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THE MYTH OF INDEPENDENCE: HOW CONGRESS GOVERNS THE FEDERAL RESERVE

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PARTICIPANTS:

Introduction:

DAVID WESSEL
Senior Fellow, Economic Studies
Director, Hutchins Center on Fiscal and Monetary Policy
The Brookings Institution

Remarks:

MARK SPINDEL
Chief Investment Officer
Potomac River Capital LLC

Panel Discussion:

YLAN MUI, Moderator
Reporter
CNBC

SARAH BINDER
Senior Fellow, Governance Studies
The Brookings Institution

LAURENCE MEYER
President
Monetary Policy Analytics

RANDALL KROSZNER
Norman R. Bobins Professor of Economics
University of Chicago Booth School of Business

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P R O C E E D I N G S

MR. WESSEL: Good afternoon. I'm David Wessel, I'm director of the Hutchins Center on Fiscal Monetary Policy here at Brookings. I'm very pleased today to welcome the authors of this new book, Sarah Binder and Mark Spindel. Sarah is a senior fellow here at Brookings and is also a professor of political science at George Washington University. She's made a career out of studying Congress which is somewhere between frustrating or interesting, depending on your political persuasion. She has written about gridlock and filibuster. And she and Mark, who is the founder of a hedge fund in town called, Potomac River Capital, have taken a whack at something that I think is really important, I think there is a lot of short hand that comes with discussion what the federal reserve is.

Somehow, in any discussion of the Federal Reserve, the word, independent, always appears. But I think the definition is sometimes not completely clear. Some people talk about it being independent within the government, other people talk about the virtues of independence maybe being questioned now that we're in an era of low inflation. There are questions about what aspects of the feds responsibilities monetary versus regulatory. Should they be independent of the political system? Questions about is it really so wrong if the treasury and the Fed coordinate on something, particularly at a time of low interest rates and quantitative easing.

So, these are all really big questions. What Mark and Sarah have done successfully is, I think, take us back to the roots of the Federal Reserve in 1913. It's basically a political history of the relationship between the Fed and the Congress. So, what we're going to do is, Mark is going to speak some about the book and then Mark is going to take a seat in the audience but he'll participate in a panel discussion that will be moderated by Ylan Mui from CNBC. We have two former Fed governors, Randy Kroszner and Larry Meyer, and then Sarah Binder will join them up on stage. So, to start, I'd like to welcome Mark Spindel to the stage.

MR. SPINDEL: 2:07 p.m. September 29, 2008. Who remembers where they were? Anybody? When I called my friend, Sarah Binder, my neighbor and conveniently an expert on Congress, which had at that exact moment, torpedoed George W. Bush's TARP bill. Bond markets were in disarray, the economy was in disarray. The Fed had supported this legislative effort and for sure, Congress was in disarray. Never let a crisis go to waste. One could never have known that our conversation would lead to this. And like the Congress, and the Fed for that matter, Sarah and I have accumulated many debts along the way. This afternoon is a perfect example and as befits a project that attempts to break down silos, we had a lot of help and guidance from a range of colleagues. Policymakers, staffers, journalists, peers and other Fed watchers.

Indeed, we're very grateful to Brookings and the Hutchins Center, to David Wessel and his colleagues for supporting our work today and their general focus on monetary politics. To Randy and Larry who I have known professionally for some time and have been learning from for even longer. Especially Larry, whose pre-Fed, Fed and post-Fed insights have always been a vital component of how we think about politics and policy shaping markets in the economy.

Sarah and I are incredibly grateful to have CNBC's Ylan Mui here today. Thank you, Ylan, for your participation from this side of the screen. And finally, just before I kick off, what we mean by the myth, thank you to Sarah. Ours is a unique collaboration, academic and practitioner. To be sure the protagonists in our story influence markets and the economy and are influenced by them. We hope our collaboration helps shed some new light on how Congress governs the Fed.

"The Myth of Independence." Our title gives it away. Conventional wisdom endorses a deeply entrenched notion of Fed Independence. Generally, people assume the Fed is an independent central bank within the government. Congress creates the Fed, sets its goals and insulates itself from inflationary temptation. People assume the Fed has instrument independence. And while you've never known it from the recent Fed share sweepstakes, structural features, extraordinary long terms for governors, staggered tenure for the chair, public private partnership, Federal Reserve, are supposed to ensure their autonomy. And yes, conventional wisdom also pegs the elemental 1951 accord as the source of modern Fed independence.

These are common claims made by central bankers and members of Congress, among others. We find this conventional wisdom mostly myth. And today, we want to try and convince you that Congress and the Fed are better thought of as interdependent institutions. The Feds perspective is clear. Congress is our boss. Precisely what Ben Bernanke told Kate Davidson when she asked him if he had advice for incoming Fed Chair Yellen. Why, because Congress always retains the power to reopen and revise the Federal Reserve Act. In the book, we review repeated episodes over the Feds history of legislative efforts to shape monetary policy at least indirectly. By shaping the governance and structure of the Fed. Why is that important, because the Feds power is contingent on securing exactly this kind of political support? And that political support from Congress is contingent on the Feds stewardship of the economy. If Fed autonomy is conditional on support from Congress, what type of independence is that? And certainly, Congress depends on the Fed. Imagine these 535 lawmakers setting interest rates.

Of course, it's more than that. Members of Congress are motivated both by making good public policy and, of course, getting reelected. So, they need someone to blame when the economy sours. Who better than the almighty Federal Reserve. Hardly frozen in time, legislative attention to the Fed is counter cyclical. Rising with inflation or unemployment and waning as the economy recovers. Suggesting again, the conventional notion of independence is largely conditional. There is a nice chart in chapter 2, page 35, for those following along.

Attention matters. Revisions or threats to revise the Acts signal congressional dissatisfaction and over the past century, have dramatically altered our central bank. Now, of course, monetary policy is not made in isolation. The economy needs a healthy mix of monetary policy from the Fed and fiscal policy from Congress, another element of interdependence. And Congress empowers the Fed as the supreme financial regulator. Interdependence embodies more than monetary policy.

But independence plus accountability just doesn't capture the political risks inherent in their relationship which is precisely why we care so much about interdependence. The relationship between Congress and the Fed reveals a recurring cycle of crisis, blame and reform. And we see this over the Feds hundred year history. Crisis comes, Congress blames the Fed, reopens the Act. Sometimes empowering it, sometimes clipping its wings, often demanding more transparency and D, usually all of the above. Exhibit A, Dodd Frank gave the Feds sup and reg power over systemically important financial institutions. Limited lender of last resort power. Imposed more transparency, particularly on emergency lending and imposed more oversight, created a vice chair for supervision.

A nice feature of this cycle, it solves a puzzle for us. Why, when the Fed fails to prevent a crisis, such as it did in 2007 and 2008, does Congress react by giving the Fed even more power? How can you blame someone and then give them more responsibility. Well, the more responsibility the Fed has and the more concentrated the power is in the Washington based board of governors, the easier it is for Congress to turn and blame them when things go wrong.

