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THE STRUCTURE OF FEDERAL RESERVE INDEPENDENCE

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THE STRUCTURE OF FEDERAL RESERVE INDEPENDENCE

Peter Conti-Brown^{*}

Abstract: A century after its founding, the Federal Reserve, with the ability to influence nearly every aspect of public and private economic life, is one of the most powerful agencies in the history of the American Republic. Legal scholars have, for the most part, not taken note. This article is an effort to remedy that lack of attention by exploring the arguable source of the Fed's power, the institutional features that constitute its extraordinary independence. The article makes two contributions. First, it argues that the prevailing lenses for analyzing Fed independence—agency independence in administrative law and central bank independence in the social sciences—are insufficient to describe the many ways that Fed independence does and does not operate in practice. Instead, the article describes the structure of Fed independence by introducing a more comprehensive approach, called the audience-mechanism framework. That framework evaluates Fed independence by reference to the many audiences—inside and outside government, inside and outside the Federal Reserve System—that shape Fed policy via a collection of legal and non-legal mechanisms. The net effect of these mechanisms, vis-à-vis each audience, constitutes the Fed's independence from that audience. Second, the article then illustrates the framework through a descriptive topography of Fed independence from private banks (and the Reserve Banks), the President (and the Treasury), and Congress, but also presents a preliminary map for evaluating independence from audiences such as other agencies, international central bankers, Fed career employees, and others. In the process of that descriptive topography, the article challenges widespread mischaracterizations about, for example, the nature of the Fed's budgetary independence (which is not expressly authorized by statute), the consequences of the Governors' fourteen-year terms (which are almost never served), the role of the Reserve Banks within the System, and other aspects of Fed independence that figure prominently in academic and policy discussions. The upshot of the audience-mechanism framework is that the spirited debates regarding Fed independence are essentially meaningless when that independence is not specified by audience and mechanism. The more theoretically comprehensive and descriptively accurate characterization that the audience-mechanism framework allows, then, is essential for academics and policy-makers engaged in debates about the nature of the Fed, its past, and, increasingly, its future.

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INTRODUCTION

On December 23, 2013, the Federal Reserve System will celebrate its one-hundredth anniversary. Over the course of that century, the Fed¹ has become one of the most important governmental agencies in the history of the American republic, a transformation one scholar has called “the most remarkable bureaucratic metamorphosis in American history.”² The consequences of its policies influence nearly every aspect of public and private life. Given this importance and influence, “[n]o one can afford to ignore the Fed.”³

Legal scholars have largely not taken note.⁴ This article represents an effort to remedy that neglect by focusing on the arguable source of the Fed’s ability to wield its influence: the institutional arrangements that constitute the Fed’s extraordinary independence. Legal scholars and judges have, of course, long been interested in the legal and institutional structure of agency independence generally,⁵ and some of those broader efforts have included analysis of the Fed within

¹ The article refers to the Federal Reserve Board only in reference to the pre-1935 entity, the Board of Governors for its post-1935 incarnation, and Reserve Banks throughout. The shorthand “Fed” and “Federal Reserve” refer to the entire System unless otherwise indicated. See Part I.A. for an explanation of the relationship between the many entities that compose the System.

² DONALD KETTL, LEADERSHIP AT THE FED 9 (1988)

³ STEVEN K. BECKNER, BACK FROM THE BRINK: THE GREENSPAN YEARS xi (1997)

⁴ There are important exceptions. The most thorough is the work of European legal scholar Rosa Lastra, who focuses on central banking generally. See ROSA MARIA LASTRA, CENTRAL BANKING AND BANKING REGULATION 10-70 (1996) (hereinafter LASTRA, BANKING REGULATION); ROSA MARIA LASTRA, THE LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY 41-72 (2006) (hereinafter, LASTRA, LEGAL FOUNDATIONS). See also Rosa M. Lastra and Geoffrey P. Miller, *Central Bank Independence in Ordinary and Extraordinary Times* 31-50, in JAN KLEIMAN, CENTRAL BANK INDEPENDENCE: THE ECONOMIC FOUNDATIONS, THE CONSTITUTIONAL IMPLICATIONS, AND DEMOCRATIC ACCOUNTABILITY (2001). For a recent exception, see Colleen Baker’s work, *The Federal Reserve as Last Resort*, 46 U. MICH. J. L. REFORM 69 (2012), *The Federal Reserve’s Use of International Swap Lines*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2226708. Robert Hockett & Saule T. Omarova are at the beginning of a broader project in the role of government as market actors, which includes engagement with the Federal Reserve System. See “Private” Means to “Public” Ends: *Governments as Market Actors*, 14 THEOR. INQ. IN LAW (forthcoming 2013). Timothy Canova has also sustained a critique of the Fed generally and central bank independence specifically. See, e.g., Timothy A. Canova, *Central Bank Independence as Agency Capture: A Review of the Empirical Literature*, 30 BANKING & FIN. SERVS. POL’Y REP. 11 (2011); 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 by now dated overview of the Federal Open Market Committee, see Mark Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111 (1989).

⁵ For an early example by a prominent author, see William Howard Taft, *The Boundaries Between the Executive, the Legislative and the Judicial Branches of the Government*, 25 YALE L. J. 599, 608 (1916) (“Whether the President has the absolute power of removal without the consent of

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that context.⁶ But while some of the agency-independence analysis is applicable to the Fed to some extent, the Fed's independence is distinct, even unique, making wholesale application of the agency-independence paradigm unwieldy at best and inaccurate at worst.⁷ So too with efforts in the prodigious "central bank independence" literature.⁸ While those theoretical and empirical efforts have revealed much of value regarding the consequences of central bank independence from government, much of that focus fails to account for the Fed's independence in all its complexity. A more comprehensive framework and analysis are needed to understand the full structure of Fed independence.

This article undertakes that more comprehensive effort to evaluate that structure. Part of a broader project,⁹ the article draws on a sustained analysis of the Federal Reserve Act of 1913 (especially as amended in 1935), legislative materials, memoirs and biographies of Fed Chairs¹⁰ and other insiders, and other archival resources, as well as a secondary literatures from law, history, economics, and political science. The article makes two contributions. First, it joins a growing chorus of administrative law scholars that has challenged courts' focus on agency independence as an appointments-and-removability contest between Congress and the President adjudicated by the federal judiciary.¹¹ Fed independence is much more complex than the removability paradigm allows, in terms of both the ways in which the Fed is (or is not) independent, and the audience from whom the Fed is (or is not) independent. To that end, the article introduces a refined framework, called the audience-mechanism framework, that

the Senate in respect to all offices, the tenure of which is not affected by the Constitution, is not definitely settled."). Several recent articles provide excellent overviews of the literature. See Aziz Z. Huq, *Removal as a Political Question*, 65 STAN. L. REV. 1, 23-31 (2013); Barkow, *supra* note 6, at 16-18; Lisa Schultz Bressman and Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 631-637 (2010).

⁶ See, e.g., Rachel Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15 (2010) (describing mechanisms of Fed independence within the context of agency independence generally); Adrian Vermeule, *Conventions of Agency Independence*, COLUM. L. REV. (forthcoming 2013) (discussing conventions of Fed independence within the context of agency independence generally).

⁷ See notes 210-216 and accompanying text for examples of some of these mischaracterizations.

⁸ Alan Blinder, *The Quiet Revolution: Central Banking Goes Modern* 1 (2004) (describing the explosion of research in CBI).

⁹ See Part V for areas of future research. The article's aim is to develop the framework for analyzing Fed independence, illustrate that framework with key audiences, and then continue that engagement with future articles and eventually a book. As the footnotes make clear, the majority of historical materials and references below are drawn from the secondary sources. Other aspects of the project will draw on more sustained historical research than was necessary for this article.

¹⁰ A note on usage: the Federal Reserve Act refers to the "Chairman" and "Vice Chairman" of the Board of Governors. See 12 U.S.C. § 242. Standard usage among scholars of the Fed is to follow the gendered statutory language. I depart from that statutory usage in favor of the generic term, even though some instances—Chair Bernanke, for example—will strike some as unfamiliar.

¹¹ See Part I.B.1, *infra*.

allows for a more comprehensive evaluation of Fed independence. The audience-mechanism framework defines Fed independence as the separation of the Fed's policy process from other *audiences* by means of *mechanisms*, both legal and environmental. Note the two elements of the definition. First, the Fed is independent, to the extent it is independent, from numerous "audiences," not just from the President.¹² These additional audiences include the President, the Treasury, Congress, private banks, the Reserve Banks, central bankers throughout the world, non-bank market participants, Fed career economists, Fed regulators, other federal agencies, the general public, the courts, and more. The article focuses on three audiences—private banks (through the Reserve Banks), the President (and, somewhat separately, the Treasury), and the Congress—but consideration of the additional audiences named is also essential for a fully developed account of Fed independence.¹³

Second, the Fed's independence is regulated by both legal mechanisms (defined as those mechanisms specified by statute) and environmental mechanisms (everything else, especially conventions, judicial rules, institutional practices, markets, and more), and thus conclusions founded too much on either legal/formal arguments or environmental/functional arguments will miss the more complex picture of Fed independence.

The upshot of the audience-mechanism framework is that scholarly and policy arguments about the virtues or vices of Fed independence, when left unspecified by audience and mechanism, are largely meaningless. Fed independence is not a binary category, but nor is it an easily quantified continuous one.¹⁴ Instead, Fed independence requires further specification: independence from whom, and independence secured how?¹⁵

The audience-mechanism framework disciplines the academic inquiry into both what Fed independence means in theory but especially how such independence is practiced, including as that practice has evolved. The products of that inquiry are the article's second contribution, with several descriptive insights. Two are worth flagging in the introduction. First, contrary to every academic characterization to date, the statutorily mandated fourteen-year tenure for

¹² The "audiences" term is borrowed from Daniel Carpenter in his robust analysis of the FDA's power and autonomy. DANIEL CARPENTER, REPUTATION AND POWER: ORGANIZATIONAL IMAGE AND PHARMACEUTICAL REGULATION AT THE FDA 18 (2010).

¹³ See Part V.B, *infra* for a brief discussion of five other audiences that require closer analysis than is provided in this article. The Treasury and Reserve Banks also more comprehensive treatment than they receive here, and should stand alone as separate audiences. I combine them with the President and private banks mostly for space purposes.

¹⁴ See John Goodman, *The Politics of Central Bank Independence*, 23 COMPARATIVE POLITICS 323, 330 (1993) ("Independence is a continuous, not dichotomous, variable. In other words, there are degrees of central bank independence."). For this reason, the audience-mechanism framework would be somewhat inconsistent with the recent effort to construct agency independence as a continuous variable by summing the presence of legal mechanisms of independence vis-à-vis sometimes unspecified governmental actors. See

¹⁵ See Part V, *infra*, for discussion of a third definitional consideration: independence to what end?

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members of the Board of Governors is much less than it seems. As a matter of practice, only three non-Chairs have served that full period. The consequence of the failure to serve full terms directly bears on the independence of the Fed from the President: Although the statutory language specifically endorses the view that appointments should occur only every two years, at least initially, in practice Presidents have, since the Fed's reorganization in 1935, been able to control the Board through much more regular appointments.¹⁶

Second, the Fed's budgetary independence from Congress is secured mostly by convention, and not by statute.¹⁷ To put it bluntly, the Fed has the authority to create the money that funds its conferences, employee salaries, and many other expenses, but, in contrast to other central banks such as the European Central Bank, it lacks direct statutory authority to do so. The Fed's circuitous history with the "real bills" doctrine,¹⁸ the gold standard, and the quasi-independence of the Reserve Banks that ended with the Banking Act of 1935 make the 1913 statutory authorization that does govern the Fed's budgetary independence relevant to an era long passed. The Federal Reserve Act has not kept pace with the practice of monetary policy. The result is the Fed's complete budgetary independence. And again, to the extent that scholars have engaged the topic at all, they have missed these legal and historical details and have, consequently, mischaracterized the nature of the Fed's budgetary independence.

In addition to the theoretical and descriptive contributions noted, the article's legal and institutional analysis of Fed independence also makes a practical contribution. The financial and economic policies the Fed has undertaken during the financial crisis, in its aftermath, and now as it prepares to unwind those policies have generated criticism in Congressional hearings,¹⁹ by academics,²⁰ in the press,²¹ and in litigation.²² But whatever one's view of these policies, the audience-mechanism framework and the insights it generates are useful in assessing whether and to what extent such challenges will change the shape of Fed independence in the coming years. It will therefore be of value to scholars in both law and the social sciences, litigants challenging and defending the structure of the Federal Reserve in the future, members of Congress seeking to regulate Con-

¹⁶ See Part III.B.1, *infra*.

¹⁷ See Vermeule, *supra* note 6.

¹⁸ See Part IV.A.4, *infra*, for a fuller discussion of the real bills doctrine.

¹⁹ See, e.g., Executive Session and the Semiannual Monetary Policy Report to the Congress, February 26, 2013.

²⁰ See, e.g., JOHN B. TAYLOR, FIRST PRINCIPLES: FIVE KEYS TO RESTORING AMERICA'S PROSPERITY 121-144 (2013).

²¹ See, e.g., Reuven Brenner and Martin Fridson, *Bernanke's World War II Monetary Regime*, WALL ST. J., March 24, 2013.

²² For a recent defeat, see *Bloomberg, L.P. v. Board of Governors of the Federal Reserve System*, 601 F.3d 143, 147-49 (2d Cir. 2010) (affirming district court's decision mandating disclosure under FOIA of crisis loans made through the discount window). For a somewhat quirky example, see MarketWatch, *Chinese Woman Reportedly Wants to Sue Federal Reserve over QE*, April 15, 2013, available at <http://blogs.marketwatch.com/thetell/2013/04/15/china-woman-reportedly-wants-to-sue-federal-reserve-over-qe/>.

gressional relationships with the Fed, and the political and career employees within the Reserve System as they make sense of the System's independence in a post-crisis, post-Dodd-Frank world.

This article proceeds as follows. Part I provides the context for the debate by outlining the structure of the Fed, describing the practice of monetary policy and why Fed independence is a controversial concept, and then explaining the basic academic approaches to central bank and agency independence already in place. Part I.B. then explains the audience-mechanism framework and how it builds on but differs from those other approaches. Part I concludes with Table 1, which displays the article's contributions by relating legal and environmental mechanisms to each audience. The rest of the article adds detail and analysis to the rough outline provided in Table 1.

Part II looks at the Fed's relationship with the private banks it regulates. This is an important starting point: that central bank independence has become a shorthand for independence from government is an ahistorical interpretation that focuses on only one half of the Compromise of 1913 that created the System as a balance between private and public interests. Part II explains more about that Compromise, and then identifies the legal and environmental mechanisms of independence between the Fed and private banks, mediated largely by the Reserve Banks. The role of the Reserve Banks in the System is crucial, even after their authority was diminished in 1935, and is frequently overlooked. Part II explains how the private banks and Reserve Banks—through legal and environmental means—fluence Fed policy politically and substantively.

Part III discusses the Fed's relationship with the President, with specific focus on (1) the relationship between the Chair and the President as a matter of law, personality, and stature; (2) the law and practice of Governor appointments meant to relax the President's hold on the Board, but in practice a means of extending that control; and (3) the Fed's relationship with Treasury, and what that history means (and does not mean) for legal and environmental mechanisms of independence.²³

Part IV then outlines the relationship between the Fed and Congress, with specific focus on the Fed's budgetary autonomy and the circuitous history of the practice of open market operations and the consequences for Fed budgetary independence. Part IV explains how this budgetary autonomy came to be, why scholars have missed or mischaracterized this independence, and why it matters.

Finally, Part V explains why a more nuanced understanding of the legal and environmental bases of Fed independence matters, irrespective of one's views of the Fed's policy decisions of the last decades. As the Fed transitions out of its recent extensive purchases of government and mortgage-backed securities²⁴ (conventionally described as the third round of quantitative easing, or QE3), the na-

²³ The Fed's relationships with Treasury and the President are functionally and formally distinct. For purposes of brevity, however, they are treated together in Part III.

²⁴ See Board of Governors of the Federal Reserve System, Press Release, September 13, 2012.

ture and structure of Fed independence is likely to become relevant once again.²⁵ Some economists have predicted that the Fed's exit from quantitative easing will result in significant losses that will make the System unprofitable. How the Fed would fund itself under that scenario can open again the question of its budgetary autonomy. Part V also flags for future research the application of the audiences-mechanisms framework, including the many other audiences essential to an understanding of the Fed's independence, the relationship between the President and the FOMC, and the potential for incorporating the *why* of central bank independence into this analysis.

A final word of modesty: as important as a comprehensive legal and institutional assessment of Fed independence is, the present effort is a limited one. A proper multidimensional assessment of the Fed's independence, like that of any other agency, will require much more than a single article can provide. What follows, then, is admittedly ambitious and necessarily incomplete. But even incomplete, the ambition is important: Legal scholars, with only the exceptions noted above, have not given the Federal Reserve its due. The article represents a partial attempt to correct that course, and points to ways that the Federal Reserve into can become more clearly the subject of legal academic research.

I. THE AUDIENCE-MECHANISM FRAMEWORK FOR EVALUATING FEDERAL RESERVE INDEPENDENCE

This article defines Fed independence as the separation of the Fed's policy process from other audiences by means of mechanisms, both legal and environmental. This definition stands in contrast to the focus of legal doctrine and most of the central bank independence (CBI) literature, both of which focus on legal mechanisms and the Fed's relationship with the President and (in the case of CBI) Congress. The article's theoretical framing of Fed independence is both important and incremental. It is important because the legal-separation-from-the-President focus within agency and central bank independence is inadequate to explain Fed independence as it is practiced. But it is incremental because the article is far from the first to note the importance of other audiences and other mechanisms. The incremental contribution is to bring those audience and mechanism arguments into a single framework, and then expand the range of both concepts as applied to the Federal Reserve.

In order to understand Fed independence, one must understand the nature and structure of the Federal Reserve itself. Part I.A. provides that overview, focusing on monetary policy. Part I.B. then briefly surveys the agency and central bank independence literatures. It also shows how much of that, in both cases, the aim of the literatures is either distinct from a comprehensive evaluation of Fed independence, or else insufficient to allow for that evaluation. Part I.C. then introduces the audience-mechanism framework and includes Table 1,

²⁵ See, e.g., Michael S. Derby, *Fed's Dudley Suggests No Urgency in Paring Back QE3*, WALL ST. J., April 16, 2013.

which lays out the ways that legal and environmental mechanisms interact with one another for a net effect of Fed independence vis-à-vis each audience.

A. What the Fed Is, What the Fed Does

Because much of the nature of the Fed's independence relates directly to the way that the Fed undertakes its duties, especially in monetary policy, a brief explanation of structure and practice of monetary policy is useful.²⁶

The original Federal Reserve Act created the Federal Reserve System, which consisted of the Federal Reserve Board, based in Washington, D.C.; Federal Reserve Banks in what would become twelve cities throughout the country; and member banks, which were private, commercial banks that subscribed to the stock of Reserve Banks and gained access to the System's regulatory apparatus.²⁷ In 1933, Congress created the Federal Open Market Committee (FOMC), the System's monetary policy-making arm. Under the Banking Act of 1935, the System was reorganized and the Federal Reserve Board replaced by the Board of Governors of the Federal Reserve System. At the same time, the FOMC was refashioned to include all seven members of the newly created Board of Governors of the Federal Reserve System (which replaced the now defunct Federal Reserve Board). Today, the remaining seats on the FOMC are filled by the President of the Federal Reserve Bank of New York and four of the eleven other Reserve Bank Presidents on an annually rotating basis.

