

The Institutions of Federal Reserve Independence

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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 rarely analyzed. Scholars, central bankers, and other policymakers assume that the Fed's independent authority to make policy is created by law—specifically, the Federal Reserve Act, which created 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 Fed independence is as it seems. Removability protection does not exist for the Fed Chair, but it exists in unconstitutional form for the Reserve Bank presidents. Governors never serve their full fourteen-year terms, giving every President since FDR twice the appointments that the Federal Reserve Act anticipated. And the budgetary independence designed in 1913 bears little relation to the budgetary independence of 2015. This Article thus challenges the prevailing accounts of agency independence in administrative law and central bank independence literature, both of which focus on law as the basis of Fed independence. It argues, instead, that the life of the Act—how its terms are interpreted, how its legal and economic contexts change, and how politics and individual personalities influence policymaking—is more important to understanding Fed independence than the birth of the Act, the language passed by Congress. The institutions of Federal Reserve independence include statute, but not only the statute. Law, conventions, politics, and personalities all shape the Fed's unique policy-making space in ways that scholars, central bankers, and policy-makers have ignored.

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Introduction

On December 23, 2013, the Federal Reserve System celebrated its centennial. Over the course of that century, the Fed¹ has become one of the most

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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 Federal Reserve Act⁴ itself that defines the Fed’s independence. Economists and political scientists interested in central bank independence—interested enough to give the concept its own acronym (CBI)⁵—take largely as given that law defines central bank independence.⁶ And legal academics, in the exceptional event that they have taken note of the Fed,⁷ have analyzed its independence within the context of administrative law⁸ under the framework developed to assess “agency

primarily, my exceptional colleagues at the Stanford Law School Library (especially Rachael Samberg, Sergio Stone, Erika Wayne, and George Wilson) for their expertise and resourcefulness. I note unusual primary source contributions in the footnotes below.

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 Federal Open Markets Committee (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. 12 U.S.C. ch. 3 (2012)

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

6. *See infra* Part I.

7. 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, *THE LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY* 41-72 (2006) [hereinafter, LASTRA, *LEGAL FOUNDATIONS*]; ROSA MARIA LASTRA, *CENTRAL BANKING AND BANKING REGULATION* 10-70 (1996) [hereinafter LASTRA, *BANKING REGULATION*]; *see also* Rosa M. Lastra & Geoffrey P. Miller, *Central Bank Independence in Ordinary and Extraordinary Times*, in *CENTRAL BANK INDEPENDENCE: THE ECONOMIC FOUNDATIONS, THE CONSTITUTIONAL IMPLICATIONS, AND DEMOCRATIC ACCOUNTABILITY* 31-50 (Jan Kleiman ed., 2001) (discussing the balance between central bank independence and democratic accountability). For a recent exception, *see* Colleen Baker, *The Federal Reserve as Last Resort*, 46 U. MICH. J.L. REFORM 69 (2012); and Colleen Baker, *The Federal Reserve’s Use of International Swap Lines*, 55 ARIZ. L. REV. 603 (2013). Robert Hockett and Saule T. Omarova work on a broader project in the role of government as market actors, which includes engagement with the Federal Reserve System. *See* Robert Hockett & Saule T. Omarova, “Private” Means to “Public” Ends: Governments as Market Actors, 14 *THEORETICAL INQUIRIES IN LAW* (2013), <http://ssrn.com/abstract=2222444>. 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).

8. *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*, 113

independence” generally.⁹ Unsurprisingly, statutes are at the center of that analysis, too.

This Article argues that the idea that Fed independence is determined solely by the Federal Reserve Act is wrong for two reasons.¹⁰ First, in some cases, the statute does not say what economics, political scientists, and legal academics have assumed it says. The Federal Reserve Act is invoked but not read. Second and more often, the statute has created a system that subsequent practices have changed, strengthened, or undermined so completely as to render the original statutory system misleading or worse. The law as written has become displaced by the law as implemented. The result is that reading the Federal Reserve Act in isolation tells us very little about the way this unique government agency exercises its extraordinary power.

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),¹¹ other legislative materials, memoirs and biographies of Fed Chairs and other insiders, and other archival resources. The result—part of a broader project¹²—is a more comprehensive account of the legal context of Fed independence and its evolution than scholars have yet been able to give.

The Article’s contributions are primarily descriptive. The effort is to provide a more grounded understanding of how the law does and does not determine the Fed’s distinct policymaking 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 by the Federal Reserve Act of 1913 and the Banking Act of 1935, which refounded the Fed.

Understanding the Article’s contributions requires knowing more about the System’s circuitous governance structure. The System consists of two committees: the Board of Governors of the Federal Reserve System, composed of seven presidential appointments, requiring Senate confirmation, who serve

COLUM. L. REV. 1163 (2013) (discussing conventions of Fed independence within the context of agency independence generally).

9. For an early example by a prominent author, see William Howard Taft, *Boundaries Between the Executive, the Legislative and the Judicial Branches of the Government*, 25 YALE L. J. 599, 608 (1916), which states, “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 Barkow, *supra* note 8, at 16-18; Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 631-37 (2010); Aziz Z. Huq, *Removal as a Political Question*, 65 STAN. L. REV. 1, 23-31 (2013).

10. 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 POWER AND INDEPENDENCE OF THE FEDERAL RESERVE* (forthcoming 2015).

11. Pub. L. No. 73-66, 48 Stat. 162, enacted June 16, 1933.

12. See CONTI-BROWN, *supra* note 10.

fourteen-year terms. One of these “Governors” is designated the Fed Chair, a separate presidential appointment that also requires Senate confirmation, who serves renewable four-year terms. The second committee is the Federal Open Market Committee (FOMC), composed of all seven Governors plus the twelve presidents of the regional Federal Reserve Banks. Of those twelve Reserve Bank presidents, five carry a vote on the FOMC at any given time: the president of the Federal Reserve Bank of New York and four others on a rotating basis. The Fed Chair is also the Chair of the FOMC; the Vice Chair of the FOMC is the president of the Federal Reserve Bank of New York. These Reserve Bank presidents are appointed by a board of directors themselves appointed by private banks and the Board of Governors. The Article elaborates on this process in more detail below.

The Article discusses three aspects of this multi-layered governance structure often described as the core of the Fed’s independence. First, it explains that the Fed’s extraordinary budgetary autonomy—its ability to create the money with which it funds itself—is not authorized by statute, but arose out of changes to the way that monetary policy was conducted over the course of the Fed’s century. Second, the Article explains that 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 Article argues that removability protections ironically do not exist for the Fed Chair, but do exist in unconstitutional and probably non-justiciable form for the presidents of the Reserve Banks. This absence of protection for the Fed Chair is true despite the fact that, in administrative law, agency independence is usually equivalent with removability protection for the agency head. In this respect, the Fed’s “independence,” then, is as much a function of politics as it is of law.

This more nuanced approach to the role of law in insulating the Fed from politics gives insight into the roles that law and history play in creating the boundaries of the Fed’s policymaking space. The Fed’s metamorphosis over the last century demonstrates how a law’s text gets displaced by its implementation. This is not to say that norms and conventions, as opposed to formal law, are doing all the work of creating independence—although the Fed provides examples of these kinds of “soft constraints,” too.¹³ 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 literature.¹⁴ This dynamic between policy,

13. See Kathryn Judge, *The Federal Reserve: A Study of Soft Constraints*, LAW & CONTEMP. PROBS. (forthcoming), <http://ssrn.com/abstract=2484047>.

14. See, e.g., 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).

law, and history is “institutional” in that it is part of a broader array of “humanly devised constraints that structure 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.¹⁵ 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 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 the two: the institutional development of Fed independence relies on statutory authorization as well as 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 formal statutory structure—a conception of agency independence currently favored by courts. And it warns against overconfidence in the legislature’s ability to design institutions by statute. As Terry Moe famously put it, “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.”¹⁶

In place of these alternatives, it endorses a view that takes into account law, politics, *and* history, almost a view of institutions that relies on “complete, totalized contingency” of historical events.¹⁷ The idea is not that law is irrelevant in designing institutions; indeed, the Article argues at length that law is an essential part of that story. The argument is that law takes on a life of its own through the lived experience of institution building. The interaction between the statute and these “totalized contingencies” tell the fuller story of the Fed’s institutional design better than the standard, statute-based accounts.

This Article proceeds as follows. Part I outlines the existing academic accounts of central bank and agency independence, including their reliance on the unchallenged assumption that law is central in creating that independence.

The Article then evaluates the three primary legal mechanisms that scholars have relied on to explain Fed independence and, conversely, accountability: budgetary independence (Part II), long tenures of Governors and short tenures of Fed Chairs (Part III), and removability protection (Part IV). A brief conclusion suggests how this descriptive account of the laws of Fed independence might

15. Douglass C. North, *Institutions*, 5 J. ECON. PERSPS. 97, 97 (1991).

16. See Terry M. Moe, *The Politics of Bureaucratic Structure*, in CAN THE GOVERNMENT GOVERN? 267 (John E. Chubb & Paul E. Peterson, eds., 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.”).

17. Christopher Tomlins, *What Is Left of the Law and Society Paradigm After Critique? Revisiting Gordon’s “Critical Legal Histories”*, 37 LAW & SOC. INQUIRY 155, 164 (2012).

affect our conceptions of central bank design and how a better understanding of the Fed's institutional evolution can help guide future policy discussions about the Fed's governance, structure, and what is meant by "Fed independence" in the first place.

I. The Existing Accounts 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 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 causing consequent inflation, at a 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 avoiding the economic devastation that this inflation brings.¹⁸ Central bank independence resolves that problem, allowing us to pursue a long-term policy—price stability—even in the face of short-term pressures from 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 ultimately prefer, but that is very hard to achieve 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 bankers' ears are both created by law. To invoke the other metaphors of central bank independence, we separate central bankers from the political process so that they

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

can “take away the punch bowl just when the party is getting started,”¹⁹ or “lean against the winds of deflation or inflation, whichever way they are blowing.”²⁰

The four components of this standard account are thus that the statute is doing the work here, that the President is the main external pressure on the Fed, that the Chair is the metonymic equivalent of the Federal Reserve System, and that purpose of Fed independence is to achieve price stability. While the standard account goes some distance to specify what is meant by “Fed independence,” it also fails to capture the complexity of the Fed’s structure and functions in a way that can impede serious discussion 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 first must understand the traditional ways that scholars have talked about the Fed’s independence and institutional design. This Part provides that summary.

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

The conventional explanation for Fed independence is that monetary policy is necessarily a politically controversial exercise.²¹ Under the classic formulation, creditors prefer to see higher interest rates and lower inflation; debtors prefer to see lower interest rates and higher inflation. It is the authority to adjust these interest rates—which influences how much it costs the

19. William McChesney Martin, Chairman, Bd. of Governors of the Fed. Reserve Sys., Address before the New York Group of the Investment Bankers Association of America 12 (Oct. 19, 1955), 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, U.S. News & World Rep., Feb 11, 1955, at 56; see also KETTL, *supra* note 2, at 83 (citing the interview).

20. *Nomination of William McChesney Martin, Jr.: Hearing before S. Comm. on Banking & Currency, 84th Cong. 5* (1956) (statement by William McChesney Martin, Jr.); KETTL, *supra* note 2, at 83 (citing hearing testimony). I thank Erika Wayne for the help in locating this source.

21. See, e.g., Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Central Bank Independence, Transparency, and Accountability, Speech to the Institute for Monetary and Economic Studies International Conference (May 25, 2010). Again, note that the Article focuses on the Fed as regulator of the dollar. Elsewhere, I go 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. See CONTI-BROWN, *supra* note 10, ch. 4. This Article does not assume a background understanding in the operations of monetary policy, but it does refer to some ways in which that policy has evolved. For thorough, yet still accessible explanations of monetary policy, see STEPHEN AXILROD, THE FEDERAL RESERVE: WHAT EVERYONE NEEDS TO KNOW 41-64 (2013); and BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 27-51 (2005) [hereinafter THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS].

government to service its debt, Jane Doe to pay for a mortgage or student loans, and 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 or to cater to some electoral interest.

The debate regarding *why* politicians would ever cede even partial control over the money-regulating process—in other words, why politicians would ever create independent central banks—is ongoing.²² So too is the debate over *to what end* the regulation of money is ceded to central banks, whether price stability, economic growth/employment regulation, systemic risk regulation, or some combination of these.²³ 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?²⁴

There are three literatures that provide insight into this question: agency independence in legal theory, central bank independence in economics and political science, and structure and process theory in political science. All three are useful starting points for the present inquiry, and this Article builds on each. But all three focus on different questions than the *how* of agency independence. For example, legal theory is concerned in part with the constitutional contours of appointment and removability; economists studying CBI concerned with the empirical consequences of legal separation between central banks and the fiscal policymaker; and structure-and-process theory on the consequences that specific features of institutional design have on agency performance. And even when they focus on the mechanics of Fed independence, they miss the nuances of the broader institutional framework by focusing on the statute as written. Thus, while these accounts of Fed “independence” provide an essential starting point for understanding the space within which the Fed makes policy, they do not provide the full story of that space.

