



## View from the Beltway

# The Fed's Ugly Struggle for Independence

BY OWEN ULLMANN

*And the central bank's legacy, warts and all.*

President Donald Trump's campaign to exert control over the Federal Reserve appears to be an unprecedented power play in the 112-year history of the nation's central bank, which prides itself on its independence from partisan dictates. That independence is needed, Fed officials argue, so that it can best manage the U.S. economy with appropriate policies to ensure stable growth with low inflation and unemployment. And while politicians should be pleased with such an outcome over the long term, the Fed's short-term efforts to achieve that goal may produce unpleasant results just when the pols are running for office. Not surprisingly, they prefer policies that promote short-term gain, even if the consequences are long-term pain for the American public.

When Congress established the Federal Reserve System in 1913, it surprisingly went to considerable lengths to structure it in ways that would discourage interference from

politicians, an unusually selfless move that put the interest of the public ahead of what might be more advantageous to their careers. Perhaps they wisely realized that if they were hoping to serve many years, their own interests and those of their constituents were more closely aligned

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around a healthy economy that kept chugging along. After all, the impetus for creating the Fed was a long string of financial panics and economic setbacks that served no one's interest. The Panic of 1907, which produced

massive bank runs and economic chaos, directly led to the Fed's creation.

Since then, we haven't eliminated financial crises triggered by the latest high-risk investment craze in pursuit of huge gains, but the U.S. economy has certainly performed better on average. Inflation and recessions still occur, but the central bank keeps learning how best to minimize them, and bank runs are a thing of the past, thanks to deposit insurance.

It is tempting to attribute the Fed's performance over the past century to its independence from political interference, but a closer look at the central bank's history reveals it often has been under the sway of partisan politics. The difference now is that Trump is very transparent about his intention to create a Fed that will do his bidding, whereas prior presidents were more subtle in their attempts to influence monetary policy. Only after they left office have historians seen

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how they sought to manipulate the Fed for partisan gain.

In its first two decades of existence, the Fed hardly distinguished itself as a shrewd steward of the economy. In the 1920s, it kept interest rates low, a move that fueled a stock market buying spree on borrowed money. Then, when the market crashed in 1929, the Fed did everything wrong. It oversaw a massive contraction of the money supply and failed to act as “lender of last resort” to prevent a wave of bank failures. Believing that liquidity was needed to weed out weak firms, it produced a credit freeze, deflation, and a faltering economy that fell deeper and longer into crisis. Some economists would add that the central bank’s fear that too ample credit would weaken the dollar and cause global central banks such as the Bank of England to demand gold for their dollar reserves (the United States was on a gold standard) only financially suffocated the economy more.

In the midst of the Great Depression, Congress gave the Fed more independence under the Banking Act of 1935, which removed the Treasury secretary and Comptroller of the Currency as *ex officio* members of the Fed Board of Governors. Although those two officials were ostensibly acting in the best interests of the central bank, they certainly had close political ties to the

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president at the time and exerted influence on monetary policy.

Despite that move toward greater independence, the Fed still felt obligated to keep interest rates low to help the government manage its burgeoning debt during World War II and the years after. Finally, in 1951 the Fed



Ronald Reagan



James Baker



Paul Volcker

## Just Having Tea in the Library

In his 2018 memoir, former Fed Chair Volcker revealed that President Ronald Reagan’s chief of staff, James Baker, summoned him to a meeting in the White House library in the summer of 1984. The venue, Volcker suspected, was chosen to avoid the taping system in the Oval Office. As Reagan sat silently, Baker told Volcker, “The president is ordering you not to raise interest rates before the election.”

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and Treasury reached an accord that allowed the Fed to manage monetary policy as it saw fit to keep inflation in check without feeling the pressure to help the Treasury manage its debt.

Pressure from the Treasury may have eased, but that didn’t prevent presidents from using their own methods of intimidation to get their way on monetary policy. In 1965, President Lyndon Johnson was incensed over the Fed’s decision to raise interest rates due to concerns about inflation from Johnson’s “guns and butter” policy of increased federal spending on both the Vietnam War and domestic programs. Johnson wanted low rates to keep the economy expanding, and he saw the Fed’s action as a political attack. In late 1965, Johnson summoned Fed Chair William McChesney Martin to his ranch, where he shoved him around the room where they were meeting, shouted at him, and questioned his loyalty to the country and the troops. While Martin, the longest serving chair in Fed history (1951–1970), did not fully

cave to Johnson’s bullying, Fed policy nonetheless remained relatively accommodating during Johnson’s presidency, lighting the fuse for the high inflation that would explode years later.

