

Central Bank Activism

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ABSTRACT—Today, the Federal Reserve is at a critical juncture in its evolution. Unlike any prior period in U.S. history, the Fed now faces increasing demands to expand its policy objectives to tackle a wide range of social and political problems—including climate change, income and racial inequality, and foreign and small business aid.

This Article develops a framework for recognizing, and identifying the problems with, “central bank activism.” It refers to central bank activism as situations in which immediate public policy problems push central banks to aggrandize their power beyond the text and purpose of their legal mandates, which Congress has established. To illustrate, the Article provides in-depth exploration of both contemporary and historic episodes of central bank activism, thus clarifying the indicia of central bank activism and drawing out the lessons that past episodes should teach us going forward.

The Article urges that, while activism may be expedient in the near term, there are long-term social costs. Activism undermines the legitimacy of central bank authority, erodes its political independence, and ultimately renders a weaker central bank. In the end, the Article issues an urgent call to resist the allure of activism. And it places front and center the need for vibrant public discourse on the role of a central bank in American political and economic life today.

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INTRODUCTION

On January 20, 2021, Joe Biden was sworn in as 46th President of the United States. A few hours into his first day in office, President Biden promised to “[c]ontrol the pandemic, provide economic relief, tackle climate change, and advance racial inequality.”¹ To be sure, that is a veritable list of problems that require serious policy solutions. But among the various federal government institutions equipped to play a part, this Article questions whether the U.S. central bank—the Federal Reserve (“Fed”)—should have an outsized role.

¹ Tweet, @POTUS, 6:03 PM, Jan. 21, 2021.

Indeed, the Fed has been pulled to the center of a wide range of social, political, and economic debates more forcefully than any other federal government agency or institution.² It has, for example, been called upon to help small business and local government, mitigate climate change, and redress gender and income inequality.³ The Fed is not alone. Central banks around the world are now perceived to have “quite a bit” to do with “social justice and environmental decay.”⁴

But this vision of central banking expands their role immensely. Central banks are constituted to be monetary authorities, and in many countries bank

² As one former Deputy Governor of the Bank of England has recently remarked, “[f]ifteen years ago, the world of central banking seemed sober, calm and apolitical. Since then the financial crisis, euro meltdown and now Covid-19, together with persistently weak underlying growth, have reinjected politics into central banking, creating dilemmas and tensions.” Paul Tucker, *Do We Need a New Constitution for Central Banking*, Economics Observatory, Dec. 22, 2020, <https://www.economicsobservatory.com/do-we-need-new-constitution-central-banking>.

³ Balazas Koranyi, Francesco Canepa & Frank Siebelt, *From Climate Change to Equality, Lagarde Turns ECB More Political*, REUTERS, Oct. 26, 2020 <https://www.reuters.com/article/ecb-lagarde-insight/from-climate-change-to-equality-lagarde-turns-ecb-more-political-idUSKBN27BoHM>; <https://www.politico.com/news/2020/08/29/federal-reserve-race-economic-activism-404560>; *To Narrow Racial and Economic Disparities, Atlanta Fed Chief Raphael Bostic is Rethinking What the Fed’s Mandate Means*, <https://www.washingtonpost.com/business/2020/08/21/bostic-fed-race-economy/>.

⁴ Pedro Nicolaci da Costa, *Inequality, Climate Change and the Role of Central Banks*, FORBES, Dec. 4, 2019, <https://www.forbes.com/sites/pedrodacosta/2019/12/04/inequality-climate-change-and-the-role-of-central-banks/?sh=709e97834dc8>. The press has recently begun to comment on the increasing pressure to conscript central banks into ancillary social issues, with varying opinions on the matter. *Compare The Perils of Asking Central Banks to Do Too Much*, ECONOMIST, Mar. 13, 2021 (“tempting as it is to allow authority to flow to those who use it well, adding to central-bank mandates poses both economic and political risks”); with Martin Wolf, Opinion, *Monetary Financing Demands Careful and Sober Management*, FINANCIAL TIMES, Apr. 9, 2020, <https://www.ft.com/content/dc233540-798e-11ea-9840-1b8019d9a987> (further urging that “exceptional circumstances” that put the “job of the central banks to support the overriding need for the state to protect the people’s lives and livelihood. . . . Its independence, while normally desirable, is a means to an end, not an end in itself.”). There are also a number of legal academics that have advocated an expanded role of the Fed of late. See Jonathan Macey, *Fair Credit Markets: Using Household Balance Sheets to Promote Consumer Welfare*, 100 TEXAS L. REV. (forthcoming 2021) (manuscript at 46, 52-54 (arguing for new Fed facilities that would be made available to individuals facing emergency liquidity needs); Saule Omarova, *The People’s Ledger: How to Democratize Money and Finance the Economy*, 74 VAND. L. REV. (forthcoming 2021) (manuscript at 4-5) (arguing for an expanded use of the Fed’s balance sheet to deliver more direct financial services to citizens); Morgan Ricks, John Crawford & Lev Menand, *FedAccounts: Digital Dollars*, 89 GEO. WASH. L. REV. 113, 115-119 (2021) (arguing for expanded access to bank accounts at the Fed).

regulators and supervisors, too.⁵ Addressing a broader panoply of social ills largely falls outside their wheelhouse, for lack of the legal authority to do so and or the policy tools to get such jobs done. Still, regardless of these limitations, as renowned financial historian Harold James has recently remarked, the tremendous social, economic, and political shocks of the past ten years have put intense pressure on central banks to “multi-task.”⁶

In some quarters, central bankers seem keen to engage in this mission creep. Christine Lagarde, President of the European Central Bank (“ECB”), has committed to using “whatever we have” to fight climate change; just as her predecessor, Mario Draghi, promised to do “whatever it takes” to save the eurozone from the financial crisis—conjuring images of Machiavelli and the Medici, not a rules-bound institution.⁷ Patrick Honohan, former governor of the Bank of Ireland, has likewise urged that “central banks have been behind the curve of society’s response to these issues . . . like climate change and inequality. . . and could make a worthwhile contribution in a number of respects.”⁸ Even former U.K. Chancellor of the Exchequer, George Osborne, has extolled the virtues of an “activist central bank” as a means of ensuring “our best days lie ahead.”⁹ Putting their words to action, these various central banks have begun to engage in a range of actions and experiments, earning themselves new pithy epithets—“central bankers of the future”¹⁰ and central bankers of a “brave new world.”¹¹

⁵ See, e.g., Christina Parajon Skinner, *Central Banks and Climate Change*, draft manuscript at 24, Oct. 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3703142.