22. 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), which argues that CBI is a means by which interest groups that have benefitted from rent-extracting political deals secure price stability to lock in the benefits of those deals, with WILLIAM BERNHARD, *BANKING ON REFORM* 11 (2002), which argues that CBI resolves an intraparty conflict over the practice of monetary policy.

23. The focus of the debate most recently has been on whether the Fed’s monetary goal should be the optimization of price stability and maximum employment, or whether the Fed should focus, as other central banks focus, on price stability alone. For an excellent and thorough overview of the debate, skewed heavily in favor of the dual mandate, see *Fulfilling the Full Employment Mandate: Monetary Policy & the Labor Market*, FED. RESERVE BANK OF BOSTON (Apr. 12, 2013), <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* 124-28 (2013).

24. The book from which this 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 what end does Fed independence serve? See CONTI-BROWN, *supra* note 10.

1. Agency Independence in Administrative Law

Courts and legal scholars have long analyzed the nature of agency independence in the context of administrative law. But “agency independence” in this context 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.”²⁵ Thus, “agency independence” is not concerned with agency independence in the generic sense of that term—not 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 administrative law’s focus on removability,²⁶ and the doctrinal gist is easily summarized. Congress may not require the President to seek the Senate’s advice and consent prior to removal, as the “reasonable construction of the Constitution” would forbid that kind of blending of legislative and executive functions without express authorization.²⁷ But Congress may limit Presidential removal of an agency head to a more narrow 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 has deemed removability conditions on agency heads constitutionally permissible.²⁸ So too for lower-level executive appointees like independent counsel,²⁹ but not if the agency head and the lower-level appointee are both deemed to be protected by statute from being summarily fired by the President.³⁰

The doctrinal summary does not 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 the purposes of judicial oversight is wrapped up in the basic question of whether Congress can restrict the President’s ability to fire these subordinates for any or no reason.³¹

25. 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).

26. See Barkow, *supra* note 8; Huq, *supra* note 9; Vermeule, *supra* note 8.

27. *Myers v. United States*, 272 U.S. 52, 116, 176 (1926), *overruled in part by Humphrey’s Executor v. United States*, 295 U.S. 602 (1935).

28. *Humphrey’s Executor v. United States*, 295 U.S. 602, 627-28 (1935).

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

30. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 483-84 (2010).

31. 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).

On their own terms, these cases are controversial to scholars of presidential authority.³² But as a means of evaluating agency independence writ large, the removability focus is even more susceptible to criticism. That is, leaving aside questions of whether Congress can ever influence division within a unitary executive, and focusing instead on the meaning of agency independence, the removability focus captures only part of the agency independence picture. The rest of the picture requires more explanation.

Because removability provides a narrow picture of the features of agency independence, there has been a chorus of criticism arguing against the judicial conception of agency independence as a function of removability protections.³³ Scholars contend that the paradigm focuses on the wrong mechanisms of independence;³⁴ ignores the ways in which executive agencies—those whose heads are removable at will—use presidential review to increase “self-insulation;”³⁵ creates meaningless distinctions between executive and independent agencies;³⁶ focuses on the wrong problems³⁷ and the wrong parties;³⁸ reflects a misunderstanding of how the administrative state actually functions;³⁹ elides the other ways, unrelated to removability, in which the

32. See STEVEN G. CALABRESI & CHRISTOPHER S. YOO, *THE UNITARY EXECUTIVE: PRESIDENTIAL POWER FROM WASHINGTON TO BUSH* (2008). For a conflicting view, see, for example, Victoria F. Nourse & John P. Figura, *Toward a Representational Theory of the Executive*, 91 B.U. L. REV. 273 (2011). Interestingly, two proponents of the unitary executive theory have, in footnotes, come to opposite conclusions about the FOMC’s constitutionality. Compare John O. McGinnis & Michael B. Rappaport, *Reconciling Originalism and Precedent*, 103 NW. U. L. REV. 803, 850 n.173 (2009) (“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.”).

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

34. See Barkow, *supra* note 8; Bressman & Thompson, 607-612, *supra* note 9; Vermeule, *supra* note 8.

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

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

37. See Barkow, *supra* note 8.

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

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

President controls independent agencies,⁴⁰ and gives courts the power to review political decisions that are fundamentally incompatible with judicial review.⁴¹ 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.”⁴²

The Federal Reserve’s independence illustrates the reasons why some scholars are frustrated with removability as the paradigm for evaluating agency independence, as some scholars have noted.⁴³ There is simply more to the Federal Reserve Act than removability, and in the case of the Federal Reserve System, removability is less straightforward than it may first appear.

2. Central Bank Independence in Economics

Although legal scholars have mostly either ignored the Fed or analyzed it in conjunction with other agencies of very different stripes, economists and political scientists⁴⁴ have long focused on central banks and central banking.⁴⁵

40. Bressman & Thompson, *supra* note 9.

41. Huq, *supra* note 9.

42. Vermeule, *supra* note 8, at 1168.

43. Vermeule, *supra* note 8.

44. The political science literature on central banking takes a view that is largely distinct from that 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 interests. For the most innovative interest-group theories, see Miller, *supra* note 22; and John Goodman, *The Politics of Central Bank Independence*, 23 COMP. POLS. 323, 339 (1993), which argues 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. William Bernhard provides an explicitly electoral theory, arguing that CBI is in the long-term interests of both executive-branch and legislative-branch coalition partners, though for different reasons. The legislative branch sees central bank independence as a monitoring device for ensuring 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,” 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, which can diminish the executive’s own electoral prospects. See BERNHARD, *supra* note 22, 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, *supra* note 22, also provides perhaps the single best introduction into the design questions associated with political scientists’ CBI inquiries.

45. For a full review of the extensive literature linking CBI to monetary policy, see CARL E. WALSH, *MONEY, CREDIT & BANKING* 419-24 (2d ed. 2003). Note, however, that the policy outcome that most of these studies analyze is inflation, not economic growth. Indeed, two influential studies suggest that there is no significant relationship between economic growth and CBI. See Alberto Alesina & Lawrence Summers, *Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence*, 25 J. MONEY, CREDIT & BANKING 151 (1993); Jakob de Haan & 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

Interestingly, although this Central Bank Independence (CBI) literature rarely overlaps with the agency independence literature summarized above, their conceptions of independence are strikingly similar. While the term “independence” in the CBI context has meant “different things to different people,”⁴⁶ the focus, as with agency independence, is on law: “practically all existing attempts at the systematic characterization of [central bank] independence rely solely on legal aspects of independence.”⁴⁷

Conceptually, CBI focuses on answering the consequences of independence rather than its mechanics. But not completely. Stanley Fischer’s now-famous articulation divides CBI between “goal independence” and “instrument independence.”⁴⁸ 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.⁴⁹ And there, the focus is mostly on the statute.⁵⁰ It is the

de Haan, *The European Central Bank: Independence, Accountability, and Strategy*, 93 PUB. CHOICE 395, 396 (1997).

46. BERNHARD, *supra* note 22, at 19. For examples of the work engaging CBI at different definitional levels summarized here, see de Haan, *supra* note 45; James Forder, *Central Bank Independence: Conceptual Clarifications and Interim Assessment*, 50 OXFORD ECON. PAPERS 307 (1998); Gabriel Mangano, *Measuring Central Bank Independence: A Tale of Subjectivity and of Its Consequences*, 50 OXFORD 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); and Christopher Waller, *Performance Contracts for Central Bankers*, 77 FED. RESERVE BANK OF ST. LOUIS REV. 5 (1995).

47. ALEX CUKIERMAN, CENTRAL BANK STRATEGY, CREDIBILITY AND INDEPENDENCE 371 (1992) (collecting sources); see, e.g., Alesina & Summers, *supra* note 45, at 153 (listing mechanisms, all legal, that separate central banks from political interference); see also LASTRA, BANK REGULATION, *supra* note 7, at 12 (discussing legal and non-legal aspects of central bank independence). 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 Q. REV. (2012).

48. Stanley Fischer, *Central-Bank Independence Revisited*, 85 AM. ECON. REV. 201 (1995).

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

50. A partial exception is Lastra’s taxonomical effort. Lastra orients her discussion of CBI around mechanisms of independence, which she refers to as “safeguards,” that come in three varieties: “organic, functional, and professional.” LASTRA, BANKING REGULATION, *supra* note 7. 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, individual personalities play an extremely important role. Similarly, Cukierman acknowledges these limitations. See CUKIERMAN, *supra* note 47, at 371-72 For representative

law, passed by Congress and recorded in the U.S. Code, which establishes the “goals” of central banking. It is law, passed and recorded, 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 the Fed’s 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 constructing “indices of legal aspects of CB independence,” the emphasis is on “only the written information from the [statutes].”⁵¹

The question remains whether these assumptions about law and statutes—at least as applied to the Federal Reserve—are correct.⁵²

3. Central Bank Independence in Political Science

Political scientists who have studied agency design have explored more than other disciplines the actual contours of the administrative state. Even so, they have, for the most part, focused on law as the primary mechanism in that design.

An earlier generation of scholars of the bureaucracy took the view that delegation was abdication: that by delegating responsibility to agencies, Congress created a “headless fourth branch” that controlled governmental decision-making without accountability.⁵³ But in the 1980s and 1990s, Matthew McCubbins, Roger Noll, and Barry Weingast—collectively, McNollGast—⁵⁴ and other scholars⁵⁵ renewed the confidence in congressional design, showing that

work in the genres of central bank memoirs and histories that are sensitive to the role of personality, see MARRINER S. ECCLES, *BECKONING FRONTIERS: PUBLIC AND PERSONAL RECOLLECTIONS* (1951); ALAN GREENSPAN, *THE AGE OF TURBULENCE: ADVENTURES IN A NEW WORLD* (2007); KETTL, *supra* note 2; and LAURENCE H. MEYER, *A TERM AT THE FED* (2008).

51. CUKIERMAN, *supra* note 47, at 371.

52. This approach may be open to the kind of criticism lodged by social scientists in a related dispute about legal inputs and economic outputs. The “Law and Finance” literature found a strong positive correlation between the common law and economic growth, but legal scholars immediately and almost uniformly rejected the result. See Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (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, Jan.-Feb. 2005, 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 La Porta et al.).

53. See Gersen, *supra* note 25, 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).

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

55. See, e.g., Jonathan R. Macey, *Organizational Design and Political Control of Administrative Agencies*, 8 J. L., ECON., & ORG. 93 (1992).

Congress can shape the goals and behavior of agencies through the way it structures them. 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.”⁵⁶

The structure-and-process theorists focused on the variety of mechanisms through which Congress might assert control over agencies—including, but going but far beyond, the removability framework on which lawyers and judges rely. The focus of structure-and-process theory is therefore inherently on institutional design, whether it stems from Congress’s⁵⁷ *ex ante* legislative decisions as institutional designer or more broadly on, well, the structures and processes associated with a given agency.

The structure-and-process thesis is an important extension of the narrow focus on removability in administrative law. And in many ways, the new work in administrative law scholarship challenging the judicial conception of agency independence is either expressly or impliedly a subset of the structure-and-process thesis.

But the focus in this context, as in administrative law and CBI, remains on law. The main areas of discussion are the nature of Presidential review of agency work product;⁵⁸ threats and practices of auditing;⁵⁹ limits on jurisdiction;⁶⁰ and the expansiveness of the wording of authorizing statutes.⁶¹ Largely missing from structure-and-process analysis is the role of non-statutory legal change—how the law in its implementation can upend, even replace, the statutory design.

B. A New Approach to Federal Reserve Independence

The literatures of agency independence and central bank independence provide essential elements to the framework for evaluating Fed independence, including their close attention to the Federal Reserve Act underlies that independence. Where those alternatives go wrong, though, is in their assumption that law is not simply the beginning of the inquiry, but the end. Structure-and-

56. Gersen, *supra* note 25, at 339.

57. Even here, though, the focus may well be on Congress as standing metonymically for the President, Congress, and other groups that participate in the legislative process.

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

59. *E.g.*, Jeffrey S. Banks, *Agency Budgets, Cost Information, and Auditing*, 33 AM. J. POL. SCI. 670 (1989).