In 1964, testifying before Congress at the Feds half century celebration, then Chairman William McChesney Martin observed, "now we do bear the slings and arrows of the public. You are in the position of being able to blame us if it goes wrong. We are certainly not asking for applause if it goes right but I think we will bear the opprobrium of the people if things go wrong and we have to. This is part of our responsibility." Absorbing blame, that's what they're there for. And Congress, Congress makes more threats as the economy falters, classic blame avoiding behavior. When we examine legislative attention to the Fed in that chart on page 35, a very clear pattern emerges. Congressional behavior is reactive and counter cyclical. They are acutely aware of the Feds impact on the economy. When the economy is sailing along, Congress takes all of the credit and leaves the Fed alone. And when unemployment rises with more people out of work, legislators blame the Fed and threaten it with reform. Put simply, in bad economic times, lawmakers try to deflect blame back to the Fed.

So, before I turn this over to the panel, we did want to see if there is evidence that legislative action or threats can check the power and independence of the Federal Reserve. We touch on many in the book, but I just want to focus on one contemporary issue this afternoon and a caveat. Exploring what the Fed would have done in the absence of congressional threats or action, the counterfactuals are hard to find.

Economic theory tells us that central bankers have the autonomy to choose monetary tools. But that theory doesn't square very well with the Feds effort to adopt and inflation target. A tool used by many central banks around the world. The idea is, that by setting a numeric target, you can help set expectations about future monetary policy. Bernanke, started advocating for an inflation target when he joined the board in 2002. But there is a political problem. The Fed has a dual mandate, jobs and inflation. And a target for inflation only covers half that mandate. Bernanke, the central banker most commonly associated with inflation targeting, knew that putting a target in place required the consent of Congress. You see this in transcripts of FOMC debates, before the crisis and after. Here's Don Cohn in December, 2008. "Having an inflation target won't have any affect if it is repudiated by the Congress." It comes up in Bernanke's memoir. He initially approached Barney Frank about scaffolding the target. The powerful chairman of the House Financial Services Committee pushed back, arguing that emphasizing one side of the inflation employment duality, especially during a recession, sent the wrong signal.

Ultimately, it took Bernanke almost ten years to convince his boss. Sensitive to that pushback, the target needed explicit permission from Congress to be announced. More recently, there has been talk from current and former FOMC members about raising the target. Let me interrupt my talk to see what the boss had to say.

(VIDEO PLAYING)

So, in there it calls for the Fed and important cases by the Fed to increase their inflation target. In this case, Republicans in Congress push back against any such change. Don't do anything without talking to us. Conventional wisdom suggests the Fed claims independence. But clearly, it is acutely sensitive to the need to secure political support for its policy choices. One might also ask what a higher inflation target would accomplish in an environment where the Fed has failed to hit its current 2 percent goal. We'd probably not be having a debate about a December rate hike if the target were higher. This is what interdependence looks like.

Let me stop. We are especially privileged to have Larry and Randy, two former members of the Board here today, and I'm going to turn the afternoon over to our panel. As such, let me reintroduce Ylan Mui, our moderator. Ylan is a reported for CNBC where she focuses primarily on economic and regulatory policy. Can I just say monetary politics? Her background in print journalism encompasses 15 years at the Washington Post where she covered among other topics, the Federal Reserve. I met her about five years ago when she first picked up the Fed beat. Her insightful reporting and engaging manner has always brought an important perspective for Sarah and me. We are privileged to have her and her panelists here today to help us explore the myth of independence. Thank you.

MS. MUI: Well, thank you very much, Mark, for that kind introduction. Thank you as well to Brookings and to the Hutchins Center for hosting this discussion today. It is my honor to introduce your panelists to you. I'll start right here to my left, Larry Meyer. He is president of Monetary Policy Analytics, Inc. and he has served on the Feds board of governors from 1996 to 2002. Sarah Binder, is a senior fellow in governance studies at the Brookings Institution. She is also a professor of political science at George Washington University and she specializes in Congress and legislative politics. Over there on the end is, Randy Kroszner. He is the Norman R. Bobbins professor of economics at the University of Chicago's Booth School of Business. He served on the Feds board from 2006 to 2009. Thank you all for being here.

One thing that I thought was so interesting out of Mark and Sarah's book was this idea that political and congressional attention to the Fed is counter cyclical. And we have here, actually on opposite sides of the podium, two former Fed governors who served at essentially opposing ends of business cycle. So, Larry, I'd like to start with you. You served at a time of relative prosperity and stability. Did Congress leave you alone and let you do what you wanted?

MR. MEYER: Well, the first thing I disagree with is the cover and the title, it's not a myth. It's a very interesting book. But let me talk about what's wrong with it because that's more fun, but most of it is right. It is just the cover, the last sentence and one or two other sentences. The narrative is great, it just needs a new title. It is good to be here with Mark, and old friend, Sarah, a new friend and, of course, Randy and Ylan. So, let me start out and tell you what I want to do. I'm going to do three things but hardly anything of the third because that's what's right and more interesting what's wrong and why I think it's wrong.

So, I want to start with first, what I think is wrong, second, why I think they got it wrong and I'll very briefly tell you why I still really like the book. The statements here, are the cover and the very last page, 240, let me see if I can find 240. The very last sentence. At best, the Federal Reserve earns partial and contingent independence from Congress and thus we conclude barely any independence at all. Wow. You know, I never thought I was a tool of

Congress. I never would have accepted that position if I thought I was going to be a tool of Congress. I was never a tool of Congress. You can see how I testified and you'll know that.

So, there is another sentence in here that I think is particularly good and here they say, from atop Capitol Hill, Congress depends on the Fed both to steer the economy and absorb public blame. Well, now that's right. The first part is independence. They are there to steer the economy without political interference and the last is, it's the nature of politics, it's the nature of the game and it is Congresses privilege since they put the Fed into existence and they can change it any time they want. So, I could get it wrong. They never correctly identified what independence means. They never talked about goal versus instrument independence until page 225. Too late, damage done.

So, let me explain what happened here. First, they say the Fed does not have goal independence. Now remember, central banks around the world, none of them have goal independence. Legislatures have set the goals in what they think is the public interest. That is always the way it is, no central bank has goal independence. What independence means in the context of central banking is instrument or operational independence which means having the right to adjust their instruments to achieve the congressional mandate without political interference. So, that's what we want to see. How is policy different because of what Congress said or did?

Now, the goal independence problem is that they say they don't have goal independence and therefore they're not independent. Okay, that's completely wrong. The go for the jugular when they say they don't even have instrument independence. And Mark set me up very nicely, thank you, by talking about their key story about why they don't have instrument independence. And that's because they have to consult with Congress and get a buy in from Congress before they implemented an explicit numerical inflation objective. Now remember, it took 65 years for Congress to impose on the Fed, a mandate, and artfully described as maximum employment and price stability, but who's there. Now, they never defined either and particularly price stability. So, central banks around the world, by the time the Fed got around to having an explicit objective in 2012, they were basically late in the game. Everybody else had explicit inflation objectives.