The FOMC controls monetary policy using one of four basic measures, one of which came into use only recently. These tools are the federal funds rate, discount rate, reserve requirements, and what is called "quantitative easing." The control of the federal funds rate is today by far the most important and most commonly used of the Fed's tools. The federal funds rate refers to the rate at

²⁶ For more thorough and accessible explanations of monetary policy, see STEPHEN AXILROD, THE FEDERAL RESERVE: WHAT EVERYONE NEEDS TO KNOW 41-64 (2013); BD. OF GOV. OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 27-51 (2005).

²⁷ The Fed is also advised by several Advisory Councils, the most prominent of which is the Federal Advisory Council which was created by the original 1913 Act and intended by some of the Act's drafters as part of the balance between private and public interests. See HOWARD HACKLEY, THE STATUS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL GOVERNMENT 42-45 (1972) (unpublished, on file with the Stanford Law Library). An explanatory note is appropriate on the provenance of this extraordinary document. Hackley, then General Counsel for the Board of Governors, prepared this 200-page manuscript for internal purposes. It is an extremely valuable scholarly source that contains both references to other useful primary documents (such as early opinion letters from the Comptroller General) and is a useful reflection of the Board's view of several important legal issues at the time. Upon learning of the document's existence from William Greider's journalistic history of the Fed, see GREIDER, SECRETS OF THE TEMPLE: HOW THE FEDERAL RESERVE RUNS THE COUNTRY 49, 736 (1989), I asked the reference librarians at Stanford Law School if they could secure it. For more details on Erika Wayne's impressive success, see Peter Conti-Brown, *We Have Winners! – and a Paean to Law Librarians*, The Conglomerate Blog, May 26, 2011, available at <http://www.theconglomerate.org/2011/05/we-have-winners-and-a-paen-to-law-librarians.html>.

which banks lend money to each other, usually for short-term loans (overnight, or slightly longer). The effective federal funds rate is the average of these rates reported by the banks. The FOMC, in its eight annual meetings, establishes the target federal funds rate, or the rate it wishes to see in the markets for interbank, short-term loans.

To reach this target, the Fed buys or sells securities on the open market, through the trading desk at the Federal Reserve Bank of New York. When the FOMC decides to raise interest rates, it sells securities; when it decides to lower interest rates, it buys securities. To understand why, one must consider the Fed plays in establishing and maintaining the money supply.

When the Fed buys a Treasury security on the open market, it provides its counter-party with cash—an electronic modification to the counter-party's balance sheet. This purchase removes the security from a bank's balance sheet, and replaces it with greater reserves in the bank's account at the Federal Reserve. In this way, the Fed has expanded the money supply by removing from the banking system a more illiquid asset—the government bond or, more recently, the mortgage-backed security—and replacing it with cash, the most liquid of assets. If the bank already had the requisite level of reserves required by the Fed (more on that momentarily), the cash that now sits on the bank's balance sheet is something extra. Banks are generally in the business of taking the extra and injecting it into the economy. Under normal conditions, the bank will lend the majority of what it has received from the Fed for its security, expanding the money supply in the economy. Because most consumers don't carry around much cash on their persons or under their mattresses, the money lent by the Fed's initial counter-party to another person or institution will eventually end up in another bank, who will then lend to another individual or institution with the same consequence. The effect is a more or less predictable expansion of the money supply throughout the banking system.

When such a monetary expansion occurs, banks start to feel flush. Projects that otherwise would not get funded, get funded. People who would otherwise not get loans, get loans. The result, under the best conditions, is economic growth. But under other conditions, what looks like economic growth is, in fact, inflationary pressures that threaten to undermine the economy's stability. When the Fed fears that inflation, not growth, drives expansions, it intervenes, in the oft-quoted metaphor cited by Fed Chairman William McChesney Martin, "in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up."²⁸ It restricts the money supply by doing

²⁸ William McChesney Martin , Chairman, Bd. of Governors of the Fed. Reserve, Address before the New York Group of the Investment Bankers Association of America 12 (Oct. 19, 1955), available at http://fraser.stlouisfed.org/docs/historical/martin/martin55_1019.pdf. Note that Martin himself was quoting an unnamed contemporaneous source. But he was in any event fond of metaphors. In an interview, he described the Fed's aspiration for money and credit to "flow . . . like a stream. This stream or river is flowing through the fields of business and commerce. We don't want the water to overflow the banks of the stream, flooding and drowning what is in the fields. Neither do we want the stream to dry up, and leave

the reverse of the purchase of the Treasury securities described above—it sells them to its counter-parties. When the Fed sells these securities on the open market, at the market price, it replaces cash on the bank's balance sheet with a less liquid government security. In turn, the Fed's counter-party bank will either call in loans due—or, far more likely, initiate fewer subsequent loans—thus either diminishing or slowing the expansion of the money supply.

So far this explanation has skated over the significance of interest rates. After all, the Fed has done nothing explicitly with interest rates—it has merely injected or retracted liquidity to expand or shrink the money supply. The connection between open market operations and interest rates is as basic as a supply and demand graph from introductory economics. Here, the supply and demand is for money, a commodity just like any other, such as crude oil, pineapples, or squirrel bait. The price of money, in these markets, is expressed in terms of interest rates. When there's less money, people will pay more for it—and the interest rates increase. When there is more money, people will pay less for it, and the price of money decreases. Thus, while the difference between the federal funds effective rate and the federal funds target rate is actually more complicated than this simple explanation suggests, the reality is that the Fed can and does affect interest rates through open market operations similarly to the process described above: by affecting the quantity of money, it changes the price of money.

Two other monetary-policy levers are more easily explained, with this background in mind. The second is the lending that occurs through the figurative “discount window,” referred to today, more accurately, as the discount rate. The discount rate is the rate, set by the Reserve Banks subject to the approval of the Board of Governors, at which the Fed lends directly to the banks themselves.²⁹ The original conception of the Fed was as the lender of last resort,³⁰ and the discount rate was the mechanism by which the Fed might make these loans to an otherwise solvent bank in crisis. Historically, the discount rate was of far more importance to the maintenance of the banking system. Today, it has been almost completely replaced by open market operations, although in times of crisis—including the recent crisis—the discount window is much more actively used.³¹

the fields parched.” Interview in U.S. News and World Report, Feb 11, 1955, 56 (cited in KETTL, *supra* note 2 at 83). And another: “Our purpose is to lean against the winds of deflation or inflation, whichever way they are blowing.” Testimony before U.S. Senate, Committee on Banking and Currency, Nomination of William McChesney Martin, Jr., hearings, 84th Congress, 2d Sess, 1956, 5 (cited in KETTL, *supra* note 2 at 83).

²⁹ The rates given at the discount window actually refer to three different kinds of loans: primary credit, secondary credit, and seasonal credit. For ease of explanation, I collapse all three into the generic “discount rate.”

³⁰ ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE, VOLUME 1: 1913-1951 68-69 (2003) (stating that although the various proposals considered in the debates preceding the enactment of the Federal Reserve Act were diverse and conflicting, “[a]ll proposals recognized that a central bank could serve as lender of last resort in a banking crisis.”)

³¹ The use of the discount window to non-banks has created controversy. See Terminating Bailouts for Taxpayer Fairness Act, summary available at <http://www.vitter.senate.gov/newsroom/press/vitter-brown-unveil-legislation-that-would-end->

The third lever is the reserves requirement with which all banks—whether members or not of the Federal Reserve System—must comply.³² The Board of Governors can increase or decrease that rate, and by so doing, increase or decrease the money supply. There is little dramatic change, though, that a prudent Fed can do with reserve requirements: ratcheting up reserve requirements too high is unnecessary, since a finer tuned increase of rates is always possible, and decreasing reserve requirements too much only exposes individual institutions to idiosyncratic chances of default.

The final lever is the newest—and most controversial—addition to the Fed’s toolkit. Called, euphemistically, quantitative easing, it is essentially the answer to the perplexing question of what a central bank can do when interest rates are already at zero, and yet there is inadequate economic expansion. In such cases, conventional open market operations to influence interest rates are useless—conventional interest rates cannot go below zero.³³ But the continued purchase of securities on the open market can have the same effect of decreasing interest rates even when that floor is reached. Quantitative easing is thus the increased purchase of these assets in order to inject even more money into the system. The hope of quantitative easing is that the injection of this amount of money will do what lowering interest rates to zero could not do—namely, get the economy moving again.

B. Two Insufficient Approaches to Evaluating Fed Independence

The conventional justification for Fed independence is that the process just described—changing the quantity of money and thereby influencing interest rates throughout the economy—is necessarily a fraught exercise.³⁴ Under the classic formulation, creditors in society prefer to see higher interest rates and lower inflation; debtors prefer to see lower interest rates and higher inflation. It is entirely because of the authority to adjust these interest rates—which necessarily influence how much it costs the government to service its debt, Jane Doe to pay for a mortgage or student loans, or the relative attractiveness of investments in the stock market—that makes the decisions and institutional design of the Fed so controversial. Society must be able to assume that those monetary levers are pulled for reasons other than reelection or venality.

The debate regarding the *why* of Fed independence continues apace as a fas-

[too-big-to-fail-policies](#). During the recent crisis, the term of the discount window was extended from overnight loans to 30 day loans.

³² See Monetary Control Act of 1980.

³³ Economists since before Keynes have suggested ways to effect a lower-than-zero real interest rate. See JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 155 (1936, ed. 2011). For a more recent articulation of this kind of argument, see N. Gregory Mankiw, *It May Be Time for the Fed to Go Negative*, NY TIMES, April 18, 2009.

³⁴ See, e.g., Ben Bernanke, *Central Bank Independence, Transparency, and Accountability*, Speech to the Institute for Monetary and Economic Studies International Conference, Bank of Japan, Tokyo, Japan, May 25, 2010.

cinating, complex, and much disputed academic and policy question.³⁵ This article will leave to the side the why of Fed independence.³⁶ Instead, the focus is on the legal and non-legal mechanics of independence. In other words, the questions are *from whom* is the Fed independent, and *how* is that independence accomplished and maintained?

There are two veins of research that provide insight into this comprehensive evaluation: agency independence in law, and central bank independence in economics and political science. Both are useful starting points, but they are either focused on different questions—the constitutional contours of appointment and removability for law, the empirical consequences of legal separation between central banks and the government for CBI—or else they are unsuited for that comprehensive task.

1. Agency Independence

Courts and legal scholars have long analyzed the nature of agency independence. But this is something of a misnomer: as Gersen noted, agency independence is a “legal term of art in public law, referring to agencies headed by officials that the President may not remove without cause. Such agencies are, by definition, independent agencies; all other agencies are not.”³⁷ Thus, “agency independence” is not concerned with agency independence in the generic sense of that term—whether the agency can pursue its own agenda without outside interference—but only whether the President can summarily fire the head of the agency.

Others have documented the doctrine’s historical development,³⁸ but the gist is easily summarized. Congress may not require the President to seek Senate advice and consent prior to removal, as the “reasonable construction of the Constitution” would forbid that kind of blending of legislative and executive functions without express authorization.³⁹ But Congress may condition Presidential

³⁵ For interesting assessments of the *why* question, compare Geoffrey P. Miller, *An Interest-Group Theory of Central Bank Independence*, 27 J. LEGAL STUD. 433 (1998) (arguing that CBI is a means by which interest groups which have benefitted from rent-extracting political deals secure price stability to lock in the benefits of those deals) with WILLIAM BERNHARD, *BANKING ON REFORM 11* (2002) (arguing that CBI resolves an intra-party conflict over the practice of monetary policy).

³⁶ The focus of the debate most recently is on whether the Fed should have as its monetary goals the optimization of price stability and maximum employment, or should focus, as in the case of other central banks, on price stability alone. For an excellent and thorough overview of the dual employment debate, skewed heavily in favor of the dual mandate, see the papers presented at the April 2013 conference at the Boston Fed, *Fulfilling the Full Employment Mandate: Monetary Policy & the Labor Market*, available at <http://www.bos.frb.org/employment2013/agenda.htm>. For a more critical assessment, see TAYLOR, *supra* note 20 at 124-128.

³⁷ Jacob E. Gersen, *Designing Agencies*, in RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW 333, 347-48 (Daniel A. Farber & Anne Joseph O’Connell eds., 2010).

³⁸ See Huq, *supra* note 5; Barkow, *supra* note 6; Vermeule, *supra* note 6.

³⁹ *Myers v. United States*, 272 U.S. 52, 116, 176 (1926).

removal of an agency head to a more limited range of causes, depending on the nature of the office in question. For offices that are created to “perform . . . specified duties as a legislative or as a judicial aid”—that is, independent commissions like the Federal Trade Commission—the Court deemed removability conditions on agency heads constitutionally permissible.⁴⁰ So too for lower-level executive appointees like the independent counsel,⁴¹ but not if the agency head and the lower-level appointee are both deemed to be protected by for-cause removability protection.⁴²

As a quick-and-dirty overview, the doctrinal summary isn’t very satisfying. The point is only that some kinds of restrictions are permissible, some are not, and the meaning of agency independence for judicial purposes is narrowly circumscribed within that President-and-removability framework.⁴³

On their own terms, these doctrinal conclusions are controversial to scholars of presidential authority on each side of the cases just summarized.⁴⁴ But as a means of evaluating agency independence writ large, the removability focus is even more susceptible to criticism. A growing chorus of scholars has challenged the removability paradigm because it, for example, focuses on the wrong mechanisms of independence,⁴⁵ ignores the ways in which executive agencies (i.e., those

⁴⁰ *Humphrey's Executor*, 295 U.S. 602, 627-28 (1935).

⁴¹ *Morrison v. Olson*, 487 U.S. 654 (1988).

⁴² *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3146-47 (2010)

⁴³ One prominent jurist regards the language of *Free Enterprise Fund* as more fully consistent with the sweep of executive power envisioned by Myers than the more skeptical *Humphrey's Executor*. See *In re Aiken County*, 645 F.3d 428, 444-46 (2011) (Kavanaugh, J., concurring)

⁴⁴ See STEVEN CALABRESI AND CHRISTOPHER YOO, THE UNITARY EXECUTIVE: PRESIDENTIAL POWER FROM WASHINGTON TO BUSH (2008). See, e.g., Victoria F. Nourse and John P. Figura, *Toward a Representational Theory of the Executive*, 91 B.U. L. Rev. 273 (2011) for a conflicting view. Interestingly, two proponents of the unitary executive theory, in footnotes, have come to opposite conclusions about the constitutional permissibility of the FOMC. Compare John O. McGinnis and Michael B. Rappaport, *Reconciling Originalism and Precedent*, 103 NW. UNIV. L. REV. 803, 850 n.173 (“While we believe that the appropriate precedent rules do not protect the decisions that allow the creation of independent agencies from being overruled (assuming as we believe that they conflict with the original meaning), one important exception may exist to this claim. We are inclined to believe that the independence of the Federal Reserve is now so well accepted that it should be regarded as an entrenched precedent.”) with Steven G. Calabresi, *Some Normative Arguments for the Unitary Executive*, 48 ARK. L. REV. 23, 86 n.150 (1994) (“The independence of the Federal Reserve, and of the money supply, provides by far the hardest case for me. Nonetheless, I would note that practical independence can always be achieved within our formal constitutional structure if public opinion thinks it desirable that it should exist. Presidents who fire Watergate special prosecutors or who appoint their campaign managers to be Attorney General rapidly learn that the public has no patience with politicized law enforcement. For this reason, I do not believe we need an independent counsel law in this country to protect against partisan interference with the law enforcement machinery. Similarly, I do not believe we need an independent Federal Reserve Board to protect against presidential manipulation of the money supply. Our best protection against that evil comes from an informed public opinion about the nature of money, and, in the absence of that, statutory guarantees of agency ‘independence’ have proven to be of very little use.”).

⁴⁵ See Vermeule, *supra* note 6; Barkow, *supra* note 6; and Bressman and Thompson, *supra* note 5.

whose heads are removable at will, and are subject to Presidential regulatory review through the Office of Information and Regulatory Affairs) use presidential review to increase “self-insulation,”⁴⁶ creates meaningless distinctions between executive and independent agencies,⁴⁷ is focused on the wrong problems⁴⁸ and the wrong parties,⁴⁹ reflects a misunderstanding of how the administrative state actually functions,⁵⁰ elides ways in which the President controls independent agencies beyond removability,⁵¹ and gives to courts review of decisions that are fundamentally incompatible with judicial review.⁵² Vermeule summarizes the point well. Identifying a “mismatch” between “the doctrinal law as embodied in judicial decisions and the revealed behavior of political actors,” he notes that “the legal test that courts deem central to agency independence is neither necessary nor sufficient for operative independence in the world outside the courtroom. The legal test . . . does not capture the observable facts of agency independence in the administrative state.”⁵³

The Federal Reserve’s independence illustrates some of the scholars’ frustrations with removability as a paradigm for comprehensive evaluation of agency independence, even as some scholars have looked at the Fed within this context.⁵⁴ Indeed, the relationship between the President and the FOMC especially touches on appointment and removability in ways that scholars have not fully analyzed.⁵⁵ But otherwise, the removability paradigm points only to one small part of the phenomenon of Fed independence, and even there provide very little by way of meaningful guidance.⁵⁶

2. Central Bank Independence

Although legal scholars have mostly either ignored the Fed or analyzed it in conjunction with other agencies of very different stripes, economists and political scientists⁵⁷ have long focused on the inputs and outputs of central banks and

⁴⁶ Jennifer Nou, *Agency Self-Insulation Under Presidential Review*, 126 HARV. L. REV. 1755 (2013).

⁴⁷ Kirti Datla and Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 CORNELL L. REV. 769 (2013).

⁴⁸ See Barkow, *supra* note 6.

⁴⁹ M. Elizabeth Magill and Adrian Vermeule, *Allocating Power Within Agencies*, 120 YALE L. J. 1032 (2011).

⁵⁰ Jody Freeman and Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. (2012).

⁵¹ Bressman and Thompson, *supra* note 5.

⁵² Huq, *supra* note 5.

⁵³ Vermeule, *supra* note 6, at 3.

⁵⁴ Vermeule, *supra* note 5.

⁵⁵ See text accompanying notes 238 to 243 for a brief exploration of this question.

⁵⁶ See Part III.A.1, *infra*.

⁵⁷ The political science literature on central banking is largely distinct from the view of economics. Scholars have puzzled over why politicians would willingly cede control over monetary policy, an area that arguably has outsized impact on the politicians own electoral health.

central banking.⁵⁸ Interestingly, although these literatures rarely overlap, their conceptions of independence are strikingly similar. While the term “independence” in the CBI context has meant “different things to different people,”⁵⁹ the focus is, as with agency independence, almost exclusively on the legal mechanisms that separate the central bank from interference by the political branches, especially the executive.⁶⁰

There's an important conceptual focus to CBI that focuses more on the why

For the most innovative interest group theories, see Miller, *supra* note 4; John Goodman, *The Politics of Central Bank Independence*, 23 COMPARATIVE POLITICS 323, 339 (1993) (arguing that interest groups can influence politicians to adopt CBI because the politicians do not expect to be in power by the time the negative electoral consequences of more conservative monetary policy arise). For an explicitly electoral theory, see the series of articles and book by William Bernhard, arguing that CBI is in the long-term interests of both executive branch and legislative branch coalition partners, for different reasons. For the legislative branch, central bank independence is seen as a monitoring device to ensure that the monetary policy decisions of the executive are not inappropriately prejudicial to the electoral prospects of legislatures. The executive branch will agree, because failure to do so may result in what Bernhard calls “legislative punishment,” or the myriad ways in which legislators can punish the executive for failures to pursue policies sympathetic to their electoral interests. The most damaging form of legislative punishment is the withdrawal of coalitional support such that the executive's own electoral prospects are diminished. See BERNHARD, *supra* note 35 at 2; William Bernhard, *A Political Explanation of Variations in Central Bank Independence*, 92 AM. POL. SCI. REV. 311 (1998). Bernhard's BANKING ON REFORM also provides perhaps the single best introduction into the design questions associated with political scientists' CBI inquiries.