⁶ See HAROLD JAMES, MAKING A MODERN CENTRAL BANK 457 (2020) (remarking, at the launch of this book that tremendous social economic and political shock has put pressure on the central bank to “**multi-task**”); see also Laura Alix, *Pressure Mounts on U.S. Bank Regulators to Stress Test for Climate Change*, AM. BANKER, Sept. 20, 2020.

⁷ Editorial Board, *Lagarde Does Whatever She Can*, WALL ST. J., Dec. 9, 2020, https://www.wsj.com/articles/lagarde-does-whatever-she-can-11607527307?mod=opinion_lead_pos4; Eur. Central Bank, *Verbatim of the Remarks Made by Mario Draghi*, Speech at the Global Investment Conference in London, July 26, 2012, <https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>.

⁸ Patrick Honohan, *Should Monetary Policy Take Inequality and Climate Change Into Account*, PETERSON INST. FOR INT’L ECON. 2, Oct. 2019, <https://www.piie.com/sites/default/files/documents/wp19-18.pdf>.

⁹ George Osborne, Opinion, *How to Keep Proving the Economic Pessimists Wrong*, WALL ST. J., Dec. 14, 2014, <https://www.wsj.com/articles/george-osborne-how-to-keep-proving-the-economic-pessimists-wrong-1418600536>

¹⁰ Speech, Agustin Carstens, General Manager, Bank of International Settlements, *Central Bankers of the Future*, Dec. 11, 2020, <https://www.bis.org/speeches/sp201214.htm>.

¹¹ Balazs Koranyi & Francesco Canepa, *Central Bankers Seek New Role in Brave New World*, REUTERS, Nov. 10, 2020.

The Fed meanwhile faces considerable pressure to expand.¹² Indeed, some already see the Fed gradually succumbing to the pressure of unprecedented times, using “incremental adaptations of the policy instruments that are available” to accomplish new and larger aims.¹³ The Fed has long been committed to a rhetoric of apolitical technocracy, but there is a growing chorus of media, commentators, and scholars suggesting that it would be “morally and ethically wrong for central banks to . . . remain on the sidelines” of key social issues.¹⁴ But such value judgments are for Congress, who has the constitutional authority to specify the policy objectives that the Fed has authority to pursue.

Principally, the Federal Reserve Act mandates the Fed maintain price stability and maximum employment¹⁵ and act as “lender of last resort” to financial institutions in distress.¹⁶ Other legislation requires the Fed to mind the “safety and soundness” of financial institutions,¹⁷ and to look after the stability of the financial system overall.¹⁸ Neither the text nor purpose of this well-known legislation authorizes the Fed to redress problems associated with small business, climate, or equality—regardless of how important these

¹² See *infra* Part I.A. For a broad empirical treatment of central banks and political pressure, see Carola Conces Binder, *Political Pressure on Central Banks* (2018) (unpublished manuscript), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3244148.

¹³ Mohamed A. El-Erian, *Evolution, Impact, and Limitations of Unusual Central Bank Policy Activism*, FED. RSRV. BANK OF ST. LOUIS REV. 258 (2012), <https://files.stlouisfed.org/files/htdocs/publications/review/12/07/243-264El-Erian.pdf>; see Peter Conti-Brown & David A. Wishnick *Technocratic Pragmatism, Bureaucratic Expertise, and the Federal Reserve*, 130 YALE L.J. 636, 639-41 (2021) (urging that the Fed can address things like climate change, the covid-19 pandemic, and cyber risk under the umbrella of “technocratic pragmatism” which allows “the Fed to develop the expertise necessary to address emergent problems as long as it remains constrained by norms designed to preserve its long-run legitimacy”).

¹⁴ El-Erian, *supra* note 13.

¹⁵ Federal Reserve Act § 2A.

¹⁶ *Id.* §§ 2A (price stability), 10B (discount window), 13(3) (emergency lending to nonbank financial institutions). As will be later discussed, the original 13(2) power was not intended as a LOLR power, in the contemporary sense of the term. Throughout the 1920s the Reserve Banks accepted eligible paper on demand, using the discount rate to adjust demand. The philosophy behind the policy was grounded in the so-called real bills doctrine.

¹⁷ Bank Holding Company Act 1956.

¹⁸ While this is not an express mandate of the Federal Reserve, it seems implied by the Dodd-Frank Act 2010.

problems are today.¹⁹ They may well be issues for other branches of the government, but strictly speaking, they are not problems for the Fed.

Yet central banks are often pressured to engage in “activism” when their policy goals and tools—set out *ex ante* by the legislature—fall short of some present economic problem. In principle, problems that fall outside the predetermined perimeter of central bank policy ought to be addressed by the elected legislature or Executive, either through direct action or explicit allocation of responsibility to the central bank. But should they fail to do so, likely because of insurmountable political frictions, central bankers may feel exogenously pressured (by the public or other branches of the government) or endogenously compelled (from factions within the institution) to step in and flex some muscle.

The core claim of this Article is that, when the Fed bends or stretches its legal mandates to address social or economic problems of the day (if and as they might emerge), it engages in “activism” that will present problems for society on a number of dimensions. Each problem will build upon the last, they are as follows:

First, and most plainly, central bank activism can be *ultra vires*. Like all administrative agencies, the Board of Governors of the Federal Reserve System (“Fed Board”) makes policy and regulation based on authority delegated to it by the U.S. Congress. And, like all agencies, it is required to act within the ambit of the legislative authority it has been delegated; to go beyond what Congress has permitted and asked it to do, would be an unconstitutional assumption of legislative authority.²⁰ Congress first conceived the Fed as an institution with a limited purpose in society; in 1913, the Fed was tasked with maintaining an elastic currency and supervising its member banks.²¹ While the Fed’s legal purpose grew throughout the twenty and twenty-first centuries, that growth was always statutorily prescribed, not politically imposed or self-aggrandized. The Fed—although it is a unique institution in many respects—is similar to other regulatory agencies insofar

¹⁹ Though it is not a doctrine relied on today, the so-called Real Bills doctrine appears to have been hard-wired into the Federal Reserve Act, including in section 13(2). This theory of automatic monetary policy intended to tie the amount of money to real economic activity. Technically, real bills could be seen as an approach to monetary policy that aims to accommodate business in the first instance. *See generally* THOMAS M. HUMPHREY & RICHARD H. TIMBERLAKE, GOLD, THE REAL BILLS DOCTRINE, AND THE FED: SOURCES OF MONETARY DISORDER, 1922-1938 (2019).