Martin’s successor, Arthur Burns, encountered a different type of intimidation from President Richard Nixon, who made it clear he wanted rates kept low in advance of his 1972 re-election campaign. Nixon, not known for his subtlety, threatened to push legislation that would curb the Fed’s ability to set interest rates and vowed to install his own political allies on the Board of Governors to outvote Burns. The White House even leaked a false report that Burns was seeking a pay raise. Nixon’s hardball moves were all the more remarkable since Burns had considered him a friend when he was chairman of President Dwight Eisenhower’s Council of Economic Advisers and Nixon was vice president. Burns capitulated with accommodative monetary policy that ensured a strong economy throughout

1972—and threw gasoline on an inflationary fire already burning.

President Jimmy Carter replaced Burns with business executive G. William Miller in 1978 and quickly discovered that Miller knew nothing about monetary policy and proved incompetent in the job as inflation steadily worsened. That was a stronger argument for removing a Fed official for “cause” than the dubious claim of mortgage fraud Trump has cited in a so-far failed effort to oust Fed Governor Lisa Cook. But Carter shrewdly offered Miller the job of Treasury Secretary, a post with more perks and status than that of Fed chair. Miller took the bait and Carter replaced him with the legendary Paul Volcker.

Volcker did Carter no favors by jacking up interest rates to double-digit levels to combat out-of-control inflation. His extraordinary and courageous moves contributed to Carter’s rout in the 1980 election and caused a deep recession during President Ronald Reagan’s first two years in office. By 1983, the economy was growing smartly, inflation was coming down swiftly, and Volcker was a hero to Wall Street. Reagan had little choice at the time but to renominate him.

Reagan often cited the Fed’s independence in setting monetary policy—partly to deflect some of the blame for the 1981–1982 recession—and he showed political savvy in renaming Volcker in 1983. Still, he, too, tried to bully the Fed chair, not an easy task when your target stands seven inches over six feet. In his 2018 memoir, Volcker revealed that Reagan’s chief of staff, James Baker, summoned him to a meeting in the White House library in the summer of 1984. The venue, Volcker suspected, was chosen to avoid the taping system in the Oval Office. As Reagan sat silently, Baker told Volcker, “The president is ordering you not to raise interest rates before the election.” Volcker wrote that he was “stunned”

by the brazen political pressure. But since he had no plan to raise rates at the time, Volcker walked out without saying a word.

Reagan replaced Volcker in 1987 with the politically astute Alan Greenspan, an acolyte of Ayn Rand, known for her view that put self-interest above all else. Greenspan was considered a loyal Republican, but he ran afoul of President George

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H.W. Bush in 1991. Bush planned to renominate him that year but delayed an announcement in hopes Greenspan would lower rates more in order to stimulate growth during the anemic “jobless recovery” that followed the 1990–1991 recession. Greenspan did not comply because of fears of reigniting inflation. Bush later blamed Greenspan for costing him re-election in 1992, telling interviewer David Frost, “I reappointed him and he disappointed me.”

For the next quarter-century, the Fed enjoyed unprecedented independence from overt presidential pressure thanks to the “Rubin Rule,” named for Robert Rubin, the Goldman Sachs co-chairman who became President Bill Clinton’s National Economic Council director and later Treasury secretary. Rubin counseled the White House to avoid public comments or pressure on the Fed concerning interest rates. Clinton renominated Greenspan twice and presided over a healthy economy.

The Rubin Rule survived during the presidencies of George W. Bush

and Barack Obama, giving Greenspan and his successor, Ben Bernanke, a free hand to deal with a variety of crises, including the housing crash and Great Recession of 2007–2009. When Bernanke retired in 2014, Obama allowed Janet Yellen to manage the economy without interference. Yellen proved deft in the job, earning high marks from economists surveyed by the *Wall Street Journal*. But Trump, who once privately groused that the barely five-foot Yellen was too short for the post, decided to replace her in 2018 with Fed Governor Jerome Powell. Trump also remarked privately that the six-foot Powell, in his mid-sixties at the time, looked the part of a Fed chair, while his chief competitor, former Fed Governor Kevin Warsh, who was in his mid-forties, looked too young and handsome.

