THE INSTITUTIONS OF FEDERAL RESERVE INDEPENDENCE

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Abstract: The Federal Reserve System has come to occupy center stage in the formulation and implementation of national and global economic policy. And yet, the mechanisms through which the Fed creates that policy are assumed but rarely analyzed. These assumptions—of scholars, central bankers, and other policy-makers –are that the Fed's independent authority to make policy is created by law: specifically, the Federal Reserve Act with its creation of removability protection for actors within the Fed, long tenures for Fed Governors, and budgetary autonomy from Congress.

This article analyzes these assumptions about law and argues that nothing about them is as it seems. Removability protection does not exist for the Fed Chair, but exists in unconstitutional form for the Reserve Bank presidents; the fourteen-year terms of the Governors are never served, giving every President since FDR twice the appointments the Federal Reserve Act anticipated; and the budgetary independence designed in 1913 bears little relationship to the budgetary independence of 2015. The article thus challenges the prevailing accounts of agency independence in administrative law and central bank independence in economics and political science, both of which focus on statutory mechanisms of creating Fed independence. It argues, instead, that the *life* of the Act—how its statutory terms are interpreted, how the legal and economic contexts change with the times, and how individual personalities influence policy-making—is more important to understanding Fed independence than the *birth* of the Act, the language passed by Congress. Fed independence is not simply a creature of statute, but an ecosystem of formal and informal institutional arrangements, within and beyond the control of the actors and organizations most interested in controlling Fed policy.

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INTRODUCTION

On December 23, 2013, the Federal Reserve System celebrated its centennial. Over the course of that century, the Fed[1] has become one of the most important governmental agencies in the history of the American republic, a transformation one scholar has labeled "the most remarkable bureaucratic metamorphosis in American history."[2] 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]

At the core of that "remarkable bureaucratic metamorphosis" is a much-invoked but as often misunderstood set of institutional arrangements that constitute the Fed's unique independence. In the standard popular and academic account, law is at the center of that independence: indeed, it is the statute itself, under this view, that defines that independence. Economists and political scientists interested in central bank independence—having written enough on the phenomenon to give it an acronym (CBI)[4]—take as given that law defines central bank independence.[5] And legal academics, in the exceptional event that they have taken note of

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[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, the Board of Governors, or the FOMC, as will be clear from the context. Absent clarification, "the Fed" refers to the entire System.

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

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

[4] ALAN BLINDER, THE QUIET REVOLUTION: CENTRAL BANKING GOES MODERN 1 (2004) (describing the explosion of research in CBI).

[5] See Part I, *infra*.

the Fed,[6] have analyzed its independence within the context of administrative law[7] and agency independence generally.[8] Again, unsurprisingly, statutes are at the center of that analysis, too.

This article argues that the idea that Fed independence is determined by the Federal Reserve Act is wrong.[9] In some cases, the statute does not say what people have assumed it says. More often, the statute has created a system that subsequent practices have changed, strengthened, or undermined so completely as to render them dead letter. The law as written becomes displaced by law as implemented. The result is that reading the Federal Reserve Act tells us very little about the way this unique government agency exercises its extraordinary power.

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[6] 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).

[7] 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).

[8] 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 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 7, at 16-18; Lisa Schultz Bressman and Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 631-637 (2010).

[9] The standard account is more robust than this: it looks, too, at the legal relationship between the President and the Fed Chair for purposes of monetary policy. The book from which this article is drawn challenges as incorrect all four of those bases: law, the President, the Fed Chair, and monetary policy. See PETER CONTI-BROWN, THE POLITICS OF THE PUNCH BOWL: GOVERNANCE, ACCOUNTABILITY, AND INDEPENDENCE AT THE U.S. FEDERAL RESERVE (Princeton University Press, forthcoming 2015).

To make this argument, the article draws on the language, structure, and history of the Federal Reserve Act of 1913 (especially as amended in 1935), other legislative materials, memoirs and biographies of Fed Chairs and other insiders, and other archival resources. The result—part of a broader project[10]—is a more comprehensive account of the legal context of Fed independence and its evolution.

The article's contributions are primarily descriptive. The effort is to provide a more grounded understanding of how the law does and does not work to create the Fed's distinct policy-making space. The article explains the context and historical change of the many mechanisms of Fed independence, providing for the first time an explanation of how the Fed's funding, appointments, and removability protections have evolved since they were first installed in the key legislative enactments of the Federal Reserve Act of 1913 and the Fed's reformulation in the Bank Act of 1935. Specifically, the article discusses three features. First, how removability protections do not exist for the Fed Chair, but exist to unconstitutional (and probably non-justiciable) form for the presidents of the Reserve Banks. This is true despite the equivalence in administrative law of agency independence with removability protection for the agency head. Second, how the fourteen-year non-renewable term of the Fed Governors (meant to enhance Fed independence) and the four-year renewable term for the Fed Chair (meant to enhance accountability) have become precisely the opposite: filling Governor vacancies has made the Fed more dependent on the President, filling Chair vacancies has made it less. And third, the Fed's extraordinary budgetary independence—its ability to create the money with which it funds itself—is not authorized by statute, and indeed was at the core of one of the central fights in the framing of the Fed.

This more grounded approach to the laws of Fed independence also give insight into the theoretical understanding of the role law—and history—play in creating the boundaries of the Fed's policy-making space. The Fed's metamorphosis over a century demonstrates how law gets displaced by its implementation. This is not to say that norms and conventions are doing the work of creating independence, as opposed to formal law, although the Fed provides examples of these kinds of "soft constraints," too.[11] Instead, the laws of Federal Reserve independence demonstrate the iterative, interactive conversation between formal law, modern practice, and historical change. In this sense, the "institutions" of the article's title follow and extend Douglass North and others in the New Institutional Economics literatures.[12] This dynamic between policy, law, and history is "institutional" in that it is part of a broader array of "humanly devised constraints that structure

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[10] See *id*.

[11] See Kathryn Judge, *The Federal Reserve: A Study of Soft Constraints*, LAW & CONT. PROBS. (forthcoming 2014).

[12] See, e.g., Avner Greif, Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders,* 49 J. ECON. HIST. 857 (1989). For an excellent overview of the New Institutional Economics and law, see Ron Harris, *Legal Scholars, Economists, and the Interdisciplinary Study of Institutions*, 96 CORNELL L. REV. 789 (2011)

political, economic and social interaction" that "consist[s] of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)," as North described it.[13] But the Fed's independence shows us something more: some of the institutional changes at the heart of the Fed's independence do not reach the level of "humanly devised constraints," but are at times the product of history's dramatic contingencies and unintended consequences.

The implications of the article for legal theory, then, are not just to illustrate the chasm between law on the books and law on the ground. The article invites, instead, a careful analysis of the relationship between them: the institutional development of Fed independence relies on statutory authorization, statutory implementation, and the subtle but steady drip of change exerted by individual personalities, outside forces, and the influence of chance. This lens warns against a legal theory of agency independence that relies on the durable, formal statutory structure (a conception of agency independence favored by courts). And it warns against overconfidence on the politics of legislative design.[14] In place of these alternatives, it endorses a view of law, politics, and history, almost (but not quite) a view of institutions that relies on "complete, totalized contingency" of historical events.[15]

This article proceeds as follows. Part I provides the context for the debate by outlining the basic academic approaches to central bank and agency independence already in place, including their reliance on the unchallenged assumptions about the centrality of law in creating that independence. The rest of the article evaluates the three primary mechanisms in law that scholars have relied on to explain Fed independence (and accountability): budgetary independence (in Part II), long tenures of Governors and short tenures of Fed Chairs (in Part III), and removability protection (in Part IV). Part V then concludes, including with thoughts on how this descriptive account of the laws of Fed independence might affect our normative conceptions of central bank design, including whether the appointments processes currently in place function as they should.

I. THE LITERATURES OF FED INDEPENDENCE

The standard account of Fed independence goes something like this. The Fed's independence is the *statutory* separation—that is, the separation designated by statute, in this case the Federal Reserve Act—between the *President* and the Fed

[13] Douglass C. North, *Institutions*, 5 J. ECON. PERSP. 97, 97 (1991).

[14] See Terry M. Moe, *The Politics of Bureaucratic Structure*, in CAN THE GOVERNMENT GOVERN? 267, eds. John E. Chubb and Paul E. Peterson (1989). ("American public bureaucracy is not designed to be effective. The bureaucracy arises out of politics, and its design reflects the interests, strategies, and compromises of those who exercise political power.")

[15] Christopher Tomlins, *What is Left of the Law and Society Paradigm after Critique? Revisiting Gordon's "Critical Legal Histories,"* 37 Law & Social Inquiry 155, 164 (2012)

Chair for the purposes of *monetary policy*, usually meaning *price stability*. The separateness is needed, under this account, because the President's electoral orientation—his need to either face the national electorate or ensure his successor wins the next election for policy continuity and legacy building—will induce him to goose the economy artificially by printing money and consequent inflation, to the long-term cost to the economy. In technical terms, we face a time inconsistency problem: our short-term interests in inflation-based prosperity are in tension with long-term interests in the avoiding the economic devastation that this inflation brings.[16] Central bank independence resolves that problem, allowing us to pursue a long-term policy—price stability—even in the face of short-term pressures coming in the other direction.

Here is where the metaphors of Fed independence begin: central bank independence is our Ulysses contract. It lashes the politicians (usually the President) to the mast to give society the outcome that everyone would prefer, but that is very hard to do because so many in society are singing seductively about the virtues of running the printing press to provide monetary stimulus. Thus relieved of the pressures of navigating the difficulties of inconsistent preferences, the politicians hire central bankers (usually the Fed Chair) as the oarsmen, shuts their ears with bees' wax, and the central bankers/oarsmen then guide the ship of the economy outside of the short-term temptations for artificial prosperity and toward the destination of price stability and moderate growth. The binds on the politicians and the wax in the central banker's ears are both created by law. To change millennia and invoke the other metaphors of central bank independence, we separate central bankers from the political process so that they can "take away the punch bowl just when the party is getting started,"[17] or "lean against the winds of deflation or inflation, whichever way they are blowing."[18]

The four components of this standard account—that the statute is doing the work here, that the President is the exclusive external pressure on the Fed, that the Chair is the metonymic equivalent of the Federal Reserve System, and that Fed independence is just about price stability—gets beyond the usual impatience of public debate about whether the Fed is independent, and whether it should be

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[16] See Finn E. Kydland & Edward C. Prescott, *Rules Rather Than Discretion: The Inconsistency of Optimal Plans*, 85 J. POL. EC. 473 (1977).

[17] 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 fields parched." Interview in U.S. News and World Report, Feb 11, 1955, 56 (cited in KETTL, *supra* note 2 at 83).