²⁰ The structure of the constitution allocates power among three distinct branches, with legislative power allocated to the legislative branch. *See generally* M.J.C. VILE, CONSTITUTIONALISM AND THE SEPARATION OF POWERS (1967).

²¹ Federal Reserve Act 1913.

as its officials are unelected.²² In a democratic society, the Fed must be constrained by Congress. Central bankers are not, after all, ‘philosopher kings.’²³

Second, central bank activism alters the balance of power between the Fed, the Executive branch, and the Congress. This can happen in a number of different ways. Most generally, whenever the Fed enlarges the scope of its own authority, it assumes power from Congress to define the Fed’s role (and undermines Congress’s ability to hold the Fed accountable). Insofar as the Fed engages in credit allocation or monetary finance, for example, it acts in place of power that should be more properly exercised by the fiscal authority of the Treasury. And, to the extent the Fed reacts to popular (and Presidential) pressure for new or increased action, it enlarges the power of the presidency to influence the policy of the Fed — something Fed chairs have fought against since 1913.²⁴

Third, activism invites political interference which may undermine the Fed’s autonomy and perhaps its independence.²⁵ Independence from political pressure is generally recognized as critical to the Fed’s ability to effectively transmit policy — in order to be effective at anchoring inflation expectations, for example, central banks have to be able to credibly commit to pursuing low inflation; but because politicians, seeking short-term gains in popularity, tend to want a ‘hot economy’, politicians can inevitably be counted upon to try to pressure the Fed into keeping interest rates low, even if it that means increased inflation down the road. A norm against political interference in this regard allows the Fed to commit to price stability without skepticism about its ability to remain stalwart. The Fed needs a widespread norm of independence because it is the steward of price stability in our economy. But forward-leaning interpretations of its mandate, that suggest it to be politicized, will erode that norm. Damage to Fed independence can lead society down a very slippery slope. If beholden to political beliefs, the Fed

²² For a thorough treatment on the legitimacy of central bank power, see PAUL TUCKER, *UNELECTED POWER* (2019).

²³ The notion of a philosopher king, an all-knowing, benevolent ruler, handing down wisdom to citizens and officials, was theorized by Plato. Plato, *The Republic*, 5.473d.

²⁴ See Christina Parajon Skinner & Michael Salib, *Executive Override of Central Banks: A Comparison of the Legal Frameworks in the United States and United Kingdom*, 108 *GEORGETOWN L.J.* 905, 905, 957-68 (2020).

²⁵ For a general treatment of Fed independence, see PETER CONTI-BROWN, *THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE* 2-3, 179-80 (2016). *But see* SARAH BINDER & MARK SPINDEL, *THE MYTH OF INDEPENDENCE: HOW CONGRESS GOVERNS THE FEDERAL RESERVE* 4-5, 10-11, 16-18 (2017) (pointing out that, despite its now revered status in the popular mind, independence is far from absolute)

will soon find itself in the business of restricting or re-directing dollars in the economy depending on which group or industries are in or out of political favor. Such practice is anathema to a market economy in a democratic society.

For all of these reasons, there is much at stake in seeing activism plainly—and actively debating it. Public understanding of and discourse around central bank activism makes a subterranean “transformation of the state”—which some central bank watchers are predicting—more difficult to accomplish.²⁶ It also may, in turn, place the onus on Congress to act through legislation and modify the duties of the Fed, should society demand it.

This Article begins that debate by creating a novel framework for viewing and understanding central bank activism. It offers a descriptive account of central bank activism, conceptualizing activism in terms of both current and historic episodes of activism. The Article also offers a normative account of activism, exploring the dangers of this behavior to the U.S. economy and its democracy. Finally, it makes suggestions for how to constrain activism while, at the same time, allowing for a central bank that is modern, adaptive, and agile.

To that end, the Article proceeds in three parts. The first part builds a descriptive account of central bank activism. How do we recognize central bank activism and set it apart from lawful policy maneuvering and application? Part I first offers a working definition of activism; it then explains the bases for that definition by considering the three arenas in which the Fed is or has been called on to engage in activism—in managing the global financial and economic crises of 2008 and 2020; in mitigating climate change; and in redressing gender (and more so) income inequality. Without a doubt, these are all extremely important problems for society to solve—but to what extent are they problems that the Fed can undertake without damage to the rule-of-law and the efficacy of the central bank?

Part II gives a bit more descriptive context, by studying past episodes in history when the Fed has engaged in activism. This Part considers three examples in U.S. history where central bank activism occurred, and draws out lessons learned. The first example involves the First and Second Banks of the United States; America’s earliest efforts at a central bank. Activist efforts in institutional design—fashioning a bank that would mix public and private functions in ways that facilitated credit allocation—doomed that bank to popular resentment and ultimately Andrew Jackson’s veto. The second

²⁶ Grant Wilson, *The Limits of Central Bank Activism May Finally be in Sight*, FINANCIAL REV., Nov. 29, 2020, <https://www.afr.com/markets/debt-markets/the-limits-of-central-bank-activism-may-finally-be-sight-20201129-p56iwb>.

example involves various of the Fed's activist endeavors during the 1920s, largely under the leadership of the New York Federal Reserve Bank. That Reserve Bank's President, Benjamin Strong, pursued a policy objective of price stability long before Congress had given the System a mandate to do so; Strong also set discount rate policy to help a foreign ally. The Fed Board also engaged in bouts of activism to deter banks from lending for certain speculative practices or investments. The third example is from the 1970s, at which point the Fed's focus on price stability became blurred. Instead, it attended to more politically palatable objectives, like prodding up employment. This resulted was an uncontrolled period of "Great Inflation," which inflicted significant macroeconomic pain. On the whole, Part II shows that activism is not a new phenomenon, and never without costs.