⁵⁸ For a full review of the extensive literature linking CBI to monetary policy, see CARL E. WALSH, MONETARY THEORY AND POLICY 419-424 (2d ed., 2003). Note, however, that the policy outcome that most of these studies analyze is *inflation*, and not economic growth. Indeed, two influential studies suggest that there is no significant relationship between economic growth and CBI. See Alberto Alesina and Lawrence Summers, *Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence* 25 J. MONEY, CREDIT & BANKING 151 (1993); Jacob de Haan and Willem J. Kooi, *Does Central Bank Independence Really Matter? New Evidence for Developing Countries Using a New Indicator*, 24 J. BANKING & FIN. 643 (2000). Some scholars also view this literature as composed of two competing literatures, a theoretical branch that focuses on why CBI would or would not produce better monetary stability, and an empirical branch that tests the relationships between these literatures. See Jakob de Haan, *The European Central Bank: Independence, Accountability, and Strategy*, 93 PUB. CHOICE 395, 396 (1997).

⁵⁹ BERNHARD, *supra* note 57 at 19. For examples of the work engaging CBI at different definitional levels summarized here, see Jakob de Haan, *The European Central Bank: Independence, Accountability, and Strategy*, 93 PUB. CHOICE 395 (1997); James Forder, *Central Bank Independence: Conceptual Clarifications and Interim Assessment*, 50 OX. ECON. PAPERS 307 (1998); Gabriel Mangano, *Measuring Central Bank Independence: A Tale of Subjectivity and of Its Consequences*, 50 OX. ECON. PAPERS 468 (1998); Henriette Prast, *Commitment Rather Than Independence: An Institutional Design for Reducing the Inflationary Bias of Monetary Policy*, 49 KYKLOS 377 (1996); Christopher Waller, *Performance Contracts for Central Bankers*, 77 FED RESERVE BANK OF ST. LOUIS REV. 5 (1995).

⁶⁰ Alesina & Summers, *supra* note 58 at 153 (listing mechanisms, all legal, that separate central banks from political interference). See also LASTRA, BANK REGULATION, *supra* note 5 at 12. Indeed, one recent effort criticizes the CBI literature as being insufficiently focused on rules. See Andreas Freytag, *Does Central Bank Independence Reflect Monetary Commitment Properly? Methodological Considerations*, PSL QUART. REV. (2012).

of independence than the how. Under Stanley Fischer's now famous articulation, CBI is divided between "goal independence" and "instrument independence."⁶¹ Goal independence refers to the freedom to select the ends of monetary policy; instrument independence is the freedom to select the means of pursuing statutorily specified goals. But even there, the focus is mostly on the statute.⁶²

C. The Audience-Mechanism Framework for Evaluating Federal Reserve Independence

The audience-mechanism framework builds on but is largely distinct from the agency and central bank independence approaches just outlined. If the aim of the law and scholarship on agency and central bank independence is to assess the President's and Congress's constitutional prerogatives on the institutional design of the administrative state, or to establish a theory for testing the efficacy and implications of a central banks' separation from government, then these literatures cannot be criticized for failing to account for Fed independence in its full complexity. In that sense, the phrases "agency independence" and "central bank independence" are terms useful for the narrow inquiries of constitutionality of institutional design and the empirical consequences of various legal separations of central banks from the rest of government.

But if the aim is to evaluate the ways that a "headless fourth branch" can exist outside the traditional structure of government, as many critics in the judiciary and the academy have expressed,⁶³ or that the Federal Reserve has become

⁶¹ Stanley Fischer, *Central-Bank Independence Revisited*, 84 AM. ECON. REV. 201 (1995).

⁶² A partial exception is Lastra's taxonomical effort. 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." LASTRA, BANKING REGULATION, *supra* note 4. 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. "Professional" safeguards are part of what Lastra calls "de facto" independence, and is "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.* As will be seen throughout the rest of the article, the role of individual personalities is extremely important. For representative work in the genres of central bank memoirs and histories sensitive to the role of personality, see KETTL, *supra* note 2; LAURENCE H. MEYER, *A TERM AT THE FED* (2008); ALAN GREENSPAN, *THE AGE OF TURBULENCE: ADVENTURES IN A NEW WORLD* (2007); MARRINER S. ECCLES, *BECKONING FRONTIERS: PUBLIC AND PERSONAL RECOLLECTIONS* (1951).

⁶³ From courts, see, e.g., *City of Arlington, Tex. v. FCC*, — S. Ct. —, 2013 WL 2149789 (2013) ("The collection of agencies housed outside the traditional executive departments, including the Federal Communications Commission, is routinely described as the "headless fourth branch of government," reflecting not only the scope of their authority but their practi-

too independent⁶⁴ or that its independence must be defended against any Congressional adjustment,⁶⁵ then the government-separation-by-law approach to Fed independence is descriptively insufficient, for two reasons.

First, the government and law focus pays too much attention to the relationship between the Fed and the President, or the Fed and the rest of the government (in the CBI context). These dynamics speak only to a small—albeit important—part of the Fed’s independence. In reality, the Fed faces a number of “audiences,” to use Carpenter’s term. In his words:

Government agencies live among numerous audiences, and these audiences overlap and blend into one another. Audiences include the political and judicial authorities who endow organizations with power; interest groups and civic associations; organizations of professional and scientific expertise; media syndicates in print and broadcast, and the mass publics who digest the information produced by these syndicates; the companies, corporations, and citizens who are governed by agencies; the clienteles who rely upon agencies for benefits and for order. In political systems like the U.S.—with formal separation of powers among legislative, executive, and judicial branches; with federalist structures that multiply and refract government capacity; and with pluralist political structures that often scatter the forces of business, labor, religion, race, and ethnicity—these audiences stand ever more diffuse.⁶⁶

So it is with the Federal Reserve: the audiences that surround, provoke, influence, and ultimately determine the shape of its policy processes are several, identifiable, and diffuse. Of course, scholars writing in one vein of the public choice tradition have long focused attention on the ways in which the bureaucracy interacts with, for example, “the key committees and members of Congress[] and the private interest” in order to shape administrative policies.⁶⁷ Scholars have also looked closely at private influence on the Federal Reserve.⁶⁸ Barkow, in the

cal independence.”); *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1817 (2009) (“There is no reason to magnify the separation-of-powers dilemma posed by the Headless Fourth Branch by letting Article III judges-like jackals stealing the lion’s kill-expropriate some of the power that Congress has wrested from the unitary Executive.” (internal citation omitted)). From scholars, the defenders of the unitary executive take particular aim at Humphrey’s-type restrictions on removability as empowering the full independence of the administrative state. See, e.g., CALABRESI & YOO, *supra* note 44 at 34.

⁶⁴ See, e.g., RON PAUL, END THE FED (2009).

⁶⁵ See, e.g., Bernanke, *supra* note 34.

⁶⁶ CARPENTER, *supra* note 12 at 34.

⁶⁷ Gordon Adams, *The Iron Triangle: The Politics of Defense Contracting* 24 (Nancy Sokoloff ed., 1981). For more on public choice and bureaucratic policy-making, see Jerry Mashaw, *Public Law and Public Choice: Critique and Rapprochement*, in RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW (Farber & O’Connell, eds.) (2010). For a contrary view of bureaucracy-private interest interaction, see STEPHEN CROLEY, *REGULATION AND PUBLIC INTEREST* 4 (2008) (explaining that the public choice critique “shows far too little attention the actual processes through which administrative agencies regulate, and that such inattention is largely responsible for the dominant, jaundiced view of regulation.”).

⁶⁸ See Miller, *supra* note 5 (citing the role of private groups in the protection of CBI); JOHN T. WOOLLEY, *MONETARY POLITICS: THE FEDERAL RESERVE AND THE POLITICS OF MONETARY POLICY* 69-85 (1986).

agency context, has also argued that agency independence primarily focuses on independence from private interests—that is, as a means to insulate the bureaucracy from agency capture.⁶⁹

But Fed independence, if it is concerned with the Fed's ability to pursue its policy course without dictation from outside parties, must combine references to those private interests, the government, and the interests of many other audiences.⁷⁰ The audience-mechanism framework thus reaches more broadly than either the government or public choice paradigm allows.

The second problem with the government-and-legal-mechanism paradigm is the focus on legal mechanisms. This is especially true in the administrative law context, where the removability of the Chair is the singular focus. Central bankers' job protection is not, as several scholars have noted, the only legal mechanism available in the design of agencies, or central banks. Other mechanisms (some of which are explored more thoroughly below) include term length, funding source, discretion to choose policy instrument, work product review, and more.⁷¹

But even a broader focus on a variety of legal mechanisms is inadequate. Extra-legal sources also circumscribe agency activities in a variety of ways. Here, Vermeule's argument that conventions are distinct from law, but also shape the way that institutional independence is practiced and evolves, is important.⁷² To evaluate Fed independence, scholars and policymakers must be sensitive to these kinds of non-legal mechanisms.⁷³ As demonstrated throughout the rest of the article, these other, environmental mechanisms can be just as important, sometimes much more important, than the legal mechanisms identified by statute. For these reasons, the audience-mechanism framework focuses not only on a va-

⁶⁹ Barkow, *supra* note 6

⁷⁰ Carpenter's analysis of "audiences" in his two books is more apt than the terminology itself. The emphasis is on the parties/constituencies which have some influence over the process or content of Fed policies. The "audiences" addressed fully below, and suggested for future research in Part V, *infra*, are not passive witnesses to a Stoppard play, but those whose opinions and power change the shape of Fed activity.

⁷¹ Data and Revesz, *supra* note 47. Bressman and Thompson, *supra* note 5; Barkow, *supra* note 6. LASTRA, BANKING REGULATION, *supra* note 4.

⁷² Vermeule argues that law, politics, and conventions animate the way that agency independence is experienced and regulated by the agencies themselves and by the political branches. To establish this taxonomy, Vermeule draws on the understanding of conventions from Commonwealth systems where conventions are "(1) regular patterns of political behavior (2) followed from a sense of obligation." Each element of the definition can take stronger or weaker forms, but one of Vermeule's main points is that these conventions dictate individual (and institutional) behavior, even though they are not a core part of the law. Vermeule, *supra* note 6 at 16-17.

⁷³ Vermeule, *supra* note 6, recommends that judges take note of the conventions of independence when adjudicating the traditional removability cases. Hug, *supra* note 5, would disagree, and argues that courts have no place in making these kinds of determinations in the first place. While this article doesn't wade too deeply into that doctrinal debate, the audience-mechanism framework suggests judges will have difficulty in assessing independence in a way that fits within a constitutional framework.

riety of legal mechanisms, but also on non-legal, or environmental mechanisms.⁷⁴

The audience-mechanism framework thus evaluates the legal and environmental mechanisms in search for a net effect on the Fed's independence from each audience. This initial effort is not meant to be exhaustive: many other mechanisms, legal and environmental, are relevant to the Fed's relationships with many other audiences. But the effort is meant to point toward something more comprehensive than has been undertaken, and with a focus on the ways that legal and environmental mechanisms interact.

Table 1 summarizes the article's schematic and descriptive contributions, and the relationships between legal and environmental mechanisms. Sometimes that net effect results in greater Fed independence from the specific audience, sometimes less, and sometimes the consequence is uncertain. In all cases, an exclamation of Fed independence—either in support or condemnation—without reference to the legal and environmental mechanisms, and especially the net effect of those mechanisms, is essentially rhetoric without content. The rest of the article is devoted to explicating the legal and environmental mechanisms described in Table 1.

⁷⁴ The article resists Vermeule's "conventions" as unnecessarily narrow. Some environmental mechanisms could include judicially-crafted doctrines that exist outside the statutory framework, such as the doctrine of equitable discretion the DC Circuit used in the 1980s to prevent challenges to the FOMC's constitutionality. See text accompanying notes 238 to 243, *infra*.

1. Table 1: The Structure of Federal Reserve Independence

Independence from Private Banks		
Legal Mechanisms	Environmental Mechanisms	Net Effect
1. Bank participation on Reserve Bank boards of directors and limited role in selection of Reserve Bank Presidents	1. Political power of Reserve Banks and private banks invested in survival of Reserve System	1. Reserve Banks, despite many anachronistic features, stay as regulators
2. Employment and investment restrictions of Governors and Reserve Bank Presidents	2. Intellectual identity through moral suasion (especially restrictions for members of the Board at the Federal Reserve Bank of New York)	2. Uncertain; intellectual capture difficult to test empirically
Independence from President		
Legal Mechanisms	Environmental Mechanisms	Net Effect
1. Four-year term of Chair	1. Practice of reappointment across party administration	1. Uncertain: some Chairs will change views to cater to President (Martin); some will develop independent basis of support (Volker, Greenspan). Practice of reappointment also not a convention; more easily broken without incurring political costs.
2. Fourteen-year term of member of Board of Governors	2. Practice of early retirement and high turnover	2. Contra legal mechanism, Presidents since Roosevelt have chosen their Board.
Independence from Treasury		
Legal Mechanisms	Environmental Mechanisms	Net Effect
After 1935, removal of the Secretary of Treasury from Board.	Convention of Fed-Treasury Accord of 1951, after long series of extra-statutory struggles regarding Fed participation in monetizing the public debt. Also dependent on conventions of Fed separation (travel to conferences, some aspects of coordinated work, etc.)	Strong convention of independence following Accord protects Fed from much Treasury interferences, but relationship still highly dependent on personalities of Fed Chairs and Secretaries of the Treasury.
Independence from Congress		
Legal Mechanisms	Environmental Mechanisms	Net Effect
Exemption from appropriations	Historical evolution of monetary policy	Full Budgetary Independence

II. PRIVATE BANKS AND THE FEDERAL RESERVE

This article starts with private banks in a self-conscious effort to incorporate, following Barkow,⁷⁵ the inquiries from one strain of public choice scholarship into the broader inquiry into Fed independence. The government focus that academics have taken in the last decades stands in marked contrast to the contours of the original debate over the founding of the Fed, and indeed the place of

⁷⁵ See Barkow, *supra* note 66.

banking in the United States generally. Part II therefore looks closely at why private banks are essential to the Fed independence inquiry, and then catalogues some of the legal and environmental mechanisms by which private banking influence is and is not manifest in Fed decision-making. Here, the focus is on the structure of the quasi-public, quasi-private Reserve Banks. These much misunderstood features of the System wield considerably less influence today than they did prior to the Fed's reorganization in 1935, but they cannot be discounted. In the most recent 2010 reorganization of the Fed, the Reserve Banks are likely responsible for the System's continued role as the nation's preeminent banking regulator.

Part II.A. outlines the Compromise of 1913, and why that Compromise acted almost as a constitutional "invitation to struggle" between the private and public branches of the System.⁷⁶ Part II.B. discusses the modern System, and the ways in which the private banks participate through the Reserve Banks as a matter of law. Part II.C. then looks at the environmental mechanisms of independence, and focuses on the relationship between the Reserve Banks and the private banks informally. Special consideration is given to the Federal Reserve Bank of New York. Part II.C. also discusses the role of the Reserve Banks and the private banks in maintaining the System's role as the primary regulator of thousands of smaller banks, even as the Board of Governors and the Senate sought to relinquish that authority in the Dodd-Frank negotiations. Because of the unique institutional arrangements that constitute the Reserve Banks, they are situated to exert considerable extra-System influence on Congress, despite the Board's preeminence in virtually every other aspect of Fed policy-making.

A. *The Compromise of 1913*

Despite their exclusion from the usual CBI inquiry, suspicions about the role that bankers play in central banking animate much of the critique of the Fed throughout history, including to the present. As Allan Sproul—one of the most influential Reserve Bank Presidents in history—described it, "[t]he possibility that there might be a 'money power' able and willing to flout the economic policies of elected Government, or exposed to the coercion of special private interests, disturbs many men and attracts demagogic assault."⁷⁷ Such has been the sentiment since the beginning of the Republic. Thomas Jefferson and Andrew Jackson, with their supporters, hated government-sponsored banks⁷⁸; Alexander Hamilton

⁷⁶ EDWARD S. CORWIN, THE PRESIDENT: OFFICE AND POWERS 1787-1984, at 201 (5th ed. 1984) (using the oft-repeated phrase in the context of the constitutional allocation of foreign policy powers).

⁷⁷ Address at the mid-winter meeting of the New York State Bankers Association, January 25, 1954, quoted in JEROME A. CLIFFORD, INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM 32 (1965).

⁷⁸ I choose the term carefully. Although frequently indulged, the temptation to refer to the first and second Banks of the United States as "central banks" is to engage in a kind of prochronism that is without defensible intellectual basis.

and Henry Clay,⁷⁹ with their followers, loved them. Indeed, it is not a stretch to say that partisan politics in the United States were birthed by a government-bank midwife, as the question of government banking created coalitions that endured even during periods when the existence of a government bank was not in controversy. As the eminent 19th century financial historian Albert Bolles put it, “[w]hen the smoke of the contest [over government banks] had cleared away, two political parties might be seen, whose opposition, though varying much in conviction, power, and earnestness, has never ceased.”⁸⁰

So it was in the years prior to the creation of the Federal Reserve System. The conventional story of the Fed’s creation describes an acute financial crisis in 1907, resolved by a bailout orchestrated by JP Morgan. As the story goes, the Panic of 1907 made bankers and politicians wary of continued reliance on the private bailout model. The Federal Reserve System was the political response to those concerns.⁸¹

This story is technically true, but in important ways incomplete. The primary reason is that it links, almost ineluctably, the Panic of 1907 and the Act of 1913. For understanding how private banks influence Fed decision-making—and indeed, for much of the following analysis, especially regarding the Fed’s budgetary independence in Part IV—this uncritical link is a mistake. The Panic of 1907 occurred in, well, 1907; the Federal Reserve Act of 1913 in 1913. The six years in between were extraordinarily important for the fate of the Federal Reserve, including as they did three Congressional elections in which Democrats first seized control of the House (in 1910)⁸² and then the Senate (in 1912). Most important, the presidential election of 1912—a four-way race between incumbent Republican President William Howard Taft, erstwhile Republican former President Theodore Roosevelt, Socialist Eugene Debs, and Democratic New Jersey Governor Woodrow Wilson—was one of the most significant in the 20th century. In the words of one historian, the 1912 election was a “remarkable moment” that

⁷⁹ Clay is an interesting character in these debates—like James Madison and many other Jeffersonian Democrats politically active long enough to debate both the First and Second Banks of the United States, Clay was initially opposed to central banks, and eventually in favor. See ROBERT V. REMINI, HENRY CLAY: STATESMAN FOR THE UNION 40, 139 (1993).

⁸⁰ 2 Albert S. Bolles, *The Financial History of the United States, from 1789 to 1860*, at 32 (4th ed.1894).

