The Politicization of Monetary Policy: The Vice Chairman as the Administration's Point Man

Thomas Havrilesky

The Trend in Politicization

Traditionally, the Federal Reserve Chairman has been considered the most important figure in the monetary policy arena. Evidence regarding whether the Chairman systematically resists administration and congressional pressures or succumbs to them is a matter of moment for scholars and financial market participants alike (Havrilesky 1993). In light of the persistent political pressures, since the 1960s, and the trend, since 1935, of deterioration of traditional constraints on the political manipulation of monetary policy,[1] such evidence is of considerable concern to those who would reform our institutions in order to contain latent inflationary excesses. As the erosion of monetary discipline in the 1935–75 period was a prelude to the double digit inflation of the 1970s and early 1980s, continued breakdown in the current decade is a likely precursor of adverse future consequences.

One of the remaining traditional constraints on monetary excesses is the presence of non-politically appointed members on the Federal Open Market Committee (FOMC). Numerous studies show that nations with less political, more autonomous, central banks have

---

Cato Journal, Vol. 13, No. 1 (Spring/Summer 1993).

The author is Professor of Economics at Duke University. He wishes to thank Rob Plowden for his help with the media sources cited herein and John Gildea for useful suggestions.

[1]Constraints on the political manipulation of monetary policy that have been weakened or destroyed since 1935 include the gold reserve requirement on currency, the gold reserve requirement on bank reserves, the decentralization of power within the Federal Reserve and private sector representation within the Federal Reserve. For further detail see Havrilesky (1991). Time series measures of the external pressures on monetary policy are presented in Havrilesky (1993).

superior inflation performance. If Congresspersons Paul Sarbanes (D-Md.), Byron Dorgan (D-Mass.), David Hamilton (D-Ind.), and Henry Gonzalez (D-Tx.) have their way with individual legislation that they are each currently sponsoring, all voting members of the Federal Open Market Committee will be politically appointed and the politicization of monetary policy will take a quantum leap forward.

In some cases the politicization of monetary policy proceeds in a more subtle manner. It does not feature acts of Congress. It is not even marked by legislative discussion, overt executive branch initiatives, or discernible external pressure on the Federal Reserve. This paper considers one such instance.

The Role of the Vice Chairman

Virtually unnoticed in the drift toward politicization during the past six decades is a change in the role of the vice chairman of the Board of Governors of the Federal Reserve System. Since 1951 there have been eight vice chairmen: C. Canby Balderston, James L. Robertson, George Mitchell, Stephen Gardner, Frederick Schultz, Preston Martin, Manuel Johnson, and David Mullins. Of these eight, the first three were chosen from within the Federal Reserve System; they were awarded the post because of seniority within and service to the System. C. Canby Balderston had been a director of the Federal Reserve Bank of Philadelphia. He served as William McChesney Martin's first Vice Chairman and was reappointed under Dwight Eisenhower and John Kennedy. When his term expired in 1966 he was replaced by J.L. Robertson who had initially been appointed to the Board by Harry Truman. In 1973, George Mitchell, a Kennedy Board appointee, was given the number two position on the Board because he, like Robertson before him, was its most senior member at the time.

The role of the vice chairmanship changed forever in 1976. In that year the Ford administration selected Stephen Gardner to be the number two person at the central bank. Gardner had no Fed experience but rather was identified with the administration where he had served as deputy secretary of the Treasury and was instrumental in promoting administration-supported banking legislation. The governor with the greatest seniority at the time was Henry Wallich, an academic economist with firm conservative views on monetary policy. The departure from tradition did not go unnoticed. Gardner's nomination was resisted in his confirmation hearings by senators who believed the Board to be packed with administration loyalists, each sponsored by Chairman Arthur Burns (Schellhardt, *Wall Street Journal,* 15 December 1975). The choice of Gardner rather than Wallich likely reflected Burns' imprint rather than that of Gerald Ford, who, like Dwight Eisenhower, affirmed a hands off attitude toward monetary policy (Havrilesky 1993).

Consonant with other aspects of the advance of politicization in the 1970s, such as systematic Federal Reserve compliance with executive branch desires for monetary policy (Havrilesky 1993), the 1976 change created a precedent. Jimmy Carter's appointment of Frederick Schultz sustained the practice of selecting an administration, rather than a Federal Reserve, loyalist as vice chairman. Before Carter appointed Schultz in 1979 he had been the President's choice for Undersecretary of Health, Education and Welfare until Secretary Califano opted to pick his own staff. Schultz was a Florida legislator who had run unsucessfully for Senate in 1972; in addition, he was a major contributor to Carter's campaign (*New York Times,* 13 April 1979; 16 April 1979). As with Gardner's confirmation process, there was resistance because Senate Banking Committee Chairman William Proximire (D-Wis.) believed the nominee's ties to the administration were too strong.

The politicization of the vice chairmanship peaked in stridency with Ronald Reagan's choice of Preston Martin in March 1982. In 1967 Governor Reagan had selected Martin as California's Savings and Loan Commissioner and in the early 1970s Martin was picked by Richard Nixon to be Chairman of the Federal Home Loan Bank Board. As Vice Chairman, Martin came to play the role of spokesperson for supply side devotees within the Reagan camp who favored easy monetary policy. For example, Jude Wanniski referred to him as "our great hope" who "will save us from the madmen . . . who want to shut down our economy" and Jack Kemp said that he would make a "very good" chairman (McGinley, *Wall Street Journal,* 8 May 1984). In December 1983, fired by ambitions for the chairmanship that were doubtlessly fueled by supply side cadres, Martin became openly critical of the Fed's non-expansionary monetary policy. He blatantly broke the Fed's rules by sending minutes of the latest Federal Open Market Committee meeting to the press accompanied by a note explaining his dissent on the side of monetary stimulation (McGinley, *Wall Street Journal,* 8 May 1984). Undaunted by the ensuing scorn of his colleagues, the Vice Chairman continued to dissent and use the media to promote monetary ease (Murray, *Wall Street Journal,* 27 August 1984). For a vice chairman to go public in this manner was interpreted in central banking circles as an affront to the institution wherein even dissent voting on monetary policy directives by vice chairmen is a rarity. For example, in 86 split decision FOMC votes on monetary policy from 1976 to 1991, only six dissents were cast by vice chairmen and Martin was responsible for five of these.