Part III answers the key normative question: "why worry (much) about central banking activism?" For many, questions of activism might fall in the gray. After all, one might ask, if a central bank lacks the positive legal authority to engage in "green quantitative easing," but can use its policy tools to push the world towards a better climate equilibrium—would that be 'so bad'? Are there trade-offs worth accepting? While intoxicating to consider, it is a dangerous slippery slope that governments have slid down too fast before. Long-term costs usually outweigh the gains. For one, opening the door to *ultra vires* action—where ends may justify the means—can damage the Fed's legitimacy and independence. That damage translates to a less effective Fed; one that misallocates resources, and can neither stymie economic crises nor buoy the economy. Moreover, overreliance on the Fed might provide just a temporary fix while obscuring the responsibilities of other institutions that should be taking action.

Still, nuance is important. It is practical to evaluate activism along a spectrum insofar as the Fed must have some leeway to modernize and react to emergent crisis, while hewing closely to the rule-of-law. The legitimacy of activism may well vary, in this way, depending upon: (i) how explicit is the legal authority to solve a problem; (ii) how explicit is the legal authority to address a particular problem; (iii) how much expertise the Fed has with respect to that problem; and (iv) how strong are the mechanisms for accountability.²⁷ Accordingly, the final part of the Article sketches out a framework that the Fed (or Congress) might consider as a means of carrying a burden of proof that, when new policy initiatives are pursued, they

²⁷ In this regard, the Article reinforces those scholars, like Professor Peter Conti-Brown and David Wishnick, that seek to develop paradigms to help the Fed "navigate the tension" between popular demands to aggrandize power, on the one hand, and the need to avoid forays into "resolutely political problems." Conti-Brown & Wishnick, *supra* note 13, at 639.

constitute in-bounds adaptations or agility maneuvers, and not power-aggrandizing activism.

Ultimately, this Article aims to generate public discourse surrounding the legitimate role of the Fed in our society.²⁸ Inasmuch as contemporary social and political pressures stand to fundamentally re-shape the Fed, they have also thrown up critical questions core to a society founded on the rule-of-law and those that pertain to the scope, and power, of the administrative state. By stimulating that debate, this Article may also muster more attention to the need for Congress to reconsider the necessary and proper authority of the Federal Reserve in America today.

I. WHAT IS CENTRAL BANK 'ACTIVISM'?

How do we recognize central bank activism, and under what conditions does it occur? Answering that question is the focus of this Part. As the following case studies will show, central bank activism can arise in response to economic problems that require solutions that sit beyond or outside the Fed's legal mandates. Often, because these problems feel acute, political and popular pressure will build on the central bank to expand its policy tools beyond what the letter or spirit of the law had theretofore admitted and allowed.²⁹

To illustrate the concept, this Part considers three examples of contemporary activism. The first example involves the Fed's expansion of its LOLR authority in the past ten years. The second two examples remain largely hypothetical, but potentially imminent—they consider the pressure and potential for the Fed to engage in climate or re-distributional policy.

Collectively, these three cases shed light on activism's main hallmarks: the rise of some tension between legal text and purpose or historic usage, on the one hand, and an economic policy problem on the other; which creates

²⁸ As Paul Tucker has surmised, it is now time for “[w]idespread vigilance and awareness of subtle but cumulative attempts to repoliticise central banking to service sectional interests—what is cheered today might bring tears tomorrow.” Tucker, *supra* note 2.

²⁹ Although this article confines its study to central banks, activism among administrative agencies is not unique to the Fed. In recent months, commentators have also remarked on activism at the Federal Trade Commission (“FTC”). The Editorial Board, Op., *A Case of Blindsight Regulation*, WALL ST. J., Jan. 11, 2021, https://www.wsj.com/articles/a-case-of-blindsight-regulation-11610407907?mod=opinion_lead_pos3 (“Congress has empowered the FTC to prevent, prohibit and publish ‘unfair or deceptive’ business practices. The Federal Trade Commission Act doesn’t define these terms, so the FTC is supposed to know them when it sees them. The agency increasingly sees them wherever it looks.”)

pressure on the central bank to take or evolve a legal power outside the legislative process. In addition to that disconnect, activism threatens to upset some structural dynamic, either by: (i) a re-allocating power between the Fed, Congress, and the Executive branch (i.e., the Treasury); (ii) creating an opening for new or increased political pressure going forward; or (iii) assuming value-judgment-making that is otherwise reserved for elected officials in the political branches. Ultimately, these various cases of present and past activism land at different points along a spectrum of legitimacy, which will be considered in Part III.

A. *Lender of Last Resort*

The first example of central bank activism involves one of the Fed's most core, historic roles—its responsibility to act as a “lender of last resort” (“LOLR”) to financial institutions and the financial system during periods of crisis or emergency.³⁰ The basic notion of a central bank as LOLR is that, in situations of market turmoil, the central bank should step in and lend “freely,” but only to solvent institutions and at a penalty rate.³¹ This is famously known as Bagehot's dictum, and Walter Bagehot as the “father” of central banking.³²

There are several provisions of the Federal Reserve Act that empower the Fed to act as a LOLR. One, authorized by section 10B of the Federal Reserve Act, is known as the “discount window,” and was added to the Federal Reserve Act in February 1932.³³ Section 10B provides that “any Federal Reserve bank . . . may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank.”³⁴ Pursuant to

³⁰ See Thomas M. Humphrey, *Lender of Last Resort: The Concept in History*, *ECON. REV.* 8, Mar./Apr. 1989, https://www.richmondfed.org/~media/richmondfedorg/publications/research/economic_review/1989/pdf/er750202.pdf.

³¹ LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET 23, 25, 97 (1873).

³² See Ben S. Bernanke, *Fed Emergency Lending*, *BROOKINGS*, Dec. 3, 2015, <https://www.brookings.edu/blog/ben-bernanke/2015/12/03/fed-emergency-lending/> (discussing how Bagehot's dictum influences the Fed). Notably, there are many references to Bagehot in the 1913 Federal Reserve Act congressional records.

³³ 12 USC 347b(a). As added by act of Feb. 27, 1932 (47 Stat. 56). This provision was added by emergency legislation in 1932, and the Glass-Steagall Act (also known as the Banking Act of 1933) made it a permanent fixture, with some amendments, to the Federal Reserve Act.