[18] Testimony before U.S. Senate, Committee on Banking and Currency, Nomination of William McCheseney Martin, Jr., hearings, 84th Congress. 2d Sess, 1956, 5 (cited in KETTL, *supra* note 2 at 83). I thank Erika Wayne for the help in locating this source.

independent. But it doesn't go very much further. In the broader project on Fed independence, I contend that each of the four aspects of the standard account is wrong. Wrong in some cases because it is plainly inaccurate. Wrong in other cases because they are too narrow. Taken as a whole, the standard account provides a verisimilitude of Fed independence without capturing its complexity, and, in that way, both obscures the reality of Fed independence and impedes serious discussion about the ends and means of central bank design.

This article focuses on only one element of that account: the focus on the Federal Reserve Act as the means by which Fed independence is accomplished. In order to understand why this part of the standard account is wrong, we must understand the ways that scholars have talked about institutional design and Fed independence. Part I provides that summary.

A. *Alternative Approaches to Evaluating Fed Independence: Law, Economics, and Political Science*

The conventional justification for Fed independence is that the stuff of monetary policy—specifically, targeting nominal interest rates through the provision or contraction of liquidity—is necessarily a controversial exercise.[19] 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 a politician's desire to inflate away the public debt, to cater to some electoral interest, or to pursue pure venality.

The debate regarding *why* politicians would ever cede even partial control over that money-regulating process—in other words, why politicians would ever create independent central banks—is ongoing.[20] So too is the debate about *to what end*,

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[19] 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. Again, note that the article focuses on the Fed as regulator of the dollar. CONTI-BROWN, *supra* note 9, chapter 4 goes into more detail about the relationship between Fed independence and the Fed's other missions, including bank regulation, bank supervision, systemic risk regulation, and supervision of the payment system. This article does not assume a background in understanding the operations of monetary policy, but does refer to some aspects of how that policy has evolved. For thorough and still 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).

[20] 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

the regulation of money, whether price stability, economic growth/employment regulation, systemic risk regulation, or some combination of these.[21] The article will leave to the side these debates, and instead focus on the *mechanics* of independence. In other words, *how* is that independence accomplished and maintained?[22]

There are three literatures that provide insight into this question: agency independence in law, central bank independence in economics and political science, and structure and process theory in political science. All three are useful and essential starting points for the present inquiry. This article builds on each. But all three are either focused on different questions—for example, the constitutional contours of appointment and removability for law, the empirical consequences of legal separation between central banks and the fiscal pols-maker for CBI, the consequences for specific features of institutional design on agency performance. Or, even when they are focused on the mechanics of Fed independence, they miss the nuance of the broader institutional framework of Fed independence by focusing exclusively on the statute as written.

1. Agency Independence in Administrative Law

Courts and legal scholars have long analyzed the nature of agency independence. But this is something of a misnomer: as Gersen has 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."[23] 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 agency's head.

Other scholars have documented the removability focus in administrative law's historical development,[24] but the doctrinal gist is easily summarized. Congress may not require the President to seek Senate advice and consent prior to

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REFORM 11 (2002) (arguing that CBI resolves an intra-party conflict over the practice of monetary policy).

[21] 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 JOHN B. TAYLOR, FIRST PRINCIPLES: FIVE KEYS TO RESTORING AMERICA'S PROSPERITY 124-128 (2013).

[22] The book from which the article is drawn goes into much more detail on three additional questions: what is the Federal Reserve? From whom is the Fed independent in theory and practice? And to what end, Fed independence? See CONTI-BROWN, *supra* note 9.

[23] 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).

[24] See Huq, *supra* note 8; Barkow, *supra* note 7; Vermeule, *supra* note 7.

removal, as the "reasonable construction of the Constitution" would forbid that kind of blending of legislative and executive functions without express authorization.[25] But Congress may condition Presidential 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.[26] So too for lower-level executive appointees like independent counsel,[27] but not if the agency head and the lower-level appointee are both deemed to be protected by for-cause removability protection.[28]

As a quick-and-dirty overview, the doctrinal summary doesn't say much about the operational independence of administrative agencies. We learn 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 removability framework.[29]

On their own terms, these doctrinal conclusions are controversial to scholars of presidential authority on each side of the cases just summarized.[30] But as a means of evaluating agency independence writ large, the removability focus is even

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

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

[27] *Morrison v. Olson*, 487 U.S. 654 (1988).

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

[29] 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)

[30] 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.").

more susceptible to criticism. That is, leave aside the questions of whether Congress can ever influence division within a unitary executive, and focus instead on the meaning of agency independence, and one sees immediately why the removability focus captures only a small part—although, as this article argues, a surprisingly important part—of the agency independence picture.

Because of this narrowness, there is near scholarly unanimity that the removability focus is something of a fetish.[31] For example, scholars contend that the paradigm: focuses on the wrong mechanisms of independence,[32] ignores the ways in which executive agencies (i.e., those whose heads are removable at will and, separately, are subject to Presidential regulatory review through the Office of Information and Regulatory Affairs) use presidential review to increase "self-insulation,"[33] creates meaningless distinctions between executive and independent agencies,[34] is focused on the wrong problems[35] and the wrong parties,[36] reflects a misunderstanding of how the administrative state actually functions,[37] elides ways in which the President controls independent agencies beyond removability,[38] and gives to courts review of decisions that are fundamentally incompatible with judicial review.[39] 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."[40]

The Federal Reserve's independence illustrates some of the scholars' frustrations with removability as a paradigm for comprehensive evaluation of agency independence, as some scholars have noted.[41] There is simply more to the Federal Reserve Act than removability, and removability itself is a less straight-forward phenomenon in the case of the Federal Reserve System than the equivalence theory would have it.

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[31] But see Neomi Rao, *Removal: Necessary and Sufficient for Presidential Control*, 65 ALA. L. REV. 1205 (2014).

[32] See Vermeule, *supra* note 7; Barkow, *supra* note 7; and Bressman and Thompson, *supra* note 8.

[33] Jennifer Nou, *Agency Self-Insulation under Presidential Review*, 126 HARV. L. REV. 1755 (2013).

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

[35] See Barkow, *supra* note 7.

[36] M. Elizabeth Magill and Adrian Vermeule, *Allocating Power within Agencies*, 120 YALE L. J. 1032 (2011).

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

[38] Bressman and Thompson, *supra* note 8.

[39] Huq, *supra* note 8.

[40] Vermeule, *supra* note 7, at 3.

[41] Vermeule, *supra* note 8.

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 scientists[42] have long focused on the inputs and outputs of central banks and central banking.[43] Interestingly, although the CBI and agency independence 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,"[44] the focus is, as with agency independence, on law: "practi-

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[42] 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. For the most innovative interest group theories, see Miller, *supra* note 6; 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 20 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.

[43] 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).

[44] BERNHARD, *supra* note 42 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

cally all existing attempts at the systematic characterization of [central bank] independence rely solely on legal aspects of independence."[45] That literature is summarized in the footnotes below.

There is an important conceptual focus to CBI that focuses more on the why of independence—to what end—than on the mechanics of Fed independence. Under Stanley Fischer's now famous articulation, CBI is divided between "goal independence" and "instrument independence."[46] 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.

Fischer's formulation has been, for the most part, the last word on those mechanical questions.[47] And there, the focus is mostly on the statute.[48] It is the law, passed by Congress and recorded in the U.S. Code, that establishes the "goals" of central banking. It is law, passed and recorded in the same way, that provides the freedom to select the "instruments" of central banking. And it is the law that empirical economists cite when they attempt to determine the extent of independence and the correlation between that independence and economic indicators such as GDP growth, inflation, and unemployment. As Alex Cukierman, perhaps the leading empiricist of CBI, has explained it with admitted reservation: when

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(1995).

[45] ALEX CUKIERMAN, CENTRAL BANK STRATEGY, CREDIBILITY AND INDEPENDENCE 371 (1992) (collecting sources). See, e.g., Alesina & Summers, *supra* note 43 at 153 (listing mechanisms, all legal, that separate central banks from political interference) See also LASTRA, BANK REGULATION, *supra* note 8 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)

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

[47] For an exception, see Ricardo Reis, *Central Bank Design*, 27 J. Economic Perspectives 17 (2013). Reis explores more about the mechanics of central bank design, but, once again, the focus is on legislation.

[48] 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 6. 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. Similarly, Cukierman acknowledges these limitations. See CUKIERMAN, *supra* note 45 at 371-72 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).

constructing "indices of legal aspects of CB independence," the emphasis is on "only the written information from the charters."[49]

It is the aim of this article to determine whether these assumptions about law—at least as applied to the Federal Reserve—are correct.[50]

3. Independence in Political Science

Political scientists looking at agency design have explored more contours of the administrative state, even as they have, for the most part, focused on law as the primary mechanism in that design. An earlier generation of scholars of the bureaucracy viewed the question of congressional delegation to agencies under the view that delegation was abdication, the creation of a "headless fourth branch" that controlled governmental decision-making without accountability.[51] But in the 1980s and 1990s, McNollGast[52] and other scholars[53] following in that tradition introduced a renewed confidence that congressional design can shape the goals and behavior of agencies. This work came to be known as the "structure and process" approach to agency control. As Gersen summarizes, "[a]lthough the structure and process thesis now has many variants, its simplest form asserts that legislatures can control agency discretion (policy outcomes) by carefully delineating the process by which agency policy is formulated."[54]

The structure-and-process theorists focused on the variety of mechanisms—including but far beyond the removability focus of lawyers and judges—available to Congress through which that control might be asserted. That focus is therefore

[49] CUKIERMAN, *supra* note 45 at 371.

[50] This approach may be open to the criticism lodged by social scientists in a related dispute about legal inputs and economic outputs. The "Law and Finance" literature that found a strong positive correlation between the common law and economic growth, legal scholars immediately and almost uniformly rejected the result. See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer, and Robert W. Vishny, *Law and Finance*, 106 J. POL. EC. (1998). The economists were undeterred on epistemological grounds: "Lawyers don't do empirical work. They just argue with each other." Nicholas Thompson, *Common Denominator*, Legal Affairs (2005), available at http://www.legalaffairs.org/issues/January-February-2005/feature_thompson_janfeb05.msp. It should be noted, however, that a lawyer-economist may have had the last word. See Holger Spamann *The "Antidirector Rights Index" Revisited*, 23 REV. FIN. STUDS. 467 (2010) (comprehensively calling into question the econometric determinations based on the categorization of law in thirty-three of the forty-six counties originally analyzed by LLSV).

[51] See Gersen supra note 23 at 339. For more discussion of the "headlessness" phenomenon, see LOUIS FISHER, THE POLITICS OF SHARED POWER: CONGRESS AND THE EXECUTIVE 148 (4th ed. 1998)

[52] Matthew D. McCubbins, Roger G. Noll, and Barry R. Weingast, *Administrative Procedures as Instruments of Political Control*, 3 J. L. & Econ. 165 (1987); Matthew D. McCubbins, Roger G. Noll, and Barry R. Weingast, *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 Va. L. Rev. 431 (1989).

[53] See, e.g., Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, J. of L., Econ, & Org. 93 (1992).