60. *E.g.*, Jacob E. Gersen, *Overlapping and Underlapping Jurisdiction in Administrative Law*, 2006 SUP. CT. REV. 201; Macey, *supra* note 55.

61. *See generally* JOHN D. HUBER & CHARLES R. SHIPAN, *DELIBERATE DISCRETION?: THE INSTITUTIONAL FOUNDATIONS OF BUREAUCRATIC AUTONOMY* (2002).

process theory goes much further, but generally does not focus on central banks⁶² and lacks an account of the law's historical evolution. This Article is an effort to provide that account in the context of our central bank.

To be clear, the flawed assumption in this previous scholarship does not eliminate its value. In many cases, these literatures aim to assess the President's and Congress's constitutional prerogatives to shape the institutional design of the administrative state; or to establish a theory for testing the efficacy and implications of a central bank's separation from specific governmental organizations; or the use of law to accomplish some end desired by Congress, interest groups, or the President. In that sense, the literatures cannot be criticized for failing to take a more comprehensive view of Fed independence; that view was not a part of, or required for, that research.

But if judges and scholars aim to evaluate the ways that a "headless fourth branch" can exist outside the traditional structure of government, as many critics in the judiciary and the academy have expressed,⁶³ or to quantify and evaluate claims that the Federal Reserve is or is not independent of other governmental actors or organizations, then the law-based approach to independence is insufficient. The nearly exclusive focus on the words of a law fails to engage with the law's statutory and historical context and evolution. This is especially true in the judicial evaluation of agency independence, which is often focused on the removability of the Chair.⁶⁴

But even a broader focus on a variety of legal mechanisms would be inadequate. Extralegal sources also circumscribe agency activities in a variety of ways. Here, Vermeule's argument about conventions is important to keep in mind: conventions are distinct from law, but shape the way that institutional independence manifests and evolves.⁶⁵ To effectively evaluate Fed

62. For an excellent exception, see CHRISTOPHER ADOLPH, *BANKERS, BUREAUCRATS, AND CENTRAL BANK POLITICS: THE MYTH OF NEUTRALITY* (2013).

63. See, e.g., *City of Arlington v. FCC*, 133 S. Ct. 1863, 1878 (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.*, 556 U.S. 502, 525-26 (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)). Among scholars, the defenders of the unitary executive criticize *Humphrey's*-type restrictions on removability for empowering the full independence of the administrative state. See, e.g., CALABRESI & YOO, *supra* note 32, at 3-4.

64. As summarized earlier in the Article, other scholars evaluating agency independence have looked beyond removability and focused on term length, funding sources, discretion to choose policy instruments, work product review, and more. LASTRA, *BANKING REGULATION*, *supra* note 7; Barkow, *supra* note 8; Bressman & Thompson, *supra* note 9; Datla & Revesz, *supra* note 36.

65. Vermeule argues that law, politics, and conventions animate the ways that agencies experience and the political branches regulate agency independence. 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 8, at 1185.

independence, scholars and policymakers must be sensitive to these kinds of nonlegal mechanisms.⁶⁶ Even still, informal constraints that become customary or conventional are only part of the picture. A contextual understanding of the law's history and evolution is another element that contributes to institutional independence, even when this evolution is ongoing and conventions are not yet solidified. This Article is the story of that ongoing process.

II. The Curious Case of the Fed's Budgetary Independence

The power of the purse is one of the primary means of Congressional control over agencies. That power is a unique and often misconstrued aspect of Congress's relationship with the Fed, because the Fed has the ability to fund itself from the proceeds of open market operations that it controls without interference from the political branches. Part II discusses this largely uncharted statutory and historical framework. 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."⁶⁷ Instead, the story is an interesting one because of the interplay between the current budgetary practice and the statutory language authorizing this practice, separated as they are by a century of dramatic change in 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 space 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 of Fed budgetary independence based in both law and history. It illustrates how legal and non-legal institutions interact to increase the distance between Congress and the Fed. It explains the extraordinary nature of the Fed's budgetary independence, stemming from the ability to create the money with which it funds itself. And it reveals 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 external changes in making a legal mechanism

66. Vermeule recommends that judges take note of the conventions of independence when adjudicating the traditional removability cases. Vermeule, *supra* note 8, at 1194. Huq would disagree, and argues that courts have no place in making these kinds of determinations in the first place. Huq, *supra* note 9. While this Article does not wade too deeply into that doctrinal debate, the analysis here suggests judges will have difficulty fitting independence into any given constitutional framework: courts are not institutionally well-suited to make sense of the nonlegal institutions that shape agency independence.

67. *Current FAQs: What does it mean that the Federal Reserve is "independent within the government"?*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., http://www.federalreserve.gov/faqs/about_12799.htm (last updated Feb. 6, 2015) [hereinafter *Current FAQs*].

of independence look very different from the independence that is lived in the world of central banking.

A. The Structure of Fed Budgetary Independence

The Federal Reserve is the only truly autonomous budgetary entity in the entire federal government, including Congress and the President.⁶⁸ 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 primary forms of funding for governmental entities. First, the vast majority of institutions—from Congress to the Courts to the White House, and most agencies, institutions, programs, and commissions in between—are funded through Congress’s annual appropriations process. Second, most of the government’s actual expenditures are part of the government’s mandatory commitments.⁶⁹ 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.⁷⁰

And then there is the Fed. The Fed funds itself with a portion of the proceeds from its open-market operations, or the purchase and sale of assets on the open market. 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.⁷¹

The Fed also receives income for “priced services” provided to private banks, which include the cost of transporting and printing new currency, check

68. Congress could always legislate to create its own money; but then, of course, it would first have to legislate to create its own money. U.S. CONST. art. I, § 8, cl. 5. The Fed faces no such barrier.

69. These outlays are not truly mandatory, since Congress 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. For more on Social Security funding, see 3 GOVERNMENT ACCOUNTABILITY OFFICE, PRINCIPLES OF FEDERAL APPROPRIATIONS LAW 15-282 (3d ed. 2008).

70. For a thorough overview of these various types of funding structures, see *id.* at 15-120—15-132.

71. BD. OF GOVERNORS OF THE FED. RESERVE SYS., ANNUAL REPORT: BUDGET REVIEW 2 (2013), <http://www.federalreserve.gov/publications/budget-review/files/2013-budget-review.pdf>.

clearing, and other services related to currency distribution and the general payment system.⁷²

Some scholars have supposed that the Fed, like some other banking regulators, funds itself through assessments on private banks.⁷³ While it is true that the Fed collects money from member banks for “priced services,”⁷⁴ those assessments cover just 8.4% of its expenses.⁷⁵ The rest comes from the proceeds from its open-market operations.

The Fed not only funds itself largely from the proceeds of its substantial assets, but it can also create money in pursuit of its policy objectives. As a result, the Fed’s funding structure is without parallel in the federal government. The Fed conducts monetary policy by, among other options, creating money. With this money, it can buy government—and, more recently, non-government⁷⁶—securities.⁷⁷ These interest-bearing assets generate money that the agency can subsequently use to fund itself.⁷⁸ The Fed thus has the ability to create from scratch the money it eventually uses to pay its employees, fund its conferences, and renovate its buildings.

B. Statutory Basis for Fed Budgetary Independence

The Fed’s budgetary independence is therefore unequalled in the federal government. But here is the striking reality about this independence: Congress never expressly authorized it. That relevant section of the Federal Reserve Act 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

72. *Id.* at 9.

73. See Barkow, *supra* note 8.

74. Bd. of Governors of the Fed. Reserve Sys., *supra* note 71, at 9.

75. *Id.*

76. See *Statement Regarding Transactions in Agency Mortgage-Backed Securities and Treasury Securities*, FED. RESERVE BANK OF NEW YORK (Sept. 13, 2012), http://www.newyorkfed.org/markets/opolicy/operating_policy_120913.html.

77. See THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 21.

78. Chair Bernanke has contested a “money-printing” characterization of the Fed’s monetary authority. See Interview by Scott Pelley with Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., (Dec. 6, 2010), 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 AHMED, LORDS OF FINANCE: THE BANKERS WHO BROKE THE WORLD 20-25 (2009). Technically, then, the Fed is not printing money at all, but rather filling the banking system with additional reserves, in return for which the Fed receives income-generating bonds. The inflationary effects of these policies are hotly disputed, but that the Fed can create the money with which it buys interest-bearing bonds is uncontested. It can “print” the money it uses to implement its monetary policy decisions, and use the proceeds of those decisions to fund its budget.

sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment.”⁷⁹

Unquestionably, this statutory authorization exempts the Fed from Congressional appropriations.⁸⁰ 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.”⁸¹ 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 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, which terminated in 1935 when monetary policy came under the exclusive purview of the newly forged Board of Governors; (2) the so-called “real bills doctrine;” and (3) 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 begins in 1907 with an acute financial crisis that was eventually resolved through 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 their concerns.⁸²

This story is technically, but deceptively, true. It is deceptive because it links, almost ineluctably, the Panic of 1907 and the Federal Reserve Act of 1913. For the purposes of understanding how the Fed’s budgetary independence came to be, making this uncritical link is a mistake. The Panic of 1907 occurred in, well, 1907, and the Federal Reserve Act of 1913 in 1913. The six years in between were extraordinarily important for the fate of the Federal Reserve

79. 12 U.S.C. § 243 (2012).

80. See CONG. BUDGET OFFICE, THE BUDGETARY IMPACT AND SUBSIDY COSTS OF THE FEDERAL RESERVE’S ACTIONS 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).

81. 12 U.S.C. § 243. 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 effectuating the FOMC’s monetary policy decisions. The annual report does not make clear on whose balance sheet the proceeds of open market operations reside—whether the FRBNY’s, or the Board’s, or the twelve Reserve Banks equally. Presumably, those proceeds either belong directly to the Board or are shared in proportion to the Reserve Banks’ capital stock.

82. See Katharina Pistor, *Towards a Legal Theory of Finance* 26 (Columbia Law & Econ. Working Paper No. 434, 2012), <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.”); see also 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.”).

System, as they included two Congressional elections in which Democrats seized control first of the House (in 1910)⁸³ and then the Senate (in 1912).⁸⁴ 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.”⁸⁵ That philosophical moment intervened between the Panic and the Act in ways that were essential to the ultimate shape the System took.

On a basic level, the elections mattered because they shifted partisan control. The first proposals following the Panic of 1907 were entirely Republican; the final bill was almost exclusively Democratic.⁸⁶ Of the Republicans, Senator Nelson Aldrich led the monetary reform efforts. In 1908, Congress passed the Aldrich-Vreeland Act, which created the National Monetary Commission with Aldrich at the head.⁸⁷ The Commission imagined a structure very different from the system that the Federal Reserve Act eventually created. That structure, the National Reserve Association (NRA),⁸⁸ was to be a mix of public and private appointments, 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.⁸⁹

The election of 1912 capped a change of the 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. The two major results of that Compromise were the creations of the leanly staffed, mostly supervisory Federal Reserve Board,

83. See Office of the Historian, *Party Divisions of the House of Representatives, 1789-Present*, U.S. HOUSE OF REPRESENTATIVES (2015), <http://history.house.gov/Institution/Party-Divisions/Party-Divisions/>.

84. See *Party Division in the Senate, 1789-Present*, U.S. SENATE (2015), https://www.senate.gov/pagelayout/history/one_item_and_teasers/partydiv.htm. The Congressional and Presidential elections of 1908 were less important for the shape of the System.

85. JOHN MILTON COOPER JR., *THE WARRIOR AND THE PRIEST: WOODROW WILSON AND THEODORE ROOSEVELT* 141 (1983); see also SYDNEY M. MILKIS, *THEODORE ROOSEVELT, THE PROGRESSIVE PARTY, AND THE TRANSFORMATION OF AMERICAN DEMOCRACY 2* (2009) (discussing the importance of the election for the political and ideological debates it produced).

86. 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 A. JEROME CLIFFORD, *THE INDEPENDENCE OF THE FEDERAL RESERVE SYSTEM* 40 (1965).

87. An Act To Amend the National Banking Laws, ch. 229, 35 Stat. 546 (1908), *repealed by* Technical Amendments to the Federal Banking Laws, Pub. L. No. 103-325, 108 Stat. 2292, 2294 (1994).