³⁴ Federal Reserve Act, § 10B.

that authority, Federal Reserve banks can make loans to depository institutions that are part of the Federal Reserve system.³⁵

Congress designed section 10B with financial and economic emergencies in mind.³⁶ For context shoring up that point, Congress added 10B to the Federal Reserve Act in the midst of the tremendous economic hardship of the Great Depression (in the Glass-Steagall Act), mainly in order to give banks the confidence they needed to continue lending despite the uncertain times.³⁷ Indeed, reflecting on that era, former Fed General Counsel Howard Hackley once remarked that the creation of the discount window was “largely psychological”:

to give[] assurance to these frightened and timid bankers throughout the country that if they will only respond to the requirements of commerce, if they will only help in relieving themselves and the country from this depression and in doing so exhaust their eligible assets, then and only then may they make use of their ineligible assets.³⁸

Congress displayed similar motivation when it expanded the Fed’s LOLR powers to other kinds of institutions in July 1932 by adding section 13(3).³⁹ The addition of 13(3) made it possible for the Reserve Banks to lend

³⁵ There is other federal law that gives state non-member banks and thrifts access to the Fed’s discount window. See Peter Conti-Brown & David Skeel, *Using the Federal Reserve’s Discount Window for Debtor-in-Possession Financing During the COVID-19 Bankruptcy Crisis*, BROOKINGS, July 2020, <https://www.brookings.edu/wp-content/uploads/2020/07/Conti-Brown-Skeel.pdf> (“After the passage of the Monetary Control Act of 1980, any depository institution can access the Fed’s discount window.”)

³⁶ These eligible institutions can borrow from the discount window at any time, but in practice banks tend to limit their discount window borrowing to emergency situations only to avoid a stigma associated with resorting to the Fed for help. See Fed. Reserve Bank of New York, *The Discount Window*, FED. RESERVE BANK OF N.Y., July 2015, <https://www.newyorkfed.org/aboutthefed/fedpoint/fed18.html>; Huberto M. Ennis & David A. Price, *Understanding Discount Window Stigma*, RICHMOND FED. ECON. BRIEF., Apr. 2020.

³⁷ As further proof that 10B was designed with emergencies in mind, the original bill imposed various conditions on accessing the discount window, including a penalty rate of interest, exigencies required, and a demonstration that the bank could not access credit elsewhere. HOWARD HACKLEY, *LENDING FUNCTIONS OF THE FEDERAL RESERVE BANKS: A HISTORY* 105-8 (1973). It is important to note, however, that in the early days of the Fed, 13(2) was most of the discount window and 10B was pre-FDIC. In those days, banks could continue borrowing under 13(2) if they were assured that 10B would be there in times of emergency. In many ways 13(2) was the centerpiece of the Federal Reserve Act.

³⁸ *Id.* at 101.

³⁹ 12 USC 343. As added by act of July 21, 1932 (47 Stat. 715). As will be discussed, two years later the Industrial Advances Act added section 13(b) to the Federal Reserve Act, which, during the 1930s and 40s, became a much more active lending program than 13(3).

to “individuals, partnerships, and corporations,” not just member banks. But such loans had to be “strictly limited” to “unusual and exigent” circumstances.⁴⁰ To cabin 13(3), Congress narrowed the kind of paper acceptable for discount much more than it had under 10B.⁴¹ Additionally, the statute gave permission for further conditioning, by giving the Fed Board power to issue rules concerning the parameters by which Reserve banks would be allowed to make 13(3) loans.⁴² Taking Congress up on that invitation, a July 26, 1932 circular set out even stricter terms than the text of the statute had: it required that the Reserve banks demand a statement from each applicant seeking 13(3) assistance explaining the purposes for which the loan proceeds would be used and the efforts the borrower had made to obtain credit elsewhere first, from other financial institutions.⁴³ Again, this all shows that the purpose of 13(3) was foremost for emergency, “to provide needed credit to business concerns and individuals,”⁴⁴ and for sparing use.⁴⁵

Section 13 has been amended three times since its original passage. First, in 1935, Congress relaxed the original collateral requirements of that provision. These changes made it possible for a Reserve bank to make a 13(3) advance to an individual, partnership, or corporation so long as that loan was secured by a U.S. treasury security or U.S. agency debt.⁴⁶ In 1991, Congress further loosened the collateral requirements—no longer would a 13(3) borrower need to supply collateral that was as good or better than what would otherwise be eligible for discount under section 10B.⁴⁷ Collateral would only need to be “secured to the satisfaction of the Federal reserve

⁴⁰ *Id.* HACKLEY, *supra* note 37, at 129-30. There were other limiting conditions imposed at the time: five members of the Board had to vote in favor of the loan and could limit the duration of the assistance. *Id.* at 128.

⁴¹ *Id.*

⁴² The current text reads: “All such discounts for any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.” Federal Reserve Act, 13(3)(A).

⁴³ This would include description of all of the borrower’s banking relationships maintained over the past year. HACKLEY, *supra* note 37, 129-30.

⁴⁴ HACKLEY, *supra* note 37, at 129.

⁴⁵ But not many nonbanks would have the necessary commercial paper to discount. Notably, firms with a bank charter who are not subject to reserve requirements are not eligible for ordinary lending under Reg A, even if they are member banks.

⁴⁶ 21 U.S.C. 221, § 347.

⁴⁷ Pub. L. 102-242, Title IV, § 473, 105 Stat. 2386. While other constraints remained in place, no longer would collateral need to be “of the kinds and maturities made eligible for discount for member banks.” *Id.*

bank.”⁴⁸ Section 13(3) was amended for a third time in 2010, as part of the Dodd-Frank Act.⁴⁹ That time, Congress made it more difficult for the Reserve banks to lend selectively under 13(3)—it gave Treasury a veto over such facilities and required that all 13(3) assistance be delivered through facilities that were “broad-based.”⁵⁰

As this historical tour around section 13 should by now make plain, Congress has generally intended and expressed that provision to be narrow and restrained. There is little doubt that between 1932 and the present day, Congress understood 13(3) to be for “individuals, corporations, or partnerships” in the business community; limited to emergency situations; and for the purpose of easing liquidity conditions in the financial system.⁵¹ Since 2008, however, the Fed has actively interpreted 13(3) in a way that expands the scope of 13(3).⁵²

⁴⁸ *Id.*; see also Colleen M. Baker, *The Federal Reserve As Collateral’s Last Resort*, NOTRE DAME L. REV. (forthcoming 2021) (manuscript at 1397-98) (discussing collateral requirements in connection with LOLR).