[54] Gersen, supra note 23 at 339.

inherently on institutional design, whether via ex ante legislative decisions of Congress[55] in its role as institutional designer, or more broadly on, well, the structures and processes associated with a given agency, whether legislative or executive.

The structure and process thesis is an important extension of the narrower focus on removability in administrative law. And in many ways, the new work in administrative law scholarship—as opposed to administrative law in courts—that challenges the judicial conception of agency independence, is expressly or by implication a subset of the structure and process thesis.

But the focus in this context, as in administrative law generally and CBI, remains on law: for example, the nature of Presidential review of agency work product;[56] threats and practices of auditing;[57] limits on jurisdiction;[58] and expansiveness of the wording of authorizing statute.[59] Largely missing from the analysis is the role of non-statutory legal change and how the law in its implementation can upend, even replace, the statutory design.

B. *The Institutions of Federal Reserve Independence*

The agency-independence and central-bank-independence literatures both provide the essential frameworks for evaluating Fed independence, including the focus on the statute that this article also adopts. Where those alternatives go wrong, though, is with the flawed assumption that law is not simply the beginning of the inquiry, but the end. Structure-and-process theory goes much further, but either does not focus on central banks[60] or lacks an account of law's historical evolution. This article is an effort to provide that account.

To be clear, the flawed assumption does not eliminate the value of this scholarship. In many cases, the aim in these literatures 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 specific governmental organizations, and the use of law to accomplish some end desired by Congress, interest groups, or the President. In that sense, the literatures can't be criticized for failing to take a more comprehensive view of Fed independence because that view wasn't a part of, or required for, that research.

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[55] Even here, though, the Congressional focus may well be on Congress metonymically for the President, Congress, and other groups that participate in the legislative process.

[56] Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245 (2001); Michael A. Livermore and Richard L. Revesz, *Regulatory Review, Capture, and Agency Inaction*, 101 GEO. L. J. 1337 (2013).

[57] Jeffrey S. Banks, *Agency Budgets, Cost Information, and Auditing*, 33 AM. J. POL. SCI. 670 (1989).

[58] Jacob Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUPREME COURT REVIEW 201 (2007); Macey, supra note 53.

[59] JOHN D. HUBER AND CHARLES R. SHIPAN, DELIBERATE DISCRETION?: THE INSTITUTIONAL FOUNDATIONS OF BUREAUCRATIC AUTONOMY (2002).

[60] For excellent exceptions, see Christoppher Adolph, BANKERS BUREAUCRATS, AND CENTRAL BANK POLITICS: THE MYTH OF NEUTRALITY (2013).

But if the aim of these judges and scholars 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,[61] or to quantify and evaluate claims that the Federal Reserve is or is not independent of other governmental actors or organizations, then the law-as-independence approach is insufficient. That is, the near exclusive focus on law fails to engage with the law's statutory and historical context and evolution. This is especially true in the administrative law context, where the removability of the Chair is the singular focus.[62] 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.[63] To evaluate Fed independence, scholars and policymakers must be sensitive to these kinds of non-legal mechanisms.[64]

But informal constraints that become customary or conventional are only part of the picture. A contextual understanding of law's evolution is another belongs to that institutional context, too, even when its evolution is ongoing and conventions are not yet solidified. This article is the story of that ongoing process.

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[61] From courts, see, e.g., *City of Arlington, Tex. v. FCC*, 133 S. Ct. 1863 (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 practical 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 30 at 3-4.

[62] Again, other scholars evaluating agency independence have looked more broadly than the narrow removability focus to include term length, funding source, discretion to choose policy instrument, work product review, and more Datla and Revesz, *supra* note 34. Bressman and Thompson, *supra* note 8; Barkow, *supra* note 7. LASTRA, BANKING REGULATION, *supra* note 6.

[63] 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 7 at 16-17.

[64] Vermeule, *supra* note 7, recommends that judges take note of the conventions of independence when adjudicating the traditional removability cases. Huq, *supra* note 8, 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 analysis here suggests judges will have difficulty in assessing independence in a way that fits within a constitutional framework: courts are not institutionally well-suited to make sense of these non-legal institutions.

II. THE CURIOUS CASE OF THE FED'S BUDGETARY INDEPENDENCE

One of the primary means of Congressional control over agencies—the power of the purse—represents a unique and often misconstrued aspect of Congress's relationship with the Fed. Part II discusses this largely uncharted statutory and historical framework: the Fed's ability to fund itself from the proceeds of open market operations that it controls without interference from the political branches. This budgetary independence is not uncharted because it is unacknowledged. To the contrary, the Fed includes on its own website and in its detailed annual reports a frank admission that the System's "income comes primarily from the interest on government securities that it has acquired through open market operations."[65] Instead, the story is an interesting one because of the interplay between the current practice and the statutory language authorizing this practice, separated as they are by a century of dramatic change in the conduct of monetary policy. As a result, although this feature of the Federal Reserve Act has been widely cited as a defining characteristic of Fed independence, the relationship between the Act and the current practice has caused scholars to mislabel or incorrectly analyze the Fed's budgetary independence every time it has been addressed.

This Part provides the first analysis, based in law and history, and illustrates how legal and non-legal institutions interact to create greater distance between Congress and the Fed. It explains the extraordinary nature of the Fed's budgetary independence—the ability to create the money with which it funds itself—but also the evolution from an authority strictly circumscribed by law (still on the books) and practice (long since abandoned). The Fed's budgetary independence demonstrates the role of historical contingency and the swirling external changes that make a legal mechanism of independence something very different from that independence as it is lived in the world of central banking.

A. *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.[66] 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.[67] First, the vast majority of governmental institutions—from the Congress to the Courts to the

[65] What does it mean that the Federal Reserve is "independent within the government"? available at http://www.federalreserve.gov/faqs/about_12799.htm.

[66] 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.

[67] 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).

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.[68] 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.

And then there is the Fed. The Fed funds itself with a portion of the proceeds from its open-market operations. In the Fed's own words, from the most recent budget report, "[t]he major sources of income were interest earnings from the portfolio of U.S. government securities ($49.0 billion) and federal agency mortgage-backed securities (MBS) ($31.4 billion) in the System Open Market Account. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 2012, a total of $88.4 billion."[69] 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.[70] While true that the Fed collects money from member banks for "charged services,"[71] such assessments, cover just 25% of its expenses.[72] The rest, as stated, comes from the proceeds from its open market operations.

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-government[73]—securities.[74] These interest-bearing assets generate money that the agency can subsequently use to fund itself.[75] The Fed thus has the ability to create

[68] 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.

[69] BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, ANNUAL REPORT: BUDGET REVIEW 1 (2013), *available at* http://www.federalreserve.gov/publications/budget-review/files/2013-budget-review.pdf.

[70] See Barkow, *supra* note 7.

[71] BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, *supra* note 69, at 17.

[72] *Id.*

[73] 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).

[74] See Federal Reserve: Purposes and Functions (2005).

[75] Chair Bernanke has contested a "money-printing" characterization of the Fed's monetary

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

B. *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.[76]

Unquestionably, this statutory authorization exempts the Fed from the Congressional appropriations.[77] 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."[78] It does not allow the Fed to create, and fund itself with, its own Federal Reserve notes.

To understand how this relatively modest statutory authorization metamorphosed into the Fed's present and complete budgetary independence, one must

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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 proceeds of those decisions to fund its budget.

[76] 12 U.S.C. § 243.

[77] 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).

[78] 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.

understand more about the evolution of the Federal Reserve System over the past century. Three features are of particular importance: (1) the quasi-autonomy 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.

C. *The Compromise of 1913 and the Quasi-Autonomy of the Federal Reserve Banks, 1914-1935*

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.[79]

This story is technically but deceptively true. The primary reason is that it links, almost ineluctably, the Panic of 1907 and the Act of 1913. For understanding how the Fed's budgetary independence came to be, 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 System, including as they did two Congressional elections in which Democrats first seized control of the House (in 1910)[80] and then the Senate (in 1912).[81] 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 elections in American history. In the words of one historian, the 1912 election "verged on political philosophy."[82] That political philosophical moment

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[79] 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.").

[80] See Party Divisions of the House of Representatives, 1789-present, available at http://history.house.gov/Institution/Party-Divisions/Party-Divisions/.

[81] The Congressional and Presidential elections of 1908 were less important for the shape of the System.

[82] 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).

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 of 1907 were entirely Republican; the final bill was almost exclusively Democratic.[83] 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.[84] The Commission imagined a structure very different from the system the Federal Reserve Act eventually created. That structure, the National Reserve Association (NRA),[85] 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, not by the government.[86]

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.[87]

The tension between the two poles—public and private, accountable to the political process and independent from it—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 the central debates preceding the passage of the Act centered on how to navigate those

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[83] 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).

[84] 35 Stat. 546 (1908), repealed by Technical Amendments to the Federal Banking Laws, Pub. L. No. 103-325, 108 Stat. 2292, 2294 (1994).

[85] Milton Friedman and Anna Schwartz, A Monetary History of the United States (1964).

[86] 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).

[87] In fact, the Act allowed for "eight to twelve" Reserve Banks, the exact number of location of which were then decided by the Secretaries of Treasury and Agriculture during the course of 1914.

[88] PAUL WARBURG, THE FEDERAL RESERVE SYSTEM: ITS ORIGIN AND GROWTH, vol. 1, 12 (1930).

two poles, or the "whirlpool of socialism and the jagged rocks of monopoly."[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.

So it was that one of the consequences of this 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,[91] emphasized the *federal* in the Federal Reserve System in these terms:

In the United States, with its immense area, numerous natural divisions, still

[89] CLIFFORD, *supra* note 83 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] See HOWARD HACKLEY, THE STATUS OF THE FEDERAL RESERVE SYSTEM IN THE FEDERAL GOVERNMENT 31 (1972) (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.) (unpublished, on file with the author and 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.

[91] 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 48 at 200-229, and CLIFFORD, *supra* note 83 at 242-45.

> 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.[92]

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.[93] 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.[94]

So it was that the Reserve Banks—those entities in charge, by statute, of generating the funds from which the Federal Reserve Board would, through semiannual assessment, fund itself, became financially autonomous organizations. Their financial autonomy meant that they raised money through the business of banking for banks: that is, "discounting," or lending money at interest, to the member banks within the System. In the words of the first Secretary of the Federal Reserve Board,

> 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.[95]

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 today, 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.

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

[93] 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)

[94] 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 ALLAN MELTZER, HISTORY OF THE FEDERAL RESERVE SYSTEM 62-75 (2003); CLIFFORD, *supra* note 83 at 66-67.

[95] H. PARKER WILLIS, THE FEDERAL RESERVE SYSTEM 128 (1915).

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.[96]

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.[97] The assessment provision, however, was unchanged.[98]

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.

D. *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 in fact refers to a set of standards that, depending on the particulars, limit the central bank's discretion in pursuing any given monetary policy.[99] 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

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[96] 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).