So, the story is they say, an inflation objective is an instrument, it is not an instrument. It is a specification in numerical terms of an objective. So, this is really, how do you balance this, what is the role of Congress, what is the role of the Feds. I think that's kind of tension. The Fed, we had talked about this, we couldn't get it done, I couldn't get it done, and others who wanted it really couldn't get it done. We all knew that the Fed was going to have to consult with Congress, bring them along because this was a politically contentious issue. But independence is using the funds rate balance sheet policy to achieve a 2 percent objective or to achieve what price stability is. I'm not surprised Congress might say, I told you price stability, somebody said during the debate, that's zero. We had that debate that first meeting I was there, Greenspan said it was zero. But the rest of us decided it was 2 percent.

What did they get right, almost the narrative. There are only a few sentences in there that I would pick out and that discussion of the inflation objective. What they get right is the story. This is the story in chapter 2 the title, "The Blame Game," that's what it's about. That's the nature of politics. Blaming the Fed when something goes wrong. But it is more than that as Sarah and Mark said. It's that the Fed has to be very careful to maintain relationships with Congress, to protect their independence because the best thing is to get it right. If Congress doesn't think you get it right, then you have to rely on the political capital that you've built up in those personal relationships that Ben was very good at doing as I'm sure, Janet Yellen is as well.

So, that's why the Fed has maintained its independence. Because they recognize, every chairman comes into that position and knows one of its core responsibilities is to interact with Congress, build relationships that you'll need to fall back upon to protect independence of the institution.

MS. MUI: But Larry, doesn’t that statement right there support the thesis of Sarah and Mark's book and the interdependence between the Fed and Congress?

MR. MEYER: No, I don't think so. So, tell me what decision the Fed made since 1977 because I'm not a historian, I don’t go there. What decision did they make with respect to the funds rate, balance sheet policy was influenced by Congress?

MS. MUI: Sarah, I think this is a good time to bring you in.

MS. BINDER: Well, let me just quickly echo Mark's thank you and you can tell we had a lot of feedback along the way and no exemplified here which is really awesome that people are engaging and challenging the argument. I should say, it is not a book I could have written by myself and it is a much better book for having written it with Mark.

Let me step back and then answer the direct question. I would suggest there may be a difference between, in Larry's terms, political interference with the Fed and political influence on the Fed and the distinction may be worth probing out a little bit more. I would also suggest, I'm not so sure that Congress neatly recognizes the distinction that central bankers clearly recognize between goals dependence on the legislature and instrument independence. I'm not so sure from our reading of congressional history that Congress sees that distinction. We see it throughout the ways in which Congress leans on and reshapes the Fed whether it is the leaning back, pushing back on the inflation target, whether it is in position of transparency requirements over time which every single time the Fed has fought because it infringed on their ability to pursue policy the way they wanted to. And, of course, along the way, reading the FOMC transcripts and again, we're not obviously in the room where it happens.

So, we are dependent on transcripts for a long period but not the recent period and you pick up constant reflections on political risk, political cost. What are the costs we're going to face if we push ahead? One example and I think it struck me as sort of iconic like what's the classic example of Fed independence is Paul Volker in the early 1980s really combating stagflation. When you open up the transcripts and read what they're saying, it is such things as Volker 1981, if we get this one wrong, we're going to have legislation next year without a doubt. We may get it anyway, it's a matter of judgement as to how that might come out where the risks are, but I think we know where the risks are. Discussions about when are we going to stop hiking grades, when are we going to ease policy. There is constant discussion in the FOMC about the political costs, how long can we do this before we lose political support.

So, there are other examples here but I think Mark and I both appreciate the importance of being very clear as Larry had said about being sure where we are drawing lines between instruments and goals.

MS. MUI: So, Sarah and Mark talk in the book about that cycle of crisis, blame and reform. Randy, you were lucky enough to serve during all three of those things. Tell us what that was like.

MR. KROSZNER: Yes. So, thank you. I'm delighted to be here to be commenting on this book. This is an issue that doesn't get as much systematic attention as it deserves. I think the distinction that Larry drew is a very important one, I'll come back to that in a bit. I'll give some anecdotes from that period because it's obviously one in 2008 where we were doing a lot of things that the Fed had not done before. We were using the so-called section 13-3 powers which, as Sarah and Mark talk about in the book, when the Fed did not respond in the early 1930s to the crisis because the first line of the Federal Reserve Act is to provide a more elastic currency. There had been a private clearing house system that did that and it was the judgement that it had failed in the panic of 1907 and so, we created a government organization to do that because England had had the old lady of thread needle street since 1694 et cetera. The Fed didn't act when it should have and then the Federal

Reserve Act was amended to give these specific powers, and the term from the act is unusual and exigent circumstances and then outline broadly what could be done in those unusual and exigent circumstances.

So, we were very mindful of that during that time period. We worked very closely with the legal staff to understand, well, what can we do. Because there was very little precedent for what unusual and exigent circumstances were. It was a very high minded phrase but exactly what is pressing enough and what is unusual enough to allow the Fed to act. Then there was a description after that of the things the Fed could do. What would or wouldn't be within the rubric. Remember, this legislation was passed in the 1930s. So, the institutions and instruments and markets that we have today are not exactly the same as the 1930s so we had to make what would be a reasonable interpretation of that. But we were certainly very mindful of using the powers that we had but not going beyond the powers that we had. I think, certainly as the Fed as Sarah and Mark point out, came in for a lot of blame for, why didn't you see this, why didn't you do something. There was very little response from Congress that you went beyond your powers. You may have used powers in ways that we didn't like but it wasn't that the powers that you went beyond those powers. We were certainly very mindful of that whenever we were thinking about the 14 different programs that we had come up with in 2008-2009 for providing support whether it was to primary dealers, whether it was in particular markets, in areas we had never done before.

So, I think Sarah and Mark are right, we were extremely mindful of that. We wanted to make sure that we were acting within the power that Congress had given us because we were aware that if we went far beyond that we were worried that future Feds would not have these powers to be able to respond to a crisis. Of course, being at University of Chicago, I'm very much influenced by Milton Friedman and Anna Schwartz's view of the 1930s which basically said that the depression became the Great Depression, because the Fed did not act. I think most people would agree with that. Certainly, with three of the five of us on the board at the time who have been students of the 1930s, we were not going to make the same mistakes that the Fed made of inaction. Obviously, there are lots of debates about whether we did the right things or not. But we were going to use the powers that we had within what our interpretation of the law was. As I said, I don't think Congress responded with, you went beyond powers, I think responded with, we didn't like the way you used those powers and so we wanted to reform some of those.

There was much more public pressure on the Fed exactly as these guys say, in downturn times. And, of course, in extremist in 2008-2009. So, I often describe this as the Fed goes from being front page of the business section in general newspapers being the front page of the newspaper and not just in the business section but the front page of the newspaper. It was always on the front page of the Wall Street Journal, but that's sort of a more specialized publication, but in just in general ones. And that, of course, there's a lot more attention being paid to everything that the Fed does. Aficionados knew how powerful the Fed was and there were some members of Congress who were really kind of Fed aficionados and knew that. But it was really only in 2008-2009 when the Fed's balance sheet went from $800 billion to $2.4 trillion like that where we were exercising our emergency powers. People went suddenly wow; this institution has a lot of power that we didn't fully realize. Of course, Congress it would take a long time for them to legislate to be able to spend one $1.5 trillion, this was done very, very quickly in response to the crisis. Exactly as I think both in the spirit and the substance of those amendments to the Federal Reserve Act in the 1930s had given the Fed the right to do.