Trump turned on Powell almost immediately in 2018 for not cutting rates enough and has waged an even harsher campaign against the Fed chair during his second term in the White House. Trump has repeatedly railed against Powell for not slashing interest rates, hurled insults at him, even accused him of malfeasance because of cost overruns involving extensive renovations at the aging Fed headquarters.

True, Powell and company blew it in 2021 by failing to raise rates soon enough to stem a spike in inflation largely caused by supply disruptions from the Covid-19 shutdowns in 2020. Still, after misreading the inflation surge as “transitory,” Powell’s Fed pulled off a rare “soft landing” by getting inflation under control without a recession that most economists had predicted. That accomplishment won him reappointment by President Joe Biden and should earn him gratitude from the public for a belated but nonetheless job well done.

The long history of conflict and *détente* between the Fed and White House is instructive because the central bank is rarely wholly immune

from presidential pressure; someone is always looking over its shoulder. What matters is whether the Fed chair and other board members stay focused on acting in the best interest of the nation rather than bending to political pressure or partisan favoritism. The large Fed staff adds to the notion that the Federal Reserve itself is too often political. In reality, the staff is less devoted to partisanship than it is devoted—too devoted—to the institution and its chair. This “cult of the chairmanship” often creates the perception of partisanship when the staff is actually too adoring of the boss.

A former Fed official who previously worked in a Republican administration complains that the Fed hasn’t always lived up to its responsibilities to act in a non-partisan manner, and cites two examples that involve Trump: Yellen’s Fed delayed planned rate hikes in 2016 until after Trump’s election, presumably to help Hillary Clinton. And Powell’s Fed cut interest rates 50 basis points in September 2024, surprisingly close to Election Day, presumably to help Vice President Kamala Harris.

“When I was a Fed governor, that would’ve been absolutely unthinkable,” the official said. “Powell’s ac-

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tion in particular can only be described as brazenly political. The bond market agreed they did the wrong thing because the ten-year bond went up 75 basis points in a matter of six or seven weeks after they cut. That means it wasn’t economics, it was politics.”

Donald Kohn, a forty-year Fed veteran who rose through the ranks

## The Rubin Rule

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**Robert Rubin and Alan Greenspan**

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from staff member to Board vice chair, defends both of those rate moves as reasonable based on incoming data. He said the Fed waited before raising rates in late 2016 because both growth and inflation came in lower than expected. As for the September 2024 rate cut, Kohn notes that unemployment had risen nearly a percentage point from the previous year and inflation was still heading down, so it looked like policy was very tight. Still, he added, the Fed should have cut in July instead of waiting until September, which would have avoided any appearance of partisanship.

“People at the Fed were careful not to bring up elections or political considerations but you don’t know what’s in their minds,” Kohn said, who went on to stress that he is convinced politics is not the key driver of Fed decisions. “All the chairs I worked closely with, Volcker, Greenspan, and Bernanke in particular, all had very clear notions that they were playing to history, that people would be judging them ten, twenty, thirty years from now,” he said. “You’re taking a step

back and saying, ‘How’s this going to look a generation from now?’ The rationale for independence is to have people take a longer perspective than the next election. Those chairs—and I’m sure Janet Yellen and Jay Powell, as well—had that longer perspective. It was partly driven by their knowledge of Federal Reserve history, their determination not to repeat the mistakes of the late 1960s and 1970s. It’s in the DNA of the Fed since then.”

That’s a valuable insight Trump should keep in mind. He wants a pliable chair to do his bidding, but history shows he can’t count on it once his candidate assumes office, particularly if the Supreme Court upholds the Fed’s independence, as it seems to be preparing to do.

Fed chairs have clashed with the men who chose them at least as often as not. And while they have made mistakes in setting policy and occasionally buckled under pressure, they valued their independence over any obligation to retain partisan loyalty. Trump discovered that when he selected Powell, and he may soon learn that again. ♦