[97] Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684.

[98] *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 90 at 7-8.

[99] See BEN BERNANKE, THE FEDERAL RESERVE AND THE FINANCIAL CRISIS (2012).

from which it would pay its own expenses.

So too with the real bills doctrine. 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 money."[100] This is because of the inherent difficulty in determining what counts as a "real bill" that a Reserve Bank can permissibly discount.[101] As mentioned, not even every Reserve Bank practiced the principle, which has allowed for some fascinating comparisons between, for example, the Atlanta and St. Louis Reserve Banks, which each had oversight over different parts of the state of Georgia, but practiced different kinds of discounting techniques.

This point bears emphasis: *this was not the view at the time*. The real bills doctrine and the gold standard were seen as essential to the Federal Reserve Act's legitimacy. The claim that the new "Federal Reserve Notes" would represent "fiat money" were fighting words at the time that the new System's critics lodged at it at the time. The colorful Carter Glass is quotable at length here:

> Fiat money! Why, sir, never since the world began was there such a perversion of terms; and a month ago I stood before a brilliant audience of 700 bankers and business men in New York City, and there challenged the president of the National City Bank to name a single lexicographer on the face of the earth to whom he might appeal to justify his characterization of these notes. I twitted him with the fact that not 1 per cent of the intelligent bankers of America could be induced to agree with his definition of these notes, and asked him to name a single financial writer of the metropolitan press of his own town, to whom he might confidently appeal to justify his absurd charge. "Fiat money" is an irredeemable paper money with no specie basis, with no gold reserve, but the value of which depends solely upon the taxing power of the Government emitting it. This Federal reserve note has 40 per cent. gold reserve behind it, has 100 per cent short-term, gilt edge commercial paper behind it, which must pass the scrutiny, first, of the individual bank, next of the regional reserve bank, and finally of the Federal Reserve Board.[102]

Note Glass's twin reliance on the 40% gold-reserve ratio, and the invocation of the "short-term, gilt-edge commercial paper." The gold standard and real-bills doctrine were the selling points for the framers of the Fed. It was a perceived limit on how money could be raised by the System. The point is not that the real bills doctrine actually provided no limit on which bills could theoretically be discounted. It is that (1) some people within the System perceived such limitations, and acted accordingly, and (2) that Congress thought that it was not granting to an institution unfettered access to money creation with which it could then, in

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[100] FRIEDMAN & SCHWARTZ, *supra* note 85 at 194.
[101] See KETTL, *supra* note 2 at 23 for more on this point.
[102] Congressional Record: Proceedings and Debates of the Congress, Volume 51, Issue 17

turn, fund itself.

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.[103]

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."[104]

Neither the gold standard nor the real bills doctrine survives today. 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.[105] 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 here. The purpose 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, subject to none of the restraints that existed at that time.[106]

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[103] Quoted in KETTL, *supra* note 2 at 22.

[104] CLIFFORD, *supra* note 83 at 25.

[105] There is an extensive literature on the historical gold standard. The most accessible starting point is AHAMED, *supra* note at 75. 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 BRETTON 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).

[106] There is another fascinating element to the Fed's budgetary independence, particularly in the ways that these interact with legal and informal mechanisms. And that is the flip side of

E. *Scholarly Engagement with Fed Budgetary Independence*

Scholars have long noted that the Fed is not subject to the appropriations 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 Board is funded by assessments on member banks.[107] Others correctly note that the Fed is funded by assessments on the *Federal Reserve* Banks, rather than the member banks, but do not note the role played by proceeds from open market operations.[108] 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.[109] One

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/.

[107] Barkow, *supra* note 7 at 44 ("For example, the Federal Reserve is authorized to levy assessments against member banks to fund its operating budget."); Leader, *supra* note 67 ("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.").

[108] 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 8 ("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).

[109] Dombalagian, *supra* note 107 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

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,"[110] 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 unique budgetary independence.[111] 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.[112] 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."[113] And while the Fed may well find itself in a situation where its conventional means of securing funding will be inadequate, that eventuality, if it occurs, seems a flimsy basis for anticipatory reliance on the President for "aid in budget battles with Congress." The reality is that the Fed's budgetary independence is extraordinary, based only in part on statute, and illustrative of how the institutions of Fed independence—legal and non-legal—interact side by side to create the space within which the Fed operates. And that is a space that scholars have repeatedly mischaracterized.

F. *Conclusion: Implications of the Fed's Budgetary Autonomy*

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.[114] 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

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.").

[110] 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).

[111] Huq, *supra* note 8, at 29 (citing Bressman and Thompson, *supra* note 8 at 633-34.

[112] Bressman and Thompson, *supra* note 8 at 633.

[113] *Id.* at 633-34.

[114] ALLAN H. MELTZER, HISTORY OF THE FEDERAL RESERVE, VOLUME 2 BOOK 1 at xi (2010).

flies commercial.[115]

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.[116] And unlike non-appropriated agencies funded through market assessments, 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.[117]

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 original conception. 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 originally limited funding apparatus. Whereas the statutory mechanism anticipates checks on the Fed's ability to create the money with which it funds itself, the current practice has no such limitation. 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.[118]

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[115] 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.").

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

[117] 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).

[118] 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

For legal theory, the changing context of monetary policy—including the statutory change in eliminating the Reserve Banks' autonomy in 1935—has given new meaning to a statutory decision. The Congress in 1935 meant to separate the Fed from the congressional appropriations process, a decision that has endured. But it also meant to provide limits to that non-appropriations funding process. One by one, the limitations were erased. The statute presents one version of budgetary independence: one that relies on the good graces of the Reserve Banks, subject to the gold standard and the real-bills doctrine. The budgetary independence that the Fed enjoys today is very different.

For the practice of modern monetary policy, the Fed's extra-statutory payment system raises questions about democratic legitimacy. All else equal, it is better to have legislative authorization for a practice so central to the Fed's freedom of movement. But the political reality is that a decision to reopen the question—and there have been many efforts over the decades to do just that[119]—are very likely to introduce only more added legal complexity with even more unintended consequences. We will return to the policy implications for so difficult a legal thicket, but the argument that we should enshrine in statute the transparent practice that has arisen over the last eighty years is a difficult one to make.

III. The Length of Fed Service: Practical Repeal and Statutory Design

The reciprocal of independence is accountability, and the institutional design of the Federal Reserve System is an effort to balance both. One of the key statutory instances of that balancing act is the very long terms of the Board Governors (fourteen years, non-renewable) and the short terms of the Fed Chairs (four-years, renewable). As the Fed's website explains, "[t]he Federal Reserve, like many other central banks, is an independent government agency but also one that is ultimately accountable to the public and the Congress." To this end, "members of the Board of Governors are appointed for staggered 14-year terms and the Chairman of the Board is appointed for a four-year term."[120]

The reality of the lived experience of Fed tenure is the opposite. Governors'

> 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.

[119] See CONTI-BROWN, *supra* note XX at Ch 9.

[120] See *Current FAQs*, "What does it mean that the Federal Reserve is 'independent within the government'?, available at http://www.federalreserve.gov/faqs/about_12799.htm

terms are a source of presidential control, Chairs' terms are a source of Fed independence.

This Part explains how practice has come to reverse the plain statutory intention. It begins by explaining the context for the fourteen-year term and how practice has undermined it, and relates further how the Fed Chair makes use of her two statutory roles (as both Chair and Governor) to create a distinct political base that limits the President's freedom of appointment.

A. *The Myth of the Fourteen Year Term*

While the Chair is perceived in substance and form as the power behind the System generally, the presence of the other Governors, and the formal and informal institutions that support their independence from the President, are worth highlighting. Here, the legal protection of a non-renewable term and the practice—by no means compelled, but widely followed—of significantly shorter tenure are at cross purposes. The result of that combination is also unexpected, given the emphasis in the Federal Reserve Act and in the scholarship interpreting the Fed's independence: instead of *limiting* the President's ability to choose his Board, the practice of frequent resignations has enhanced it. Since the second founding of the Federal Reserve in 1935, the President has effectively chosen his Board.

This was not the original design. When the Federal Reserve System was reorganized in 1935, Congress included this instruction on the transition from the old Federal Reserve Board-system to the new Board of Governors:

> Upon the expiration of the term of any appointive member of the Federal Reserve Board in office on the date of enactment of the Banking Act of 1935, the President shall fix the term of the successor to such member 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 more than one member in any two-year period, and thereafter each member shall hold office for a term of fourteen years from the expiration of the term of his predecessor[121]

The idea was to prevent the President from stacking the Board and thus providing it with distance and independence. 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"[122] 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."[123] But a tradition of early resignation—a non-

[121] 12 U.S.C. § 242.
[122] Bressman and Thompson, *supra* note 8 at 607-608.
[123] Jorge J. Pozo, *Bank Holiday: The Constitutionality of President Mahuad's Freezing of Accounts*

legal institution—makes this legal guarantee less important than it seems. Excluding the Chairs, the average term of the governors since the Board was constituted in 1935[124] is just over six years, well within the mainstream of independent agencies.[125] 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,[126] although two others served portions of two terms totaling fourteen years or more.[127]

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.

Table 1 shows how, in practice, a convention of frequent resignations has made this legal mechanism of independence effectively inert.

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and the Closing of Ecuador's Banks, 15 N.Y. INT'L L. REV. 61, 90 (2002). See also, e.g., Barkow, *supra* note 7 at 24; Bernstein, *supra* note 6 at 148 n.182.

[124] 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 oficio 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.

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

[126] George W. Mitchell served from 1961 through 1976. *Id.*

[127] Edward W. Kelley, Jr., served between 1987 and 2001; J.L. Robertson served from 1952 to 1973. *Id.* Note, too, that M.S. Szymczak served from 1933 to 1961, the longest serving member of the Board. His appointment is not included in this analysis, because he was appointed to the Federal Reserve Board, and thus not subject to exactly the same appointment procedure.

Table 1: Presidential Appointments to the Board of Governors, 1935-2013[128]

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	5.5	7	1.3

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 1 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."[129] But there is a proviso: "except that this restriction shall not

[128] Source: *Membership*, *supra* note 125. Presidential Administrations calculated to the month, with President Obama's administration ending in August 2014. 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.

[129] 12 U.S.C. § 242.

apply to a member who has served the full term for which he was appointed."[130] The opportunities to translate the benefits of Board service to personal rewards in the banking sector are probably significant. And yet, Governors much more often than not end their terms early.

The consequence here is that the extraordinary legal institution—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 serve their full term.[131] Whether because the anonymity of the "C-list political celebrity" or the lack of authority relative to the Chair, the reason is unclear.

B. *The Myth of the Four-Year Term*

Because each Fed Chair is also a sitting Governor, she has two appointments: one a four-year renewable term as Chair, the other a fourteen-year non-renewable term as Governor. But the Federal Reserve Act also allows each Governor to serve the "unexpired term of his predecessor," a means by which a Governor can extend well beyond the fourteen-year term. Combine the two, and a Fed Chair could serve for almost twenty-eight years, subject to Presidential reappointment every fourth year.