But that certainly changed the dynamic because there was a much broader group of people who were commenting on the Fed in a more detailed way. As these guys point out and always in downturns, the Fed will be blamed. But there was much more of a focus, both because of the blame game that they talk about, it was a much more intense downturn so people, of course, wanted to focus on someone else rather than them for the problems. But also, just because the Fed became a much more public institution in the sense of much more public discussion of it, it became much, much more intense. I was happy that I don't that Congress, although, obviously Dodd Frank reformed Congress's powers, giving some powers and taking other powers away, they didn't feel that we had gone beyond the powers that had been given us even though, in some cases, they didn't like the way in which we exercised them.

MS. MUI: You bring up an interesting point which is that in the past decade or so, the Fed has become a much more public facing institution. To what degree does the Feds political support depend on public support? I think you guys quote in your book, that famous stat about the Fed being less popular than the IRS or something like that. How important is it for the Fed to shore up the public support in the ultimate goal of building that political support.

MR. KROSZNER: I think that certainly is important. You can see during the financial crisis and as is pointed out in the book, Ben Bernanke, who is not, there are some people who love to be in the limelight and love to be up on stage, that's not the Ben that I know. Ben decided to go do town halls, do “60 Minutes,” not something that central bank governors typically do because it was seen as incredibly important to try to articulate what we were doing and why. This was extremely unusual what we were doing. We were in unusual circumstances. We were exercising these powers that really had never been systematically used before people were very concerned and confused whether it is Congress or public and for good reason, so it was a very unusual time.

So, it was felt that not just speaking with members of Congress and with Senator Dodd and Chairman Frank and Chairman Dodd, but a broader public and that was an important conduit. So, there were multiple points of support and I think it was all done through trying to articulate what we were doing and why, not just sort of the legal basis support. This is, I think we were not affective in drawing that Main Street Wall Street distinction and saying, well we're really focused on helping out Main Street and if the financial system collapses, housing prices could fall, as they did in Japan, 80 or 90 percent. We don't want that to happen because it would be devastating for homeowners. The particular entry points, the particular instruments, as Larry was pointing that we were using, were providing support to the financial system through supporting the financial system directly. We didn't have the powers to go to the individual homeowners. But that distinction wasn't readily apparent and, of course, the Congress was happy to castigate us for not doing that but they hadn't given the powers to do those sorts of things.

MS. MUI: Larry, how much time did you spend meeting with individual lawmakers, if any?

MR. MEYER: Only when I testified, mainly screaming at them. The only time was, when I was nominated and there were visits to various congressman. I could tell who was a Republican and who was a Democrat before I even sat down. And the only one I had a hard time with, with Sarbanes who said, this is what you should do. These are the values you should have. I said, no. I'm a governor, I'm going to do what I think is appropriate. I call it, the no looking back rule, you've got one shot at me. Nominate me, confirm me, then I'm on my own.

In terms of the congressional interaction, the most interesting part would (inaudible) get all the time. When it was a possibility it would raise rates or not lower them, signed by 15 members of Congress. We lost at that and we put it in the circular file. I got only one letter from somebody in the public and it was in pink, bold letters and it was entitled, Dear Spawn of Satan. So, I said, that's not for me and I took it to Greenspan.

MS. MUI: Sarah, one of the theories that you guys come to at the end of the book is that perhaps the Fed becomes more reliant on Congress as the move closer and closer to the zero lower bound as the Fed sort of runs out of ammunition. Why is that and considering where we're at, is the Fed more dependent on Congress today than it has been in previous generations?

MS. BINDER: Well, I think, you put your finger on one of the anomalies here about independence. Which is, and then we'll come to the question about what happens when you get in a deflation area as opposed to an inflation area context. All the theories that economists give us about why we need independence of central banks, is that we fear lawmakers juicing the economy in search of reelection and going too far and fueling inflation. So, we create an independent central bank, lawmakers dutifully tie their hands behind their back and then set the goals and let the system run. Well, over a hundred years of Fed history, that certainly accounts in the 1970s, but doesn't help us much on other episodes, certainly not the crisis that gave birth to the Fed in 1913, the Great Depression in the 30s or the most recent one, the financial crisis.

So, the rationale for independence, it theoretically makes sense for inflationary times but for what certainly Ben Bernanke has written about that in times of deflation, bring in the fiscal cavalry. We're waiting for them to come because no central bank can do the things one really needs to generate demand to stimulate the economy in a period of deflation.

MS. MUI: In order to achieve its goals, the Fed needs Congress more than ever, is what you're saying.

MS. BINDER: Yeah and Jenny Young, as her phrase is typically, a healthy mix, we need a healthy mix of monetary and fiscal policy and, of course, the story in the wake we show in the book in the wake of the financial crisis is, after the initial stimulus, differences of opinion on Capitol Hill whether for ideological reasons or partisan reasons, ended the fiscal stimulus.

MR. MEYER: Let me just say, fiscal policy and it is used as a stabilization policy doing something the Fed would do has absolutely nothing to do with Fed independence. You could say that things like helicopter money, which the Fed can't be forced to do, which couldn't be a good idea and they could cooperate on. Difficult but I think it's certainly possible. So, fiscal policy is another story. They dreamed of it when they needed, they're not dreaming of it now when they don't need it. So, I don't think that's an issue. Does Congress know the difference between co-independence and instrument independence, no they know very little about monetary policy, but you have to ask, what do they do? They set the goals and they give the Fed freedom.

But Sarah made a very important point and you get to the point where you just can't test this. We can't identify particular points where I would say where the Federal Reserve Act was revised or whatever, that forced the Fed to do something different than it otherwise would do. But was it ever an influence. So, I would say there is one thing they could have looked at and that is the very large balance sheet today. There was concern. Republicans hated it but they did it anyway. But today you have to ask, why wouldn't they want to shrink the balance sheet, as Ben has often said. I think of an economic reason. I could give a political reason, to make Congress happier. I think the big story is policy space. They'd rather increase the balance sheet from 3 to 4.5 than from 4.5 to 6 and they're going to have to do asset purchases again.

So, I think that's a place where there is also the question of, what happens if they suffer capital losses because they're not allowed to register capital losses. All kinds of things like that where politics come into it to a degree. But never in the sense of, what should they do with the funds rate, when should they carry out asset purchases.

MS. MUI: But the funds rate is not the only important decision that the Fed makes. I mean, Randy, we can think back to 2008 when the Fed had already bailed out AIG. There is the question about what happens with Lehman Brothers and I know this has been sort of analyzed ad nosism but the Feds decision not to act, walk us through how much of that, you said it was a legal interpretation. But was that legal interpretation constrained by the political realities that the Fed was kind of already tapped out.