⁴⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 780).

⁵⁰ that is, 13(3) would have to be structured as a facilitate to which a class of institutions would be eligible rather than as a loan to any one individual, partnership or corporation. See Press Release, Bd. of Governors of the Fed. Reserve Sys., *Federal Reserve Board Approves Final Rule Specifying its Procedures for Emergency Lending Under Section 13(3) of the Federal Reserve Act*, Nov. 30, 2015, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20151130a.htm>.

⁵¹ An open question is municipalities, which are corporations not sovereigns. Likely, the Fed has not lent to municipalities because of the credit risks analysis (and politicization) that would attend such lending. Lev Menand, *The Federal Reserve and the 2020 Economic and Financial Crisis*, 24 STANFORD J. OF L. BUSS. & FINANCE (forthcoming 2021), manuscript at 125-26; see also, Beth LeBlanc, *Fed chief rejects Tlaib’s push to lend to distressed cities like Detroit*, DETROIT NEWS, Feb. 12, 2020, <https://www.detroitnews.com/story/news/politics/2020/02/12/tlaib-pushes-federal-reserve-lend-distressed-cities/4737801002/> (reporting that, in response to Rep. Tlaib’s urging the Fed to lend more freely to distressed cities/states/territories like Detroit & Puerto Rico, Chair Powell replied, “What I believe is that that’s not a job for the Fed ... The Fed has a particular role and particular authorities, and lending to state and local governments and supporting them when they’re in bankruptcy, that’s not part of our mandate”).

⁵² To preview, descriptively, what follows does fit the concept of activism; normatively, however, I accept LOLR activism as both desirable and inevitable, as will be discussed in Part III.

1. *Asset Purchases*

As part of its crisis-fighting role the Fed has expanded its use of 13(3) to rescue assets—a seeming departure from the more traditional use of 13(3) which is aimed at providing liquidity to individuals or institutions.⁵³

Since the original passage of the Federal Reserve Act in 1913, the Fed has had the power to buy assets in the open market under section 14 of that Act.⁵⁴ In normal times, these open market operations (“OMO”) effectuate monetary policy by affecting the supply of reserves, which in turn impacts the federal funds rates, which in turn affects other prevailing market rates.⁵⁵ It was not until the global financial crisis of 2008 that the Fed began to think about asset purchases on a large scale as an emergency crisis-fighting measure,⁵⁶ as events of that crisis exposed the limits of the Fed’s traditional monetary

⁵³ The observation that the Fed seems ready to rescue markets became known colloquially as the “Greenspan put.” See Sandeep Dahiya et al., *The Greenspan Put*, working paper, Jan. 2019, <https://ssrn.com/abstract=2993326> or <http://dx.doi.org/10.2139/ssrn.2993326>.

⁵⁴ Federal Reserve Act, § 142b. The reader should note that the Federal Open Market Committee, FOMC, has a separate legal existence from the Board of Governors. Federal Reserve Act, § 12A (creating and authorizing FOMC); Federal Reserve Act, § 14 (empowering Reserve Banks to conduct open market operations). For more detailed explanation of how the FOMC conducts monetary policy, see BD. OF GOVERNORS OF THE FED. RESERVE SYS., FUNCTION: CONDUCTING MONETARY POLICY 32-38 https://www.federalreserve.gov/aboutthefed/files/pf_3.pdf

⁵⁵ See Laura Hopper, *What Are Open Market Operations? Monetary Policy Tools, Explained*, Aug. 21, 2019, <https://www.stlouisfed.org/open-vault/2019/august/open-market-operations-monetary-policy-tools-explained>. *Effective Federal Funds Rate*, FRED FED. RESERVE BANK OF ST. LOUIS, <https://fred.stlouisfed.org/series/FEDFUNDS> (last visited July 26, 2020). Post-2008, the Fed adjusts the interest rate that banks earn on their reserves (“IOR”)—an administered rate—to “nudge” the market-determined federal funds rate (because, today, the Fed has opted to remain in an “ample” reserve environment thus rendering slightly moot its prior efforts to affect the amount of reserves in as a means of influencing the money supply). For a general explanation of these frameworks, see Jane Ihrig & Scott Wolla, *How Does the Fed Influence Interest Rates Using Its New Tools*, FED. RESERVE BANK OF ST. LOUIS, Aug. 5, 2020, <https://www.stlouisfed.org/open-vault/2020/august/how-does-fed-influence-interest-rates-using-new-tools>. The reader may also be interested to know that the Fed switched from borrowed reserves targets (M1 targeting) to federal funds rate targeting sometime in the 1980s. See Daniel L. Thornton, *When Did the FOMC Begin Targeting the Federal Funds Rate? What the Verbatim Transcripts Tell Us*, FED. RESERVE BANK OF ST. LOUIS, June 2005, <https://s3.amazonaws.com/real.stlouisfed.org/wp/2004/2004-015.pdf>.

⁵⁶ Section 14 of the Federal Reserve Act was intended to give Reserve banks authority to purchase government and agency-sponsored debt in the open market so as to affect the amount of money in circulation, that is, as part of ordinary monetary policy operations.

policy tools to stymie financial crisis—that is, interest rate policy.⁵⁷ To that end, the Fed (like other central banks) turned to “unconventional” monetary policy tools⁵⁸ such as quantitative easing, or “QE.”⁵⁹ The purpose of QE was to ease market conditions in the moment, and then to generally lower medium- and long-term interest rates.⁶⁰ In 2020, in response to the covid-pandemic and ensuring market panic, the Fed reignited the post-2008 asset purchase programs.⁶¹ While QE was billed as

⁵⁷ When the bankruptcy of Lehman Brothers roiled financial markets, the Fed dropped interest rates to close to zero in December 2008 (for the first time in decades), but without sufficient effect. Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Dec. 15-16, 2008, at 9, <https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081216.pdf>.

