Politicization of the Fed

This week Treasury Secretary Timothy Geithner warned Republicans against politicizing the Fed. My question is this, is a move to depoliticize the Fed through the political process qualify as increasing or decreasing the politicization of the Fed? As near as I can tell, Mr. Geithner’s and my answers differ on that account.

Once upon a time, the Federal Reserve had a single mandate of price stability. Then in 1977, Congress forced the Fed to balance concerns for employment and inflation (the dual mandate). This move, by a Democratic Congress and President, inevitable increased the politicization of the Fed.

Historically central banks have focused on the single mandate of price stability. Most sound central banks still do. For the Fed to be concerned about employment is to enter the political fray. Is unemployment always bad? Is unemployment worse during election season?

Under a single mandate of price stability, the vast majority of appointees to the Board of Governors were trained Ph.D. economists. After all, price stability becomes a technical issue requiring technical knowledge. We can see by the appointments to the Board of Governors from President George W. Bush and President Obama, that politicians have indeed been politicizing the Fed for some time now.

Let’s look at the recent appointments. The Board of Governors (which is supposed to have seven seats filled) has one empty seat, three attorneys, an MBA, and only two Ph.D.’s (Bernanke and Yellen). What do attorneys know about price stability? On average, very little (look at how fast pain and suffering damages have risen). Monetary theory is not a standard course of study in law schools (or MBA programs for that matter). Is it any wonder that the only objections regarding quantitative easing from the Fed have come from Federal Reserve Bank Presidents and not the political hacks who have been appointed to the Board of Governors?

The way to depoliticize the Fed is to get rid of the dual mandate (as suggested recently by Indiana Rep. Mike Pence). Return the role of the Fed to monitor of price stability. When the dual mandate is gone, political hacks will no longer want to sit on the Board of Governors. After all, detailed discussions of the Taylor Rule can’t possibly be fascinating to people whose main focus is a political agenda.

The irony, of course, is that since Congress gave the Fed the dual mandate, only Congress can remove it. Yep, you have to use politicians to depoliticize the Fed. It’s that move that Geithner is so worried about. He’s so worried that he’s calling down up and up down. Geithenr, after all, is a political appointee who wants to use the Fed to conduct policy as his boss, President Obama, sees fit. So while I “agree” that the Fed should not be politicized, I think that Timmy is suffering from “Vizzini” syndrome.

Inigo Montoya (talking to Vizzini), “You keep using that word, I do not think it means what you think it means” *The Princess Bride*