⁸¹ See Katharina Pistor, *Towards a Legal Theory of Finance* 26 (November 18, 2012). ECGI - Law Working Paper No. 196; Columbia Law and Economics Working Paper No. 434. Available at SSRN: <http://ssrn.com/abstract=2178066>. (“Mr. JP Morgan was able to coordinate a private sector rescue of the U.S. financial system in 1907, but only because relative to the capacity of the private entities involved in the rescue its size was still manageable. The crisis raised sufficient concerns about the reliability of private sector bailouts to provide the political impetus for a new central bank, the Federal Reserve, established in 1913.”); ROBERT F. BRUNER & SEAN D. CARR, *THE PANIC OF 1907: LESSONS LEARNED FROM THE MARKET’S PERFECT STORM* 2 (2009) (“Though the duration of the crisis was relatively brief, the repercussions proved far-reaching, resulting in the formal establishment of a powerful central bank in the United States through the Federal Reserve System.”).

⁸² See Party Divisions of the House of Representatives, 1789-present, available at <http://history.house.gov/Institution/Party-Divisions/Party-Divisions/>.

“verged on political philosophy.”⁸³ That political philosophical moment intervened between the Panic and the Act in ways that were essential to the ultimate shape the System took.

On a most basic level, the elections mattered because of partisan control. The first proposals following the panic were almost entirely Republican; the final bill was almost exclusively Democratic.⁸⁴ Senator Nelson Aldrich was the Republican leading the monetary reform efforts. In 1908, Congress passed the Aldrich-Vreeland Act, which created the National Monetary Commission with Aldrich at the head.⁸⁵ The Commission imagined a structure very different from the system the Federal Reserve Act eventually created. That structure, the National Reserve Association,⁸⁶ was to be a mix of public and private appointments, but dramatically weighted toward the private. For example, the board of the NRA was to have forty-six directors, forty-two of whom—including the Governor and his two deputies—were to be appointed directly and indirectly by the banks.⁸⁷

The election of 1912 intervened, and capped a change of the partisan guard in the House, Senate, and White House, and the Democrats made the cause of monetary reform their own. The key consequence of this political transformation was what might be called the Compromise of 1913. Under that Compromise, the final result was the mostly supervisory, leanly staffed Federal Reserve Board, based in Washington, DC, and the quasi-autonomous twelve “Reserve Banks,” considered by several active participants in the Act’s drafting to be essentially private institutions.

The tension between the two poles—public and private, accountable to politics and independent therefrom—is essential to understanding the nature of Fed independence, then and now. Paul Warburg, the German-American banker whose ideas in the early 1900s set the stage for much of the debate preceding the enactment of the Federal Reserve Act, described it this way: “The view was generally held that centralization of banking would inevitably result in one of two alternatives: either complete governmental control, which meant politics in banking, or control by ‘Wall Street,’ which meant banking in politics.”⁸⁸ One of

⁸³ John Milton Cooper Jr., *The Warrior and the Priest: Woodrow Wilson and Theodore Roosevelt* 141 (1983), quoted in Sydney M. Milkis, *Theodore Roosevelt, the Progressive Party, and the Transformation of American Democracy* 2 (2009).

⁸⁴ The vote in the House of Representatives was 298 to 60; only two Democrats voted against the bill, whereas 35 Republicans voted in favor. In the Senate, the vote was 43 to 25 (with 27 not voting). The Democrats were unanimous in favor, and all but three Republicans voted against. See JEROME A. CLIFFORD, *INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM* 40 (1965).

⁸⁵ 35 Stat. 546 (1908), repealed by Technical Amendments to the Federal Banking Laws, Pub. L. No. 103-325, 108 Stat. 2292, 2294 (1994).

⁸⁶ Milton Friedman and Anna Schwartz, *A Monetary History of the United States* (1964).

⁸⁷ See E.W. Kremmerer, *The Purposes of the Federal Reserve Act as Shown by Its Explicit Provisions*, 99 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 62, 64 (1922).

⁸⁸ Paul Warburg, *The Federal Reserve System: Its Origin and Growth*, vol. 1, 12 (1930).

the central debates preceding the passage of the Act centered on how to navigate those two poles, the “whirlpool of socialism and the jagged rocks of monopoly” in the words of one scholar.⁸⁹

The consequence of that Democratic navigation was the existence of the government-controlled Federal Reserve Board on the one hand, and the private Reserve Banks on the other.⁹⁰ The System would not, in theory at least, be dominated by one faction or the other.

If the creation of those entities signaled a commitment to both poles, the practice was far different. From the beginning, the two factions fought for predominance.⁹¹ Only in 1935, with the passage of the Banking Act, did the predominance of the Board become clear. In that Act, the Reserve Banks could do very little—and lost entirely their control of monetary policy—without approval of the newly created Board of Governors. The Compromise of 1913, in the form it initially took, lasted less than twenty years.

A. *The Legal Mechanism of Fed-Bank Independence*

While the Banking Act of 1935 significantly curtailed the Reserve Banks’ role in the System, the Act did not destroy the Reserve Banks. Today private banks still maintain their primary interface with the Federal Reserve System through the Reserve Banks. The legal mechanisms of Fed-Bank independence start with those unusual institutions. If the Federal Reserve System has been neglected by legal scholars, the Reserve Banks have been even more neglected: there is virtually nothing written about Reserve Banks’ legal structure.⁹²

Under the Federal Reserve Act, “[e]very Federal reserve bank shall be conducted under the supervision and control of a board of directors.”⁹³ The member banks play an important role in the oversight of the Reserve Banks through the selection of two-thirds of the Reserve Banks’ boards of directors. Each Reserve Bank’s board is divided, by statute, into three classes, each with three directors. Class A Directors are “chosen by and [shall] be representative of the stockholding banks.”⁹⁴ Class B Directors are selected by the stockholding banks⁹⁵

⁸⁹ CLIFFORD, *supra* note 84 at 21. See also CARTER GLASS, ADVENTURE IN CONSTRUCTIVE FINANCE 112-120 (1927) (discussing the ways in which President Wilson envisioned the Federal Reserve Board as mediating the interests of government and banks).

⁹⁰ HACKLEY, *supra* note 27 at 31 (citing several sources from the legislative history for the view that the Federal Reserve Board was intended to be a governmental institution; the Reserve Banks as private corporations.).

⁹¹ Meltzer, History of the Federal Reserve, vol. 1, at 65; Clifford, *supra* note 84 at 66-67.

⁹² Art Wilmarth is, from what I can tell, the only exception. See Arthur E. Wilmarth, Jr., *The Financial Services Industry’s Misguided Quest to Undermine the Consumer Financial Protection Bureau*, 31 REVIEW. BANKING & FIN. L. 881, 941-944 (2012). Hockett & Omarova, *supra* note 4, address some of the New York Fed’s trading features, but not its institutional relationships with the rest of government.

⁹³ 12 U.S.C. § 301.

⁹⁴ 12 U.S.C. § 302.

⁹⁵ 12 U.S.C. § 304.

"with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers."⁹⁶ And Class C Directors are "designated by the Board of Governors of the Federal Reserve System" under the same "due but not exclusive consideration" to the factors listed for Class B Directors.

While regulated banks participate in the selection of Reserve Bank directors, the more important question is the legal obligations of those directors. These are few, and have changed under Dodd-Frank. The directors select the Reserve Banks' "president, vice presidents, and such officers and employees as are not otherwise provided for in" the Federal Reserve Act.⁹⁷ But Dodd-Frank made an important change in that selection process. Before 2010, all three classes of Reserve Bank directors selected the President of each Reserve Bank, subject to approval by the Board of Governors.⁹⁸ Dodd-Frank inserted the clause "and shall be appointed by the Class B and Class C directors of the bank" to preclude member banks' representatives serving as Class A directors from that selection process.⁹⁹

Another significant legal mechanism of private bank influence is the bankers' access, through the Reserve Bank board and through the Reserve Bank presidents, to the Federal Open Market Committee. This access is, to be sure, circuitous. But all twelve Reserve Bank Presidents participate in each of the eight annual FOMC meetings; the New York Fed President on a permanent voting basis; and four others by statutory rotation for annual terms. If bankers want messages transmitted to the FOMC, they need only pass that message to their Reserve Bank president.

The structure of the Federal Reserve Act, then, creates a formal, legal proximity between the regulated and regulator that does not exist anywhere else among the federal banking agencies. And while the Dodd-Frank changes insulate the Reserve Bank presidents further from the private banks, the remnants of the Compromise of 1913 have left a structure that places private banks in close legal proximity to their regulators.

That is not to say that the banks are unencumbered in their legal access to the Reserve Banks. For example, the Chairman of each Reserve Bank must be a Class C director—that is, one not chosen by the member banks.¹⁰⁰ And at the Board of Governors level, Governors are "ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank."¹⁰¹ But the legal structure of the Reserve Banks—even as it has grown increasingly restrictive to private banks over the last eighty years—does provide a clear path of access for the private banks to the FOMC and, conse-

⁹⁶ 12 U.S.C. § 302.

⁹⁷ 12 U.S.C. § 341.

⁹⁸ 12 U.S.C. § 341 (2009).

⁹⁹ 12 U.S.C. § 341.

¹⁰⁰ 12 U.S.C. § 305.

¹⁰¹ 12 U.S.C. § 242.

quently, the Board of Governors.

B. *The Environmental Mechanisms of Fed-Bank Independence*

The legal mechanisms of bank-Fed interaction are present, but do little more than create a means of communication. It is the environmental mechanisms that determine what kinds of communication actually occur.

1. New York Fed and the FOMC

The permanent presence of the president of the New York Fed is a departure from the original vision of the 1935 FOMC. That permanence was not added until 1942.¹⁰² But the permanent vote might only be that—a vote, the same as the other rather anonymous permanent votes of the non-Chair Governors. It would be a legal mechanism that allowed private banks to express themselves to the FOMC, but not much more.

But the role of the New York Fed on the FOMC is more than that vote. As the Fed states in its official publication, “[t]he FOMC, under law, determines its own internal organization and by tradition elects the Chairman of the Board of Governors as its chairman and the president of the Federal Reserve Bank of New York as its vice chairman.”¹⁰³ The legal basis for the Fed’s claim is somewhat opaque. After listing the statutorily-prescribed method of selected Reserve Bank representatives on a specific rotating basis, Section 12A provides that “the details of such elections may be governed by regulations prescribed by the committee, which may be amended from time to time.”¹⁰⁴ The meaning of “such elections” is the key to determining whether the FOMC actually does have the authority to choose its own Chair and Vice Chair. If “such elections” refers to the means by which Reserve Bank representatives are selected to join, in the first instance, the FOMC, then the ability to then designate the Chair and Vice Chair seems a bridge too far. But if the election is in reference to the process by which the FOMC is constituted, the legal position seems more defensible.¹⁰⁵

This question bears on more than legal arcana. The influence of the New York Fed president on Board matters is sizeable, given not only his permanence but also his status as the Vice Chair of the FOMC. This status may well have been the reason why New York Fed President Timothy Geithner was the third in the trio of crisis responders that included the Treasury Secretary Henry Paulson

¹⁰² 56 Stat. 647 (July 7, 1942).

¹⁰³ *Id.*

¹⁰⁴ 12 U.S.C. § 263(a).

¹⁰⁵ Interestingly, though, a close reading of the statute suggests that the influence of the Reserve Banks can be severely restricted by the exercise of this rulemaking authority. The statute also provides that “[i]n such elections”—again, unclear as to the antecedent—“each board of directors shall have one vote.” *Id.* That restriction does not attach to the seven Governors. The FOMC could conceivably change its rules such that the Governors are each given two or three or ten votes to the Reserve Bank Presidents’ single votes.

and Fed Chair Ben Bernanke. Board Vice Chair Donald Kohn, Vice Chair from 2006 through 2010, was nowhere near as prominent as Geithner, despite the coincidence of his tenure with the most active part of the Fed's intervention during the financial crisis. What this environmental mechanism the New York banks is direct access to the FOMC that it otherwise would not have, amplified beyond the vote on the FOMC to the higher stature of the Vice Chairmanship of that committee.

2. Regulatory Capture

Regulatory capture is another kind of environmental mechanism of Fed-bank interaction. And as with the New York Fed's Vice Chairmanship on the FOMC, the significance is the amplification of influence. If the New York Fed President—and directors and other employees—are “captured,” the banks’ interests are amplified in monetary policy and bank regulation. Claims of regulatory capture are frequently made against the Fed generally and New York Fed specifically.¹⁰⁶ The academic questions, then, are three: what does capture mean, has it occurred at the Fed, and what is the effect?

These are very difficult questions to answer, and provide promising veins of future research. Carpenter’s recent treatment of the problems of measuring capture suggests both under- and overspecification in much of the work on the subject: underspecification in, for example, the failure to determine whether a “captured” result occurred via faithful implementation of a statute itself produced by a captured legislative process;¹⁰⁷ overspecification because frequent critics of captured agencies do not, as they must, put forward “some notion of the public interest in mind as a counterfactual,”¹⁰⁸ a counterfactual essential to determine whether, indeed, the captured result is inconsistent with the public interest.

To be sure, critics of the Fed’s relationships with the banking industry are more engaged in a conceptual effort than an empirical one,¹⁰⁹ and there are empirical efforts that seek to map the extent of Fed-institutional relationships.¹¹⁰

¹⁰⁶ See Lawrence G. Baxter, *Capture Nuances in Financial Regulation*, 47 WAKE FOREST L. REV. 537, 549-551 (2012) (collecting news sources of criticisms of Jamie Dimon’s position on the board of directors of the Federal Reserve Bank of New York).

¹⁰⁷ Carpenter, Detecting and Measuring Capture 3-4.

¹⁰⁸ *Id.* at 2.

¹⁰⁹ For specific work on the capture at the Fed, see Simon Johnson, *The Quiet Coup*, THE ATLANTIC, May 2009, <http://www.methatlantic.com/magazine/archive/2009/05/the-quiet-coup/7364>; James Kwak, Cultural Capture and the Financial Crisis, in Preventing Capture: Special Interest Influence and How to Limit It (Daniel Carpenter & David Moss eds., forthcoming 2013). See also David Freeman Engstrom, *Corralling Capture*, 36 HARV. J. L. PUB. POL’Y 31 (2013).

¹¹⁰ For the last, see Daron Acemoglu, Simon Johnson, Amir Kermani, James Kwak, and Todd Mitton, *The Value of Connections in Turbulent Times: Evidence from the United States*, available at <http://www.econ.northwestern.edu/seminars/Nemmers13/Johnson.pdf> (measuring the value to firms affiliated, through the New York Fed and through common nonprofit board memberships, with New York Fed President and Treasury Secretary designee Tim Geithner.).

The point, again, is that capture represents an environmental magnification of the legal proximity that the banks already experience with the Fed through the Reserve Banks.

3. Political Power of the Reserve Banks

The last environmental mechanism of Fed-bank dependence may also be the most important in terms of the Fed's own ability to sustain its unique structure. While the boards of directors of the Reserve Banks play mostly a selection role that is itself checked by Board approval of their choices, they have been astonishingly successful in deploying of political resources to preserve themselves. There is much about the Reserve Bank System that is anachronistic yet persistent. The former role of providing, with haste and in armored cars, the currency needed to stave off bank runs is no longer necessary in a world of FDIC insurance and, more importantly, electronic transfers.¹¹¹ And the very locations of the twelve reserve banks reflect political compromises concerning an America that no longer exists: a new Reserve System with twelve banks created in 2013 would certainly include New York, Chicago, and San Francisco; would probably include Philadelphia, Boston, and Atlanta; might include Minneapolis, Dallas, and St. Louis; and would probably not include Cleveland, Kansas City, and Richmond.

And yet the Reserve System as constituted in 1913 persists. Whatever else may influence that persistence, the presence of teams of prominent Reserve Bank Presidents and directors who can influence legislation when the Reserve System is challenged can be the System's ace in the hole. This was certainly the case in the recent lead-up to Dodd-Frank. Senator Dodd sought to remove bank supervision from the purview of the Reserve Banks.¹¹² The Board of Governors was indifferent.¹¹³ But in time, the effect of the Reserve Banks—and the banks they regulated—made their presence felt. The final version of the bill, while it limited some of the Fed's authority to make emergency lending decisions,¹¹⁴ left the bailiwicks of the Reserve Banks in tact while it massively expanded the authority of the Board of Governors.¹¹⁵

Of course, the power of the banks, through the Reserve Banks is not absolute. As noted above, the Banking Act of 1935 dramatically restricted the role that the Reserve Banks played previously.¹¹⁶ That political power is, however, one of the environmental mechanisms of the Fed's independence—or perhaps better, dependence—on the banks it regulates.

¹¹¹ See ECCLES, *supra* note 62 at 60-75 for an illustrative example of this version of the Federal Reserve Banks.

¹¹² See IRWIN, *supra* note 218 at 192-197 for the full account of the Reserve Banks' lobbying effort, including via the deployment of the member banks.

¹¹³ Id.

¹¹⁴ Id.

¹¹⁵ Id.

¹¹⁶ See notes 81-201, *infra*, and accompanying text.

C. Conclusion

Bank participation is at the core of the Compromise of 1913. They are an essential audience for understanding how Fed independence functions, and how it evolves. Legally, private banks are granted direct access to their regulators by owning stock in the Reserve Banks, filling one third of the board seats, and selecting another third of the directors. There is nothing like this arrangement in the government as a matter of legal structure. The environmental mechanisms of Fed-bank interaction magnify that proximity. The extent of that magnification is the question. More descriptive and empirical work is needed to assess the environmental consequences of that legal proximity.

III. THE PRESIDENT AND THE FED

Part III now turns to the traditionally primary point of reference in evaluating Fed independence, the relationship between the Fed and the President and Secretary of the Treasury. Part III.A. evaluates the nature of the relationship between the President and the Fed Chair. Part III.B. then addresses the role of the non-Chair Governors of the Board, and again flags a misunderstanding about the relationship between legal and environmental mechanisms: while the Governors have extraordinary fourteen-year terms meant to protect independence and stagger appointments across a Presidential Administration, the practice of Board service is different. Governors almost never serve their full terms, and because the President fills appointments when they become vacant, Presidents have routinely had the ability to fill the Board.

Part III.C. briefly addresses the unique relationship between the Fed and the Treasury, including with a recitation of one of the most important episodes in the Fed's history, the Fed-Treasury Accord of 1951 that liberated the Fed from its role in managing the process and interest rates for the public debt.

A. Chair-President Independence

1. Legal Mechanism of Independence: Removability of the Chair

Given the hallmark of independence that removability has become, it is perhaps remarkable that the Federal Reserve Act is silent on the question of Chair removability. Vermeule concludes from this silence that a "convention" of for-cause removability must be inferred in light of the conventions of Fed independence generally.¹¹⁷ But even if a court were to read for-cause removability into the statute, it would only show the narrowness of the removability lens. Whether the Chair is legally removable—here, not in the sense of designated by statute, but in the sense that the President's removal could result in court sanction—is something of a sideshow and is only partially relevant to the question whether

¹¹⁷ Vermeule, *supra* note 6 at 3.

the Chair is in fact independent. This is true for three reasons.

First, even on its own terms, it is not entirely accurate to claim the statute puts no condition on the Chair's removal: the Chair, in his role as a member of the Board of Governors, is removable only "for cause."¹¹⁸ Vermeule rightly argues that the Chair is far more important than the other Governors, and provides evidence from the legislative history of the 1935 Act bearing on the question. But the nature of the Chair's participation on the Board is, as Vermeule, more complicated than, say, an SEC Commissioner without the statutory removability protection. The Fed Chair serves simultaneously two very different terms: four-year renewable terms as Chair, and a fourteen-year (partially) non-renewable term as Governor. That interaction is different from other agencies, such as the FCC, FEC, and SEC, and it matters for understanding how the removability restriction for the Governor affects the Chair's independence.