88. MILTON FRIEDMAN & ANNA SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES* (1964).

89. See E.W. Kemmerer, *The Purposes of the Federal Reserve Act as Shown by Its Explicit Provisions*, 99 ANNALS AM. ACAD. POL. & SOC. SCI. 62, 64 (1922).

based in Washington, DC, and of the twelve quasi-autonomous “Reserve Banks,” which several active participants in the Act’s drafting considered essentially private institutions.⁹⁰

The Compromise hence incorporated two poles into the Federal Reserve System—public and private, accountable to the political process and independent from it. The tension between these poles 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.”⁹¹ One of the major debates preceding the passage of the Act centered on how to navigate those two poles, between the “whirlpool of socialism and the jagged rocks of monopoly.”⁹²

The Democrats chose to navigate the poles by balancing them—by creating, on the one hand, the government-controlled Federal Reserve Board, and the private Reserve Banks on the other.⁹³ Thanks to these equal and opposite forces, the System would not, in theory at least, be dominated by either faction.

As a result of this Compromise, the Reserve Banks—not the Federal Reserve Board—were tasked with the conduct of what we now call monetary policy. The System was considered a federalist one, with decentralized authority located in the Reserve Banks. Carter Glass, a zealous guardian of the Compromise,⁹⁴ emphasized the *federal* nature of the Federal Reserve System in these terms:

90. In fact, the Act allowed for “eight to twelve” Reserve Banks. The exact number was then decided by the Secretaries of Treasury and Agriculture over the course of the year 1914. Federal Reserve Act of 1913, sec. 2 (codified in 12 USC § 222).

91. 1 PAUL WARBURG, *THE FEDERAL RESERVE SYSTEM: ITS ORIGIN AND GROWTH* 12 (1930).

92. CLIFFORD, *supra* note 86, at 21; *see also* CARTER GLASS, *AN ADVENTURE IN CONSTRUCTIVE FINANCE* 112-20 (1927) (discussing the ways in which President Wilson envisioned the Federal Reserve Board would mediate the interests of government and banks).

93. *See* Howard Hackley, *The Status of the Federal Reserve System in the Federal Government* 31 (1972) (unpublished manuscript) (on file with author and the Stanford Law Library) (citing several sources from the legislative history for the view that the Federal Reserve Board was intended to be a governmental institution, and the Reserve Banks private corporations). For more details on the provenance of this extraordinary document, *see* Peter Conti-Brown, *We Have Winners! – and a Paean to Law Librarians*, *THE CONGLOMERATE* (May 26, 2011), <http://www.theconglomerate.org/2011/05/we-have-winners-and-a-paen-to-law-librarians.html>.

94. Glass could get emotional about his attachment to the 1913 Federal Reserve System, he and was deeply hostile to the Board of Governors 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* GLASS, *supra* note 92, at 1-15, 37-58 (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 among ideas from Glass, Paul Warburg, Woodrow Wilson, Nelson Aldrich, and even William McAdoo and David Houston (the Secretaries of, respectively, Treasury and Agriculture,

Federal Reserve Independence

In the United States, with its immense area, numerous natural divisions, still more numerous competing divisions, and abundant outlets to foreign countries, there is no argument, either of banking theory or of expediency, which dictates the creation of a single central banking institution, no matter how skillfully managed, how carefully controlled, or how patriotically conducted.⁹⁵

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.⁹⁶ 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.⁹⁷

And so it was that the Reserve Banks became financially autonomous organizations. Their financial autonomy came because they raised money through the business of banking for banks: that is, by “discounting,” or lending money at interest, to the member banks within the System. They were not part of the congressional appropriations process, and they conducted their business separately from the Federal Reserve Board. 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.⁹⁸

who were in charge of selecting the locations of the twelve Reserve Banks). See Ron Chernow, *Father of the Fed*, AUDACITY, Fall 1993, at 34-45. For a more thorough, still biased, still overwritten, but less entertaining account of the Fed’s founding, see PAUL WARBURG, *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 Memorandum from Marriner Eccles to President Franklin D. Roosevelt (Nov. 3, 1934) (on file with the Franklin D. Roosevelt Library). My thanks to Sergio Stone for locating a digital copy of this document. Glass, by then a Senator, was Eccles’s sensitive foe. For more on the politics of the 1935 Act, see CLIFFORD, *supra* note 86 at 242-45; ECCLES, *supra* note 50, at 200-29; KETTL, *supra* note 2, at 51.

95. H.R. REP. NO 63-69, at 12 (1913).

96. Kemmerer, *supra* note 89, at 64.

97. 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 CLIFFORD, *supra* note 86, at 66-67; and I ALLAN H. MELTZER, *HISTORY OF THE FEDERAL RESERVE SYSTEM: 1913-1951*, at 62-75 (2003).

98. H. PARKER WILLIS, *THE FEDERAL RESERVE SYSTEM* 128 (1915).

The Reserve Banks, not the Federal Reserve Board, controlled the purse strings under the original Compromise.

The original assessment provision⁹⁹ 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 reliant on the Reserve Banks to conduct its business separately and autonomously. At the time, the Board did not have an independent open-market operations policy and did not have direct oversight of private member banks to provide a source of income. The assessment went 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 policies.¹⁰⁰

The era of autonomy for the Reserve Banks ended with the passage of the Banking Act of 1935. The Board gained authority over open-market operations,¹⁰¹ though the assessment provision remained unchanged.¹⁰² During that early period before the Banking Act, however, there was a separation between assessment authority and operations authority. The Federal Reserve Board could assess the Reserve Banks for its expenses, including 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 thus could not create the money with which it funded itself.

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

Even if the Act that Congress passed had left monetary policy to the Board's discretion from day one, the statutory authority to levy assessments on the

99. Federal Reserve Act of 1913, § 10 (codified in 12 U.S.C. § 243 (2012)).

100. MELTZER, *supra* note 97, at 75-82. 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 & Gary Richardson, *Monetary Intervention Mitigated Banking Panics During the Great Depression: Quasi-Experimental Evidence from a Federal Reserve District Border, 1929-1933*, 117 J. POL. ECON. 1031 (2009).

101. Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684 (codified at 12 U.S.C. § 228 (2012)).

102. *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. Hackley, *supra* note 93, at 7-8. In 1933, however, Congress amended the statute to liberate the Fed from the government's claim on those funds completely. 12 U.S.C. § 244 ("funds derived from such assessments shall not be construed to be Government funds or appropriated moneys").

Reserve Banks would still be different from the authority the Board uses today. The difference is in the Fed's ability to set the terms of its control of the monetary system. Under the original system in 1913, there were two significant restrictions on the Fed's ability to issue currency: the gold standard and the real bills doctrine. Debating the relative merits of the gold standard, real bills doctrine, or decentralized central banking is not the point here. The point is only that all three principles limited the ways in which the Federal Reserve Board could raise its revenue. The modern Board of Governors 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.¹⁰³

To understand this tension, we need to know more about these related principles, the gold standard and the real bills doctrine. Under the gold standard in 1913, a nation's central bank had to meet national and international demands to convert its currency into gold at a specified rate, significantly limiting the central bank's discretion in determining the value and quantity of its currency.¹⁰⁴ Under that regime, neither the Board of Governors nor the original Reserve Banks had the unlimited power to create the money the Board would assess from the Reserve Banks, and from which it would pay its own expenses.

So too with the real bills doctrine. Under the real bills doctrine, a central bank could only accept certain kinds of "bills" for discount, meaning that it could extend credit and expand the money supply only in response to certain kinds of collateral. If a bank showed up at its local Federal Reserve Bank and demanded a loan, the Reserve Bank would need collateral. Under the real bills doctrine, that collateral had to point to a commercial transaction that had already occurred. It could not be for a promise for a future transaction. The bill had to be "real."¹⁰⁵

103. There is another fascinating element to the Fed's budgetary independence, and in particular the ways that these elements interact with other legal and informal mechanisms of independence. It is the flipside of the Fed's money creation power: what is done with that money on the back end. Here the Fed is once again transparent; the proceeds of open-market operations, after paying off 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 remitting the proceeds of open-market operations to the Treasury follows a similar trajectory of evolution from an original statutory basis—here expressly abrogated in 1933—as other elements of the Fed's budgetary independence. The present practice began with a public announcement from the Fed in 1947, and has continued ever since. Sarah Binder, *Would Congress Care if the Federal Reserve Lost Money? A Lesson from History*, MONKEY CAGE (Feb. 24, 2013), <http://themonkeycage.org/2013/02/24/would-congress-care-if-the-federal-reserve-lost-money-a-lesson-from-history/>.

104. See BEN BERNANKE, *THE FEDERAL RESERVE AND THE FINANCIAL CRISIS* (2012).

105. For more on the intellectual and historical development of the real bills doctrine, see RICHARD GROSSMAN, *UNSETTLED ACCOUNTS: THE EVOLUTION OF BANKING IN THE INDUSTRIALIZED WORLD SINCE 1800* 5-6 (2010); and ROBERT CRAIG WEST, *BANKING REFORM AND THE FEDERAL RESERVE, 1863-1923* (1977). While an important limitation on a central bank's management of the money supply in 1913, the mechanics of the doctrine were difficult to identify with precision. As Friedman and Schwartz indicate, "the real bills criterion . . . provided no effective limit to the amount of money." Friedman & Schwartz, *supra* note 88, at 194. This is because of the inherent difficulty in determining what counts as a "real bill" that a Reserve Bank can permissibly discount. For more on this point, see Kettl, *supra* note 2, at 23. 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,

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.¹⁰⁶

Note Glass's twin reliance on the forty per cent gold-reserve ratio and the "short-term, gilt-edge commercial paper." Indeed, the gold standard and real-bills doctrine were the selling points for the framers of the Fed. It was a perceived limit on how much money could be raised by the System. Regardless of whether the real bills doctrine actually provided any limit on which bills could theoretically be discounted, the point is that (1) some people within the System perceived such limitations and acted accordingly, and that (2) Congress thought that it was not granting the Fed an unfettered ability to create money with which the Fed could then, in 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.¹⁰⁷

which each had oversight over different parts of the state of Georgia, but practiced different kinds of discounting techniques. See Troost & Richardson, *supra* note 100.

106. 51 CONG. REC. 563 (1913) (statement of Rep. Glass).

107. KETTL, *supra* note 2, at 22 (quoting President Wilson).

Thus, Congress authorized the Fed to levy assessments against the Reserve Banks under a gold standard and real bills regime, where the Reserve Banks enjoyed autonomy to determine their own monetary policy. This authorization becomes radically different without the features of that regime. Without monetary policy rules like the gold standard and real bills doctrine, the Federal Reserve has complete discretion to determine the extent and value of the size of its balance sheet. 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.”¹⁰⁸

Neither the gold standard nor the real bills doctrine survives today. The real bills doctrine died an informal death in the 1920s.¹⁰⁹ The gold standard has a circuitous history, surviving in fits and starts until the United States formally withdrew its support for the international gold standard in 1971.¹¹⁰ 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.

E. Scholarly Engagement with Fed Budgetary Independence

Scholars have long noted that the Fed is not subject to the appropriations process, and that this status is a source of its independence. Every legal scholar to have engaged this question, however, has either mischaracterized or failed to capture the whole story. Some scholars mistakenly claim that the Board is funded by assessments on member banks.¹¹¹ Others correctly note that the Fed is funded

108. CLIFFORD, *supra* note 86, at 25.

109. See MELTZER, *supra* note 97, at 53-56.

110. There is an extensive literature on the historical gold standard. The most accessible starting point is AHAMED, *supra* note 78, at 78. 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).

111. Barkow, *supra* note 8, at 44 (“For example, the Federal Reserve is authorized to levy assessments against member banks to fund its operating budget.”); Onnig H. Dombalagian, *Requiem for the Bulge Bracket: Revisiting Investment Bank Regulation*, 85 *IND. L. J.* 777, 795 n.88 (2010) (“The FRB . . . funds itself through assessments on member banks and profits from its proprietary trading activities.”); Laurie Leader, *The Federal Bank Commission Act: A Proposal to Consolidate the Federal Banking Agencies*, 25 *CLEV. ST. L. REV.* 475, 492 (1976) (“[T]he operating costs of the Federal Reserve System are paid through Federal Reserve funds, which constitute an indirect assessment on supervised banks.”); Angel Manuel Moreno, *Presidential Coordination of the Independent Regulatory Process*, 8 *ADMIN. L.J. AM. U.* 461, 502 n.255 (1995) (“The FRB . . . [is] funded through members’ fees.”); Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 *WM. & MARY L. REV.* 503, 525 (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*

by assessments on the *Federal Reserve* Banks, rather than member banks, but do not note the role played by proceeds from open-market operations.¹¹² 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.¹¹³ One prominent legal scholar and historian has cryptically cited the Reserve Board assessments provision of the Federal Reserve Act for the conclusion that it creates a “straightforward accountability system,”¹¹⁴ although the author does not explain what that system is or 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.¹¹⁵ 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.¹¹⁶ 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.”¹¹⁷ And while the Fed may well find itself in a situation where its conventional means of securing funding will be inadequate, that possibility, 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

J. ON REG. 313, 350 (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, 540 (2003) (“The Fed has the power to assess member banks to supply funds for its operating expenses.”).