MR. KROSZNER: Well, at least from my perspective, I can't speak for the other board members. Ben is here, so you can bring Ben in to get his views. I don't think it was a view that the Fed was tapped out. I think one, the narrative of the crisis is that somehow that Lehman was the spark and actually, I think it was much more a symptom rather than the cause. How did we get to this position where all the investment banks were barely able to fund themselves and one, in particular, wasn't able to fund itself? We thought we had a merger partner for it so some people have these conspiracy theories that we had to shoot one of them. Again, there may have been a lot of discussions but I wasn't in every discussion but I never heard anyone say that that's what we've got to do to prove or medal with Congress or with the public. We thought we had a merger partner in Barclays. This is well described in Hank Paulson's book and others. There is nothing newsworthy but we thought we did and we had a merger partner for Merrill Lynch with Bank of America. So, basically what we needed was a capital infusion and the Fed is very clearly not able to do a capital infusion. That's very clear, you can provide lending to a solvent institution against good collateral.

Now, in the middle of the financial crisis, exactly what constitutes as solvent institution and what constitutes as efficiently good collateral, that's obviously a matter of interpretation. That is not something that is completely fair cut and some people have argued that Lehman was obviously solvent or insolvent and we should or shouldn't have acted. We had the legal power to do so. At least, from my point of view, and again, I can't say this for anyone else, Lehman was certainly different that Goldman Sachs and Morgan Stanley. Because some people said, well you gave Goldman Sachs and Morgan Stanley economic charters on an emergency basis, again exercising our section 13.3 powers on unusual and pressing circumstances. Why didn't you just do that for Lehman and it would have solved the problem. Well, we didn't feel the same comfort with the viability of Lehman's business model. Basically, Lehman had been picked apart for months over that summer. They were much larger than Bear Stearns but by the time September came around in many of the interconnected markets, they were actually smaller than they were. They problem that came up was not in the over the character derivatives markets which is what we were concerned about and those interconnected markets with Bear Stearns what had happened with the money market funds, the interconnection that we didn't fully see and I think no uncertainly the SEC didn't fully see either.

But this was an institution that was much weakened. It wasn't clear it had a viable business model. It wasn't clear how much capital it actually had. At that time, trying to estimate the value of liquid assets on any institutions balance sheet, you're going to have a fairly wide standard error and when institutions have one to two percent capital, it doesn't take very much of a standard error in the middle of a crisis to think well, maybe it's solvent or maybe it's not solvent. So, we didn't feel the same level of comfort as we did with Goldman Sachs and Morgan Stanley to be able to say yes, these institutions have sufficient capital, they have a plan where we feel confident that they would be able to build to our usual capital standards, that they have viable business models. We didn't feel that or at least I should say, I didn't feel that was the case with respect to Lehman Brothers and that's exactly why we were looking for merger partners. Now, that didn't happen, we couldn’t get the effective capital infusion. As Hank points out in his book, he had been talking with Dick Fuld for a long time. There are a number of people, the Korean Development Bank and others who wanted to invest but the problem was, it would have been to dilutive of shareholders like Dick Fuld who said, no I'm not going to take $4 a share when I've got my billion dollar stock grant a year ago it was over $100 a share, so this isn't right. The argument, of course, was $4 is better than zero and that, I think, was the right argument ultimately but not a very effective argument at that time.

So, I think, we felt that Lehman was a different case. It would have been both, in a narrow sense beyond our powers because we couldn’t do the capital infusion, that's what you needed. But we were looking for that through the mergers just like JP Morgan Chase being the merger partner for Bear Stearns was effectively capital infusion, but a private sector capital infusion.

MR. MEYER: So, let me just say, Randy, that's a great and clear discussion of the Lehman decision. That was, should we or shouldn't be. But the question here really goes to, should the Fed have that power or shouldn't it. They had that power, they exercised. It's a legitimate question for Congress whether or not they should let the central bank intervene in individual institutions. Now, as Ben said, he's happy they took that away and I would have been too. It makes the economy more susceptible to crises, I will admit, but there are some things that should be in the central bank's power and one of them that I don't think. So, that's a political issue and Sarah and Mark talk about it as clipping the Feds wings. I think you could argue that that's the case but I think that was legitimate for Congress to say, should that be in there or shouldn't that be in there.

MS. MUI: Sarah.

MS. BINDER: Well, it does raise the question of whether 13.3, the special emergency lending's are goals or tools. I think we agree that they're tools. The other changes to 13.3 in light of the performance of the Fed and as Randy said, it's not that they didn't think they were stepping over the line, he said Congress didn't like the way they were using it. The other result was now the board of governors in using 13.3 has to get sign off from the secretary of the treasury. That doesn't sound like a clear independence to me.

So, I just think that there are lines here between sheer versions of independence and the ways in which politics and congressional politics can come to have some pressure on the use of these tools. I agree with Larry completely and Mark and I have struggled with this, what is the counterfactual, what would have happened in the absence of a world without Congress. But we do see what happens when the Congress uses the tool and regardless of how it was used, it was clipped back. So, we see evidence here that we can connect the use of the tools to pay a cost for not heeding those political signals that they may have been hearing, for better or for worse.

MS. MUI: Another point of leverage that Congress or at least the Senate has in shaping the Feds decision making process is deciding who sits on the Feds board of governors. Randy, I believe your re-nomination was blocked by Democrats and that could have shaped the makeup of the board and the perhaps the decisions the board made in the future, remember covering Janet Yellen's nomination and at that time, that was said to be one of the most politicized Fed nomination battles in modern history. Certainly, we may have been on a different monetary policy course, had Larry Summers becoming Fed chair, judging by his subsequent comments. I'd like to hear you all talk a little bit about, has the role of the Fed and the positions on the Feds board become overly politicized in today's environment.

MR. MEYER: This is a sanctioned political role of the president. He is required to do that. And, of course, Democrats pick Democrats, Republicans pick Republicans, they have different views of monetary policy. So, an interesting book with this would be to see how different one presidential set of appointment was in changing the course of monetary policy, I'm sure we could show that. But that's the way the law is set up. Political independence of the Fed is mostly about interference by presidents. Nixon and Burns successfully, Volker and LBJ unsuccessfully. That's where I think the real pressure is on the Fed with respect to policy, with respect to instruments and what they should do. So, it's just the way it is.

MS. MUI: Sarah, is this an example of political interdependence being baked into the design of the Fed?

MS. BINDER: For sure and it has not been constant over time. Congress is, in fact, watching Nixon and Burns in the 70s, had a solution to that which is to require the chair to come before Congress for a confirmation vote where it never had to do that before. Lawmakers themselves in those debates said, who is the boss. We have other lawmakers saying this on the floor of the Senate. Clearly, I think Congress sees these as an avenue for exerting at least direction to the Fed, they try to exploit it.

Just quickly on the confirmation process, we've had for over the course of the Obama Fed and now into the Trump Fed are vacancies. That's the way politics plays out and obviously better for me to say, what difference does it make for the making of all the work of the board to have three, four, maybe potentially five seats vacant.

MS. KROSZNER: I've been unanimously confirmed twice before the re-nomination so I don't think it was a broader political thing that was going on. So, I do think that there has been a little bit of a change in that because now President Bush nominated a number of people who, I don't believe, were Republicans. Like I don't know Don Cohn's political affiliation even though I was there, I never talked to him about it, but my hunch is he's probably more likely, if he is registered as a party, probably more likely as a Democrat than a Republican, but it never came up. The president had no hesitation to do that. It does seem now that there tends to be more pairing of, and that would, I think, be a very interesting thing to look at to try to get at this issue. It used to be just when people would come up but now there seems to be a few positions open. It would be a pairing of someone who would be more appealing to Republicans and some would be more appealing to Democrats.