Second, while it's accurate to say, as Vermeule does, that "no President has ever formally discharged the Fed Chair,"¹¹⁹ the history of Chair removal is more complicated than that. That is, the President has never written a letter to a Fed Chair terminating his employment of the kind that prompted litigation in *Humphrey's Executor v. United States*, where President Roosevelt made that demand on a Commissioner of the Federal Trade Commission.¹²⁰ But three Chairs in the modern era have functionally been removed from their positions as Chairs before the end of their fourteen-year terms as Governors. Two of those were removed before the conclusion of their four-year terms as Chairs.

The first is Marriner Eccles, the Father of the modern Fed, appointed to the Chair by Roosevelt in 1934 immediately prior to the Fed's 1935 reorganization. But when he was up for reappointment as Chair under President Truman, the President refused, contrary to Eccles's wishes.¹²¹ Eccles chalked up the denial of reappointment to his taking too hard a stand on a banking enforcement in California,¹²² but Truman's Secretary of the Treasury thought Eccles too independent of the President on monetary policy.¹²³ But unlike subsequent Chairs Burns¹²⁴ and Volcker not reappointed as Chairs when their terms of Governor

¹¹⁸ 12 U.S.C. § 242. Vermeule makes this point, too. Vermeule, *supra* note 6.

¹¹⁹ Vermeule, *supra* note 6.

¹²⁰ 295 U.S. 602, 629-30 (1935).

¹²¹ Truman initially proposed making Eccles Vice Chair of the Board of Governors, an offer the independently wealthy and sometimes acerbic Eccles surprisingly accepted. When Truman refused to publicly acknowledge that offer, Eccles withdrew the offer in a pointed letter to the President. ECCLES, *supra* note 62 at 439-40. Truman's offer may well have been a gesture, and their correspondence does suggest that Eccles felt it important that the Chair serve at the pleasure of the President.

¹²² *Id.* at 443-47.

¹²³ KETTL, *supra* note 2 at 63.

¹²⁴ According to Meltzer, "Burns tried hard to get reappointed. He wanted to be reappointed by a Democrat, perhaps to remove the charge that he had used monetary policy to reelect President Nixon. When Hubert Humphrey, a friend of Vice President Walter Mondale's, made a very critical speech about Burns's policy, he recognized that he would be replaced." ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE, VOL. 2 BOOK 2 923 (2012).

would have permitted reappointment, Eccles stayed on the board, and continued to make his influence felt on some of the highest profile decisions in the Fed's history.¹²⁵

Thomas McCabe, Eccles's successor, also provides an important counter example. Because of his role in the Fed-Treasury Accord that Truman had opposed, he felt pushed out—before his four-year term had ended—and resigned, paving the way for William McChesney Martin, then an official in Truman's Treasury Department.¹²⁶

The third Chair to be “removed” was William Miller, Carter’s choice for Chair. He was removed after one year for what was widely viewed as incompetence.¹²⁷ In what may well be unique in the annals of executive appointment, Miller’s removal was not to the ignominy of the non-government sector, but to his place as Secretary of the Treasury. To be sure, it’s difficult to call the appointment as the President’s spokesman for the Administration’s economic policies a “removal,” but the episode has led several to reach this very conclusion.¹²⁸

Third, the argument that the Chair is protected from removability fails as a matter of logic for the same reason that the equation of removability restriction and agency independence fails. Vermeule argues that the statutory silence on Chair removability is “contrary to widespread belief”; that is, that there is a widespread belief that the President can only remove the Fed Chair for cause.¹²⁹ The basis of this conclusion is unclear. The point may be that there is a widespread belief that the Board is an independent agency, or even the most independent of agencies. This conclusion certainly appears true: economists do not acronymize SEC or FCC independence in the way they do CBI. But, as this article has argued at length, the independence of the Federal Reserve is about much more than the removability-and-President focus of the agency independence model, and while economists certainly focus on the legal mechanisms of that independence, no model of CBI has ever focused exclusively on removability. Thus, Vermeule’s characterization of the removability of the Chair indulges in the same shorthand that he later challenges.

In this sense, the argument that the statutory silence on the Chair’s removability means that there is an implied restriction comes close to committing the logical fallacy of destroying the exception. One version of the flawed argument goes like this: The formal definition of agency independence means that an agency is only independent if the agency head is removable for cause only. Everyone understands the Fed to be an independent agency, probably the most independent of agencies. The Federal Reserve Act is silent as to the removability of the Chair of the Federal Reserve. Ergo, there is widespread acceptance of a con-

¹²⁵ This included the period of the Fed-Treasury Accord, discussed in more detail below. See KETTL, *supra* note 2 at 66-69.

¹²⁶ CLIFFORD, *supra* note 84; KETTL, *supra* note 2.

¹²⁷ KETTL, *supra* note 2.

¹²⁸ KETTL, *supra* note 2.

¹²⁹ Vermeule, *supra* note 6 at 3, 5, 10.

vention of independence for the non-removability of the Chair.

The premises are correct; the conclusion is flawed. The more accurate reconciliation of the conflicting premises—the formal definition of agency independence and the fact of Fed independence notwithstanding the statutory silence on removability—is that the formal definition is implausibly narrow. Vermeule endorses that conclusion elsewhere in his article; this article adopts the same conclusion. It does not share the conclusion that the Chair must be rendered non-removable in order to reconcile the conflicting premises. The legal and environmental independence of the Fed illustrate just how difficult it is to speak in the terms of “widespread belief” about *specific* mechanisms of independence.

The open question of the Chair’s removability is an interesting, but relatively minor question in assessing the Chair’s independence from the President. The political costs associated with such a challenge will only arise at a time when a President deems the Chair’s actions sufficiently noxious to warrant removal. If that situation arises, the Chair may recognize it and step aside, as did McCabe. He may acquiesce to the removal as Chair but stay as an Administration antagonist on the Board, as did Eccles.¹³⁰ The President may also provide the cover of appointment to another office, as may have been the case with Miller. But as a matter of structure, history, and logic, the presumption that there necessarily exists a convention of non-removability is inaccurate.

The Chair’s vulnerability to at-will removal, then, only exposes the debility of Chair removability as a metonym for agency independence.

2. Environmental Mechanism of Chair-President Independence: Chair Reappointment

Even assuming the President has the authority to remove a Governor from the Chair, one reason the President may be reluctant to exercise that authority is the expectation that a sitting Chair is a candidate, if not the leading candidate, for reappointment, even if his initial appointment was by the sitting President’s political opponent. Because of the nature of past resignations and the interaction with between the Chair’s four-year term and the fourteen-year term of the Governor who occupies the Chair, the current result is a President who nominates the Chair roughly half-way through the President’s term. This is not a statutory requirement: indeed, a recurring proposed change to the Federal Reserve Act would render the term of the Chair coterminous with the President’s own Administration.¹³¹ This proposal has failed to carry the day, and one President therefore chooses his successor’s Fed Chair.

¹³⁰ Again, Eccles wasn’t removed, only not renominated.

¹³¹ For an early version of this proposal, see Commission on the Organization of the Executive Branch of the Government, Task Force Report on Regulatory Commissions, Appendix N (Washington, DC 1949) 109-11. For something more recent example, see H.R. 1498, Federal Reserve Reform Act of 1995, 104th Cong. (1995).

One might expect, then, that the staggered terms of President and Fed Chair would render the Chair even more independent of the President, since his re-nomination is in the hands of a potential successor. There is much to be said for that view of the independent Chair. But there are several conventions—aside from the statutory silence on the Chair’s removability—that make the Chair’s renewable four-year term *more* dependent on the President, not less. First, a Chair interested in retaining the position may either seek to curry favor with the sitting President, or establish a relationship sufficient to render the non-renewal of that Chair politically costly.¹³² The most obvious mechanism to accomplish the first is to pursue an accommodative monetary policy to eliminate recessionary concerns from the election. There is indeed evidence of this phenomenon.¹³³ And in other cases, a Chair post-election has changed his views throughout his tenure to accommodate those of the Administration. William McChesney Martin, Fed Chair from 1951 through 1970 during the administrations of five presidents is the best example here.¹³⁴

But there are also examples of the Chair with an independent power base. President Reagan was disinclined to renominate Paul Volcker as Chair in 1983, but felt that the inflationary signal of non-appointment made reappointment a political necessity.¹³⁵ President Clinton’s reappointment of Alan Greenspan—despite the latter’s credentials as a leading Ayn Randian libertarian¹³⁶—was also influenced by Greenspan’s then-extraordinary reputation that might have made his non-renewal politically costly to Clinton.¹³⁷

It is difficult to determine with certainty whether past Chairs appointed across Administrations facilitated their appointments either through accommodative monetary policy or the development of an independent political base. But it is telling that of the eight Chairs of the Board of Governors since the position was created in 1935, five were appointed by a successive Administration. And four of the five were reappointed by a successor President of a different party—Martin appointed by President Truman, reappointed by Presidents Eisenhower (twice), Kennedy, and Johnson; Volcker, appointed by President Carter and re-appointed by President Reagan; Greenspan, appointed by President Reagan, re-appointed by Presidents George H.W. Bush, Clinton (twice), and George W. Bush; and Bernanke, appointed by President George W. Bush, reappointed by President Obama.

¹³² The President may also, of course, view the sitting Chair as the best person to fill the position, independent of an exchange of favors or without reference to the political costs for non-renewal.

¹³³ See, e.g., Kevin B. Grier, *Presidential Elections and Federal Reserve Policy: An Empirical Test*, 54 SOUTHERN ECONOMIC JOURNAL (1987).

¹³⁴ Christina D. Romer and David H. Romer, *Choosing the Federal Reserve Chair: Lessons from History*, 18 J. EC. PERSPECTIVES 129, 133-34 (2004)

¹³⁵ William L. Silber, Volcker: The Triumph of Persistence 232-35 (2012)

¹³⁶ See GREENSPAN, *supra* note 62 at 51-53.

¹³⁷ Bob Woodward, *Maestro: Greenspan’s Fed and the American Boom* (2000).

3. Environmental Mechanism of Chair-President Independence:
Chair as Fed Metonym

There also exists an extra-statutory poplar equivalence of the Fed Chair with the entire System that makes his status even more protected vis-à-vis the President. The foregoing discussion of the Chair's relationship to the President tells us about the Chair's independence, not Fed independence. But with respect to Fed independence from the President, the independence of the Fed Chair is essentially the entire ballgame. Although there is very little in the Federal Reserve Act that gives the Chair any independent authority, and his vote on the Board and the FOMC suggests he would be more like a Chief Justice than a Chief Executive, the practice of monetary policy and broad public perception focuses almost entirely on the independent authority of the Chair. Consider a test, without looking at the footnotes: any reader who has made it this far almost certainly knows that the current Fed Chair is Ben Bernanke, and can probably name at least Bernanke's two immediate predecessors.¹³⁸ But who is the Vice Chair of the Board of Governors?¹³⁹ Who was the previous Vice Chair?¹⁴⁰ Who is the Vice Chair for Regulation?¹⁴¹ The Vice Chair of the FOMC?¹⁴² And who, after Chair Bernanke and the present Vice Chair, are the remaining five governors?¹⁴³ These individuals are virtually unknown among the general public. Bob Woodward has put a finer point on it: The Chair of the Fed is an A-list political celebrity; at best, the Vice Chair is "B-list"; the other Governors are C-List, "anonymous politically and socially."¹⁴⁴

This equation of the Chair with the Fed has led one scholar to conclude that "the Fed's history—and the growth of its power—is largely the product of the leadership of its Chairmen."¹⁴⁵ But the public face of the Federal Reserve is only one small part of that dynamic. Unlike, the Supreme Court for example, there is not a tradition of the Chair losing a majority of the vote on the Board of Governors or the FOMC. While some members of the latter Committee have issued dissenting statements from FOMC policy decisions,¹⁴⁶ there are very few instances.

¹³⁸ Alan Greenspan and Paul Volcker.

¹³⁹ Janet Yellen.

¹⁴⁰ Donald Kohn.

¹⁴¹ This is a trick question: while the Dodd-Frank Act created the position in 2010, the President has not yet nominated anyone for the post.

¹⁴² New York Fed President William Dudley.

¹⁴³ In order of appointment, Elizabeth Duke, Daniel Tarullo, Sarah Bloom Raskin, Jerome Powell, and Jeremy Stein.

¹⁴⁴ WOODWARD, *supra* note 137 at 126.

¹⁴⁵ KETTL, *supra* note 2 at xi.

¹⁴⁶ For a recent, high-profile example, see Jeffrey Lacker, *Richmond Fed President Lacker Comments on FOMC Dissent*, December 14, 2012, available at http://www.richmondfed.org/press_room/press_releases/about_us/2012/fomc_dissenting_vote_20121214.cfm. For an academic analysis of this phenomenon, see Susan Belden, *Policy Preferences of FOMC Members as Revealed by Dissenting Votes*, 21 J. of Money, Credit & Banking 432 (1989).

es where the Chair is in dissent.¹⁴⁷ Not only, then, is the Chair the popular equivalent of the System, he is also the policy equivalent.

Exactly how that unanimity or near unanimity arose in practice is unclear.¹⁴⁸ But that convention does render the Board susceptible to the pressures of the Chair; in many senses, Board independence of the President and Chair independence of the President may be one in the same.

4. Environmental Mechanism of Fed Independence: Appearance of Independence

Finally, the informal appearances of independence from the President are an important part of the role, and depend entirely on the personalities of the President, Chair, and—to a lesser extent—the Secretary of the Treasury. For example, keeping up the appearance of Fed independence, whatever the legal mechanisms, were obsessions of Chairs William McChesney Martin,¹⁴⁹ Paul Volcker,¹⁵⁰ and Alan Greenspan¹⁵¹ seemed constantly preoccupied by the maintenance of this informal independence. And the tenure of Nixon/Ford Era Chair Arthur Burns is widely regarded as a failure in large part because of his proximity to the President. First reported in 1974,¹⁵² the recently published Burns diaries are filled with references to a close personal and emotional proximity between Burns and Nixon that raise modern eyebrows about that relationship. A few examples illustrate the point. Nixon told Burns about his appointment of prominent Democrat John Connolly as Secretary of Treasury before announcing it publicly, and then told Burns that Connolly—a politician, not an economist or businessman—would learn the ropes of his new position from Burns.¹⁵³ Burns attended cabinet meetings;¹⁵⁴ had his speeches vetted by Nixon's staff;¹⁵⁵ cleared his talking points with the President ahead of a meeting with other central bankers in Basel, Switzerland;¹⁵⁶ advised Nixon on tax, wage, and other fiscal policy;¹⁵⁷ made pledges to

¹⁴⁷ Few, to be sure, but this is not unheard of. For example, Chair William Miller reportedly lost the support of his Board, see MELTZER, *supra* note 124. On non-monetary policy, for example, Chair Paul Volcker voted in the minority in approving a merger in 1987. See SILBER, *supra* note 135.

¹⁴⁸ MELTZER, *supra* note 30 at 75-82.

¹⁴⁹ See, e.g., Robert P. Bremner, Chair of the Fed: William McChesney Martin, Jr., and the Creation of the Modern American Financial System 1, 2, 90, 116, 117, 151, 160, 180 (2004).

¹⁵⁰ SILBER, *supra* note 150, at 191-95, 266-67.

¹⁵¹ Greenspan, *supra* note 62 at 142, 146, 153, 293, 478, 479 (2007).

¹⁵² KETTL, *supra* note 2.

¹⁵³ Arthur F. Burns, Inside the Nixon Administration: The Secret Diary of Arthur Burns, 1969-1974 31 (ed. 2010).

¹⁵⁴ *Id.* at 32.

¹⁵⁵ *Id.* at 34.

¹⁵⁶ *Id.* at 40.

¹⁵⁷ *Id.* at 45, 49.

remain the President’s “true friend” on economic policies before the public;¹⁵⁸ and more.¹⁵⁹

Perhaps in part following the anti-example of Burns, Chair have appropriately sought to maintain their distance from the environmental pull of the office of the Presidency. But it remains an active dynamic, and no assessment of Fed-Chair independence is complete without analysis of the specific relationship and the specific personalities that inhere in each.

5. Conclusion

The net effect for the Chair is impossible to predict because it depends entirely on the personalities of the individuals who occupy the offices. While the legal mechanisms of reappointment across Administrations presents an opportunity for either cultivating the President or challenging him, how that dynamic will play out in practice will depend on those individuals. The open question—and this article maintains that the question remains entirely open—is whether the President can legally remove without restriction the Chair *qua* Chair. But however interesting as a matter of administrative law, the impact of that exact mechanism is far less important than the other legal and environmental mechanisms that regulate the Chair’s relationship with the President.

B. *Governor-President Independence*

While the Chair is perceived in substance and form as the power behind the System generally, the presence of the other Governors, and the legal and environmental mechanisms that support their independence from the President, are worth highlighting. Here, the legal protection of a non-renewable term and the convention of significantly shorter tenure are at cross purposes. The net effect is that each President since the Fed’s 1935 reorganization has chosen his Board.

¹⁵⁸ *Id.* at 47.

¹⁵⁹ Burns’s seven-point list of pledges he delivered to Nixon is worth quoting at length: “I informed the President as follows: (1) that his friendship was one of the three that has counted most in my life and that I wanted to keep it if I possibly could; (2) that I took the present post to repay the debt of an immigrant boy to nation that had given him the opportunity to develop and use his brains constructively; (3) that there was never the slightest conflict between doing what was right for the economy and my doing what served the political interests of RN; (4) that if a conflict ever arose between these objectives, I would not lose a minute in informing RN and seeking a solution together; (5) that the sniping in the press that the WH staff was engaged in had not the slightest influence on Fed policy, since I will be moved only by evidence that what the Fed is doing is not serving the nation’s best interests; (6) that the WH staff had created an atmosphere of confrontation which led to the exaggeration of said differences about economy policy as may exist between the Fed and the Administration; that (7) squabbling or the appearance of squabbling among high government officers could lead to a weakening of confidence in government policy and thereby injure the prospects of economy improvement.” *Id.* at 39.

1. Legal and Environmental Mechanisms: The Myth of the 14-Year Term

By statute, each member of the Board of Governors is appointed for one non-renewable term of fourteen years.¹⁶⁰ This is one of the longest terms of service in the federal government. Scholars have long discussed the Fed Governors' lengthy tenure, usually uncritically for the propositions that, first, the fourteen-year term is "staggered"¹⁶¹ such that the President cannot immediately stack the Board in his favor; or, second, that the term represents a "term of office for each member . . . made long enough . . . to prevent day-to-day political pressures from influencing the formulation of monetary policy."¹⁶² But an environmental mechanism of a tradition of early resignation makes this legal mechanism less important than it seems. Excluding the Chairs, the average term of the governors since the Board was constituted in 1935¹⁶³ is just over six years, well within the mainstream of independent agencies.¹⁶⁴ Including the Chairs, the figure is just under seven years. Indeed, it appears that only one non-Chair governor in the history of the Federal Reserve served a full 14 year term,¹⁶⁵ although two others served portions of two terms totaling fourteen years or more.¹⁶⁶

The non-renewable fourteen-year term is meant not only to insulate the Governors from the need to curry favor with the President—a principle undermined by the ability to serve unexpired terms—it is also meant to limit the President's ability to overrun the board. The fourteen-year term was not arbitrarily decided: it corresponds to the seven members of the Board of Governors, just as the ten-year term corresponded to the five-member Federal Reserve Board prior to the 1935 reorganization. The idea is that each President should get but two appointments to the Board during a four-year administration. So much is suggested by the statute itself. Section 10 of the Federal Reserve Act instructed the President, in 1935, to "fix the term of the successor to such member [as served as a member of the Federal Reserve Board, rendered defunct by the 1935 Act] at not to exceed fourteen years, as designated by the President at the time of nomination, but in such manner as to provide for the expiration of the term of not

¹⁶⁰ 12 U.S.C. § 241 (2006).