The combination of these two terms should not in principle mean that the Chair is less accountable. But in practice, this has been the reality. When a Fed Chair seeks reappointment, she is a leading candidate for that reappointment, even if her initial appointment was by the sitting President's political opponent. Because of the nature of past resignations and the interaction between the Chair's four-year term and the fourteen-year term of the Governor who occupies the Chair—and, indeed, the statute's permission to serve the balance of a previous Governor's unserved term—the current situation is that the President will nominate a Chair roughly half-way through the President's term, usually when the Chair is eligible for another four-year term as Chair.

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[130] *Id.*

[131] 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.

The consequence of these staggered terms of a Presidential Administration and the Fed Chairmanship would render the Chair *more* independent of the President, since the Chair's renomination is in the hands of a potential successor. Once secured, the Chair can do what he will on monetary policy, irrespective of the President's wishes.

The history of the Federal Reserve System is a history of this kind of independence. William McChesney Martin, Jr. served through five presidential administrations, from Truman to Nixon. And at times, he conflicted intensely with the Presidents who (re)appointed him. President Johnson found his intransigence in monetary policy vexing, and sought to charm and then remove him. Martin himself nearly resigned, but decided against it, lasting almost twenty years as Fed Chair.[132] Paul Volcker presided over a debilitating recession prior to the 1982 midterm elections, and was not President Reagan's preference for reappointment. Indeed, even before inauguration, Reagan's chief domestic policy advisor warned the public that the President-elect would not commit to asking "Paul Volcker to remain in his" position as Fed Chair.[133] But because he was a candidate, Reagan and some of his advisors feared the consequences in the bond markets to the failure to reappoint. Volcker won that reappointment.[134] And President Clinton's reappointment of Alan Greenspan—despite the latter's credentials as a leading Ayn Randian libertarian[135]—was also influenced by Greenspan's then-extraordinary reputation that might have made his non-renewal politically costly to Clinton.[136] And sometimes the cost of failing to renominate a predecessor's Fed Chair is financial, not political: President Obama reportedly renominated Chair Bernanke at some political cost out of fear that the financial markets would respond adversely at the suggestion of monetary and regulatory policies other than those pursued during Bernanke's management of the financial crisis during his four-year term as Chair.[137]

While the four-year, renewable term for the Fed Chair provides an opportunity for the President and public to reassess the accomplishments of the Fed Chair. But no sitting Chair with time left to serve as

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[132] See BREMNER, *supra* note 168 at 196-205
[133] See SILBER, *supra* note 169 at 229.
[134] *Id.* at 230-34.
[135] See GREENSPAN, *supra* note 48 at 51-53.
[136] BOB WOODWARD, MAESTRO: GREENSPAN'S FED AND THE AMERICAN BOOM (2000).
[137] RON SUSKIND, THE CONFIDENCE MEN (2011)

Governor, who is interested in reappointment, can be dismissed out of hand. The effective Fed Chair builds a financial and political constituency for reappointment. The president must take that constituency in mind when making the reappointment decision, whatever the statute says. It is indeed 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 reappointed by President Reagan; Greenspan, appointed by President Reagan, reappointed by Presidents George H.W. Bush, Clinton (twice), and George W. Bush; and Bernanke, appointed by President George W. Bush, reappointed by President Obama.

C. *Conclusion: Legislative Drift*

The scrambling of intentions between the independence-enhancing fourteen-year term of the Governors and the accountability-enhancing four-year term of the Fed Chair demonstrates the argument about law the article makes. The statutory law gives one impression; the lived experience of personnel practices—high turnover among the Governors, cultivation of a political constituency of the Fed Chairs—diverges from that impression. This drift has implications for the institutional design of central banks, to be discussed below in the article's conclusion. But that it has occurred and reversed the statutory intent at all is remarkable in its own right.

It also illustrates, again, the article's theoretical combination of traditions in law, political science, and history. The statute matters enormously, although counter-intuitively: the preservation of a Governor's ability to serve the unexpired term of his predecessor is key to the Chair's longevity. It demonstrates the political theory of legislative design captured in a historical moment, similar to Moe's conception of agency design, by capturing the intention of a long-serving Board of Governors less dependent on the President with a regularly appointed Chair more dependent. And it captures the historical-theoretical argument of "totalizing contingency" by demonstrating how those original legislative ends have been subverted. The "institutional" approach taken in this article is the combination of these disparate theoretical insights—

legal, political, and historical.

IV. THE COMPLICATED DOCTRINE OF REMOVABILITY AT THE FED

The first test of Fed independence from a legal perspective is the test of "removability": whether, that is, the Fed fits the canonical taxonomy of an independent agency by virtue of removal restrictions on the Fed Chair. In fact, the statute is silent as to Chair removability, a reality intriguing both because of the prominence of removability in administrative law and because the statute is so detailed as to the removability of other actors within the Fed generally.

This Part explores removability—its absence in one case, its complicated presence—throughout the Federal Reserve System. The result is an illustration both of where removability matters (deep within the Federal Reserve System) and where it doesn't (for the Fed Chair). It also illustrates the way that a careful statutory design can become unmoored from changing legal realities. This is especially true in the case of the presidents of the Reserve Banks: although they exercise federal policy in their roles as equals of the presidential appointees on the Federal Open Market Committee, the President must reach through three (maybe four) layers of bureaucracy before he could remove them. The structure Congress created in 1913 and 1935 is unconstitutional, but unlikely to be changed by judicial intervention: the DC Circuit has considered the question four times, and dismissed it on justiciability grounds each time. This Part explains the details of this curious history.

A. *Doctrinal Overview: Removability and Appointment*

To understand more, it is helpful to get a more developed sense of the doctrinal landscape. Article II, section 2, clause 2, requires "Officers of the United States" to be appointed by the President with the Senate's advice and consent. If Congress wants to set up a bureau or agency or department staffed by officer of the United States, presidential appointment and Senate confirmation is the constitutional minimum required by law.

But the Constitution makes clear an exception to this broad rule, for "inferior Officers." Congress may vest "in the President alone, in the Courts of Law, or in the Heads of Departments" the appointment of the inferior officers. The first analytical question, then, for the Appointments Clause is whether the challenged personnel—here, members of the Federal Open Market Committee—are principal or inferior officers. And the key precedent to answer that question is Edmond v. United States, which held that "[w]hether one is an 'inferior' officer depends on whether he has a superior."[138] Moreover, "'inferior officers' are officers whose work is directed and supervised at some level" by officers appointed by the President and confirmed by the Senate. In other words, if a federal officer has a boss

[138] 520 U.S. 651, 662-63 (1997)

who went through the Presidential-appointment-and-Senate-confirmation process, that officer is by definition an inferior one.

That's the first part of the constitutional analysis. The second concerns the general principle separation of powers that underlies the constitutional scheme. We have three branches. The President embodies the executive, and must "take care that the laws be faithfully executed."[139] He is one, but administration, ancient and modern, is legion. Hence the appointment of officers to constitute the President's administration.

It is apparently only for historical reasons that the drama over *appointments* would become a contest over restrictions on *removals*. In the iconic 1926 case, *Myers v. United States*, Chief Justice William Howard Taft reviewed a statute concerning the appointment of postmasters.[140] The statute required the appointment of these postmasters to the usual advice and consent of the Senate, but also subjected the removal of the postmaster to the same restriction.[141] The Court thought this a bridge too far, and determined that the President must have some "power of removing those for whom he can not continue to be responsible."[142]

Ten years later, the Court retreated from this view, at least in part. In *Humphrey's Executor v. United States*,[143] the Court held that Congress can, under certain circumstances, create independent agencies run by principal officers appointed by the President, but whom the President may remove only for good cause. Later, in *Morrison v. Olson*,[144] the Court sustained similar restrictions on the power of principal executive officers—themselves responsible directly to the President—to remove their own inferiors.

In 2010 the picture became more complicated. In *Free Enterprise Fund v. PCAOB*, the Supreme Court confronted the combination of those two protections: an agency head removable for cause (here, the Commissioners of the Securities Exchange Commission; although, interestingly, this removal restriction was presumed by the Court not indicated by Congress[145]) who can remove other officers only for cause (here, members of the Public Company Accounting Oversight Board). The Court held that "such multilevel protection from removal is contrary to Article II's vesting of the executive power in the President," and found the provisions that had established the second layer of for-cause protection unconstitutional.[146]

To sum up the legal doctrinal state of play: principal officers need the Senate's advice and consent to be consistent with the Appointments Clause; inferior

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[139] U.S. Const. Art. II, § 3

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

[141] *Id.* at 164.

[142] *Id.* at 117.

[143] 295 U.S. 602 (1935)

[144] 487 U. S. 654 (1988)

[145] *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. at 3148-49; see also Vermeule, *supra* note 7 at 1167.

[146] *Id.* at 3147.

officers do not. Even after an appointment through the Appointments Clause, principles of separation of powers regulate Congress's ability to protect a federal officer from at-will employment termination: Congress cannot make the removal of an executive officer subject to its own advice and consent, but it can insulate an officer from (1) getting fired for any or no reason, or (2) getting fired—again, unless for good cause—from another principal officer, so long as that officer is herself subject to direct Presidential supervision. No nesting of such protections is allowed.

Such is the doctrinal state of play. How does the Fed fit within that system?

B. *The At-Will Fed Chair*

1. The Law

The Chair of the Board of Governors serves two statutorily-defined roles: she is the Chair of the Board, nominated by the President and confirmed by the Senate to a four-year term. She is also one of seven members of the Board, nominated by the President and confirmed by the Senate to a fourteen-year term. The Federal Reserve Act is clear that, in her capacity as Governor, she is only removable for cause.[147] The statute is silent, however, with respect to her removability as Chair.

Given the hallmark of independence that removability has become in administrative law, and given the prominence that the Fed Chair receives within the System and indeed within government and the public imagination generally, it is perhaps remarkable that the Federal Reserve Act is silent on the question of Chair removability. There are at least three possible explanations: (1) Congress erred in its silence, and removability should be inferred; (2) the equation of removability with independence is nonsensical, since the Fed is widely perceived as the paragon of agency independence and its head has no such protection; or (3) removability matters, but not where it is associated so closely with appointment. That is, where the President appoints, removability is less relevant. Where he does not, it is more relevant.