The climax to Martin's crusade for stimulatory monetary policy occurred in February 1986 when he led the phalanx of three other, recently appointed, supply side proponents on the Board, Wayne Angell, Martha Seger, and Manuel Johnson, in outvoting Chairman Paul Volcker in favor of a discount rate cut. The financial services sector scored his disturbing behaviors and his internecine challenges to Volcker. After new Board members Angell and Johnson compromised with Volcker to delay the rate cut in order to avoid his resignation, Martin's assault on sound money came to an abrupt halt. He resigned from his post in April 1986, one month after his term as vice chairman expired (Bluestein, *Wall Street Journal,* 20 March 1986; 24 March 1984).

Unwilling to depoliticize the vice chairmanship but instructed by the tumult of Martin's tenure, the Reagan administration was more careful in its next, May 1986, appointment. Consistent with his pivotal role in delaying the February-March 1986 discount cut rate and thereby preventing Volcker's resignation, as vice chairman former Assistant Treasury Secretary for Economic Policy Manuel Johnson was able to advance the supply side penchant for monetary expansionism without offending the Chairman and arousing ire in private financial circles. Johnson enunciated his credo, "you can get things done without pushing your way around" (Bluestein, *Wall Street Journal,* 14 May 1986). Nevertheless, some administration hardliners were not always pleased with his inoffensive demeanor. Budget Director Richard Darman referred to Johnson as "right in terms of economics, but too nice a guy" (Wessel, *Wall Street Journal,* 6 October 1992).

With the next appointment to the vice chairmanship the Bush administration resolved the nice guy-versus-hardliner tradeoff on the side of the latter. Before David Mullins was selected in late 1989, he had served as Assistant Treasury Secretary, as a top staffer on the Brady Commission (on financial reform) and as principal author of Bush's Savings & Loan bailout program. After he informed Brady that he wanted a Board position, the Treasury Secretary blocked the appointment of Stanford Economics Professor John Taylor and instead successfully sponsored Mullins. Mullins' style in confrontations with Alan Greenspan to advance administration desires for easy money was described as "constantly pounding" against Greenspan (Wessel, *Wall Street Journal,* 6 October 1992). In the arena of giveand-take permitted by Greenspan, Mullin's steely determination combined with understanding of and acumen with financial data was invaluable in helping him make successful cases for monetary ease. In the words of a Fed staffer, "He hit it hard and did a good job" (McNamee, *Business Week,* 16 December 1991; 30 March 1992).

Conclusion

Across three-score years our monetary policy institutions have become increasingly politicized. The current promotion of legislation which would remove all non-political appointees from the Federal Open Market Committee suggests that, until the dire implications are recognized, this trend will continue in the foreseeable future. Examination of the workings of the FOMC in the past forty years reveals evidence of the politicization of monetary policy that does not always entail bold legislative or executive branch actions. A case in point here is that after 1975 the vice chairman of the Federal Reserve Board assumed the mantle of advocate of administration desires for monetary policy. Monetary policy scholars and students of monetary reform should be aware of how far the deterioration of our institutional defenses against inflationary excesses has progressed.

References

Bluestein, P. (1986a) "Tense Fed." *Wall Street Journal,* 20 March 1986: 1.

Bluestein, P. (1986b) "Martin's Resignation Doesn't Guarantee Fed Chief Volcker Will Have Easy Time." *Wall Street Journal,* 24 March 1986: 3.

Bluestein, P. (1986c) "Fed's Manuel Johnson Rises Rapidly." *Wall Street Journal,* 14 May 1986: 64.

Havrilesky, T. (1991) "The Chairman As Hero: Our Defense Against Monetary Excess?" *Cato Journal* 11(1): 65–72.

Havrilesky, T. (1993) *The Pressures on American Monetary Policy.* Norwell, Mass.: Kluwer Academic Publishers.

McGinley, L. (1984) "Fed's Vice Chairman Is Winning Support." *Wall Street Journal,* 8 May 1984: 37.

McNamee, M. (1991) "David Mullins' Brisk Stride at the Fed." *Business Week,* 16 December 1991: 82–83.

McNamee, M. (1992) "Monday Morning Quarterbacking at the Fed." *Business Week,* 30 March 1992: 22.

Murray, A. (1984) "Fed Vice Chairman's Credit Policy Line Apt to Boost His Support By Supply Siders." *Wall Street Journal,* 27 August 1984: 3.

New York Times (1979) "Schultz and Rice Chosen As Governors of the Fed." 13 April 1979: 2.

New York Times (1979) "Schultz as Fed's Vice Chairman." 16 April 1979: 2.

Schellhardt, T. (1975) "Nominee for Fed Post Is Expected to Be Gardner, Second-Ranking Treasury Aide." *Wall Street Journal*, 15 December 1975: 4.

Wessel, D. (1992) "Pushing Policy." *Wall Street Journal*, 6 October 1992: 1.