112. Bressman & Thompson, *supra* note 9, at 611 (“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.”); *see also id.* at 611 n.53 (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.”); Louis Fisher, *Confidential Spending and Governmental Accountability*, 47 GEO. WASH. L. REV. 347, 348 (1979) (“The Federal Reserve System, for example, derives funds from assessments on the Reserve banks.”).

113. Dombalagian, *supra* note 111, at 795 n.88 (2010) (“The FRB . . . funds itself through assessments on member banks and profits from its proprietary trading activities.”); 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.”); David C. Stockdale, *The Federal Reserve System and the Formation of Monetary Policy*, 45 U. CIN. L. REV. 70, 78 (1976) (“The Federal Reserve . . . has never been dependent on congressional appropriations for its operating funds. All such funds are derived from the interest earned on the System’s holdings of government securities.”).

114. Joel Seligman, *Key Implications of the Dodd-Frank Act for Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1, 23 (2012); Joel Seligman, *Self-Funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233, 255 (2004).

115. Huq, *supra* note 9, at 29 (citing Bressman & Thompson, *supra* note 9, at 633-34).

116. Bressman & Thompson, *supra* note 9, at 633.

117. *Id.* at 633-34.

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 its 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 accounts for its open-market operations in its annual reports, and it has done so—with varying degrees of transparency—for its entire one-hundred-year history.¹¹⁸ Moreover, in a century under intense scrutiny from market participants and existential critics alike, the Fed has had no major financial scandal.¹¹⁹ This is an impressive feat for any agency, let alone one that generates as much controversy as the Fed. Indeed, even when Ben Bernanke, the former Fed Chairman, flew to far-off conferences in remote towns in South Korea or the Arctic, he flew commercial.¹²⁰

This is not to say that the Fed's funding decisions should not 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.¹²¹ And unlike non-appropriated agencies funded through market assessments, the Fed is not subject even to the ebbs and flows of its own assessments. How these realities affect the Fed's budgetary decisions—from salaries to perquisites to hiring decisions—are important topics of scholarly inquiry.¹²²

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

118. For public access to all of the Fed's annual reports, see the Federal Reserve Archival System for Economic Research, <https://fraser.stlouisfed.org/title/?id=117>.

119. 2 ALLAN H. MELTZER, *HISTORY OF THE FEDERAL RESERVE, 1951-1969*, at xi (2010).

120. 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 he 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”).

121. See Budget Control Act of 2011, Pub. L. No. 112-25, § 251(a)(2), 125 Stat. 240, 241 (codified at 2 U.S.C. § 901(a)(2) (2012)) (applying only to non-exempt accounts).

122. 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).

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.¹²³

For legal theory, the changing context of the Fed's monetary policy has given new meaning to an old statutory decision. The Congress in 1935 meant to separate the Fed's funding from the congressional appropriations process, a decision that has endured in the text of the Act. But Congress 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.

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

The reciprocal of independence is accountability. The institutional design of the Federal Reserve System is an effort to balance both. One of the key statutory instances of that balance is the very long term of the Board Governors (fourteen years, nonrenewable) and the conversely short term of the Fed Chairs (four years, renewable).¹²⁴ 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."¹²⁵

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

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

Id. at 668 (emphasis added). Note, though, that Rubin does not explain how this budgetary independence is achieved within the statute, nor how it evolved.

124. 12 U.S.C. § 242 (2012).

125. See Current FAQs, *supra* note 67.

The lived reality of Fed tenure is the opposite. Governors' 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 it demonstrates how the Fed Chair makes use of her two statutorily designated roles (as both Chair and Governor) to create a firm political position that limits the President's freedom of appointment.

A. The Myth of the Governors' Fourteen Year Term

The Chair is perceived as the power behind the System. But it is first worth highlighting the other Governors and especially the formal and informal institutions that support—and erode—their independence from the President, because these institutions have evolved significantly over time. Their legal protection of a nonrenewable term and the practice—by no means compelled, but widely followed—of early resignations puts these statutory provisions at cross purposes. The result is also unexpected, given the emphasis in the Federal Reserve Act and in the scholarship on 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 Banking Act of 1935 introduced the new Board of Governors, the President has effectively chosen his Board.

This was not the Banking Act's original design. When the Federal Reserve System was reorganized in 1935, Congress included this statutory 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[.]¹²⁶

The idea was to prevent the President from stacking the Board and thus to provide it with distance and independence. A Governor's is one of the longest terms of service in the federal government. Scholars have long discussed the Fed Governors' lengthy tenure, putting forth the propositions that their "staggered"¹²⁷ fourteen-year terms prevent the President from immediately stacking the Board in his favor, or that the "term of office for each member . . . [is] made long enough . . . to prevent day-to-day political pressures from influencing the

126. Banking Act of 1935, 49 Stat. 704, codified in 12 U.S.C. § 242 (2012).

127. Bressman & Thompson, *supra* note 9, at 607-08.

formulation of monetary policy.”¹²⁸ But a tradition of early resignation—a non-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 1935¹²⁹ is just over six years, well within the mainstream of tenures in independent agencies.¹³⁰ 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,¹³¹ although two others served portions of two terms totaling fourteen years or more.¹³²

The nonrenewable, fourteen-year term is meant not only to insulate the Governors from the need to curry favor with the President, but it is also meant to limit the President’s ability to overrun the board. The fourteen-year term was not arbitrarily decided: it corresponds with a seven-member Board of Governors, just as the ten-year term corresponded with the five-member Federal Reserve Board prior to the 1935 reorganization. The idea is that each President should only get two appointments to the Board during a four-year administration.

Table 1 next page shows this pattern of frequent resignations.

128. Jorge J. Pozo, *Bank Holiday: The Constitutionality of President Mahuad’s Freezing of Accounts and the Closing of Ecuador’s Banks*, 15 N.Y. INT’L L. REV. 61, 90 (2002); see also, e.g., Barkow, *supra* note 8, at 24; Bernstein, *supra* note 7, at 148 n.182.

129. Under the original Federal Reserve Act of 1913, the Board of Governors in Washington was called the Federal Reserve Board. It was chaired by the Secretary of the Treasury, and the Comptroller of the Currency was an *ex officio* member. The other members of the Board could serve for ten years. See Federal Reserve Act, ch. 6, 38 Stat. 25, § 10 (1913). The current governance structure is codified in 12 U.S.C. § 242. Because of this difference in the Board’s original structure and term limits, I use only governors who have served since 1935.

130. See *Membership of the Board of Governors of the Federal Reserve System, 1914-Present*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., <http://www.federalreserve.gov/bios/boardmembership.htm> (last updated Nov. 6, 2014) [hereinafter *Membership of the Board of Governors, 1914-Present*].

131. George W. Mitchell served from 1961 to 1976. *Id.*

132. Edward W. Kelley, Jr., served from 1987 to 2001. J.L. Robertson served from 1952 to 1973. *Id.* Note, too, that M.S. Szymczak served from 1933 to 1961, making him the longest serving member of the Board. *Id.* 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, 1935-2013¹³³

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

If the staggered terms of the Board of Governors worked in practice as in theory, 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. The practice of frequent resignations has thus completely undermined the legal mechanism that was designed to check Presidential control over Governor appointments.

The decision not to serve a full term is surprising given 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."¹³⁴ But there is a proviso: "except that this restriction shall not apply to a member who has served the full term for which he was appointed."¹³⁵ The opportunities to translate the benefits of Board service to personal rewards in the banking sector are probably significant, and, yet, Governors more often than not end their terms early. Whether this frequent departure is due to the anonymity of the "C-list political celebrity," a Governor's lack of authority relative to the Chair, or increasingly varied ways to monetize Board service beyond the banking sector is unclear.

But the consequence is that an extraordinary legal institution—a term of service more than double the norm for other independent commissions—is subverted by practice. Presidents can essentially pick their Boards because

133. *Id.* Presidential Administrations are calculated to the month, with President Obama's administration ending in August 2014. President Roosevelt's tenure is dated from the signing of the Banking Act in August of 1935. Governors who served partial terms and were then reappointed, where other nominees might have taken their places, are treated as two appointments.

134. 12 U.S.C. § 242 (2012).

135. *Id.*

Governors do not serve their full term. This statutory mechanism designed to insulate the Board from political control has become a means by which the President exercises that control.¹³⁶

B. The Myth of the Chair's Four-Year Term

Because each Fed Chair is also a sitting Governor, she holds two appointments: one a four-year renewable term as Chair, the other a fourteen-year nonrenewable term as a 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.¹³⁷

In principle, this combination should not render the Chair 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 previous patterns of Chair resignation, the President will nominate a Chair roughly half-way through the President's term, almost always when the Chair is eligible for another four-year term as Chair.

The consequence of this staggering between the terms of the President and Fed Chair increases the independence of the Chair from the President, since the Chair's reappointment 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 lived 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 he sought to charm and then remove him. Martin himself nearly resigned, but he decided against it and lasted almost twenty years as Fed Chair.¹³⁸

Paul Volcker presided over a debilitating recession prior to the 1982 midterm elections, and he 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

136. This does not mean that the President 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*, N.Y. TIMES, June 5, 2011, <http://www.nytimes.com/2011/06/06/opinion/06diamond.html>.

137. 12 U.S.C. § 244 (2012).

138. See ROBERT P. BREMNER, CHAIR OF THE FED: WILLIAM MCCHESENEY MARTIN, JR., AND THE CREATION OF THE MODERN AMERICAN FINANCIAL SYSTEM 196-205 (2004).

asking “Paul Volcker to remain in his” position as Fed Chair.¹³⁹ But because he was a candidate, Reagan and some of his advisors feared the consequences in the bond markets of the failure to reappoint. Volcker was reappointed.¹⁴⁰

President Clinton’s reappointment of Alan Greenspan, despite the latter’s credentials as a leading Ayn Randian libertarian,¹⁴¹ was also influenced by Greenspan’s then-extraordinary reputation that might have made his nonrenewal politically costly to Clinton.¹⁴² Sometimes the cost of failing to reappoint a predecessor’s Fed Chair is more financial than political: President Obama reportedly reappointed Chair Bernanke at some political cost out of fear that the financial markets would respond adversely to the possible pursuit of monetary and regulatory policies other than those pursued during Bernanke’s management of the financial crisis during his four-year term as Chair.¹⁴³

The four-year, renewable term provides an opportunity for the President and public to reassess the Fed Chair’s accomplishments. But any sitting Chair with time left to serve as Governor, who is interested in reappointment, will likely be a strong candidate. The effective Fed Chair builds a financial and political constituency to support her reappointment. The president must keep that constituency in mind when making the reappointment decision, whatever the statute says. Indeed, of the eight Chairs since the position was created in 1935, five were appointed by a successive Administration. Four of the five were reappointed by a successor President of a different party: Martin was appointed by President Truman and reappointed by Presidents Eisenhower (twice), Kennedy, and Johnson; Volcker was appointed by President Carter and reappointed by President Reagan; Greenspan was appointed by President Reagan and reappointed by Presidents George H.W. Bush, Clinton (twice), and George W. Bush; and Bernanke was appointed by President George W. Bush and reappointed by President Obama.

The implications of a Fed Chair that can serve for twenty-years, cultivating a political base separate from the President, are important for mapping out the space within which the Fed operates. The Federal Reserve Act gives a shorter four-year tenure to the Chair to *increase* her accountability to the President. But the practice is different. The option to extend the Fed Chair’s tenure *decreases* the President’s freedom of appointment and establishes the Fed Chair as a figure in government with a more independent base of political support, rather than one dependent on the President.

139. See WILLIAM L. SILBER, VOLCKER: THE TRIUMPH OF PERSISTENCE 229 (2012).

140. *Id.* at 230-34.

141. See GREENSPAN, *supra* note 50, at 51-53.

142. BOB WOODWARD, MAESTRO: GREENSPAN’S FED AND THE AMERICAN BOOM 95-

97 (2000).

143. RON SUSKIND, THE CONFIDENCE MEN 580-82 (2011).

C. Conclusion: Legislative Drift

While the Governors' fourteen-year terms were intended to enhance independence and the Fed Chair's four-year term to enhance accountability, reality has drifted away from these intentions. This drift encapsulates this Article's argument about law. The statutory law gives one impression: the lived experience of Fed personnel practices—high turnover among the Governors, cultivation of political constituencies in support of the Fed Chairs—diverges from that impression. This drift has implications for the proper institutional design of central banks, discussed below in the Article's conclusion. But the fact that it has occurred at all, and reversed the statutory intent, is remarkable in its own right.