Vermeule explores these and related arguments.[148] His conclusion is that "formal independence" is unnecessary at the Fed, because its Chair is widely perceived to be independent without consultation to the Federal Reserve Act. Because of that silence, "its independence is protected by a network of statutory provisions and hoary conventions."[149] In reaching this conclusion, Vermeule considers the structurally similar situation of the Chair of the Consumer Product Safety Commission, whose five members enjoy removability protection, but whose chair does not. In that case, the Office of Legal Counsel concluded that the President could

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[147] 12 U.S.C. § 242

[148] See Vermeule, *supra* note 7

[149] *Id.* at 1176.

remove the Chair at will, but that Chair would continue to serve as a Commissioner.[150]

The judicial support for this view is strong, as Vermeule points out.[151] But so too is the judicial support for the opposite conclusion, that a court faced with the question whether Congress *meant* to give removability protection. Out of this apparent impasse—they both can't be true—Vermeule concludes that this independence must come not from law, but from "hoary convention," making the statutory reality irrelevant.

I don't share the conclusion, which seems to an argument that destroys the exception. A cruder version of this argument goes like this. Three premises: (1) The formal definition of agency independence means that an agency is only independent if the agency head is removable for cause only. (2) Everyone understands the Fed to be an independent agency, probably the most independent of agencies. (3) The Federal Reserve Act is silent as to the removability of the Chair of the Federal Reserve. Ergo, there is widespread acceptance of a convention 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 (1) there is more to legal independence than removability protection, and (2) whatever forces protect the Fed chair from arbitrary dismissal don't come from law. This argument is something less than Vermeule's conclusion that there are formal conventions against firing a Fed chair, but something more than the conclusion that the Fed Chair is in constant fear of being summarily fired.

The rest of the article looks at many other legal mechanisms of independence, but there are dozens of others that scholars have identified.[152] The history of Presidents' dissatisfaction with Fed Chairs illustrates the second point: whatever protection a Fed Chair has from summary dismissal is something other than legal, and not exactly conventional. While it's accurate to say that "no President has ever formally discharged the Fed Chair,"[153] the history of Chair transitions demonstrates what Presidents can and have done—and what Chairs can and have done—in response to threats on their removal.

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.[154] But this takes a narrow view of how and whether Presidents can push Fed Chairs aside. The experience of three Chairs in the post-1935 Fed demonstrates the variety of ways that a President can (or cannot, in one

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[150] *Id.* at 1176-77.

[151] *Id.*

[152] See Datla & Revesz, *supra* note 34 focusing on a variety of other legal mechanisms of independence.

[153] Vermeule, *supra* note 7.

[154] 295 U.S. 602, 629-30 (1935).

case) remove a Fed Chair from a place of influence within the System.

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.[155] Eccles chalked up the denial of reappointment to his taking too hard a stand on a banking enforcement in California,[156] but Truman's Secretary of the Treasury thought Eccles insufficiently supportive of the President on monetary policy—precisely the question of Fed independence.[157] But unlike subsequent Chairs Burns[158] and Volcker—neither of whom was reappointed as Chair when the terms of Governor would have permitted reappointment—Eccles refused to leave the Board of Governors, and continued to make his influence felt on some of the highest-profile decisions in the Fed's history, for five more years.[159] The President wanted Eccles out, and his decision not to reappoint Eccles at the conclusion of the latter's term is certainly not a removal. But Eccles's decision to stay at the Board—something no other Chair has done since for any meaningful amount of time—is a partial counter-argument to the idea that there is a convention of non-removability at the Chair. It is not a convention, so much as a reflection that a hostile maneuver like Truman's failure to reappoint (or another president's effort to remove a sitting chair) wouldn't in fact resolve the President's problem. So long as the Chair-as-Governor retains years on his term, he can (as did Eccles) continue to exercise influence in precisely the way the President hates. Of course, Eccles was not "removed" in the formal sense. But his example illustrates the political gamble that such a maneuver might represent.

The second, and very different, example is Thomas McCabe, Eccles's successor, also provides an important example of a different variety. McCabe was Truman's man. He was appointed in 1946 expressly to draw the Fed more closely to the Administration, to get the Fed that Truman felt Roosevelt had had during World War II. And, for many years, McCabe performed as Truman expected (much to the chagrin of by-then Governor Eccles). But soon the Fed—especially in the person of the itinerant speaker Marriner Eccles—made public its discomfort

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[155] 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 48 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.

[156] *Id.* at 443-47.

[157] KETTL, *supra* note 2 at 63.

[158] 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).

[159] This included the period of the Fed-Treasury Accord, which Eccles played a singular role in establishing. See Conti-Brown, *supra* note XX at ch 1.

with the Administration's expectations that the central bank would purchase government debt with no end in sight, whatever the consequences for inflation. Tensions flared, and eventually included a dramatic stand-off between the Truman Administration and the Fed.

During this heady time, Truman summoned the Federal Open Market Committee meeting to the Oval Office for the first (and only) time in its history. He separately accused them of doing "exactly what Mr. Stalin wants" by refusing to support the President.[160] Eventually, with McCabe in full agreement, the Fed and Treasury struck the famed "Accord" that paved the way forward for a more independent Fed. But part of the Accord was that McCabe would step aside, as would Eccles; in their places went members of the Administration whom Truman preferred.[161]

Was McCabe pushed out? At least one contemporaneous observer thought so: Senator Paul Douglas (D-Ill.) saw the almost immediate resignation of the two senior members of the Board of Governors, and their replacement by two Treasury insiders, as something of an unofficial deal that the "truce" declared in the Accord just meant Treasury domination, as usual.[162] If Eccles represents the risk to a President in forcing a Chair out without removing him from his Governorship, McCabe represents the possibility of a more deft touch.

William G. Miller represents a third approach: removal by promotion. Miller was President Carter's first Fed Chair widely viewed by contemporaries as an incompetent Chair.[163] In what may well be unique in the annals of executive appointment, Miller's removal was not to the ignominy of the private 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.[164]

These examples bear on the question of legal independence of the Chair by demonstrating that, even without that legal independence, the President has, in these limited cases, exercised some control over the person occupying the central chair. It also demonstrates that the presumption of a convention of removal protection where none exists in statute misses the more complicated reality of Fed appointments. The Fed Chair serves a four-year term as Chair, but a fourteen-year term as Governor. Because he can serve the unfilled terms of other Governors, the Fed Chair is constantly up for reappointment. Failure to reappoint when reappointment is statutorily permitted, then, is effectively a dismissal.

But the argument that the Chair is protected from removability by convention fails for a more basic reason: the lack of evidence that there is a widespread presumption in favor of the existence of a bar on removability. One can argue that

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[160] Kirshner (2007, 144) (quoting Federal Reserve Board, Minutes, January 31, 1951, pp. 9.

[161] CLIFFORD, *supra* note 83; KETTL, *supra* note 2.

[162] Clifford (1965, 267-68)

[163] KETTL, *supra* note 2.

[164] KETTL, *supra* note 2.

the statutory silence on Chair removability is "contrary to widespread belief,"[165] but there is no direct evidence for this conclusion. The point may be instead that there is a widespread belief that the Board is an independent agency, or even the most independent of agencies. This conclusion certainly appears among academic economists. To cite a trivial example, economists do not acronymize SEC or FCC independence in the way they do CBI. But, as this article has argued, the independence of the Federal Reserve is about much more than the removability or not of the Fed Chair, and while economists certainly focus on the legal mechanisms of that independence, no model of CBI has ever focused exclusively on removability. Thus, the characterization of the non-removability of the Fed Chair as implied indulges in the same shortcut—that non-removability is the sine qua non of an independent agency—that this article and many others have challenged.[166]

Given how often the Chair is up for reappointment, 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.[167] 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 the equivalence for agency independence. The perhaps startling reality is that, as a formal matter, there is no legal separation between the President and the Chair: the Chair is, or at least should be, fireable at the President's will. That no President has done so by angry letter only tells us more about the operation of Presidential personnel strategies rather than about laws or conventions of Fed independence.

2. Personality and Politics in Fed Independence

This is emphatically not to say that Fed independence is based in laws more varied than removability. There is a substantially basis in tradition and practice that monitors the relationship between the Fed and the President. While many of these practices don't reach the kind of law-like nature of "conventions" about which judges must take notice, they matter all the same. These informal appearances of independence from the President are an important part of the role, and

[165] Vermeule, *supra* note 7 at 3, 5, 10.

[166] See especially *id.*, *passim*.

[167] Again, Eccles wasn't removed, only not renominated.

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,[168] Paul Volcker,[169] and Alan Greenspan[170] who seemed constantly preoccupied by the maintenance of this informal independence.

The rule is perhaps best illustrated in the breach. 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,[171] 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 policy proprieties of 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.[172] Burns attended cabinet meetings;[173] had his speeches vetted by Nixon's staff;[174] cleared his talking points with the President ahead of a meeting with other central bankers in Basel, Switzerland;[175] advised Nixon on tax, wage, and other fiscal policy;[176] made pledges to remain the President's "true friend" on economic policies before the public;[177] and more.[178]

Perhaps in part following the anti-example of Burns, Chairs have appropriately sought to maintain their distance from the informal pull of the office of the

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[168] 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).

[169] SILBER, *supra* note 169, at 191-95, 266-67.

[170] GREENSPAN, supra note 48 at 142, 146, 153, 293, 478, 479 (2007).

[171] KETTL, *supra* note 2.

[172] ARTHUR F. BURNS, INSIDE THE NIXON ADMINISTRATION: THE SECRET DIARY OF ARTHUR BURNS, 1969-1974 31 (ed. 2010).

[173] *Id.* at 32.

[174] *Id.* at 34.

[175] *Id.* at 40.

[176] *Id.* at 45, 49.

[177] *Id.* at 47.

[178] 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; (t) 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.

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.

3. Removability and Personality: the Net Effect for Fed Chair Independence

What, then, is the net effect for Fed independence based on the legal and non-legal institutions of Fed independence between the Fed Chair and the President? As the foregoing illustrates, the answer to that question is impossible to predict in the abstract. The nature of that relationship is entirely dependent on the personalities of the individuals who occupy the offices. While the law of Chair reappointment, with its interaction with appointments to the Governorship, favors across-Administrations appointments when the economic climate favors the policies of the incumbent Chair, it also suggests the incentive to cater to an incoming President's wishes on economic policy. Thus, how that dynamic will play out in practice will depend on those individuals and their individual and historical contexts. The open and narrow legal question of the Chair's status—should the statute be read to imply removal protection?—is essentially irrelevant. However interesting as a matter of administrative law, the impact of the rule is far less important than the other institutions that regulate the Chair's relationship with the President.