That's traditionally how many of the other agencies like the SEC, which is very clear, the chair is from the president's party and then you get two from one side, two from the other side. I think, traditionally, that wasn't how appointments were typically made to the Fed but I think more recently, there has been more of that pairing. There has always been some of that that's been done. So, I don't want to say that this is something that is new and has only started in 2008. I think it has become a little bit more standard to have that and so, I think that is politicizing the process a little bit more.

MS. MUI: Though it seems like this time around, the process is completely different than it has been in the past. President Trump, I believe it was just yesterday, was up for lunch on Capitol Hill meeting with Republican senators and asked them for a show of hands of who their favorite Fed chair nominee might be. Apparently it was Taylor versus Powell and Yellen was mentioned. What does this do to the political environment surrounding the Fed and to that eventual nominee's political capital?

MR. MEYER: Well, it's the name of the game. What you have to ask is this. The one political interference, if you like, is the President's ability to nominate and Congress to confirm. So, that's the way it is. It is a very important one, no question about it. The question you have to ask is this. If the president picks John Taylor instead of Janet Yellen, would the president have more political influence over the Fed than otherwise.

MR. SPINDEL: You mentioned Burns who I think is the sort of iconic example where the president and his loyalty pledge for his Fed chair. I was going to say one other thing, I touched on it briefly in my introduction. The learning for Sarah and me in studying the history of our central bank was a Federal Reserve. I think I've learned all of my political science from Sarah and the United States is infused with these weird institutions. I think our central bank; the Fed is absolutely one of them. We're touching on the Presidential nominees and the congressional or Senate confirmation process. But you also have a dozen, essentially, private sector employees, presidents of the district banks.

We write in the book, moored in the same cities they were way back in 1913 who have an important vote on our monetary policy. So, it's not just the president's political prerogative. It certainly is, it's not a now, Sarah correct us if we're wrong, a sort of very low bar to get that confirmation without a filibuster confirmation process. Congress is deciding who gets to vote, it's not just simply ordained by the president's appointment. They could wake up and decide they want the presidents of the district banks from the shires to have a bigger voice to the extent they fill those chairs, that gives the districts a little bit more weight. If we took nothing away from this exploration of the myth of independence, it's this very weird federal structure to our central bank.

MR. KROSZNER: If I could just add one thing on that. When you're in the board room, it's a very, very large room because everyone has to sit around the table and there are many staff members, some of whom are here, who sit around there. On the east side of the room, is an enormous map that is probably 20 to 30 feet across and 15 to 20 feet high of the United States with all the districts in it. So, when you are meeting, you are reminded that this is a federal system and it represents all the districts of the United States. I don't know how many people actually did look at the map during the meetings but it is there as a reminder. I don't think it was an accident that they happened to put that so prominently on one of the walls. What is interesting is the building was built in the 30s. So, it was just as all these reforms were taking place but it still was seen as very important to have that up there.

MS. MUI: One point that you make in the book and that you brought up, Mark, during your earlier remarks, is that one of the ways that Congress has tried to increase its leverage over the Fed is by trying to consolidate that power within the board of governors here in Washington. So, where are we in that pendulum and which way is that pendulum continuing to swing?

MR. SPINDEL: I think in all of the revisions, a dozen and a half that we looked at, they seem more and more to concentrate power in the D.C. base board of governors. They haven't removed the votes of a rotating set of district banks. Back in the original recipe, each individual district could make its own monetary policy so we've certainly come a long way in a hundred years.

I think when we've thought about the more contemporary reform bills that are sort of ping ponging around Capitol Hill, in many ways, they would represent, not that we think they have a strong chance of passing but they would represent maybe the first bid of legislation that would try to devolve power back to the districts. So, we may have gone as far in the centralization. I think, the first or second paper that we wrote which formed part of the book was called, Decentral Banking. I think we've probably reached the limit of what this particular legislature would tolerate in terms of power and the board of governors.

MS. MUI: And Sarah, I think this maybe speaks to some of the points that Larry has been making. What is wrong? Is there a problem with having an interdependent central bank and Congress?

MS. BINDER: That's a great question. I don't think we reach any normative conclusions about what an ideal relationship would be. If anything, living in a democratic system, having a somewhat independent Fed, having it be responsive to democratic pressures is what we would expect. And that interdependence, I think, is one of the ways in which public pressures come to bear and get expressed on the Fed. So, in that sense, I think it is kind of a healthy way to think about the relationship. That's the positive spin. The negative spin is, well this is just politics interfering with experts. But I think there are some broad reason why we want legislative influence over.

MR. SPINDEL: But, I think, Randy and Larry and Ylan, you asked the question, the notion of central bank independence typically is to temper inflationary bias. I think where we may see some problems and I take Larry's and Randy's experience very intimately. But when the legislature is more hawkish than sitting members of the central bank, when they are through threats, maybe subtlety around the edges checking your ability to build the balance sheet, your ability to exercise lender of last resort power, your ability to live comfortably at the zero bound or lower. I think you do open up a potential problem in wrestling with another crisis, should we be so unfortunate as to face one. Would they be so willing to build that balance sheet?

MR. MEYER: That is really interesting. I think a full chapter on these are the greatest threat to Fed independence, to instrument independence that we have seen in the reform proposals. Just to show you the politics, some of them want all presidents to have votes, not just five. When the public supports that because presidents are more hawkish on average. So, that's the kind of political influence, that's where they have that ability to change that structure. The structure was, and it is very interesting, the governors are supposed to outnumber the presidents on the FOMC. Governors live in the same place, they live in the same neighborhood and rarely, it has happened. What happens when you only have three governors? That's not what the founding fathers wanted. That creates some issues. But I would say, I've never said this before, thank God for the president, because they are (inaudible) for independence of the Fed and for continuity in policy. So, go to it.

MS. MUI: I'd like to open it up for questions from the audience. I think there is a mic going around and right here.

QUESTIONER: My question is for Sarah. You written about attempts in the past to subject some aspect of the Fed to audit by governing accountability office. I think you concluded it is neither feasible nor desirable. Could you elaborate on that?

MS. BINDER: Sure. Out of the Fed, the idea that Congress would direct the governing accountability office to, in some form, audit what is going on. Whether it is the books, which they do now or whether it's to be in the monetary policy committee or to review it right afterwards. These are efforts by Congress to impose more transparency on the Fed. We talk about it as a creature of Ran Paul and Ron Paul but it is really the God child of Wright Patton from the 1950s. These were populous Democrats who didn't like what the Fed was doing and put pressure on the Fed by introducing audits. It took 20 years, they got an audit but carved out the monetary policy exception.

Those pressures continued. They continued through Volcrum, they continue all the way up until today. There has been strong Republican support for it, there has been some

Democratic support depending on whether you're up for reelection or come from a more moderate background. So, I will never say it can't happen. To observe the audit bills, my senses have stepped back a little bit. They are a little less intrusive than some of the Ron Paul versions of it. I would just observe; the Fed has pretty routinely fought new measures of transparency and so they fight this one as well. The question is, whether the types of GAO and audits envisioned, would that hamper the writing of making of monetary policy.