⁵⁸ Glenn D. Rudebusch, *A Review of the Fed's Unconventional Monetary Policy*, FRBSF ECON. LETTER, Dec. 3, 2018, <https://www.frbsf.org/economic-research/publications/economic-letter/2018/december/review-of-unconventional-monetary-policy/>; see also Honohan, *supra* note 8, at 2 (noting that, “[t]o contain the consequences of the crisis, central banks began to rely on a much wider range of tools than had been in recent use”).

⁵⁹ Together with forward guidance, the Fed adopted QE as an “unconventional” monetary policy to supplement its interest rate moves (which were now, by default, the Fed’s “conventional” monetary policy.). See Meeting of the Federal Open Market Comm. on Dec. 15-16, 2008, <https://www.federalreserve.gov/monetarypolicy/files/FOMC20081216meeting.pdf>. For a summary of how QE, in certain forms, could evolve into activism, see, Christina Parajon Skinner, Testimony to House of Lords, Select Comm. on Economic Affairs, Quantitative Easing, Apr. 13, 2021, <https://committees.parliament.uk/oralevidence/2015/pdf/>.

⁶⁰ The Fed expands its balance sheet by buying assets in the open-market—in contrast to usual open-market operations, however, which target the federal funds rate, and thus the short-term interest rate, the QE aims to impact the medium-term interest rate. Arvind Krishnamurthy & Annette Vissing-Jorgensen, *The Effects of Quantitative Easing on Interest Rates: Channels and Implications for Policy*, BROOKINGS PAPERS ON ECON. ACTIVITY, Fall 2011, https://www.brookings.edu/wp-content/uploads/2016/07/2011b_bpea_krishnamurthy.pdf.

⁶¹ “To support the smooth functioning of markets for Treasury securities and agency mortgage-backed securities that are central to the flow of credit to households and businesses, over coming months the Committee will increase its holdings of Treasury securities by at least \$500 billion and its holdings of agency mortgage-backed securities by at least \$200 billion.” Press Release, Federal Reserve Issues FOMC Statement, Mar. 15, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315a.htm>. At a March 15, 2020 press conference, Chair Powell announced that the Fed would commence asset purchases, to complement its other liquidity interventions, in an effort to “support liquidity and return to normal function.” He noted that “the asset purchase programs . . . are designed to restore those key markets [Treasury and MBS] to normal function.” Transcript of Chair Powell’s Press Conference Call, Mar. 15, 2020, at 7, <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200315.pdf>

“unconventional,” nothing in text of section 14 really prohibits the Fed from doing using the power for such.

But in 2020, the Fed also turned to asset purchases in its LOLR capacity by incorporating asset purchases into its 13(3) liquidity assistance cache of tools.⁶² In March 2020, the Fed relied on that LOLR authority to purchase corporate bonds and corporate bond ETFs. It characterized these bond purchases not under section 14 (as QE is done) but rather, as “liquidity assistance,” justifiable under section 13(3).⁶³

A section 13(3) justification for asset purchases probably better matches the policy purpose of what the Fed was doing with these facilities in 2020—fighting crisis—than would section 14—which in theory target aggregate demand and longer-term interest rates. Nevertheless, this interpretation of section 13(3) pushed its application beyond the traditional discounting of “notes, drafts, and bills of exchange” to “eligible participants” who are “unable to secure adequate credit accommodations from other banking institutions.”⁶⁴ The text of 13(3) does not authorize the Fed to buy private corporate bonds (or bond ETFs)—as these 2020 programs did.⁶⁵ The corporate bond facilities depended, it would seem, on an interpretation of 13(3) that presumes equivalence between buying a corporate bond and discounting a note (or some other eligible collateral). And indeed, on that interpretation, buying corporate bonds does square with 13(3)’s original purpose, to provide liquidity assistance to

⁶² See Menand, *supra* note 51, at 106.

⁶³ Bd. of Governors of the Fed. Reserve Sys., Secondary Market Corporate Credit Facility, <https://www.federalreserve.gov/monetarypolicy/smccf.htm>, (last visited Jan. 18, 2021); Fed. Reserve Bank of NY, FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility, Dec. 4, 2020, <https://www.newyorkfed.org/markets/primary-and-secondary-market-faq/corporate-credit-facility-faq>. In contrast, the QE undertaken after 2008 involved, for the most part, the purchase of treasuries and agency mortgaged-backed securities. Krishnamurthy & Vissing-Jorgensen, *supra* note 59, at 217; see generally Leonidas Zelmanovitz, *In the Face of Changes in the Demand for Money, What is the Proper Response by the Central Bank*, 8 CRITERIO LIBRE 69 (Jan. 2010) (examining the difference between the central bank’s response to flight from money market funds and quantitative easing).

⁶⁴ Federal Reserve Act, 13(3). To be clear, this Article does not suggest that lending to non-banks under §13(3) was a form of activism. Those actions were squarely within the realm of the Fed’s authority under that provision.

⁶⁵ In similar fashion, other 13(3) facilities were stood up to support money markets, commercial paper, and other asset-backed securities. Accordingly, somewhat afield from 13(3)’s language aimed at businesses and individuals, 13(3) was deployed in 2020 (as it had also been in 2008) as LOLR for asset-classes (corporate bonds was a new, 2020, addition). For a fuller discussion of the Fed’s authority in 2020 lending facilities, see Lev Menand, *supra* note 51.

members of the business community. So the text and purpose—while stretched—probably was not snapped.

But there may be a danger here in precedent. LOLR asset purchases could strike activism cords if they were ever to become prolonged or too large. The activism risk, specifically, is that if assets are not removed from the central bank balance sheet promptly and responsibly (with maturities run-off or sold back into the open market), the Fed could slip into a debt monetization role.⁶⁶ This point holds true for QE as well.