C. *Removability and the Reserve Bank Presidents: The Fed's Constitutional Problem*[179]

This is not to say that removability restrictions are not important as a matter of law and policy of Fed independence; to the contrary, removability restrictions through multiple levels of the Federal Reserve's bureaucracy render its structure unconstitutional. If *Free Enterprise Fund* presented "*Humphrey's Executor*-squared," in Judge Kavanaugh's words, the Federal Open Market Committee presents *Humphrey's Executor*-cubed.[180]

1. The Federal Open Market Committee and the Constitution

Congress created the Federal Open Market Committee (FOMC), the Federal

[179] I first made similar arguments in the essay, *Is the Federal Reserve Unconstitutional? And Who Decides?*, Library of Law & Liberty, September 1, 2013, available at http://www.libertylawsite.org/liberty-forum/is-the-federal-reserve-constitutional/. For more on this topic, see David Zaring, *Law and Custom on the Federal Open Market Committee*, draft paper, available at http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/cle_reading-_panel_3.pdf

[180] *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.* 537 F.3d 667, 686 (DC Cir. 2008)

Reserve System's monetary policy committee, in 1933 to centralize what had been the quasi-independent monetary policies of the twelve Reserve Banks, themselves created under the original Federal Reserve Act of 1913.[181] Two years later, in the Banking Act of 1935, Congress refashioned the FOMC to include all seven members of the newly created Board of Governors of the Federal Reserve System (which replaced the original 1913 Federal Reserve Board). The rest of the FOMC included five of the twelve Reserve Bank presidents on a rotating basis. After 1942, the president of the Federal Reserve Bank of New York became a permanent member of the FOMC. By convention, he is also Vice Chair of the Committee. The Committee meets six times per year to announce its outlook on the world and national economy and its decisions regarding various features of monetary policy. (I won't go into detail about the policy levers the Fed pulls; others have presented useful introductions to those levers and the operations generally. See especially Axilrod[182] and the Fed's own somewhat dated overview.[183])

It is the presence of the Reserve Banks on the FOMC creates constitutional problems, both with respect to the Appointments Clause on the one hand and separation of powers and removability on the other. The Reserve Bank president, in her rotating capacity as a member of the FOMC, could not qualify as an inferior officer by the *Edmond* standard. The Board of Governors certainly supervises the Reserve Banks in every other respect, as provided by statute.[184] In their roles as Reserve Bank presidents, the inferior officer designation seems apt. But as members of the FOMC, Reserve Bank presidents' votes count the same as those of their would-be superiors, the President-appointed, Senate-confirmed Board Governors.[185]

First, the President does not appoint, and the Senate does not confirm, the Banks' presidents. (Note that while the statute does not require that the Reserve Bank representative be the president, the president is in practice almost always the Bank's representative.)[186] Their appointment process is itself a circuitous one that begins with the Reserve Bank's board of directors. Each board is divided into three classes.[187] Class A directors are bankers selected by the regulated banks.[188] Class B

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[181] Pub.L. 73–66, 48 Stat. 162, enacted June 16, 1933

[182] Stephen Axilrod, THE FEDERAL RESERVE: WHAT EVERYONE NEEDS TO KNOW 41-64 (2013).

[183] Bd. of Gov. of the Federal Reserve System, The Federal Reserve System: Purposes & Functions 27-51 (2005).

[184] E.g., *id.* § 301.

[185] There does remain the question of whether monetary policy is, in fact, federal policy of the kind that will trigger Appointments Clause concerns. I think the answer is unquestionably yes: indeed, the very foundation of the Federal Reserve System presupposed the inability of private systems—like, for example, the clearing house model in place prior to the Federal Reserve System—that some governmental structure was necessary. If that was true in the monetary conditions of the early 20th century, I think it beyond dispute in the vastly more complicated—and vastly larger—monetary context of the early 21st.

[186] 12 U.S.C. § 263(a)

[187] *Id.* § 341

[188] 12 U.S.C. § 341

directors are non-bankers selected by the regulated banks. Class C directors are non-bankers selected by the Board of Governors in Washington, DC. Until 2010, the directors voted as a whole to select the Reserve Bank president; after Dodd-Frank, now only Class B and C directors take that vote. The President never formally indicates any preference for their appointment to their posts at the Reserve Banks, and their role within the FOMC is determined by statute.[189]

Second, the President has *no* authority to remove members of the FOMC qua members of the FOMC, just as he has no power to appoint members of that Committee. He appoints and the Senate confirms the seven members of the Board of Governors, who are statutorily members of the FOMC. We already know that Board members are removable "for cause" only.[190] But the Reserve Bank presidents are removable at the pleasure of the Reserve Bank directors. Removal of all of those directors is possible, but only after "the cause of such removal" is "forthwith communicated in writing by the Board of Governors of the Federal Reserve System to the removed officer or director and to said bank." While there is some ambiguity as to whether this writing "the cause" of such removal is equivalent to "for cause" removal, the inclusion of the term "cause" may be sufficient to trigger that presumption.[191]

In other words, if the President does not like the Reserve Banks' execution of the laws, to remove them he must:[192]

(1) Instruct the Governors that he will deem their failure to comply with his request to fire the New York Fed president as "cause" for their own termination. Again, not to the Chair alone, but to all seven governors.

(2) The Governors would have to turn to the directors and say that they will be removed if they fail to fire the Reserve Bank president, as the President requested, and that such cause would be "forthwith communicated by writing," as required by statute.

(3) The directors—all three classes, not just the ones that appointed the Reserve Bank president in the first place—would then have to fire the Reserve Bank president, who is removable at the pleasure of the board. In other words, the bankers' representatives would have to agree that the Reserve Bank president's failure to honor the U.S. President's policies—not their own—was sufficient for the Reserve Bank president's removal.

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[189] *Id.* § 263(a)

[190] *Id.* § 242

[191] See *supra* note 145.

[192] I made similar arguments in the blog post, *The Secret Service and the New York Fed: A Tale of Two Appointments*, Yale J. Reg. (October 1, 2014) available at http://www.yalejreg.com/blog/the-secret-service-and-the-new-york-fed

Restating the holding in *Free Enterprise Fund*—that Congress cannot create an agency that is insulated by two levels of removal protection—reveals the constitutional defect of the FOMC. The President cannot remove members of the FOMC without reaching through two explicit for-cause removal restrictions, on top of a third layer of at-will removability. Granted, the relationships between the three layers in the FOMC and the two in the SEC-PCAOB are different—the Presidents and the Governors are colleagues together on the FOMC, rather than separate, ostensibly hierarchical entities. But these differences don't matter, constitutionally speaking. For these reasons, the Federal Reserve, as currently designed, is unconstitutional. The separation between the U.S. President and the Reserve Bank presidents on the FOMC, is too great.

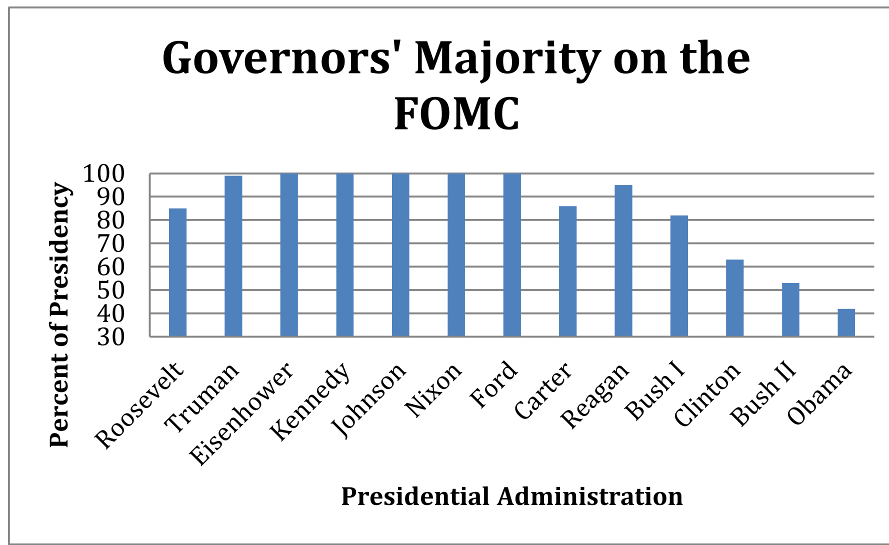
D. *Constitutional Implications of Current Appointment Practices*

It is a conceivable constitutional defense of the FOMC structure that the Board of Governors—each member of which in possession of a presidential commission and a Senate confirmation—constitutes a numerical majority of the FOMC. On that argument, so long as the majority holds, the requirements of public vetting and confirmation are satisfied. The Reserve Banks aren't creating federal policy because they are outnumbered by those Presidential appointments who are.

This is not a compelling argument, formally. As a formal matter, if the authority exercised is federal, and the officer exercising the authority a principal one, the inquiry should be over. The presence of public actors exercising constitutional power doesn't erase the unconstitutionality of private actors exercising the equivalent power. But it may be more promising, functionally: if the purpose of a constitutional limit on private exercise of federal power is public accountability, then a Governor majority on the FOMC should be sufficient to keep that private power in check.

This raises the question: how often have the Governors enjoyed a majority? The chart below indicates the historical trend.[193] After the newly created Board of Governors slowly displaced the abolished Federal Reserve Board during the last ten years of the Roosevelt Administration, the Governors enjoyed a majority nearly 100% of the time, from 1945 until 1977—the majority fell to parity, and never lower, for just sixteen days in thirty-two years. In the Carter Administration, things started to slide. Carter's appointees (and their predecessors) on the Board held an FOMC majority about 85% of the time, but that majority was back up above 90% during the eight-years of the Reagan Administration. The slow descent began after that, culminating in the Obama Administration's abysmal record at 42%. That is, 58% of the time, effectively private bankers held a majority on the

[193] I developed some of these ideas for a popular audience in Peter Conti-Brown, *The Constitutional Crisis at the Federal Reserve*, Politico Magazine, April 14, 2014.



FOMC. The Obama Administration holds another ignominious record touching on the constitutional debility of the FOMC: it is the first to Administration to take the Governors to a 4-5 minority, as opposed to parity, which it has done three times.[194]

The Governors' majority is not stable on the FOMC. This reality—especially given the expectation of continued vacancies in the end of an Administration[195]—represents a sea change over two generations. It also means that any defense the 7-5 public majority on the FOMC has enjoyed is no defense at all.

E. *Judicial Protection of Unconstitutional Structures*

The courts have an answer to the constitutional crisis: render, by judicial fiat, the previously non-removable principal officers removable by at least the Board of Governors (if not by the President). This was the result in *Free Enterprise Fund*: the members of the PCAOB are now removable at will by the Commissioners of the SEC. And the PCAOB continues to operate just as it had done; its members are appointed just as they had been; and there is no evidence anywhere (that I am aware of) that the PCAOB's enforcement behavior has changed since the case was decided in 2010. The only difference is that the Court rendered the members of the PCAOB removable by the Commissioners of the SEC.

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[194] Source: Members of the Board of Governors of the Federal Reserve System, available at http://www.federalreserve.gov/aboutthefed/bios/board/boardmembership.htm

[195] For a thorough exploration of vacancies in administrative agencies, see Anne Joseph O'Connell, *Vacant Offices: Delays in Staffing Top Agency Positions*, 82 S. Cal. L. Rev. 913 (2009).