MR. MEYER: Let me just note, the transparency is an interesting issue. The Fed has fought every attempt by Congress to impose more transparency but has gone along with it in the end and found out that it has made monetary policy more affective not less affective. It is an interesting question, what would happen if there was a GAO audit, would that affect decisions or would it just be a bloody pain in the neck.

MS. MUI: All the way in the back.

MS. IRVING: I’m Susan Irving, and I work at GAO. I actually lead the work on debt management. Every time we go to the New York Fed or the board, we make clear that we're there to talk to them as their fiscal agent for the Treasury. We're actually pretty supportive of the ban on us auditing monetary policy. We have neither the competence nor the interest in acquiring the competence to do so. It was of some concern, I think, to a number of us when there was a proposal to move the auto bailout management to the Fed because the more you give things not related to economic stability to the Fed, the more pressure there is to bring in people like us. Before the question, I wanted to raise the point that in some sense, the insight of an interdependence is not new. With all due respect, some of us have known for years that there is no such thing as an independent blank. The Constitution set up three branches of government. Neither the FCC nor the SEC nor any of them are, in fact, independent agencies. I think of them in a way for the Congress to seek to protect itself or stop itself from doing things it has the absolute power to do but thinks it should not do.

I'm old enough to have handled Lyle Rumley's confirmation for the Fed and clearly the Congress could have set monetary policy any time it wanted, but it didn't want to do it so it blamed the Fed. I haven't read the book but it seems to me that, in fact, both of you may be right. That as Larry's view, the strength given to our country and our credibility, despite efforts to come awful close to default, by an independent central bank is very important while we at the same time recognize that Congress could take it back any time it wanted because you're really subservient to the Congress.

MS. MUI: Behind you by the wall.

MR. BELL: Thanks so much for the book. I'm Sam Bell, I'm a consultant. I'm wondering whether any of you thinks the maximum employment mandate gets in the way of Fed independence. I ask because John Taylor, in 2012, wrote a book called, "First Principles," in which he said we should have a single mandate, priced stability. One of his arguments was, it will enhance independence of the central bank, focus an easier job, all of that. So, I'm curious whether the dual mandate gets in the way of independence.

MR. MEYER: So, no. This is Congress's job to give the Fed mandates. They have given them intelligent mandates but the Fed is almost unique among central banks of having to do a mandate. All the central banks pretty much act that way but typically have a price stability objective or some hierarchical system. So, the Fed is unique and some people like Taylor would prefer just to have an inflation objective. That's fine, Congress could do that at its peril.

MR. KROSZNER: I think that's exactly right because studies have been done in practice looking at different mandates across different central banks have some of them closer to being dual mandates, some of them closer to being a very narrow focus on inflation. Exactly as Larry had said, in practice, if we look over the last 25 to 30 years as central banks have been adopting these sorts of explicit mandates, it doesn't seem, you couldn't really predict different actions based on the mandate. So, in practice, central banks seem to be operating in roughly the same way regardless of what the formal mandate is. Even if it is just a very narrow focus on inflation it is very hard to ignore if Paris is burning, for example. So, the CB has a relatively narrow mandate but Marid Raggie does not ignore when the unemployment rate is extremely high when the economy is not doing well in the Eurozone and quite reasonably. And also, economics allows you to bring the two together.

So, even if you don't have some explicit mandate for looking at employment, you can focus on your inflation goal and say, ah, but employment or growth or some of these other factors will be affecting where the trajectory of inflation. So, we are consistent with our particular mandate but since these other pieces come in and our broader economic understanding of the interconnections in the way the economy works, you're going to be taking those into account. I think that's why in practice, you typically do see them act roughly in the same way even with different mandates.

MS. MUI: Except, does that change when, in situations like now we're facing both low unemployment and low inflation and depending on what your mandate might be, your choice of which side to focus on might be different.

MR. KROSZNER: I would say that the ECB and the Fed have acted in broadly similar ways in response to somewhat different shocks. The shocks came later in Europe but then the ECB has done exactly what the Fed did of buying assets, bringing interest rates down. They've actually brought them down to negative territory using very explicit forward guidance. I sometimes call that open mouth operations rather than open market operations. Marid Raggie understood the importance of that when he said, we will do whatever it takes and believe you me, it will be enough. That had an enormous impact on the markets, much more of an impact than an announcement of any particular asset purchase or any particular move in interest rates. So, I think, even in these tough circumstances, it is roughly the same. Is it exactly the same, probably not but I think roughly the central banks seem to be responding in the same kinds of ways using the same kinds of tools in response to the same kinds of shocks.

MS. MUI: In the front.

MS. GUEDA: Hi, Victoria Gueda with Politico. I wanted ask what this means in terms of how the Fed's should act towards Congress. The Fed, in my experience, has been always very hesitant to speak out publically. During speeches they'll make oblique references to proposals and Congress. They try to avoid being overtly political. I was just wondering, do you think that the Fed should be more active, more public about its positions, is it all just about making sure that you talk to Congress all the time and having good relationships with them. What should the Fed be doing better in terms of its relationship with Congress?

MR. MEYER: That's a really interesting question. Let me say this. When you say, its view, it doesn't have a view. There are different members, they all have different views. A chairman is the one who has the opportunity and some more than others, have a strong view that because they have that bully pulpit, chairmen should support the overwhelming wisdom of the economics profession. Whether it's about deficits or limited impacts of taxes on supplies, but they're the something that was more overtly political. How should they act, the answer is respectfully.

MS. MUI: Another question in the front here.

MR. CALLEN: Thank you. I'm Edward Callen, I'm a retired New York Times economics correspondent. I have a question which I want to direct primarily to the authors. You have taken a deep dive into the history of the Fed going back to the enabling legislation so let me ask the question about the history of the notion of independence. Did the notion of independence essentially take root and get much more emphasis, and you might tell us where, after the accord of 1951 which freed the Fed from supporting the Treasury market. What did it really antedate that and if so, what's the evidence.

MS. BINDER: So, that's a great question. I think what struck us possibly most was how little attention is paid to this concept of independence beyond the structural features that are built into the Federal Reserve. The fact that there is no appropriation for the Fed even in the early versions, long terms right before the '35 revisions, long terms. General ways in which, and having, of course, decentralized, having privately selected bankers having running their own monetary policy. There is very little attention beyond those structural features to any type of autonomy of the Fed. They are always coming in and certainly in the 1930s after just 20 years on the job, basically they rip up the Federal Reserve Act and start again.

For the Fed Treasury accord and just one note, in the 30s, much of the power monetary policy was not given back to the Fed when they rewrote it, they gave it to Treasury. Little checks on the Feds ability to do monetary policy. It gave it to the President to set gold prices and Treasury to the Exchange Stabilization Fund.

MR. SPINDEL: There was that Exchange Stabilization Fund which Morgenthau sort of conjured up. I think we touch on it in the book as a sort of possible balance to the balance sheet.