¹⁶¹ Bressman and Thompson, *supra* note 5 at 607-608.

¹⁶² Jorge J. Pozo, *Bank Holiday: The Constitutionality of President Mahuad's Freezing of Accounts and the Closing of Ecuador's Banks*, 15 N.Y. INT'L L. REV. 61, 90 (2002). See also, e.g., Barlow, *supra* note 6 at 24; Bernstein, *supra* note 4 at 148 n.182.

¹⁶³ Under the original Federal Reserve Act of 1913, the Board of Governors in Washington was called the Federal Reserve Board. It was chaired by the Secretary of the Treasury, and the Comptroller of the Currency was an ex officio member. The other members of the Board could serve for ten years. See Federal Reserve Act § 10 (1913). Because of this change in the Board's structure and term, I use only governors who have served since 1935.

¹⁶⁴ See Membership of the Board of Governors of the Federal Reserve System, 1914-present, available at <http://www.federalreserve.gov/bios/boardmembership.htm>.

¹⁶⁵ George W. Mitchell served from 1961 through 1976. *Id.*

¹⁶⁶ Edward W. Kelley, Jr., served between 1987 and 2001; J.L. Robertson served from 1952 to 1973. *Id.*

more than one member in any two-year period.”¹⁶⁷

Table 2 shows how, in practice, a convention of frequent resignations has made this legal mechanism of independence effectively inert.

Table 2: Presidential Appointments to the Board of Governors, 1935-2013¹⁶⁸

President	Years in Office	Number of Governor Appointments	Appointments Per Year
Roosevelt	9.7	10	1.0
Truman	7.8	9	1.2
Eisenhower	8	7	0.9
Kennedy	2.8	1	0.4
Johnson	5.2	6	1.2
Nixon	5.6	5	0.9
Ford	2.4	5	2.1
Carter	4	6	1.5
Reagan	8	8	1.0
GHW Bush	4	5	1.2
Clinton	8	6	0.8
GW Bush	8	8	1.0
Obama	3.3	4	1.2

Under a staggered-term theory of the Board of Governors, the number in the column to the furthest right should be 0.5 (an appointment every two years). As Table 2 illustrates, only President Kennedy’s appointment control over the Board met that standard. Although the legal mechanism was designed to prevent Presidential control of Governor appointments, the practice of frequent resignations has undermined that check completely.

The decision not to serve a full term is all the more surprising in consideration of the statutory incentive to serve the full term: Governors are precluded “during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank.”¹⁶⁹ But there is a proviso: “except that this restriction shall not apply to a member who has served the full term for which he was appointed.”¹⁷⁰ The opportunities to translate the benefits of Board

¹⁶⁷ 12 U.S.C. § 242. Emphasis added.

¹⁶⁸ Source: *Membership*, *supra* note 164. Presidential Administrations calculated to the month, with President Obama’s administration ending in May 2012 (the date of his most recent Board appointment). Roosevelt’s Presidency is dated from the signing of the Banking Act of 1935. Governors who filled partial terms and were then reappointed, where another nominee might have taken her place, are treated as two appointments.

¹⁶⁹ 12 U.S.C. § 242.

¹⁷⁰ *Id.*

service to personal rewards in the banking sector are probably significant. And yet, Governors much more often than not end their terms early.

2. Net Effect

The consequence here is that the extraordinary legal mechanism—a term of service that is more than double the norm for other independent commissions—is undermined completely by the practice of frequent resignation. Presidents can pick their Boards because Governors do not stay their term.¹⁷¹ Whether because the anonymity of the “C-list political celebrity” or the lack of authority relative to the Chair, the reason is unclear.

C. *Independence from the Treasury*

As mentioned above, the standard story of central bank independence refers to the temptation for the political branches—usually the executive—to inflate the currency in order to buy prosperity.¹⁷² Thus, when defenders talk of the importance of central bank independence, they usually refer to government’s temptation to monetize the public debt. This speaks directly to the relationship between the Treasury (the entity responsible for the maintenance of the public debt) and the central bank (the entity responsible for the nation’s currency). The Fed’s relationship with the Treasury is thus an important one, and indeed, could and perhaps should take its place on equal footing with the other audiences to which the Fed caters.¹⁷³ And it is an important history, the consequence of which is that Fed-Treasury interactions are governed almost exclusively by a strong, proud sixty-year tradition, but almost nothing in law.

1. Legal Independence

Almost nothing in law. The exception here is the absence of a legal mechanism of accountability rather than the presence of a legal mechanism of independence. Under the original 1913 Act, the Secretary of the Treasury was the Chairman of the Federal Reserve Board. His presence was viewed as the means by which the Fed would be accountable to the people, and was widely opposed by the Republicans who refused to support the statute in 1913. The critics feared that the Secretary would so dominate the Fed’s affairs as to render it not

¹⁷¹ This does not mean that the Fed will always get his first choice for those slots. President Obama nominated Peter Diamond for an open spot on the Board, but Diamond was deemed unqualified by Republicans opposed to the nomination. Diamond won the Nobel Prize while his nomination was pending. See Peter A. Diamond, *When a Nobel Prize Isn’t Enough*, NY TIMES, June 5, 2011.

¹⁷² See BERNHARD, *supra* note 57; LASTRA, BANKING REGULATION *supra* note 4; Miller, *supra* note 4.

¹⁷³ Fed Chair Arthur Burns’s diaries are filled with his differing loyalties between the Treasury Secretaries and President Nixon. See, e.g., BURNS, *supra* note 153 at 32 (ed. 2010).

only accountable, but subordinate to the government. Carter Glass, uniquely situated as the author of the House version of the bill and later President Wilson's Secretary of the Treasury, agreed much later that the Secretary's inclusion led to this result. In 1935, the Secretary was eliminated from the Board. The absence of that statutory mechanism of control therefore became a legal mechanism of independence.

2. Environmental Independence

But the story of the Fed's relationship with Treasury did not end in 1935 with the Secretary's elimination from the Board. Instead, that relationship became dominated by non-statutory mechanisms. Under the identical statutory structure presently in place, the Federal Reserve, during World War II, was entirely subordinate to the Treasury.¹⁷⁴ But in 1951, the Treasury granted the Fed its independence. The so-called Treasury-Fed Accord of 1951 consists of a single, characteristically (for the time and for many decades thereafter) opaque paragraph inserted into the Federal Reserve Bulletin buried between announcements of federal debt issuances:

The Treasury and the Federal Reserve System have reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt.¹⁷⁵

Even a reasonably well informed citizen of the day would likely not have recognized the extraordinary import of this dense sentence. But this sentence forms the basis of the Fed's continued independence from Treasury. The important aspect of this separation from the Treasury/President is that it is purely conventional. With all the care devoted to the legal mechanisms of independence to separate the Fed from the President—length of tenure, size of the Board, non-appointment of 5/12 of the FOMC, the essence of the Compromise of 1913—the liberation of a subordinated monetary policy occurred by virtue of a handshake and an opaque sentence included in the Federal Reserve Bulletin.

The relationship between the Secretary of the Treasury and the Chair is an important one for the pursuit of coherent national economic policies. But because the interactions between the two are governed entirely outside of the legal framework, the extent of Treasury influence over Fed policy is dependent on tra-

¹⁷⁴ For a detailed history of this period, see MELTZER, HISTORY OF THE FEDERAL RESERVE, VOLUME 2 BK 1at 579-725. See also KETTL, *supra* note 2; CLIFFORD, *supra* note 84. For a briefer treatment, see Robert L. Hertzel and Ralph F. Leach, *The Treasury-Fed Accord: A New Narrative Account*, 87 FED. RES. BANK OF RICHMOND EC. Q. 33 (2001).

¹⁷⁵ 37 FED. RES. BULL. 267 (1951). For a fuller contemporaneous discussion of the Accord, see the Fed's Annual Report of 1951, 98-101.

ditions of independence post-1951, and on the personal relationship between the two individuals who occupy that space. For example, some have questioned the Bernanke Fed's independence, in light of the close presumed connection between Bernanke and Treasury Secretary Timothy Geithner.¹⁷⁶ The net effect in this context, as with the Chair's relationship with the President, is that personalities matter much more than law.

D. Conclusion

As mentioned, the President has long been the primary focus for previous analyses of agency independence generally and central bank independence specifically. Part III has shown that this view is not without justification: the ways in which the Fed has and can interact with the President are sundry, some of which involve law, some convention and environment, and some a combination.

What do the Chair's frequent and across-Administration renewability, the President's ability to choose his Board through frequent Governor resignation, and the fragile relationship between the Fed and Treasury all mean for the Fed's relationship with the President? Only that Fed independence is a constantly evolving, and evolvable, phenomenon. As in the case of the Fed's relationship with the Treasury, it took no legislative enactment to render the Fed completely subservient to the Treasury's debt monetization, nor to liberate the Fed from that subordination thereafter. Those who would influence the Fed's independence from the President, in either direction, can do so outside of the legal mechanisms specified by statute. Thus, when discussions focus on Fed independence or accountability—from the President will frequently and erroneously be assumed to be the sole audience in this calculus—something more is needed. Proposals to adjust that independence should be mindful of legal and environmental mechanisms and the net effect that the interaction of these will create.

IV. CONGRESS AND THE FED

Scholars have described to some extent Congress's relationship to the Fed,¹⁷⁷ but one of the primary means of Congressional control over agencies—the power of the purse—represents a unique and unacknowledged absence in the case of the Congress's relationship with the Fed. Part IV discusses the Fed's budgetary independence: its ability to fund itself from the proceeds of open market operations that it controls without interference from the political branches. This is a feature that has been widely cited as a defining characteristic of Fed independence, but whose nature scholars have mislabeled or incorrectly analyzed every time it

¹⁷⁶ See Rich Miller, Jeff Kearns & Ian Katz, *Lew for Geithner Switch Ends Era of Tight Fed Treasury Ties*, Bloomberg, Jan. 10, 2013.

¹⁷⁷ See Irwin Lester Morris, Congress, the President, and the Federal Reserve: The Politics of American Monetary Policy-Making (2000); John T. Woolley, Monetary Politics: The Federal Reserve and the Politics of Monetary Policy (1986).

has been addressed.

To be sure, there are other important legal and environmental mechanisms of Congressional interaction with the Fed that impinge the Fed's independence. The statutory discretion afforded the Fed regarding the Fed's dual mandate of price stability and maximum employment¹⁷⁸ and Congressional hearings¹⁷⁹ represent two additional features that should be analyzed within the audience-mechanism framework in future work. Part IV focuses extensively on the Fed's budgetary independence given its prominence in securing the Fed's independence from Congress and the mischaracterizations of that independence that have prevailed in legal scholarship to date.

A. Budgetary Independence

1. Structure of Fed Budgetary Independence

The Federal Reserve is the only truly autonomous budgetary entity in the entire federal government, including the Congress and the President.¹⁸⁰ To understand this dynamic, one must first understand how the rest of the federal government is funded, and compare it to the unique budgetary independence of the Federal Reserve.

There are three dominant forms of funding in government.¹⁸¹ First, the vast majority or governmental institutions—from the Congress to the Courts to the White House, and most agencies, institutions, programs, and commissions in between—is funded through Congress's annual appropriations process.

Second, the majority of actual government expenditures do not occur through this appropriation process, but instead are part of the government's mandatory commitments.¹⁸² These include entitlement programs such as Social Security, Medicare, Medicaid, and other forms of direct assistance; some kinds of disaster relief; and interest on the national debt. And third, some governmental agencies, including the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the now-defunct Office of Thrift Supervision, are funded through the fees assessed against their own regulated entities.

¹⁷⁸ For more on this topic generally, see John D. Huber & Charles R. Shipan, *Deliberate Discretion?: The Institutional Foundations of Bureaucratic Autonomy* (2002).

¹⁷⁹ For a quantitative textual analysis of Fed Chair testimony in Congressional hearings, see Cheryl Schonhardt-Bailey, *The Effect of Institutions and Norms on Monetary Policy Oversight: British and American Experiences During the Financial Crisis*, May 1, 2013, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2261836.

¹⁸⁰ Of course, the Congress could always legislate to create its own money; but then it would first have to legislate to create its own money. The Fed faces no such barrier.

¹⁸¹ For a thorough overview of these various types of funding structures, see Laurie Leader, *The Federal Bank Commission Act: A Proposal to Consolidate the Federal Banking Agencies*, 25 CLEV. ST. L. REV. 475, (1976).

¹⁸² These outlays are not truly mandatory, as Congress, of course, retains the ability to repeal them. The question is, instead, whether they must be reinitiated each year, as is the case with the rest of the federal budget.

And then there is the Fed. The Fed funds itself with a portion of the proceeds from its market operations. In the Fed's own words, from a recent budget report, "[t]he major sources of income were interest earnings from the portfolio of U.S. government securities and federal agency mortgage-backed securities in the System Open Market Account. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 2009, a total of \$47.4 billion."¹⁸³ The Fed also receives income for "priced services" provided to private banks, which include the cost of transporting and printing new currency, check clearing, and other services related to currency distribution and the general payment system.

Some scholars have supposed that the Fed, like some other banking regulators, funds itself through assessments on private banks.¹⁸⁴ While true that the Fed collects money from member banks for "charged services,"¹⁸⁵ such assessments, cover just 25% of its expenses.¹⁸⁶ The rest comes from the proceeds from its open market operations, described in more detail above.¹⁸⁷

That the Fed funds itself largely from the proceeds of its substantial assets, taken together with the nature of the Fed's ability to create money in pursuit of its monetary policy objectives, means that the Fed's funding is without parallel in the federal government. The Fed conducts monetary policy by, among other options, creating money with which it can buy government—and more recently, non-government¹⁸⁸—securities.¹⁸⁹ These interest-bearing assets that generate money that the agency can subsequently use to fund itself.¹⁹⁰ The Fed thus has the

¹⁸³ BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, ANNUAL REPORT: BUDGET REVIEW 1 (2010), available at http://www.federalreserve.gov/boarddocs/rptcongress/budgetrev10/ar_br10.pdf.

¹⁸⁴ See Barkow, *supra* note 6.

¹⁸⁵ BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, *supra* note 183, at 17.

¹⁸⁶ *Id.*

¹⁸⁷ See text accompanying notes 26 to 32, *infra*.

¹⁸⁸ See Statement Regarding Transactions in Agency Mortgage-Backed Securities and Treasury Securities, September 13, 2012 (available at http://www.newyorkfed.org/markets/opolicy/operating_policy_120913.html).

¹⁸⁹ See Federal Reserve: Purposes and Functions (2005).

¹⁹⁰ Chair Bernanke has contested a "money-printing" characterization of the Fed's monetary authority. See 60 Minutes Interview Transcript, December 6, 2010, CBSNews, available at http://www.cbsnews.com/8301-18560_162-7114229.html ("One myth that's out there is that what we're doing is printing money. We're not printing money. The amount of currency in circulation is not changing. The money supply is not changing in any significant way."). This is a factually accurate but conceptually misleading point aimed at controlling a debate not directly relevant to our discussion. Bernanke is of course correct that the Fed's monetary policy framework is based on extensions of bank reserves, not the increase of paper currency (unlike, say, the Reichsbank's stunning printing bonanza during the hyperinflation of the 1920s in Weimar Germany, see LIAQUAT AHAMED, LORDS OF FINANCE: THE BANKERS WHO BROKE THE WORLD 20-25 2009). Technically, then, the Fed isn't printing money at all, but filling the banking system with additional reserves, in return for which it receives income-generating bonds. The inflationary effects of these policies are hotly disputed, but that the Fed has the ability to create money with which it buys interest-bearing bonds is not a contested point. It can "print" the money it uses to implement its monetary policy decisions, and use the pro-

ability to create from nothing the money it eventually uses to pay its employees, funds its conferences, and renovate its buildings.

2. Statutory Basis for Fed Budgetary Independence

The Fed's budgetary independence is thus without equal in the federal government. But here is the striking reality about this independence: It is not expressly authorized by Congress. The Federal Reserve's funding mechanism is located in Section 10(3) of the Federal Reserve Act. That section grants the Board of Governors the

power to levy semiannually upon the Federal reserve banks in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment.¹⁹¹

Unquestionably, this statutory authorization exempts the Fed from the Congressional appropriations.¹⁹² But, on its face, it merely allows the Fed to make the Reserve Banks pay for its expenses, "in proportion to their capital stock and surplus."¹⁹³ It does not allow the Fed to create, and fund itself with, its own Federal Reserve notes.

To understand how this modest statutory authorization metamorphosed into the Fed's present and complete budgetary independence, one must understand more about the evolution of the Federal Reserve System over the past century. Three features are of particular importance: (1) the quasi-independence of the Reserve Banks, terminated in 1935 when monetary policy came under the exclusive purview of the newly forged Board of Governors, (2) the Fed's history with what was called the "real bills" doctrine, and (3) the Fed's history with the gold standard.

3. Quasi-Autonomy of the Federal Reserve Banks, 1914-1935

Part II discussed the way that the Compromise of 1913 tried to appease the bank and non-bank constituencies by rendering a System attentive to both banks

ceeds of those decisions to fund its budget.

¹⁹¹ 12 U.S.C. § 243.

¹⁹² See Cong. Budget Office, *The Budgetary Impact and Subsidy Costs of the Federal Reserve's Action During the Financial Crisis* 3 (2010) (noting that the Fed is not subject to the appropriations process and it is able to operate independently from government influence).

¹⁹³ Interestingly, this aspect of the statute may well be affirmatively inconsistent with the Fed's practice. The Federal Reserve Bank of New York is responsible for effecting the FOMC's monetary policy decisions. It is unclear from the annual report on whose balance sheet—whether the FRBNY's, or the Board's, or the twelve Reserve Banks equally—resides the proceeds of open market operations. Presumably, those proceeds either belong directly to the Board or are shared in proportion to the Reserve Banks' capital stock.

and the public. One of the consequences of that Compromise was that the Reserve Banks—not the Federal Reserve Board—was tasked with the conduct of what we now call monetary policy. The idea was that the System was a federalist one, with decentralized authority located in the Reserve Banks.

Carter Glass, a zealous guardian of the Compromise,¹⁹⁴ described the federal system in these terms:

In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries, there is no argument, either of banking theory or of expediency, which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted.¹⁹⁵

E.W. Kemmerer, an early observer of the creation of the Fed, called the arrangement of “twelve central banks with comparatively few branches instead of one central bank with many branches” the “most striking fact” about the System.¹⁹⁶ Glass shared the view of the Reserve System as a series of central banks; indeed, he did not view the Federal Reserve Board as in charge of the central banking aspects of the system at all.¹⁹⁷ In the words of the first Secretary of the Federal Reserve Board,

¹⁹⁴ Glass could get emotional about his attachment to the 1913 Federal Reserve System (and was deeply hostile to the Board of Governors-dominant model that replaced it in 1935). “Next to my own family,” he said, “the Federal Reserve System is nearest to my heart.” ARTHUR SCHLESINGER, THE AGE OF ROOSEVELT: THE POLITICS OF UPHEAVAL 296 (1960). He challenged those who would claim credit for its paternity. See CARTER GLASS, ADVENTURE IN CONSTRUCTIVE FINANCE 1-15, 37-58 (1927) (saying that President Wilson’s counselor wrote a “romance on the subject” of the Fed’s founding and called it “history”). Glass’s claims are entertaining but overblown. While his contribution is certain, the original Federal Reserve System was born of a compromise from ideas from Glass, Paul Warburg, Woodrow Wilson, Nelson Aldrich, and even William McAdoo and David Houston (the Secretaries of, respectively, Treasury and Agriculture in charge of selecting the locations of the twelve Reserve Banks). See Ron Chernow, *Father of the Fed*, Audacity, Fall 1993, 34-45. For a more thorough, still biased, still overwritten, but less entertaining account of the Fed’s founding, see Paul Warburg’s THE FEDERAL RESERVE SYSTEM (1930). These “paternity” disputes say nothing of the Fed’s refounding in 1935, the responsibility for which lies with Marriner Eccles. See Memo, Eccles to Roosevelt, November 3, 1934, OF 90, box 2, Franklin D. Roosevelt Library. (My thanks to Sergio Stone for locating a digital copy of this document.) By then Senator Glass was Eccles’ sensitive foe. For more on the politics of the 1935 Act, see KETTL, *supra* note 2 at 51; ECCLES, *supra* note 62 at 200-229, and CLIFFORD, *supra* note 84 at 242-45.