This drift between law as written and law as lived also illustrates the descriptive power of this Article's institutional approach, which is the product of a theoretical combination of law, political science, and history. The statute still matters enormously, although counterintuitively: the Governor's ability to serve the unexpired term of his predecessor, intended to enhance independence in the Board of Governors, in turn creates longevity in the Chair. The institutional framework demonstrates the political theory of legislative design captured in a historical moment, similar to Moe's conception of agency design as subject to historical moments that reflect "the interests, strategies, and compromises of those who exercise political power."¹⁴⁴ Under the framework elaborated in this Article, the legal mechanisms that constitute the boundaries between the Federal Reserve are both consequences of Moe's historically contingent political negotiations, but they are also subject to subsequent amendment by the ongoing changes in the Fed's lived experience. These changes include frequent resignations unforeseen by the statutory designers of the Banking Act of 1935 and the ability of the Fed Chair to build an independent political base. The result is that the customary reading of the Federal Reserve Act as the source of the Fed's "independence" will not only be misleading, it will be exactly backwards.

IV. The Complicated Doctrine of Removability at the Fed

From a legal perspective, "removability" is the crux of Fed independence. Legal scholars have been interested in whether the Fed fits the canonical taxonomy of an independent agency by virtue of removal restrictions on the Fed Chair. The statute, however, is silent as to Chair removability. This silence is 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 throughout the Federal Reserve System and discovers both where removability matters (deep within the Federal Reserve

144. Moe, *supra* note 16.

System) and where it does not (for the Fed Chair). It also illustrates some ways that a careful statutory design can become unmoored from changing legal realities. This is especially true in the case of the Reserve Bank presidents. Although they craft federal policy and are equals of the presidential appointees on the Federal Open Market Committee, the President must reach through two (maybe three, and perhaps even four) layers of bureaucracy before removing them. The structure Congress created in 1913 and 1935 is, in this regard, unconstitutional, but it is unlikely to be changed by judicial intervention. The D.C. Circuit has considered the question four times and has dismissed it on justiciability grounds each time. This Part explains the details of this curious history.¹⁴⁵

A. Doctrinal Overview: Appointment and Removability

Article II, section 2, clause 2 of the Constitution—the Appointments Clause—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 officers of the United States, presidential appointment and Senate confirmation is the constitutional minimum.

But the Constitution makes an exception to this 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.¹⁴⁶ The first question under the Appointments Clause is thus whether the challenged personnel are principal or inferior officers. The key precedent for answering that question is *Edmond v. United States*, which held that “[w]hether one is an ‘inferior’ officer depends on whether he has a superior.”¹⁴⁷ 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.¹⁴⁸ In other words, if a federal officer has a boss who went through Presidential appointment and Senate confirmation, that officer is by definition an inferior one.

Determining whether an officer of the United States is “principal” or “inferior” is only the first question in assessing the constitutionality of her status. The second involves, at a general level, the principle of the separation of powers that underlies our constitutional scheme. We have three branches. The President embodies the executive and must “take care that the laws be faithfully executed.”¹⁴⁹ He is one, but his administration is a legion. Hence the importance of appointing officers to constitute the President’s administration.

But appointment is not enough: the President must also be able to supervise those he appoints to high office. And here, Congress and the President have

145. See *infra* notes 204 to 215 and accompanying text.

146. U.S. CONST. art. II, § 2, cl. 2.

147. *Edmond v. United States* 520 U.S. 651, 662-63 (1997).

148. *Id.* at 663.

149. U.S. CONST. art. II, § 3, cl. 5.

tussled over who gets to define the terms of employment for executive officers. In the iconic 1926 case, *Myers v. United States*, Chief Justice William Howard Taft wrote the opinion reviewing a statute that concerned the appointment of postmasters.¹⁵⁰ The statute required an appointed postmaster to receive the usual advice and consent of the Senate, but it also subjected the removal of the postmaster to the same restriction.¹⁵¹ 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.”¹⁵²

Ten years later, the Court retreated from this view, at least in part. In *Humphrey’s Executor v. United States*,¹⁵³ 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*,¹⁵⁴ 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 only for cause—here, the Commissioners of the Securities Exchange Commission¹⁵⁵—who can remove other officers only for cause—here, members of the Public Company Accounting Oversight Board (PCAOB). 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.¹⁵⁶

To sum up: the Appointments clause demands the Senate’s advice and consent for principal officers, but not for inferior officers, and even after appointment, separation-of-powers principles restrict 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 a principal officer from getting fired by the President for no reason or a bad reason, and it can insulate an inferior officer from getting fired by a principal officer for no reason or a bad reason, so long as that inferior officer remains subject to direct Presidential supervision. No nesting of protections is allowed.

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

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

151. *Id.* at 164.

152. *Id.* at 117.

153. *Humphrey’s Executor v. United States*, 295 U.S. 602 (1935).

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

155. Interestingly, this removal restriction was presumed by the Court, not indicated by Congress. See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 485-88 (2010); see also Vermeule, *supra* note 8, at 1167 (discussing the Court’s presumption).

156. *Free Enter. Fund*, 561 U.S. at 484.

B. The At-Will Fed Chair

1. The Law

The Fed Chair 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.¹⁵⁷ The statute is silent, however, with respect to her removability as Chair.

Given that removability has become the legal hallmark of administrative independence and that the Fed Chair wields such prominence within the System, government, and public imagination, this silence is remarkable. Initially, there seem to be three possible explanations. First, that Congress erred in its silence and that removability should be inferred. Second, that the equation of removability with independence makes no sense, since the Fed is considered the paragon of agency independence yet its head has no removability protection. And third, that removability protection matters, but only when considered next to other legal and non-legal mechanisms.

Vermeule explores these and related arguments.¹⁵⁸ He concludes that “formal independence” is unnecessary at the Fed because its Chair is widely seen as independent without consultation to the Federal Reserve Act—“its independence is protected by a network of statutory provisions and hoary conventions.”¹⁵⁹

The judicial support for this view is strong, as Vermeule points out.¹⁶⁰ But so too is the judicial support for the opposite conclusion: that Congress *meant* to give removability protection even when it did not do so explicitly.¹⁶¹ While predicting an eventual judicial resolution of this apparent impasse is beyond the scope of this Article, it does leave the question: is there a “hoary convention” that rises to the level of a law-like rule that would prevent the President from dismissing a Fed Chair prior to the end of her four-year term?

Vermeule argues that such a convention exists; this Article advances a different conception of Fed independence as more historically contingent. Consider a cruder version of Vermeule’s argument, based on three premises: The formal definition of agency independence means that an agency is only independent if the head is only removable for cause. Everyone understands that the Fed is an independent agency, probably the most independent of agencies. The Federal Reserve Act is silent as to the removability of the Fed Chair. Ergo,

157. 12 U.S.C. § 242 (2012).

158. See Vermeule, *supra* note 8.

159. *Id.* at 1176.

160. *Id.*

161. See, e.g., *Free Enterprise Fund*, 561 U.S. at 485-88 (inferring removability protection for the SEC Commissioners).

there must be widespread acceptance of a convention of independence that renders the Chair practically nonremovable.

The premises are correct; the conclusion is flawed. The more accurate reconciliation of the conflicting premises is to say, first, that there is more to legal independence than removability protection (a proposition with which Vermeule clearly agrees). And second that the forces protecting the Fed Chair from arbitrary dismissal do not come from law or even law-like conventions, but from the ebb and flow of political calculations made in the moment.

2. Removal as a Political Action

The Fed's history supports this politically contingent view of the relationship between the Fed Chair and the President. While it's accurate to say that "no President has ever formally discharged the Fed Chair,"¹⁶² the history of Presidents' dissatisfaction with and treatment of Fed Chairs is more textured than that. This history shows what Presidents can do and have done with unsatisfactory Chairs—while the Fed Chairs have significant resources at their disposal to build their own political bases, these resources are not unlimited. The relationship between Chair and President is marked much more by the politics of the moment than Vermeule's account suggests.

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.¹⁶³ But to focus on letters is to take a narrow view of whether and how Presidents can push Fed Chairs aside. The experience of three Chairs in the post-1935 Fed demonstrates the variety of ways a President can remove a Fed Chair from a place of influence within the System.

Thomas McCabe, Fed Chair from 1948-1951, provides the example. McCabe was President Truman's first appointment to the Fed Chair and was seen as his confidante.¹⁶⁴ But McCabe in effect betrayed Truman in the historic Fed-Treasury Accord of 1951. Under the Accord, the Fed and the Truman Treasury agreed to end the Fed's World War II practice of "monetizing the public debt": that is, guaranteeing that the government's debt would clear the market at an agreed-upon rate, no matter whether there was a market for that debt or not. Marriner Eccles, McCabe's predecessor who stayed on the Board of Governors after Truman refused to reappoint Eccles to the Chair, had fought hard—initially against McCabe—to liberate the Fed from these controls.

Tensions flared, leading to a dramatic stand-off between the Truman Administration and the Fed. During this heady time, Truman summoned the Federal Open Market Committee—the full committee of the Board of Governors

162. Vermeule, *supra* note 8, at 1198.

163. *Humphrey's Executor v. United States*, 295 U.S. 602, 629-30 (1935).

164. See CLIFFORD, *supra* note 86, at 243-45

plus the twelve Reserve Bank presidents that determines the Fed's open-market policy—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.¹⁶⁵ Eventually, with McCabe in full agreement, the Fed and Treasury struck the famed “Accord” that paved the way 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 Treasury whom Truman preferred.¹⁶⁶

But the Accord was not only an agreement; it also was a change in personnel. McCabe was out, and a Treasury insider—William McChesney Martin—was in. In fact, McCabe made his resignation contingent on his participating in the vetting process that named his successor. Martin was McCabe's first choice, even though the Truman Administration preferred other candidates. It is not exactly clear why Truman or his Secretary insisted on a McCabe resignation; other Fed insiders had made more noise about the need for the Accord, principally Marriner Eccles. That said, his departure, followed by a replacement from within the Truman Administration, made clear that the President forced him out for no other reason than the President's preference. Immediately after his early resignation and replacement by Martin, Senator Paul Douglas (D-Ill.) saw the personnel shifts as evidence of Treasury machinations that meant the Accord was much less than it seemed.¹⁶⁷

This kind of firing was not unique to McCabe in the Truman Administration. It also fit Truman's view of other high-profile resignations, including that of Harry Dexter White from the International Monetary Fund, who Truman insisted was “fired by resignation” because of White's suspected Communist sympathies.¹⁶⁸ Regardless, it became the common view that McCabe's resignation was part of a quid pro quo: “Chairman McCabe ‘bled’ for Fed independence,” wrote one economist writing after the fact.¹⁶⁹

William G. Miller represents a very different method of dislocating the Fed Chair: removal by promotion. Miller was President Carter's first Fed Chair, and he was widely viewed as incompetent.¹⁷⁰ 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 is

165. JONATHAN KIRSHNER, *APPEASING BANKERS: FINANCIAL CAUTION AND THE ROAD TO WAR 144* (2007) (quoting Federal Reserve Board, Minutes, January 31, 1951, p. 9).

166. CLIFFORD, *supra* note 86; KETTL, *supra* note 2.

167. CLIFFORD, *supra* note 86, at 267-68. For more on McCabe's resignation and the fallout, see BREMNER, *supra* note 138, at 81. For more on the Fed-Treasury Accord and McCabe's roll in it, see Conti-Brown, *supra* note 10, ch 1.

168. For Truman's quote on White and the surrounding events, see STEIL, *supra* note 110, at 324.

169. For the “bled” quote, see Edward J. Kane, *The Re-Politicization of the Fed* 9 J. OF FIN. & QUANT. ANAL. 743, 743 (1974).

170. KETTL, *supra* note 2, at 169-171.

odd to call a promotion a “removal,” but the episode has led several to reach this very conclusion.¹⁷¹

These examples show that neither law nor convention fully protect the Fed Chair: that protection comes, instead, from politics. Truman had, he felt, the political cover to force McCabe out; McCabe’s acquiescence certainly facilitated that calculation. And where Carter thought that removal outright might have limited his freedom of removal, he promoted Miller. In other instances, the President may not feel that freedom of movement, even when the Fed Chair is moving policy in a direction the President does not prefer.

The point of this historical exposition is to argue that the presidential decision whether to remove the Fed Chair is fundamentally a political one. Removing the Chair entails political costs, and the President will decide to incur those costs when he deems the Chair’s actions sufficiently noxious to warrant removal. The Chair’s vulnerability to at-will removal, then, shows that removability protection—whether through law or convention—is not equivalent to agency independence, at least not in the case of the Fed. As a formal matter, there is no legal separation between the President and the Chair. The Chair serves at the President’s will, and yet the Fed maintains an aura of independence. That no President has fired a Chair by angry letter tells us more about the operation of politics and Presidential personnel strategies than about laws or conventions of Fed independence.