If the FOMC removability issue were ever litigated to conclusion, the result would likely be the same.[196] The members of the FOMC not appointed by the President would be rendered removable at will by the Board of Governors, just as the Governors supervise the Reserve Banks in every other aspect of the Fed's wide regulatory berth. And, also following *Free Enterprise Fund*, that removability will immediately render them Appointments Clause-approved inferior officers.[197]

Some defenders of the present configuration may say that such a change would have a chilling effect on the FOMC conversations or votes. Would Jeffrey Lacker or Richard Fischer or Thomas Hoenig dissent, as they have done, if the Board could remove them for any reason at all?[198]

It's impossible to speak with certainty to the counterfactual, but the level of control that already exists over the selection of the Reserve Bank presidents, and the public outcry that would result from the exercise of that legal authority, is likely all the protection that people like Larcker, Fischer, and Hoenig would need. This is perhaps the greatest problem with the focus on removability as the watchword of independence: Formal protection against removability isn't necessary to make a removal decision controversial. President George W. Bush and Attorney General Alberto Gonzalez suffered after firing nine U.S. Attorneys (who had no tenure protection), as did President Richard Nixon and Solicitor General Robert Bork, after they dismissed the at-will service of Special Watergate Prosecutor Archibald Cox. The summary firing of at-will employees of the executive led to the ouster of an Attorney General and, in part, the resignation of a President.

This judicial fix is, if history is a guide, unavailable to those who would challenge the unconstitutional structure of the FOMC, because this litigation is almost certainly never going to occur. There is a reason that no court has ever evaluated the institutional design of the FOMC, arguably the most powerful of federal agencies, for constitutional defect. There is a doctrine of justiciability invented precisely to prevent this litigation from occurring.

In the 1970s and 1980s, a series of petitioners—first a Congressman, then a Senator, then private citizens, and then again another Senator—challenged the structure of the FOMC on exactly this basis. And in each case, the DC Circuit—the initial appellate forum for most litigation on this issue—refused to reach the merits.[199]

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[196] See, for example, Intercollegiate Broad. Syst., Inc. v. Copyright Royalty Bd., 684 F.3d 1332, 1334 (D.C. Cir. 2012), which found a similar institutional defect and followed the *Free Enterprise Fund* Court in judicially reconstructing the relevant statute.

[197] See *Free Enterprise Fund*, 130 S. Ct. at 3162.

[198] For an explanation and defense of these dissents, see Thomas M. Hoenig, *Monetary Policy and the Role of Dissent*, Central Exchange, Kansas City, MO, 5 January 2011.

[199] See *Melcher v. FOMC*, 836 F.2d 561 (D.C. Cir. 1989); *Committee for Monetary Reform v. Board of Governors*, 766 F.2d 538 (D.C. Cir. 1985); *Riegle v. FOMC*, 656 F.2d 873 (D.C. Cir.) (1981); *Reuss v. Balles*, 584 F.2d 461 (D.C. Cir.) (1978). As Mark Bernstein explains in his excellent (if dated) treatment of the FOMC's constitutionality, the first challenge to open-market activities was actually in the Second Circuit under the Federal Reserve Board system which antedates the FOMC structure. See Bernstein, *The Federal Open Market Committee and the Sharing of Governmental Power with Private Citizens*, 75 VA. L. REV. 111, 132 n. 90 (1989)

For the member of the House of Representatives, the private status of some members of the FOMC had nothing to do with the plaintiff's votes on the House floor, a curious theory of injury that the DC Circuit was quick to reject.[200] For the private citizens, suit was bounced because theirs were "generalized grievances shared in substantially equal measure by all or a large class of citizens" whose adjudication would "require the courts to decide abstract questions of wide public significance even though other governmental institutions may be more competent to address the questions and even though judicial intervention may be unnecessary to protect individual rights."[201]

But for the two senators—Senator John Melcher, a Democrat from Montana and Senator Donald Riegle, a Democrat from Michigan—the analysis was quite different. In each case, the plaintiffs' theory of injury was his inability to advise and consent on the appointment of a principal officer exercising federal authority delegated by the U.S. Congress. Beginning with *Riegle*, the court found that Senator Riegle's "inability to exercise his right under the Appointments Clause of the Constitution is an injury sufficiently personal to constitute an injury-in-fact."[202]

But where the Circuit gave with one hand, it took with the other. Explicitly following the logic of a law review article written by a DC Circuit judge not on the panel,[203] the court decided that "[t]he most satisfactory means of translating our separation-of-powers concerns into principled decisionmaking is through a doctrine of circumscribed equitable discretion."[204] The Supreme Court, in its subsequent treatment of legislative standing in *Raines v. Byrd*, 521 U.S. 811 (1997), has mostly embraced a similar conclusion regarding legislators' ability to challenge statutes' constitutionality. While the facts in *Raines* didn't address the question of a Senator being denied the ability to give advice and consent to a principal officer's appointment to a federal position, the decision is animated by a similar theory.[205] The courts are therefore unlikely to take up the challenge to the constitutionality of the FOMC. Any hope of redressing either constitutional defect of the FOMC—the minor one of the private bankers' non-removability, or the major one of those bankers' majority on the FOMC—resides with the Congress, and the President. In other words, "equitable discretion allows courts to dismiss a case that presents separation-of-powers concerns without making those concerns part of the standing test,"[206] a new doctrine that resides uncomfortably next to and overlapping with

[200] *Reuss*, 584 F.2d at 467.

[201] *Committee for Monetary Reform*, 766 F.2d at 543 (citing *Warth v. Seldin*, 422 U.S. 490, 499 (1975).

[202] 656 F.2d at 873.

[203] Carl McGowan, *Congressmen in Court: The New Plaintiffs*, 15 GA. L. REV. 241 (1981).

[204] 656 F.2d at 881.

[205] See Raines, 521 U.S. at 816-17 (citing *Moore* v. *U. S. House of Representatives,* 733 F. 2d 946, 950-952 (DC Cir. 1984). *Moore* relies substantially on *Riegle*.

[206] Anthony Clark Arend and Catherine B. Lotrionte, *Congress Goes to Court: The Past, Present, and Future of Legislator Standing*, 25 HARV. J.L. & PUB. POL'Y 209, 238 (2001)

other doctrines of justiciability such as the political question doctrine and legislative standing.[207]

It remains, however, the law of the DC Circuit. So it is that the judiciary created the laws that would limit agency distance from the President's personnel decisions while it simultaneously refuses to enforce those decisions. Judicial non-action becomes itself a kind of formal *and* informal mechanism of Fed independence.

F. *Conclusion: The Life of the Federal Reserve Act*

The curious case of removability protection within the Federal Reserve System—so complicated and circuitous in the case of the Reserve Bank presidents, so missing in the case of the Fed Chair—presents a quandary for a legal theory of Fed independence. The quandary is resolved by analyzing the difference between law as created and law as implemented. The law created a Fed Chair answerable to the President, every four years and with no protection from at-will termination. In practice, this structure tells us little. Sometimes the President refuses to renominate a Fed Chair (to his detriment in the case of Marriner Eccles, to his credit in the case of G. William Miller).

But removability restrictions on the Reserve Bank presidents are based in law and essentially prevent presidential meddling with Reserve Bank operations, even in the execution of the nation's monetary policy. Here, the changing context—a judicial one, with constitutional principles pronounced and adjudication of those principles declared impossible—gives the terms of the statute new life. It is allowed to continue a trajectory of institutional design not available to other agencies. In fact, Justice Breyer's dissent in *Free Enterprise Fund* included a list of all those agencies that might be affected by the court's logic.[208] Perhaps inadvertently, the FOMC was excluded from the list. It was an appropriate exclusion.

The FOMC's enduring unconstitutionality demonstrates the power of the article's argument. It is not a convention of Fed independence that it enjoys this peculiar protection from constitutional evaluation: judge-made law is still law. But it is the case that the statutory provision of insulation of Fed actors from presidential oversight is of far greater moment than it might seem. It is an unconstitutional structure that endures because the judiciary permits it.

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[207] Equitable discretion has been severely criticized, including from the bench. Judge Bork refused to acknowledge the authority of *Riegle*. In his words, "I do not consider myself bound by the panel decision[] in *Riegle* . . . . *Riegle* . . . purported to change the law of legislator standing in this circuit without submitting the issue to the full court. Under the established practice of this court, that may not be done." *Crockett v. Reagan*, 720 F.2d 1355 (D.C. Cir. 1983) (Bork, J. dissenting)

[208] *Free Enterprise Fund*, 130 S. Ct. at 3185-3201

CONCLUSION

The Fed has had an extraordinary century. But its future, including the ways in which it will continue to formulate and implement national and global economic policy, 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 the institutions of Fed independence—with an appropriate, nuanced understanding of the relationship between legal and non-legal institutions—can guide those heated debates. Without that understanding, the risk is not only that critics and defenders will talk past each other, but that they will talk past the institutional features of the Federal Reserve itself.

As this article has illustrated in detail, the Fed's relationships with Congress and the President are regulated by institutions legal and non-legal, formal and informal. The assumption that law is the exclusive source of Fed independence is wrong. But the opposite assumption, that law is a charade, is also incorrect. Instead, this article has demonstrated that there exists a divergence between the statutory law and the life the statute leads after the ink has dried. Sometimes that divergence goes farther along the same direction originally designed (more budgetary independence as a result of non-appropriations and the fall of the limits put in place). Sometimes the consequence is a reversal of original policies (the accountability-enhancing aspect of the fourteen-year term of the Board of Governors, the independence-enhancing features of the four-year term for the Chair). And sometimes the extra-statutory changes are entirely exogenous: the judicial determination that a structure is unconstitutional, even while there exists a judicial determination that the issue is not justiciable.

In each case, the point is the same: one cannot understand the nature of legal independence by reading the statute. There is a more complicated world that lies beneath.

But the benefit of understanding the law and history of the Federal Reserve is more than to get the story right. The prominence of the Federal Reserve is surely sufficient to justify the more comprehensive understanding of the institutions of Fed independence. But there are other public policy reasons why an evaluation of Fed independence from a legal-institutional perspective is important. The question of Fed independence is a perennially contested one. Is an independent Fed, as Chair Martin claimed, "the primary bulwark of the free enterprise system"?[209] Or is the Fed's independence largely responsible for the financial crisis, as Nobel-prize winning economist Joseph Stiglitz has suggested?[210]

This article has sought to challenge those who would resort immediately to a contest over first principles to a more institutionally-sensitive debate. Instead of

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[209] Address at the Eighteenth Annual Convention of the Independent Bankers Association, Minneapolis, Minnesota, May 19, 1952, cited in CLIFFORD, *supra* note 83 at 22-23.

[210] 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.

categorical conclusions regarding the defensibility of Fed independence, this article supports a more cautious approach that asks what we really know about Fed independence in the first place. While I mention changes to the Fed's institutional design that will surely generate debate, the point is focus that debate on finding a balance between independence and accountability that the life of the Federal Reserve Act has not struck. Before we can have the debate about first principles, we need to understand how those principles have been applied by legislative predecessors and, more importantly, lived in the experience of the Federal Reserve itself.