¹⁹⁵ Glass House Report, H.R. 7837, reported H. Rpt. 63-69 at 12 (1913).

¹⁹⁶ E.W. Kremmerer, *The Purposes of the Federal Reserve Act as Shown by Its Explicit Provisions*, 99 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 62, 64 (1922)

¹⁹⁷ KETTL, *supra* note 2 at 32. After the Federal Reserve Board took a stronger hand in setting discount rates in 1927, Glass sought to clamp down on the Board’s authority. For more about how these kinds of disputes between the Reserve Banks and the original Federal Reserve Board came about, see MELTZER, *supra* note 30 at 62-75; CLIFFORD, *supra* note 84 at 66-67.

The banks, in short, have all those banking powers that are not expressly mentioned in the Federal Reserve Act or directly implied as having been invested in the Federal Reserve Board. . . . There is nothing, either in the Federal Reserve Act or in the regulations of the Federal Reserve Board, to indicate that the reserve banks are to be operated in groups or through communication with one another, resulting in the establishment of a single policy as to detail. Neither is there any to prevent officers of the Federal Reserve Banks from communicating with one another, getting such information as can be exchanged by that means, or adopting their own policies as the circumstances and business needs of each district or of all appear to require.¹⁹⁸

In other words, the Reserve Banks, not the Federal Reserve Board, controlled the purse strings under the original Compromise.

The original assessment provision of the Federal Reserve Act—which is identical to the provision in place one hundred years later—thus functioned via a Federal Reserve Board without an open market operations policy and without member banks to provide a source of income.

The assessment function, then, was from the Reserve Banks' profits (including from the Banks' open market policies) to the Board, not the Board to the Reserve Banks. And even though the Federal Reserve Board participated to a limited extent in shaping the tenor of monetary policy, the reality is that the Reserve Banks could and did pursue their own monetary policy.¹⁹⁹

The era of autonomy for the Reserve Banks ended with the passage of the Bank Act of 1935, which placed the authority for open market operations of the individual banks into the Washington-based Board.²⁰⁰ The assessment provision, however, was unchanged.²⁰¹

¹⁹⁸ H. Parker Willis, *The Federal Reserve System* 128 (1915).

¹⁹⁹ MELTZER, HISTORY, 1913-1951 75-82 (2003). This open market autonomy led to some interesting natural experiments: for example, the state of Mississippi was divided between different reserve bank districts, one serviced by the Atlanta Fed, the other by the St. Louis Fed. During the banking crisis of 1930, the St. Louis Fed practiced the real bills doctrine, which prevented it from lending against anything but bills of trade; the Atlanta Fed practiced a more Bagehotian form of central banking. Richardson and Troost exploited that fact to show that the banks in the Atlanta district survived at a higher rate than those in the St. Louis district. William Troost and Gary Richardson, *Monetary Intervention Mitigated Banking Panics during the Great Depression: Quasi-Experimental Evidence from a Federal Reserve District Border, 1929–1933*, 117 J. OF POL. EC. 1031-73 (2009).

²⁰⁰ Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684.

²⁰¹ *Id.* An exception is the way in which the government treated the funds that came into the Reserve System, whether via assessment on member banks or from open market operations. In 1923, the Comptroller General of the United States determined, separate from a franchise tax, that the “funds collected by the Board by assessments on the Reserve Banks were public funds” subject to various restrictions and impositions. In 1933, however, Congress amended the statute to liberate the government claim on those funds completely. See HACKLEY, *supra* note 27 at 7-8.

During the entirety of that early period, though, the Federal Reserve Board could assess the Reserve Banks for its expenses, including by using income generated through open market operations. But the Federal Reserve Board could not dictate the outlines of those operations. There existed therefore a separation between the assessment authority and the operations authority. The Fed in this early stage could not create the money with which it funded itself. This change in what constituted the identity and function of the Reserve Banks illustrates how the statutory funding mechanism has not kept pace with U.S. central banking practice.

4. Open Market Operations Under the Gold Standard and Real Bills Doctrine

Even if monetary policy throughout the Fed's history had always been left to its discretion, the statutory authorization to levy assessments on the Reserve Banks would still be different from the authority the Board uses today. When the Act was passed, the United States was on the "gold standard," a concept that actually refers to a set of practices that essentially limits the central bank's discretion in pursuing a monetary policy.²⁰² Under that regime, neither the Board of Governors nor the original Reserve Banks had the unlimited power to create the money the Board would assess from the Reserve Banks, and from which it would pay its own expenses.

Thus, Congress's authorization to the Fed to levy assessments against the Reserve Banks under a gold-standard and real bills regime, when the Reserve Banks enjoyed autonomy to determine their own monetary policy, is radically different from the same authorization without those features. As one historian described it, the "automaticity" of the gold standard and the real bills doctrine "was expected to reduce the need for specific guidance by the government."²⁰³ Woodrow Wilson felt the same way:

Let bankers explain the technical features of the new system. Suffice it here to say that it provides a currency which expands as it is needed and contracts when it is not needed: a currency which comes into existence in response to the call of every man who can show a going business and a concrete basis for extending credit to him, however obscure or prominent he may be, however big or little his business transactions.²⁰⁴

Neither the gold standard nor the real bills doctrine survives today. While an important principle at the time, the real bills doctrine was not universally accepted, even during the Federal Reserve Board era. As Friedman and Schwartz indicate, "the real bills criterion . . . provided no effective limit to the amount of

²⁰² See Ben Bernanke, *The Federal Reserve and the Financial Crisis* (2012).

²⁰³ CLIFFORD, *supra* note 84 at 25.

²⁰⁴ Quoted in KETTL, *supra* note 2 at 22.

money.”²⁰⁵ This is because of the inherent difficulty in determining what counts as a “real bill” that a Reserve Bank can permissibly discount.²⁰⁶ As mentioned, not even every Reserve Bank practiced the principle.²⁰⁷

The gold standard has a more circuitous history, and survived in fits and starts until the U.S. formally withdrew its support for the international gold standard in 1971.²⁰⁸ The limitation of the gold standard on central banking practice is that the money supply must be managed with an eye toward long-term balance of international payments. When one country’s gold supply gets so low that market participants can doubt the convertibility of currency to gold, central-banking theory under the gold standard requires interest rate increases to attract more gold into the economy, even if that economy is in recession.

Debating the relative merits of the gold standard, real bills doctrine, or decentralized central banking are not the point of this Part. The point is only that all three principles limited the ways in which the Federal Reserve Board could raise its revenue. The modern Board of Governors, on the other hand, does not face these limits. The consequence is that the Fed can create its own budget using a statutory authorization from a different era.²⁰⁹

5. Scholarly Engagement with Fed Budgetary Independence

Scholars have long noted that the Fed is not subject to the appropriations

²⁰⁵ FRIEDMAN & SCHWARTZ, *supra* note 86 at 194.

²⁰⁶ See KETTL, *supra* note 2 at 23 for more on this point.

²⁰⁷ See Troost and Richardson, *supra* note 199. The doctrine is not dead, though. As Thomas Sargent, a Nobel-prize winning economist, has noted, the principles that motivated real bills still have influence in discussions of interest rate pegging. See THOMAS J. SARGENT, MACROECONOMIC THEORY 92 (1979) (cited in Thomas M. Humphrey, *The Real Bills Doctrine*, ECONOMIC REVIEW, Federal Reserve Bank of Richmond, September/October 1982).

²⁰⁸ There is an extensive literature on the historical gold standard. The most accessible starting point is AHAMED, *supra* note at 190. For a more academic account of the standard during the Great Depression, see BARRY EICHENGREEN, GOLDEN FETTERS: THE GOLD STANDARD AND THE GREAT DEPRESSION, 1919-1939 (1995). For an accessible recent treatment of the gold standard’s resurgence after World War II, see BENN STEIL, THE BATTLE OF BRETON WOODS: JOHN MAYNARD KEYNES, HARRY DEXTER WHITE, AND THE MAKING OF A NEW WORLD ORDER (2013). The gold standard is at the core of the existential criticisms of the Federal Reserve. For the political argument, see RON PAUL, END THE FED 71-75 (2009).

²⁰⁹ There is another fascinating element to the Fed’s budgetary independence, particularly in the ways that these interact with legal and environmental mechanisms. And that is the flip side of the Fed’s money creation power: that is, what is done with that money on the back end. And here the Fed is again transparent: the proceeds of open market operations, after paying the System’s expenses, are remitted to the public fisc. But, as Sarah Binder indicates, “the Federal Reserve Act does not require the Fed to remit profits to Treasury.” The practice of remittance of the proceeds of open market operations to the Treasury follows a similar trajectory of an original statutory basis (here expressly abrogated in 1933). The present practice occurred by public announcement by the Fed in 1947, and has continued ever since. Sarah Binder, *Would Congress Care if the Federal Reserve Lost Money? A Lesson from History*, The Monkey Cage, February 24, 2013, available at <http://themonkeycage.org/2013/02/24/would-congress-care-if-the-federal-reserve-lost-money-a-lesson-from-history/>.

process, and that its non-appropriations status is a source of its independence. What is more interesting is that every legal scholar to have engaged this question has mischaracterized it. Some scholars mistakenly claim that the Fed is funded by assessments on member banks.²¹⁰ Others correctly note that the Fed is funded by assessments on the Federal Reserve Banks, but do not note the role played by proceeds from open market operations.²¹¹ Others correctly note that the Board uses the proceeds from open market operations, but then cite the provision that authorizes assessments on the Reserve Banks.²¹² One prominent legal scholar and historian has cryptically cited the Reserve Board assessments provision of the Federal Reserve Act for the conclusion that it creates a “straightforward accountability system,”²¹³ although the author does not explain what that system is nor how it promotes accountability. A more recent article argues that “independent agencies such as the Federal Reserve . . . still ‘cannot afford to flout the views of the President,’ who continues to exercise substantial control as a consequence of his effective power of the purse,” without reference to the Fed’s

²¹⁰ Barkow, *supra* note 6 at 44 (“For example, the Federal Reserve is authorized to levy assessments against member banks to fund its operating budget.”); Leader, *supra* note 181 (“the operating costs of the Federal Reserve System are paid through Federal Reserve funds, which constitute an indirect assessment on supervised banks.”) Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503 (2000) (“The Fed has the power to assess member banks to supply funds for its operating expenses.”); Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top* 24 YALE J. ON REG. 313 (2007) (“The Fed is self-funded and obtains its operating revenue through statutorily authorized assessments on member banks.”); Steven A. Ramirez, *Law and Macroeconomics of the New Deal* at 70, 62 MD. L. REV. 515 (2003) (“The Fed has the power to assess member banks to supply funds for its operating expenses.”); Angel Manuel Moreno, *Presidential Coordination of the Independent Regulatory Process*, 8 ADMIN. L.J. AM. U. 461 (1995) (“The FRB . . . [is] funded through members’ fees.”); Onnig H. Dombalagian, *Requiem for the Bulge Bracket: Revisiting Investment Bank Regulation*, 85 IND. L. J. 777 (2010) (“The FRB . . . funds itself through assessments on member banks and profits from its proprietary trading activities.”).

²¹¹ Louis Fisher, *Confidential Spending and Governmental Accountability*, 47 GEO. WASH. L. REV. 347 (1978-1979) (“The Federal Reserve System, for example, derives funds from assessments on the Reserve banks.”) Bressman and Thompson, *supra* note 5 (“Several of the financial independent agencies have funding sources, usually from users and industry, which frees them from dependence on congressional appropriations and annual budgets developed by the executive branch”)(citing 12 U.S.C. § 243 (2006) for the proposition that the “Federal Reserve Board [is authorized] to levy assessments against Federal Reserve banks in order to pay for operating expenses and member salaries”).

²¹² Dombalagian, *supra* note 210 at 795 n.88 (2010) (“The FRB . . . funds itself through assessments on member banks and profits from its proprietary trading activities.”); David C. Stockdale, *The Federal Reserve System and the Formation of Monetary Policy*, 45 U. CIN. L. REV. 70 (1976) (“The Federal Reserve . . . has never been dependent on congressional appropriations for its operating funds. All such funds are derived from the interest earned on the System’s holdings of government securities.”); Richard J. Lazarus, *Super Wicked Problems and Climate Change: Restraining the Present To Liberate the Future*, 94 CORNELL L. REV. 1153, 1204 (2009) (“The Board [of Governors] is self-financed by its own financial transactions.”).

²¹³ Joel Seligman, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1 (2012); Joel Seligman, *Self-Funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233 (2004).

unique budgetary independence.²¹⁴ In another article, the authors expressly mention the Fed as having a “significant interest in securing the goodwill of the President to enlist the chief executive’s aid in budget battles with Congress,” despite the Fed’s unique budgetary independence.²¹⁵ The explanation is that “[e]ven agencies with an independent source of funding will have a recurring need for new authority and new sources of funding that outstrip existing demands.”²¹⁶ As Part V argues below, the Fed may well find itself in a situation where its conventional means of securing funding will be inadequate. But that eventuality, if it occurs, seems a flimsy basis for anticipatory reliance on the President for “aid in budget battles with Congress.”

B. Conclusion: Implications of Budgetary Autonomy

The analysis of the legal/customary nature of the Fed’s funding apparatus is the article’s most important descriptive contribution. But one point should be emphasized, as statements about how the Fed interacts with the money supply tend to provoke spirited arguments, to put it mildly: there is nothing secretive or nefarious about the Fed’s use of open market operations to fund itself. The Fed includes its accounting of its open market operations in its annual reports, and has done so—with varying degrees of transparency—for its entire one-hundred-year history. Moreover, the Fed has, in a century under intense scrutiny from market participants and existential critics alike, had no major financial scandal.²¹⁷ This is an impressive feat for any agency, let alone one that generates as much controversy as the Fed. Indeed, Ben Bernanke, even when he flies to far off conferences in remote towns in South Korea or in the far-off Arctic, still flies commercial.²¹⁸

This is not to say that the Fed’s funding decisions shouldn’t be scrutinized. There are important empirical questions about whether any other agency has matched the Fed’s budget growth, for example. A proper empirical inquiry would assess whether budget growth of the entire System matches or deviates from the growth of other agencies. Attention to the variance would also be useful. To take an example topical in 2013, the “sequester” that required mostly indiscriminate reductions in agency budgets did not apply to the Federal Reserve.²¹⁹ And unlike non-appropriated agencies funded through market assess-

²¹⁴ Huq, *supra* note 5, at 29 (citing Bressman and Thompson, *supra* note 5 at 633-34).

²¹⁵ Bressman and Thompson, *supra* note 5 at 633.

²¹⁶ *Id.* at 633-34.

²¹⁷ Allan H. Meltzer, History of the Federal Reserve, volume 2 book 1 at xi (2010).

²¹⁸ See NEIL IRWIN, THE ALCHEMISTS: THREE CENTRAL BANKERS AND A WORLD ON FIRE 208, 273 (2013) (describing far-flung meetings of the world’s central bankers and finance ministers and explaining that the “Fed Chair usually flies commercial; if her were to routinely catch a ride on the treasury secretary’s Air Force jet, it could be seen as compromising the central bank’s independence.”).

²¹⁹ See Budget Control Act of 2011, Pub. L. 112-25, 125 Stat. 240, § 251 (applying only to non-exempt accounts).

ments, the Fed is not subject even to the ebbs and flows of their own assessments. How these realities affect the Fed's budgetary decisions—from salaries to perquisites to hiring decisions—are important topics of scholarly inquiry.²²⁰

Rather than an exposé, the point of this analysis is to explain the way that the Federal Reserve's funding structure has moved beyond its statutory mooring. The legal mechanism provided by statute in 1913 removed the Fed from the annual legislative appropriations process. But the legislative change away from autonomy for the Reserve Banks, the non-statutory rejection of the real bills doctrine, and the executive decision to abandon the gold standard have moved away from that system. Whereas the statutory mechanism anticipates checks on the Fed's ability to create the money with which it funds itself, the practice is limited only by the Fed's own reputation. Scholars have all but ignored this statutory quirk, and even those who make passing reference do not engage in legal or historical analysis of its features.²²¹

V. FUTURE DIRECTIONS FOR FED INDEPENDENCE

Parts II-IV have illustrated, in detail, how the Fed's relationships with private banks (through the Reserve Banks), President (and the Treasury), and the Congress are regulated by legal and environmental mechanisms. Part V now briefly explains why this matters. It also outlines the next inquiries required to flesh out the audience-mechanism framework by adding audiences, adding an inquiry into the nature of the legal and environmental mechanisms that protect the FOMC

²²⁰ Some scholars have explored the Fed's potential efforts at maximizing its own revenue streams. See IRWIN L. MORRIS, CONGRESS, THE PRESIDENT, AND THE FEDERAL RESERVE: THE POLITICS OF AMERICAN MONETARY POLICY-MAKING 24 (2000) (collecting and critiquing sources).

²²¹ A partial exception is a passing reference in Edward Rubin, *Hyperdepoliticization*, 47 WAKE FOREST L. REV. 631 (2012). Rubin writes that

[t]he hyperdepoliticization of the Federal Reserve's monetary control function is further buttressed by the Fed's freedom from congressional budget control. This is due to a unique situation that, like the monetary control function, *evolved without prior planning*. In the course of its open market operations, the Fed holds large quantities of government securities and receives the interest payments on these securities. In 2011, these payments amounted to \$83.6 billion. The Fed simply returns most of this money to the United States Treasury, but it retains the amount it needs to finance its own operations—\$3.4 billion in 2011. As a result, the Fed does not need to obtain funding from Congress, and Congress has thereby relinquished its ability to control the Fed through reductions, or threatened reductions, of its annual budgetary allocation. Like its control of the money supply by committee, and the deference it receives during the semi-annual oversight hearings, the Fed's ability to fund itself could be readily reversed. Instead, Congress has followed the course of action to which it committed itself when these practices developed.

Emphasis added. Note, though, that Rubin does not explain, statutorily, how this budgetary independence is achieved, nor how it evolved.

specifically, and addresses the broader question of central bank independence is desirable in specific contexts.

A. Why this Matters: Unwinding the Fed's Crisis Policies

The prominence of the Federal Reserve is surely sufficient to justify the participation of legal scholars in the System's evaluation. But there are other public policy reasons why an evaluation of the Fed is important, and looming. Between 2007 and 2013, the Fed's balance sheet increased from \$870 billion to over \$3.3 trillion.²²² Several studies, including one from the Board of Governors, have highlighted the coming difficulties that the Fed is likely to face when the era of accommodative monetary policy subsides and the Fed must unwind the massive balance sheets it has accumulated during the last five years.²²³ There is a not implausible risk that as the Fed does so, it will face net losses such that it cannot cover its own expenses.