MS. BINDER: So, into and out of World War II, there is no independence, it was subordination to Treasury. Treasury, the accord in 1951, we do a deep dive to look at it and we argue that rather than a handshake between Fed and Treasury, so Fed had been pegging the very low rates, eventually causing inflation in the early 50s. The conventional wisdom is, the Fed and Treasury shake hands, they have an accord, Treasury says, okay you can get power back over your rate setting and the Fed has really claimed this to be the source of Fed independence. When you dig down deeper, you realize, where is Congress. Well, they played a role in tilting the power to the Fed, making Treasury the president step down. And as we argue in the book, they end up freed, yes absolutely independent of Treasury but now subservient to the Congressional boss. And Congress had its own reasons for doing that as well that we go into in the book. The Fed, I think, benefited from it as well but we certainly don't see, we see that accord as a divorce with Treasury and we see the Fed being pulled back stronger to Congress.

MS. MUI: Question here.

MR. SKINNER: Hi, I'm Richard Skinner at Johns Hopkins University. This question is particularly for Sarah because you're the Congress walk on the panel. We've heard a lot about how the Federal Reserve perceives Congress. But could you talk a little bit more about how Congress perceives the Federal Reserve, particularly the roles of the two committees of banking and house financial services and note how the Federal Reserve is pretty different from the usual departments and agencies that Congress oversees.

MS. BINDER: That's a good question and certainly the lack of needing appropriations from the Congress changes to some extent, that dynamic. I think I would say that members of Congress, in the House and Senate, there is a pretty uneven attention to the Fed and to monetary policy. There are some who do take the monetary policy quite seriously and put effort into it, others they do show up and ask the questions twice a year. But I think members, and you've got a very good taste of the chairman of financial services committee, very clear how he thinks the Fed should be proceeding. There are other clips in that July hearing that, I think, were pretty illuminating about the size of the balance sheet, praising the Fed for drawing it down, that was quite interesting. There was discussion, we call it the rules box, new this year. The Fed and the board presenting their policy report to Congress but in a box that compared Taylor one, Taylor two, I think, seven different rules and what the outcomes would be. Put it in the box, Congress has been demanding, Republicans and Congress have been demanding more rule based behavior, less discretion. Here was the Fed understanding, I believe, threats from Congress. They certainly didn't want to be told to follow the rule. I think that we see members do care quite a bit as they should, given their electoral implications from the state of the economy.

MS. MUI: Question all the way in the back over here.

MR. LEE: Purdy Lee, banking consultant. If John Taylor is nominated confirmed as Chairman of the Fed and he is successful in implementing the Taylor at the Fed and let's say that it actually looks like it is going to be successful. That putting monetary policy on autopilot, in fact, produces good results over the long term. What would that affect have, what would that consequence have on the independence of the Fed and or its decision making authority.

MR. SPINDEL: So, we've really struggled to understand this idea of appointing a less discretionary, in this case, as you've described it. And, I think, temporarily the rule would indicate a more hawkish Federal reserve, as more hawkish governor. And, I think, as we've explored it in a sort of contemporizing our thesis, it would certainly dilute some of this independence even further. It would give more power to individuals in Congress, members in the House and Senate who want to take that discretion away. Who just don't think that the kind of unconventional and creative policies that I think Larry and Randy developed and saw firsthand, have a place in this kind of central banking.

Whether we get there immediately, where there would be a revisionist history to some of his writings or some of market forgetting that they were there and just imagine that there are no atheists in the fox hole, that if there is a crisis, he would do all the kinds of unconventional policies. But, I think, I'd be a little concerned because of this dilution in independence that the central bank and that environment would be able to do what it has done previously.

QUESTIONER: Question for Professor Kroszner. The explanation the Fed has given for not providing support to Lehman Brothers is virtually unconvincing and I say so because of the fact that after all, overnight the institution transformed investment banks into commercial banks. Given what you know today, and I'm asking a question to one of the best economic historians, what do you think the absence of a backstop to (inaudible) to some extent if there is any, the role it played. Because (inaudible) actually argued that if the Americans really believed that Lehman is a fantastic institution, what don't they provide to send support which was provided to JP Morgan as a backstop for Bears?

MR. KROSZNER: Well, as I described, I think I was quite explicit on this, that we were much more concerned about the viability of Lehman Brothers that the other institutions. The business model was much more impaired at Lehman than it was at Morgan Stanley or Goldman Sachs. Everyone was facing difficulty of getting external funding and that was true, particularly for the investment banks but even commercial banks were facing those kinds of things.

As I said, I think it was much more a symptom. If you look back to see the risk spreads, where the risk spreads go up was very interesting as the risk spreads start to explode right after the Treasury intervention for Freddie Mac and Fannie Mae. This is one of these paradoxes of power. The same kind of thing happened in the U.K. when Reverend King announced that they had provided support for Northern Rock, the first bank in a century that had a bank run. So, you might have thought, ah, well the central bank has come in to save the day. It was exactly the opposite. Who is that guy, why is he talking about my bank, I want my money out.

The same kind of thing happened after Freddie Mac and Fannie Mae, oh my goodness, this problem was a lot bigger than I had realized. Again, it gets to the aficionado's things. Aficionados knew when we were very worried about these things. The broader public wasn't as focused on this but suddenly there was this bazooka that had been given to Secretary Paul and he said he wouldn't have to pull the trigger and he pulled the trigger and people were saying, my goodness, what if we start applying these marks to commercial banks or other institutions, would they be solvent or not.

As I said, I think it is much more symptom rather than cause. I do think that there was a lot going on that week because we were dealing with those, these were institutions that the Fed did not supervise because they were supervised by the SEC but we were being called into to deal with them because they were obviously a part of the interconnected financial system. And then we came to realize that another institution that we didn't supervise, AIG, was causing potentially even a greater problem with their interconnections in the market. I mentioned Lehman Brothers because people didn't want to be their counterparty. Even though they were larger than Bear Sterns, that issue of the counterparty interconnections wasn't quite as big with Lehman because September came around there weren't many there. AIG, we discovered rapidly was a much, much bigger issue.

So, I think, to some extent it was a bandwidth thing. We thought we had a likely merger partner with Barclays and I think we weren't talking with our counterparts in the UK as much as we should have. I was certainly getting some feedback as the week was going that people seemed to be less enthusiastic about supporting the transaction. Much like the transactions that we did in the U.S. with JP Morgan Chase and Bear Stearns, we had to have a memo that explained how they could meet the capital requirements so they could do these things. So, they needed the equivalent on the UK side and there was something with their company law in order for Barclays to actually do the takeover and immediately be the backstop behind the debt, would have required a vote. And so, they weren't really to suspend that rule. We hadn't focused enough on that to understand how difficult it was going to be for them to suspend that.

So, it would have been better if there had been more opportunities for thinking about other capital. That is one of the reasons why there was the push for the TARP legislation because there was no way to do a capital infusion and there was no way to convince Dick Fuld that $4 was actually a good thing to do and was a good thing for the system. We had no opportunity to do that. Now that the Treasury Department in consultation with the Fed, can declare an institution troubled and put it into receivership, that's a very different situation then we were in at that time.

MR. WESSEL: I think we're out of time. I want to thank everybody for coming. Please join me in thanking Sarah and Mark.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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(Signature and Seal on File)

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