3. Personality and Politics in Fed Independence

The focus on statutory restrictions on removability is flawed for a different reason: the President seeks to influence the Fed through personal interactions so fluid and dependent on personality that they do not even rise to the level of “conventions.” These informal appearances of insulation from the President are an important part of the role, and they 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 personal obsessions of Chairs William McChesney Martin,¹⁷² Paul Volcker,¹⁷³ and Alan Greenspan,¹⁷⁴ each of whom seemed constantly preoccupied by the maintenance of this informal independence.

The trend is 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 President Nixon. A close personal and emotional proximity between Burns and Nixon was clear from Nixon’s own political memoir, published in

171. *Id.*

172. *See, e.g.,* BREMNER, *supra* note 138, at 1, 2, 90, 116, 117, 151, 160, 180 (2004).

173. SILBER, *supra* note 139, at 191-95, 266-67.

174. GREENSPAN, *supra* note 50, at 142, 146, 153, 293, 478, 479 (2007).

1962.¹⁷⁵ The recently published Burns diaries are filled with references that raise modern eyebrows about their relationship. Nixon told Burns, for example, about his appointment of John Connolly as Secretary of Treasury before he announced it publicly. He then told Burns that Connolly would learn the ropes of his new cabinet position from Burns.¹⁷⁶ Burns also attended cabinet meetings;¹⁷⁷ had his speeches vetted by Nixon's staff;¹⁷⁸ cleared his talking points with the President ahead of a meeting with other central bankers in Basel, Switzerland;¹⁷⁹ advised Nixon on tax, wage, and other fiscal policy;¹⁸⁰ made pledges to remain the President's "true friend" on economic policies before the public;¹⁸¹ and more.¹⁸² The division of the Fed's monetary policies from the Administration's economic policies did not exist during the Nixon-Burns era.

Perhaps in reaction to the anti-example of Burns, Chairs have usually kept some distance from the President. But as an appointee, the Chair cannot help having a relationship with the President. Because of this active dynamic, no assessment of Fed independence is complete without analyzing the specific relationship between and personalities of the President and Chair. And these relationships are determined almost exclusively by the identities of the specific President and Fed Chair. Laws and customs play a smaller role than politics and personalities.

4. Removability and Personality: The Net Effect for Fed Independence

What, then, is the net effect of the Fed Chair's independence on the Fed's overall independence? As the foregoing illustrates, that question is impossible to answer in the abstract, because the nature of the Chair's independence depends on her relationship with the President, which in turn depends on the personalities

175. RICHARD M. NIXON, *SIX CRISES 309-10* (1962) (outlining Burns's willingness to suggest the Eisenhower Administration influence the Federal Reserve to swing the 1960 election toward Nixon).

176. ARTHUR F. BURNS, *INSIDE THE NIXON ADMINISTRATION: THE SECRET DIARY OF ARTHUR BURNS, 1969-1974*, at 31 (2010).

177. *Id.* at 32.

178. *Id.* at 34.

179. *Id.* at 40.

180. *Id.* at 45, 49.

181. *Id.* at 47.

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

of the individuals who occupy those offices. While the political realities of Chair reappointment will favor cross-administration reappointments when the economic climate favors the policies of the incumbent Chair, reality also suggests that the Chair has an incentive to cater to an incoming President's wishes on economic policy. Thus, how their dynamic will play out in practice will depend on those individuals and their individual, historical, and political contexts. The legal question of the Chair's removability, however interesting as a matter of administrative law, is essentially irrelevant. Whether or not law or convention protects the Chair from removal either expressly or by implication, legal or conventional removability protection is far less important to the Fed's independence than the personalities and politics in a given historical moment.

*C. Removability and the Reserve Bank Presidents: The Fed's Constitutional Problem*¹⁸³

The argument that the Fed's policy-making space is constituted by law, conventions, and politics, each converging at specific moments in history, is nowhere demonstrated better than in the question of statutory limits on the President's ability to fire federal officers within the Fed. We have already seen that there is no such restriction for the Fed Chair; that relationship is governed mostly by politics. But such is not the case with other officers inside the Fed. Indeed, the Federal Reserve Act protects the presidents of the Federal Open Market Committee (FOMC) from presidential oversight that it is unconstitutional. If *Free Enterprise Fund* presented "*Humphrey's Executor*-squared," in Judge Kavanaugh's words, the Federal Open Market Committee may present *Humphrey's Executor*-cubed.¹⁸⁴ Law matters; it just matters in unexpected ways.

1. The Federal Open Market Committee and the Constitution

The Federal Reserve Act of 1913 created twelve Reserve Banks, which proceeded to create twelve independent monetary policies.¹⁸⁵ In 1933, Congress created the Federal Open Market Committee (FOMC), the Federal Reserve System's monetary policy committee, to centralize the Banks' policies.¹⁸⁶ Two years later, in the Banking Act of 1935, Congress refashioned the FOMC to

183. I first made similar arguments in the essay, *Is the Federal Reserve Unconstitutional? And Who Decides?*, LIBRARY LAW & LIBERTY (Sept. 1, 2013), <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* (Columbia Symposium on Admin. Law & Fin. Regulation, Draft Paper, 2014), http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/cle_reading_panel_3.pdf.

184. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 537 F.3d 667, 686 (D.C. Cir. 2008).

185. Act of December 23, 1913, ch. 6, 38 Stat. 251.

186. Act of June 16, 1933, ch. 89, 48 Stat. 162.

include all seven members of the newly created Board of Governors of the Federal Reserve System, which replaced the Federal Reserve Board established in 1913.¹⁸⁷ The rest of the FOMC included five of the twelve Reserve Bank presidents on a rotating basis.¹⁸⁸ Since 1942, the president of the Federal Reserve Bank of New York has been a permanent member of the FOMC.¹⁸⁹ Here, convention plays an important role: although the statute does not require it, the president of the Federal Reserve Bank of New York is also Vice Chair of the FOMC. The Committee meets eight times per year to discuss and announce its outlook on the global and national economy and its monetary policy decisions. (This Article need not go into detail about the policy levers the Fed pulls. Others have provided useful introductions to the Fed's general operations, especially Stephen Axilrod¹⁹⁰ and the Fed's own, somewhat dated, overview.)¹⁹¹

It is the presence of the Reserve Bank presidents on the FOMC that creates two separate constitutional problems, one with respect to the Appointments Clause and the other triggering separation-of-powers/removability concerns.

2. The FOMC and the Appointments Clause

To take each in turn, the Reserve Bank presidents are either principal or inferior officers. The Board of Governors certainly supervises the Reserve Banks in every other respect, as provided by statute.¹⁹² 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. Thus, Under the *Edmond* standard, they appear to be “principal” officers who must be subject to the Appointments Clause. After all, on the FOMC, the Reserve Bank president has no superior: the FOMC is a committee, and each vote counts the same as any other. But even if the presidents are inferior officers, they are not appointed by “in the President alone, in the Courts of Law, or in the Heads of Departments” the appointment of the inferior officers,” as required by the Appointments Clause.¹⁹³

But the Reserve Banks are not appointed under either standard. The President does not appoint, and the Senate does not confirm, the Banks' presidents, nor are they appointed as inferior officers by a head of department.¹⁹⁴ Instead, the presidents are appointed through a circuitous process that begins with the Reserve Bank's board of directors. Each board is divided into three

187. Act of August 23, 1935, 49 Stat. 705.

188. 12 U.S.C. § 263(a)

189. Act of June 7, 1942, 56 Stat. 647.

190. AXILROD, *supra* note 21, at 41-64 (2013).

191. THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS, *supra* note 21, at 27-

51.

192. *E.g.*, *id.* § 301.

193. U.S. Const. art. II, § 2, cl. 2.

194. 12 U.S.C. § 263(a) (2012).

classes of three directors each.¹⁹⁵ Class A directors are bankers selected by the regulated banks.¹⁹⁶ Class B directors are non-bankers selected by the regulated banks. Class C directors are non-bankers selected by the Board of Governors in Washington, D.C.¹⁹⁷ Until the passage of the Dodd-Frank Act of 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.¹⁹⁸ The President has no legal role whatsoever in appointing either the Reserve Bank presidents or the Reserve Bank directors.¹⁹⁹

In other words, it does not matter whether the Reserve Bank presidents are considered principal officers or inferior officers; their appointment procedure violates the constitutional requirements in either context.

3. Removability and the FOMC

The Reserve Banks have a separate constitutional problem with respect to the separation of powers/removability question raised by the Supreme Court in *Free Enterprise Fund v. PCAOB*. Unlike the case with the removal of the Fed Chair, the Federal Reserve Act has an intricate, even conflicting statutory regime for the removal of the Reserve Banks. The President, though, has no role to play whatsoever. He appoints and the Senate confirms the seven members of the Board of Governors, who are statutorily members of the FOMC. Governors are removable by the President “for cause” only.²⁰⁰

From here, there is a fork in the statute. Removal authority for the Reserve Bank presidents appears to be lodged in two boards: the Board of Governors in Washington and the Reserve Banks’ board of directors (where removal is at the directors’ pleasure). Under section 248(f) of the statute, the Governors have the authority to “remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated in writing by the Board of Governors of the Federal Reserve System to the removed officer or director and to said bank.”²⁰¹

The “cause of such removal” language comes from the original Federal Reserve Act of 1913. The “cause” language is a term of art, in use in other statutes passed by the same Congress and upheld by the Supreme Court has sufficient to trigger the removability restrictions under discussion here.²⁰²

195. *Id.* § 341.

196. *Id.*

197. *Id.* § 301.

198. An Act of July 21, 2010, 124 Stat. 2126 (codified at 12 U.S.C. § 341).

199. *Id.* § 263(a).

200. *Id.* § 242.

201. *Id.* § 248(f).

202. See *Humphrey’s Executor v. United States*, 295 U.S. 602 (1935).

At the same time, the Act also gives the Reserve Bank directors the ability to “dismiss such officers or employees, or any thereof, at pleasure.”²⁰³ This provision was not part of the original Federal Reserve Act of 1913, but was added in 1919.²⁰⁴ Would a court charged with construing the statute give the Reserve Bank presidents two masters? The question is difficult to answer, but also legally irrelevant: either way, the Reserve Bank presidents are protected by two layers of removability protection, precisely the institutional design the Supreme Court struck down in *Free Enterprise Fund v. PCAOB*.

Assume a court would read the Federal Reserve Act in its fullest context, and place the appointment and removal authority in the same hands (that is, the Reserve Banks’ own board of directors). In that case, if the President does not like the Reserve Banks’ presidents’ votes on the FOMC, to remove them from office, he would have to legally reach through the Board of Governors (protected from summary dismissal) who would have to reach through the Reserve Banks’ board of directors (protected from summary dismissal) who could fire the Reserve Bank presidents at their pleasure. In other words, the President would have to reach through three layers, one beyond the two the Court already deemed unconstitutional in *Free Enterprise Fund v. PCAOB*.²⁰⁵ 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 entities. But that difference only sharpens the separation of powers problems for the Reserve Banks—their authority is the equivalent of the Board of Governors in their capacities as members of the FOMC, but while the President can exercise control over the Board through the appointment process, he gets no such authority over the Reserve Banks. For these reasons, the FOMC, as currently designed, is unconstitutional.

The unconstitutionality of the Reserve Banks’ governance highlights the way that law, politics, and custom interact to create a separate policy-making space for the Federal Reserve. Here, the focus is on law, but in an unexpected place. Judges have long looked at appointments and removability as the hallmark of an agency’s independence, as discussed above in great detail. But that focus is usually—and erroneously, in the case of the Federal Reserve—at the top. Here, the Federal Reserve Act gives ample removability protection to the Reserve Bank presidents to limit Presidential interference. That it does so in a way that violates the Supreme Court’s interpretation of the Constitution’s demands only illustrates how much law-as-written can matter, even if in surprising ways.

203. 12 U.S.C. § 614 (2012).

204. An Act of Dec. 24, 1919, 41 Stat. 379.

205. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 485-88

(2010).

4. Governor Vacancies and the FOMC

Instead of ameliorating the constitutional problems created by the law as written, the lived experience of presidential appointments and vacancies have exacerbated them. Recall that the FOMC is structured so that the President-appointed, Senate-confirmed Board Governors constitute a numerical majority of voting members. This structure could thus be defended on the grounds that, so long as the majority holds, the lack of public vetting and confirmation of Reserve Bank presidents, and the two or three levels of removability protection do not cause constitutional problems. The Reserve Bank presidents cannot create federal policy because they are consistently outnumbered by Presidential appointees.

