, again, worth highlighting. First, any conversation about the Fed's power must recognize law's inability to remain what its authors intended it to be. That is not to say that we should abandon the enterprise of statutory central bank design. It means, instead, that we should tailor those efforts to minimize new legal rules that might well subject future generations to too many dead hands of the past.

Second, an inescapable reality of institutional design is that the Fed's policymakers are people who bring with them ideologies and values that shape how they exercise their authority over the financial system and economy. Those ideologies and values are also not fixed: interaction with others inside and outside the Federal Reserve System shapes how central bankers think about the problems they confront. For both reasons, focus on understanding and simplifying Federal Reserve governance is an essential task to studying and reforming the Federal Reserve.

CONCLUSION

The U.S. Federal Reserve System has had an extraordinary century. In the words of one scholar, "the Fed's evolution into an eco-

[55] *Id.*

[56] *Id.* at 11.

nomic power of first-rate importance is the most remarkable bureaucratic metamorphosis in American history."[57] In challenging the prevailing view of Federal Reserve power and independence, I mean to invite greater understanding into that remarkable metamorphosis while grappling with the Fed's full practical, historical context. The Fed's mystique is largely a function of a lack of public knowledge of its inner workings, but also the result of a tangled governance structure and a circuitous history that together mislead even the experts.[58] My work, highlighted in this essay but explored in more depth elsewhere, seeks both to increase public understanding of the Fed's many moving parts and to reconceive them in a way that allows for a better, more fruitful understanding of this essential institution.

[57] DONALD KETTL, LEADERSHIP AT THE FED 9 (1998); *see also, e.g.*, CONTI-BROWN, supra note 1, at 239–65 (giving numerous examples of positive recent developments in reforming the Fed).

[58] *Id.* at 11.