If that occurs, the Fed will face four options: (1) slash its operating budgets such that its expenses match the more modest assessments already available from member banks through the services rendered by Reserve Banks; (2) seek to expand the base of those assessments, consistent with the original policy intention behind the System's status as a non-appropriated entity; (3) seek capital infusions from Congress; or (4) manipulate its open-market operations sufficient to cover its operating expenses. The first option is the most politically palatable and financially plausible, but could come at real cost to both the ability of the Fed to pursue monetary policy and bank supervision, and the ability of the Consumer Financial Protection Bureau to execute its mission (since the latter institution's budget is linked, by law, to the Fed's budget). The second option is the probably even more politically palatable—it doesn't include cuts to the institutions—but is more financially risky: the banks may not want the services offered in sufficient quantity to support the increased demands that such a budget would place on them. The third option is politically uncertain—the prospect of the Fed Chair going to the Congress, hat in hand, to seek additional funding could result in extraordinary legislative measures that could redo the Fed according to the prevailing monetary zeitgeist. And the fourth, of course, is scandalous. How the

²²² See Board of Governors of the Federal Reserve System, Recent Balance Sheet Trends, Total Assets of the Federal Reserve, available at http://www.federalreserve.gov/monetarypolicy/bst_recenttrends_accessible.htm (accessed on May 15, 2013).

²²³ See Robert E. Hall and Ricardo Reis, *Maintaining Central-Bank Solvency under New-Style Central Banking*, February 18, 2013, available at <http://www.columbia.edu/~rr2572/papers/13-HallReis.pdf>; Seth B. Carpenter, Jane E. Ihrig, Elizabeth C. Klee, Daniel W. Quinn, and Alexander H. Boote, *The Federal Reserve's Balance Sheet and Earnings: A Primer and Projections*, January 2013, available at <http://www.federalreserve.gov/pubs/feds/2013/201301/201301pap.pdf>; David Greenlaw, James D. Hamilton, Peter Hooper, and Frederic S. Mishkin, *Crunch Time: Fiscal Crises and the Role of Monetary Policy*, February 22, 2013, available at <http://research.chicagobooth.edu/igm/usmpf/file.aspx>.

Fed would proceed in this scenario is open to speculation.

The Fed has dismissed the idea that balance sheet considerations will influence its monetary policy decisions.²²⁴ And at least one of the papers' models depends on a scenario where Congressional gridlock and public debt will push interest rates higher, earlier than the Fed anticipates.²²⁵ In May 2013, however, the Congressional Budget Office released a report²²⁶ that drastically reduced deficit projections such that at least some commentators view the fiscal outlook as significantly less dire than was previously projected.²²⁷ The focus of these debates has been, as with most aspects of academic and popular analysis of the Fed, on monetary policy and the ways that conduct of that policy will be affected by the change in the balance sheet.

The point is simply that the Fed's actions, extraordinary and controversial though they have been since the beginning of the 2007 crisis, will continue to push the limits of our understanding of what central banks are designed to do. As the Fed continues to innovate, appropriate questions of Fed independence, democratic accountability, and institutional design will be part of the conversation. A more sophisticated understanding of how Fed independence operates, in theory and practice, will help guide those conversations.

B. *Directions for Future Research*

1. Other Audiences

There is much more work to be done to understand the landscape of Fed independence. The audiences broached here are too few to grasp the complexity of the Fed's policy process, and the ways in which individuals, groups, and institutions shape that behavior. At least four other audiences in particular warrant further investigation. First, the Fed has an extraordinary cadre of well-paid research economists who hold conferences, write papers, and otherwise engage in the process of economic knowledge generation. There are, moreover, other "mezzo-level" career employees—bank supervisors, lawyers, public relations experts, legislative assistants, and others—who shape what the Fed does in ways major and minor. Carpenter uses the term "mezzo-level" to refer to those career

²²⁴ Joshua Zumbro & Caroline Salas Gage, *Fed Officials Reject Warning Losses May Weaken FOMC Clout*, Bloomberg, Feb 22, 2013, available at <http://www.bloomberg.com/news/2013-02-22/fed-officials-reject-warning-losses-may-weaken-fomc-clout.html>.

²²⁵ See Mishkin et al. *supra* note 223 ("The combination of a massively expanded central bank balance sheet and an unsustainable public debt trajectory is a mix that has the potential to substantially reduce the flexibility of monetary policy.").

²²⁶ Congressional Budget Office, *Updated Budget Projections: Fiscal Years 2013 to 2023*, available at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/44172-Baseline2.pdf>

²²⁷ See Lori Montgomery, *Deficit Projection Reduced to \$642 Billion, CBO Says*, WASH. POST, Mary 14, 2013, available at <http://www.washingtonpost.com/blogs/post-politics/wp/2013/05/14/deficit-projection-reduced-to-642-billion-cbo-says/>.

employees just outside the scope of the usual institutional analyses, which tend to focus on politicians and high-level political employees. An important contribution to understanding the Federal Reserve will describe and/or measure the influence of those employees.²²⁸

There is already clear evidence that these employees wield enormous influence in even high-level decisions. For example, senior Fed staff members—namely, the Director of the Division of Bank Supervision and the General Counsel—have the authority to supervise the Reserve Banks in reaching consent agreements in their enforcement proceedings.²²⁹ Of the over 1,000 enforcement actions taken by the Fed over the last ten years, only eleven proceeded to an administrative hearing, and only seven of those eleven proceeded to the Board of Governors. The rest were resolved by the Fed staff.²³⁰ These regulations, pursuant to statute, constitute a blend of legal and environmental mechanisms. A more comprehensive assessment of that authority and those mechanisms is an important avenue for further research.

Second, the Fed's participation among a global fraternity—the members of this club are almost exclusively male—of central bankers. The use of international swap lines—the provision of mostly U.S. dollars to foreign central banks, although the agreements also allowed the Fed to receive foreign currency—was an extraordinarily deep and broad aspect of the Fed's policies during the financial crisis.²³¹ Exactly how the international community of central bankers influences Fed policy also remains an active, if still undefined, space for legal scholars to contribute.²³²

Third, the Fed's relationships to other federal regulators also warrants further attention. This has always been true, but these dynamics have become even more important with Dodd-Frank's creation of the Financial Stability Oversight Council, whose voting members are the Secretary of the Treasury (who serves as

²²⁸ For an excellent insider account by a career economist, see Stephen H. Axilrod, *Inside the Fed: Monetary Policy and its Management, Martin through Greenspan to Bernanke* (2009).

²²⁹ 12 C.F.R. § 265.11(15)(i). Specifically, the regulation delegates to the regional banks the authority “[t]o enter into a written agreement[s] with [regulated institutions or persons subject to the Federal Reserve Board’s enforcement jurisdiction] . . . concerning the prevention or correction of an unsafe or unsound practice in conducting the business of the [institution] . . . or concerning the correction or prevention of any violation of law, rule, or regulation, or any condition imposed in writing by the Board in connection with the granting of any application or other request by the bank or company or any other appropriate matter.” The delegation also allows Fed staff to “stay, modify, terminate, or suspend” such an agreement or any “outstanding cease and desist order.” *Id.* §§ 265.11(15)(ii) and (iii).

²³⁰ 3 Examining the Settlement Practices of U.S. Financial Regulators: Hearing Before the H. Comm. on Financial Services, 112 Cong. 2d Sess. (2012), (statement of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System), available at <http://financialservices.house.gov/uploadedfiles/hhrg-112-ba00-wstate-salvarez-20120517.pdf>.

²³¹ See Baker, *International Swap Lines*, *supra* note 4.

²³² See LASTRA, *supra* note 4 for a discussion of the Basel system and other forms of international monetary cooperation. See also Christopher J. Brummer, *How International Financial Law Works (and How It Doesn’t)*, 99 Geo. L. J. 257, 277-79 (2011).

Chair of the Council), the Chair of the Fed, the Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, the Chair of the Securities and Exchange Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chair of the National Credit Union Administration, and an independent Presidential appointee with insurance experience.²³³ The Fed's relationships with each of these members in areas of bilateral interest—supervision of national banks with the OCC, or supervision of state member banks insured by the FDIC—and the relationship between the Fed and the FSOC generally also require further attention.²³⁴

And finally, the Fed's relationship with the general public has changed dramatically over the last century, and is changing still. In 1995, the Fed began releasing, on a five-year delay, the full transcripts of FOMC meetings.²³⁵ And a recent decision in the Second Circuit also sharply diminished the Fed's ability to keep the identities of banks that use the discount window from the public.²³⁶ But the System's interactions with the public remains uneven. It is a live issue whether the Reserve Banks are government agencies for purposes of FOIA.²³⁷

2. Presidential Control of the FOMC after Free Enterprise Fund

An issue worth separate exploration entirely is the constitutionality of the FOMC in light of the Supreme Court's recent case in *Free Enterprise Fund v. PCAOB*,²³⁸ as it broaches the legal and environmental mechanisms of independence that regulate the relationship between the President and the Fed's monetary-policy arm, the FOMC. The holding in *Free Enterprise* can be reduced to a prohibition against the double insulation from the President's grasp of inferior executive officers. But while the members of the PCAOB presented only removal issues, the members of the FOMC present both appointment issues that could

²³³ See FSOC 2013 Annual Report, i.

²³⁴ The starting point for an assessment of the Fed's relationship with other agencies would be those agencies tasked with the regulation of banks and finance, including the FDIC, SEC, CFTC, OCC, NCUA, and others. For administrative law discussions of the interagency dynamic, see Freeman and Rossi, *supra* note 50. For a recent take on interagency coordination from the political science literature, see KATHRYN C. LAVELLE, MONEY AND BANKS IN THE AMERICAN POLITICAL SYSTEM 4-6 (2013). See also Daniel Hemel, *Regulatory Consolidation and Cross-Border Coordination: Challenging the Conventional Wisdom*, 28 YALE J. ON REG. 213 (2011) (discussing the ways that regulatory deconsolidation can influence actors like the Federal Reserve to seek harmonized regulations through the international system).

²³⁵ See GREENSPAN, *supra* note 62.

²³⁶ Bloomberg, L.P. v. Board of Governors of the Federal Reserve System, 601 F.3d 143, 147-49 (2d Cir. 2010).

²³⁷ See Kara Karlson, Note, Checks and Balances: Using the Freedom of Information Act to Evaluate the Federal Reserve Banks, 60 AM. U. L. REV. 213, 234 (2010).

²³⁸ Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3146-47 (2010)

contravene the principles established in *Buckley v. Valeo*,²³⁹ as well as the removal issues addressed in *Free Enterprise*.

On the appointment front, the required qualifications of members of the FOMC are specified by statute.²⁴⁰ But, as discussed above, FOMC members are selected by boards of directors of the Reserve Banks themselves, subject to the approval of the Board of Governors. The only role the President plays in the selection of the Bank Presidents is in the selection of Board Governors, who in turn approve the selection of the President via the Reserve Bank's board (two-thirds of whom are selected by the member banks, one-third by the Board of Governors).²⁴¹

Removal is even more opaque. While the President can remove a member of the Board of Governors for cause,²⁴² he has no say in the removal of the FOMC. What effect for Presidential control of the FOMC through removal? The consequence is not a *Humphreys-squared*, as Judge Kavanaugh disapprovingly described the structure of the PCAOB, but perhaps *Humphreys-cubed*: the Reserve Banks' boards can remove the Reserve Bank Presidents for cause, the Board of Governors can remove the Reserve Banks' boards for cause, and the President can remove the Governors for cause.

Future work should delve more deeply into this structure against the backdrop of changing Supreme Court doctrine. At the core of that analysis, however, must be a navigation of the role of the judiciary not in creating legal mechanisms of independence, but environmental mechanisms. Here, I refer to the doctrine of equitable discretion fashioned in the D.C. Circuit to avoid merits adjudication of this very question. In response to a case brought by a Senator challenging the structure of the FOMC on the theory that the Reserve Bank presidents' participation deprives him of his constitutional right to advise and consent on the appointment of principal executive officers, the Court acknowledged the litigant had standing to bring the challenge. It then denied merits review under a judicially-constructed doctrine of equitable discretion, which asserted that the judiciary had no place to adjudicate the case, despite litigant's demonstration that he had met the requirements of constitutional standing, because of its legislative nature.²⁴³ More work should be done to assess the nature of this curious doctrine, how it might fair in light of nearly thirty years of standing jurisprudence in the

²³⁹ 424 U.S. 1 (1976)

²⁴⁰ 12 U.S.C. § 263

²⁴¹ *Id.* § 302

²⁴² *Id.* § 242

²⁴³ *Riegle v. FOMC*, 656 F.2d 873 (D.C. Cir.) (1981). Besides in *Riegle*, the DC Circuit has passed on a merits review of the FOMC on three occasions: *Reuss v. Balles*, 584 F.2d 461 (D.C. Cir.), cert. denied, 439 U.S. 997 (1978); *Committee for Monetary Reform v. Board of Governors*, 766 F.2d 538 (D.C. Cir. 1985); *Melcher v. FOMC*, 836 F.2d 561 (D.C. Cir. 1989). The District of Montana heard the first challenge to the FOMC in *Bryan v. FOMC*, 235 F. Supp. 877 (D. Mont. 1964), but dismissed that case for lack of standing. Prior to the organization of the FOMC, a private litigant challenged the conduct of open market operations in *Raichle v. Federal Reserve Bank of New York*, 34 F.2d 910 (2d Cir. 1929) (Augustus Hand, J.)

D.C. Circuit and Supreme Court, and whether the FOMC is, indeed, unconstitutional under prevailing doctrines. The audience-mechanism framework would dispute the importance of that determination, but that framework has nothing to say about the narrow doctrinal issue that the FOMC's structure presents.

3. Additional Dimension of Fed Independence

This article has focused an assessment of Fed independence along the dimensions of audience and especially mechanism. But there is more to the Fed than these two dimensions. One could add a third dimension: mission. The debates about the responsibility the Fed has to its dual mandate illustrates the importance of mission, but an evaluation of Fed independence cannot focus exclusively on monetary policy. As mentioned above, it is often said that the Fed has a "dual mandate" of full employment and price stability.²⁴⁴ But this is inaccurate.²⁴⁵ In addition to its macroeconomic policy mandates, the Fed is also responsible for a large and growing array of banking statutes and regulations. For example, the Fed regulates the reserve requirements of branches and agencies of foreign banks as a result of the enactment of the International Banking Act of 1978,²⁴⁶ oversees comprehensive supervision and regulation of bank holding companies, under the Bank Holding Company Act of 1956,²⁴⁷ limits (or doesn't)²⁴⁸ the extent of transactions between banks and their affiliates,²⁴⁹ participates in international rulemaking organizations,²⁵⁰ substantially oversees systemic risk regulation,²⁵¹ and much more. Previous analyses of Fed independence, especially by economists and political scientists, have not always been attuned to the way independence interacts with these diverse, sometimes conflicting missions. By law and practice, the Fed experiences different kinds of independence depending on the specific mission. More work on the ways in which Fed relationships evolve with respect to bank regulation, supervision, systemic risk regulation and, of course, the conduct of monetary policy should be included in this

²⁴⁴ 12 U.S.C. § 225a.

²⁴⁵ Indeed, as John C. Williams, President of the Federal Reserve Bank of San Francisco pointed out in a recent speech, "[i]n fact, the Fed has a triple mandate." John C. Williams, *The Federal Reserve's Mandate and Best Practice Monetary Policy*, delivered February 13, 2012. The statute requires that the Fed pursue "the goals of maximum employment, stable prices, and moderate long-term interest rates." 12 U.S.C. § 225a.

²⁴⁶ 12 U.S.C. §§ 3101-3108.

²⁴⁷ Pub. L. No. 84-511, §§ 1-12, 70 Stat. 134, 135 (1956). For an overview of the history of bank holding companies, see Saule T. Omarova and Margaret E. Tahyar, *That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulation in the United States*, 31 REV. BANKING & FIN. L. 113 (2011).

²⁴⁸ For a thorough analysis of the Fed's increasingly lax approach to 23A limitations, see Saule Omarova, *From Gramm-Leach Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N. CAROLINA L. REV. 1684 (2011).

²⁴⁹ Federal Reserve Act 23A, 12 U.S.C. §371c (2006) (amended 2010).

²⁵⁰ Baker, *International Swap Lines*, *supra* note 4.

²⁵¹ See Peter Conti-Brown, *Elective Shareholder Liability*, 64 STAN. L. REV. (2012) for an overview of the Fed's responsibilities under Dodd-Frank.

analysis.²⁵²

CONCLUSION

It can be difficult to write about the Fed or Fed independence without either praising it or condemning it. Is an independent Fed, as Chair Martin claimed, “the primary bulwark of the free enterprise system”?²⁵³ Or is the Fed’s independence singularly responsible for the financial crisis, as Nobel-prize winning economist Joseph Stiglitz has suggested?²⁵⁴

This article has sought to show that both views of Fed independence are essentially nonsensical without further specification. Instead of categorical conclusions regarding the defensibility of Fed independence, this article supports a more cautious approach that places Fed independence within a context of multiple parties and multiple mechanisms. Thus, the effort here aims not to pass judgment on law reform debates or to propose wholesale rejection of specific institutional arrangements, but instead to set the parameters for more rigorous and serious debates. Scholars—especially legal scholars and historians—should attempt to step away from the political fray to make more sense of the Fed in all of its evolving legal, environmental, and institutional complexity so that the reform projects that inevitably arise can proceed on a more informed and nuanced basis.

To that end, this Article has sought to make two contributions. The first is theoretical: neither agency independence nor central bank independence literatures provide a comprehensive framework that captures all of the Fed’s independence. Others, cited extensively above, have provided the basis for a better approach than either literature offers. The article’s theoretical contribution, then, is to synthesize, with important distinctions, those perspectives and articulate a single tractable framework that allows for a more comprehensive analysis of Fed independence than has previously been provided. The audience-mechanism approach is that framework.

The second contribution is in the descriptive analysis, informed by the law and history of the Fed’s many institutional changes over the past century, that unfolds from that theoretical frame. The effort is to highlight the ways that law and environment interact to create varying degrees of independence to create a net effect on the consequences for independence vis-à-vis specific audiences. The most original contributions come from the exploration of the Fed’s budgetary independence. Other contributions about the nature of Fed-Treasury relationships, the complicated reality of the fourteen-year term of members of the Board of Governors, and the President’s control of the Chair through repeat appoint-

²⁵² For an excellent treatment of central banking and bank regulation, see LASTRA, BANKING REGULATION, *supra* note 4.

²⁵³ Address at the Eighteenth Annual Convention of the Independent Bankers Association, Minneapolis, Minnesota, May 19, 1952, cited in CLIFFORD, *supra* note 84 at 22-23.

²⁵⁴ Stiglitz Against Central Bank Independence, Times of India, Jan 4, 2013, available at <http://timesofindia.indiatimes.com/business/india-business/Stiglitz-against-central-bank-independence/articleshow/17878411.cms>.

ment, are also important for the discussion of what Fed independence means, in law and in practice.

The Fed has had an extraordinary century. Its future, however, remains contested. As scholars and policy-makers continue to make sense of what the Fed has been, what it is, and what it should be, a robust understanding of Fed independence—within a sea of audiences, regulated by both legal and environmental mechanisms—will provide a suitable roadmap for those scholarly and policy conversations.