The argument depends on whether the Governors in fact enjoy a majority. The chart below indicates the historical trend.²⁰⁶ From 1945 until 1977, after the new Board of Governors finished displacing the Federal Reserve Board over the last ten years of the Roosevelt Administration, the Governors enjoyed a majority nearly 100% of the time. 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. That majority was back up above 90% during the eight-years of the Reagan Administration. A slow descent began after that, bottoming at the Obama administration's record of 42%. That is, 58% of the time, private bankers held a majority on the FOMC. The Obama administration holds another ignominious record relating to the constitutional debility of the FOMC: it is the first Administration to take the Governors to a minority, which it has done three times.²⁰⁷

The Governors' majority on the FOMC is therefore unstable. This structural sea change has occurred largely over the last two generations, and is exacerbated by the expectation of continued vacancies at the end of an administration.²⁰⁸ This reality also means that any defense of the FOMC based on the 7-5 majority of its public officials is no defense at all.

The dynamic between the very real legal effect of the Federal Reserve Act's governance provisions establishing the FOMC, and the presidential practice of failing to fill Governor vacancies, illustrates the Article's argument: the Fed's "independence," the policy space it occupies separate from the other branches of government, is subject to a mix of law as written, law as practiced, conventions, and politics, all converging in specific historical moments. The reliance on

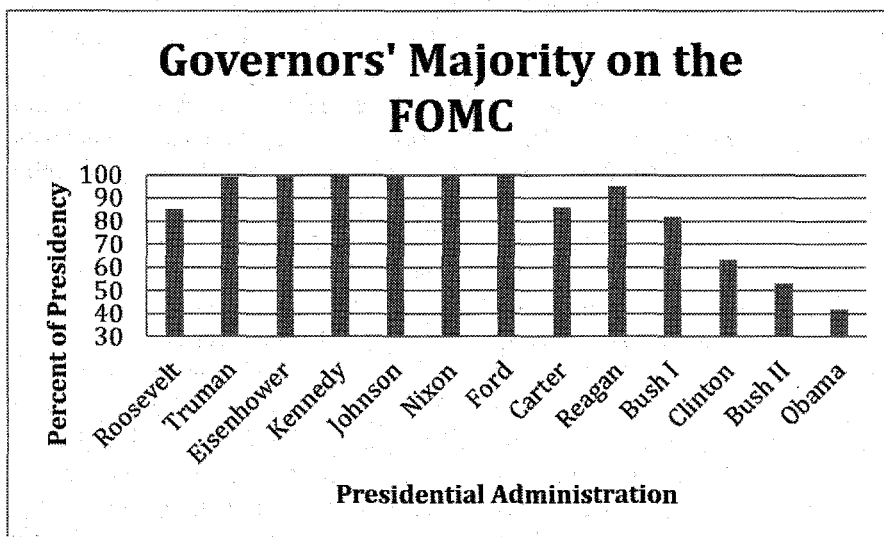
206. I developed some of these ideas for a popular audience in Peter Conti-Brown, *The Constitutional Crisis at the Federal Reserve*, POLITICO MAG., April 14, 2014, <http://www.politico.com/magazine/story/2014/04/federal-reserve-constitutional-crisis-105663.html>.

207. *Membership of the Board of Governors, 1914-Present*, *supra* note 130.

208. 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).

merely reading the Federal Reserve Act, stripped of judicial interpretations, appointment practices, and the influence of personalities, tells an incomplete and inaccurate story about the nature of the Fed's place within government.

Figure 1: Governors' Majority on the FOMC



D. Judicial Protection of the FOMC's Unconstitutional Structure

The story of the judiciary and Fed independence is not complete, however, with a conclusion that the Supreme Court would likely find the governance structure of the FOMC unconstitutional. Instead, the courts have created judicial barriers to prevent that litigation from ever reaching the merits. In this way—somewhat ironically, given how closely associated courts are with law-making—legal doctrines that have nothing to do with the Federal Reserve Act have created a kind of hedge around Fed independence that is simultaneously a legal and non-legal mechanism.

To understand this judicial hedge around Fed independence, we need to know more about the ways that individuals have challenged the FOMC's structure in the past. In the 1970s and 1980s, a series of petitioners—a Congressman, a Senator, private citizens, then another Senator—challenged the structure of the FOMC on constitutional grounds. And in each case, the D.C. Circuit—the initial appellate forum for most litigation on this issue—refused to reach the merits.²⁰⁹ Henry Reuss, a Democratic member of the House of

209. See *Melcher v. FOMC*, 836 F.2d 561 (D.C. Cir. 1989); *Comm. for Monetary Reform v. Bd. of Governors*, 766 F.2d 538 (D.C. Cir. 1985); *Riegle v. FOMC*, 656 F.2d 873 (D.C. Cir.)

Representatives from Wisconsin, argued that the appointment process for the Reserve Banks prevented him, in his capacity as a legislator, from introducing impeachment proceedings under Article I, section 2 of the U.S. Constitution. The court made quick work of this circuitous theory of injury.²¹⁰ For the private citizens, the 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.”²¹¹

But for the two senators—Senator Donald Riegle, a Democrat from Michigan, and Senator John Melcher, a Democrat from Montana—the analysis was quite different. In each case, the plaintiffs’ theory of injury rested on 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.”²¹² Where Representative Reuss and the private citizens could not demonstrate injury, Senator Riegle could.

But where the *Riegle* court gave with one hand, it took with the other. The *Riegle* court felt uncomfortable inserting itself into the legislative mix by concluding that the statutory design of the Federal Reserve Act had injured a Senator who wanted no part of that design. In other words, the court did not want to adjudicate injuries one group of legislators caused another. To avoid that adjudication, the *Riegle* court, explicitly following the logic of a law review article written by a D.C. Circuit judge not on the panel,²¹³ 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.”²¹⁴ In other words, “equitable discretion allows courts to dismiss a case that presents separation-of-powers concerns without making those concerns

(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 predates the FOMC. 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) (discussing *Raichle v. Fed. Reserve Bank of New York*, 34 F.2d 910 (2d Cir. 1929)).

210. *Reuss*, 584 F.2d at 467.

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

212. 656 F.2d at 873.

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

214. 656 F.2d at 881.

part of the standing test.”²¹⁵ The *Melcher* decision, decided eight years later, followed the *Riegle* decision.²¹⁶

The courts are therefore unlikely to put a bandage on the unconstitutionality of the FOMC. The consequence is that, with respect to the President’s ability to control the FOMC through personnel decisions, the statute creates a law that is so protective of the Fed’s distinct personality that it arguably violates the Constitution. The judiciary, invoking doctrines that have nothing to do with the statute itself, creates additional hedges around that unconstitutional structure. The appointment and removability issues around the FOMC demonstrate the problem with too much reliance on the statute alone. Fed independence is a creature of much more than legislative enactment, as important as those enactments are.

E. 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 the existing 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 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—which can function like a removal. But those decisions are more informed by political and personal forces than legal ones.

Removability restrictions around the Reserve Bank presidents, on the other hand, owe much to law. The legal structure of the FOMC essentially prevents the President from meddling with Reserve Bank participation on that Committee, despite how central monetary policy has become. But even here, context—in this case a judicial one—has given the terms of the statute new life. Courts have pronounced constitutional principles and declared adjudication of those principles impossible, thereby allowing a unique and illegal institutional design to continue its trajectory. In fact, Justice Breyer’s dissent in *Free Enterprise Fund* included a list of all those agencies that might be affected by the case’s

215. Anthony Clark Arend & 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).

216. The Supreme Court, in a subsequent treatment of legislative standing in *Raines v. Byrd*, embraced a similar conclusion regarding legislators’ ability to challenge a statute’s constitutionality. The claim underlying *Raines* different from that of a Senator who is denied the ability to give advice and consent to a principal officer’s appointment to a federal position. But the decision is animated by a similar theory. See *Raines v. Byrd*, 521 U.S. 811, 816-17 (1997) (citing *Moore v. U. S. House of Representatives*, 733 F.2d 946, 950-52 (D.C. Cir. 1984)). *Moore* relies substantially on *Riegle*. See *Moore*, 733 F.2d at 955-57.

holding.²¹⁷ Perhaps inadvertently, the FOMC was excluded from the list. It was an appropriate exclusion: given courts' previous discomfort with engaging in the constitutional issues around the appointment and removability of the Reserve Bank presidents, it is unlikely that we will see a judicial resolution to this question.

The FOMC's enduring unconstitutional structure demonstrates the descriptive power of this Article's argument. It is not merely by convention that the Fed enjoys this peculiar protection from constitutional requirements: judge-made law is still law. But it is the case that the statute insulating Fed actors from presidential oversight—in combination with judge-made law and other lived experience—is of far greater moment than it might seem. The FOMC is an unconstitutional structure that endures because the judiciary, over time, has chosen to permit it.

Conclusion

The Fed has had an extraordinary century. But its future, including the ways it will formulate and implement national and global economic policy, remains contested. As scholars and policymakers debate what the Fed has been, what it is, and what it should be, they can find guidance in understanding the institutions of Fed independence—with an appropriate, nuanced understanding of the relationship between law, conventions, history, and politics. Without that understanding, critics and defenders will not only talk past each other, but they will talk past the institutional features of the Federal Reserve itself.

As this Article has illustrated, the Fed's relationship with Congress and the President are regulated by a tangle of 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 irrelevant, is also incorrect. The reality is that the institutions of Federal Reserve independence consist of much more. The Federal Reserve Act matters, from the removal of the Fed from the appropriations process, the fourteen-year terms of the Governors, the four-year terms of the Chair, the appointment procedure of the Reserve Bank presidents, and the removability protections on those Presidents on the FOMC. But the institutions of Federal Reserve independence also include the role of personalities, including the relationship between the Fed Chair and the President. And the institutions include changes in historical practice, such as the elimination of the gold standard, real bills doctrine, and monetary autonomy of the Reserve Banks.

Taken together, this broader picture of Fed independence includes the relationship between the Federal Reserve Act as recorded in the U.S. Code and the Federal Reserve System as it lives in the world. The argument is not that law

217. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3185-3201 (2010).

is irrelevant, that all is politics. It is that law is incomplete. The Federal Reserve System—its many committees, the many individuals who reside within it, those on the outside who seek to influence it—lives in the world. To understand Fed independence, we must understand that world.

A better understanding of the ways that laws can change over time—including and especially without subsequent legislative change—has normative implications. Most important is the tangled (and unconstitutional) governance structure discussed at length in this Article. The unconstitutionality of the Reserve Banks' appointment and removal structure is not simply a question of "etiquette or protocol," as the Supreme Court put it: ensuring that these extraordinarily powerful officials of the United States government conform to the requirements of the public accountability at the appointments level is "among the significant structural safeguards of the constitutional scheme."²¹⁸

But the implications of the Article's argument, that the institutions of Federal Reserve independence are more important than the statute taken in isolation, also invites skepticism about the ability of institutional designers to make enduring changes to the Federal Reserve Act that will always match their original intentions. The very existence of the Federal Reserve Banks owes itself to a political compromise whose merits have long since receded into history. So, too, with the Fed's extraordinary budgetary independence, which has taken on a far greater degree of autonomy than its original designers intended.

That statutory change is not the most enduring kind of reform in institutional design should not invite skepticism in the potential for democratic oversight. Instead, it focuses attention on simplifying and prioritizing the appointments to the Federal Reserve. As the graph in Part IV indicates, filling the vacancies on the Fed's Board of Governors has not been a priority for the last several presidential administrations. Changing that course—in addition to simplifying the governance structure at the Federal Reserve Banks—would go a long way to ensuring greater public accountability at the Fed. There is no guarantee that statutory change will perform as expected. But regular changes to the appointments at the Fed will be more effective in ensuring that the public can participate in managing the Federal Reserve System without erasing the enduring aspects of its autonomy that the institutions of Fed independence have tried to establish.

A better understanding of the institutional context of the Fed's independence also serves another purpose, beyond pointing the way forward for discussing Fed reform. It invites skepticism about some of the certainty of viewing Fed independence as a yes-or-no binary. Instead of jumping to categorical conclusions about the defensibility of Fed independence, this Article takes a step back and suggests a more cautious approach. That approach begins by asking what we really mean by "Fed independence" in the first place. As this

218. *Edmond v. United States*, 520 U.S. 651, 659 (1997) (citing in part *Buckley v. Valeo*, 424 U.S. 1, 125 (1976)).

Article has argued at length, not all is as it seems within the Federal Reserve Act; taking a more methodologically diverse approach to the Fed through law, history, and politics, will allow for a more focused debate.