Debt monetization refers to situations in which newly printed money pays for the new government spending. Not surprisingly, central banks are not supposed to do it for reasons relating to inflation and the central bank's independence.⁶⁷ To go down such path would be a return to a bygone era when the Treasury dominated the Fed to precisely such an end. As Fed historian Allan Meltzer has written, during World War I, "the Treasury's financial demands controlled monetary policy."⁶⁸ In 1919, the Secretary of the Treasury notified the Federal Reserve "that it wanted to float wartime bonds "at a rate well below the market."⁶⁹ The Fed accommodated with favorable financing for bond purchasers.⁷⁰ When the President of the New York Fed, Benjamin Strong, sought to raise rates in 1919 to fend off inflation, Treasury Secretary Carter Glass threatened to ask the President to remove Strong from

⁶⁶ After all, there is no meaningful difference between large scale "liquidity" purchases continuing into perpetuity (how can there even be permanent liquidity crisis?) and direct debt monetization. This applies to both purchase of both corporate & Treasury securities. See SELGIN, *supra* note 77, at 1. (using the term "fiscal QE" to "refer to any large-scale central bank asset purchases undertaken not for strictly macroeconomic purposes but for the sake of either propping up particular firms or markets or funding particular government programs"). As Ben Bernanke has described the practice, "[m]onetizing the debt means using money creation as a permanent source of financing for government spending. Ben Bernanke, *Five Questions about the Federal Reserve and Monetary Policy*," Speech by Ben Bernanke delivered to the Economic Club of Indiana, Indianapolis (Oct. 1, 2012). For a straightforward explanation of debt monetization, see Ben Holland, *How Long-Feared 'Monetary Finance' Becomes Mainstream: QuickTake*, BLOOMBERG, May 5, 2020.

⁶⁷ Most historical examples of debt monetization—the Weimer Republic, Poland and Austria in the 1920s, faced severe inflation as a result of those war-financing induced policies. The U.S. also flirted with debt monetization after World War II, in agreeing to keep interest rates artificially low to help facilitate the market for U.S. treasuries. See Salib & Skinner, *supra* note 24 at 960-63 (discussing the impact on post-War debt monetization and Fed independence from the Treasury).

⁶⁸ 1 ALLAN H. MELTZER, *A HISTORY OF THE FEDERAL RESERVE: 1913-1951*, at 16 (2003).

⁶⁹ Allan Sproul, *The "Accord"—A Landmark in the First Fifty Years of the Federal Reserve System*, 58 *ECON. POL'Y REV.* 227 (1964)

⁷⁰ MELTZER, *supra* note 66, at 102.

office.⁷¹ The Fed was pressed into similar serve in the lead-up to World War II. The Fed agreed to maintain an interest rate peg that would helped the government's bond sales, but it was to the detriment of its ability to use monetary policy freely against inflation.⁷² Even the Fed itself faults this money financing-type arrangement for creating a postwar bout of inflation, noting that surging price levels were only reined in after the rate peg was phased out in 1951.⁷³

At least for now, the Fed appears resistant to monetary finance—in perception as much as practice.⁷⁴ The 13(3) corporate bond facilities have been in run-off mode since December 2020; and the Fed seems committed to one-day ceasing its QE. But there is increasingly popular appetite for monetary finance, and thus the Fed's balance sheet may still be exposed to such pressure to re-start that long-ago discarded practice.⁷⁵

A second way that asset purchase programs could be labeled activist is if they appear to allocate credit and thus favor some groups of asset-holders over others.⁷⁶ Credit allocation is a fiscal function, though, admittedly, it is

⁷¹ *Id.*

⁷² See generally *Hearing on H.R. 5357 Before the H. Comm. on Banking & Currency*, 74th Cong. 373 (1935) (statement of Marriner S. Eccles, Governor, Federal Reserve Board).

⁷³ Letter from Radha Chaurushiya & Ken Kuttner, to Messrs. Kos and Reinhart, Targeting the Yield Curve: The Experience of the Federal Reserve, 1942-51, June 18, 2003, at 11, <https://www.federalreserve.gov/monetarypolicy/files/FOMC20030618memoo1.pdf>.

⁷⁴ It is not clear that the first three rounds of QE post-2008 were ever intended to be monetary finance; indeed, the Fed committed to balance sheet normalization and took significant steps to do this in 2017. Press Release, FOMC, FOMC Issues Addendum to the Policy Normalization Principles and Plans, June 14, 2017, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20170614c.htm>.

⁷⁵ As one observer remarked in May 2020, “the Federal Reserve is buying Treasury debt on a scale that dwarfs 2008 and recalls the monetary financing arrangements during World War II. Holland, *supra* note _; Daniel L. Thornton, *Monetizing the Debt*, FED. RESERVE BANK OF ST. LOUIS, Dec. 1994, at 1. Those who espouse “Modern Monetary Theory” would, for example, favor Fed financing of the deficit. See Dylan Matthews, *Modern Monetary Theory, Explained*, Vox, Apr. 16, 2019, <https://www.vox.com/future-perfect/2019/4/16/18251646/modern-monetary-theory-new-moment-explained>.

⁷⁶ As one member of the FOMC remarked in 2008 in regard to QE, “I continue to believe the FOMC is the appropriate body for making monetary policy decisions and that replacing monetary policy with credit policies that are unconstrained by this Committee is to violate both good governance and the spirit of the operating understanding of the FOMC.” Meeting of the Federal Open Market Committee on Dec. 15-16, 2008, 139, <https://www.federalreserve.gov/monetarypolicy/files/FOMC20081216meeting.pdf>. See Macro Di Maggio, Amir Kerman & Christopher Palmer, *Unconventional Monetary Policy and the Allocation of Credit*, Working Paper 2016-08 (Dec. 2016), <https://www.hbs.edu/behavioral-finance-and-financial-stability/Documents/2016-08%20How%20QE%20Works.pdf>.

not black-and-white. The key question insofar as activism is concerned is whether allocation is an “incidental” feature of the program (as appeared to be the case in 2020), or the primary aim (the worrisome potential).⁷⁷ Asset-purchase-driven credit policy is not supported by the text or purpose of the Federal Reserve Act and skews the ordinary balance of power between the Treasury and the Fed.⁷⁸

In crafting the Federal Reserve Act in 1913, Congress plainly intended the Treasury to predominant where fiscal or credit matters were concerned. Indeed, out of explicit concern that a newly created Fed would take for itself too much fiscal-type power, the Congress of 1913 added section 10(6) to that Federal Reserve Act. It provides:

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent appears *to conflict* with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the *supervision and control* of the Secretary.⁷⁹

⁷⁷ As economist George Selgin has explained, “[a]lthough every sort of central bank monetary understanding has fiscal consequences of some kind, economists typically distinguish between those that have only incidental fiscal consequences and those specifically aimed at supporting particular enterprises, markets, and investments. Only the last undertaking are generally understood to encroach upon ‘fiscal’ policy.” GEORGE SELGIN, *THE MENACE OF FISCAL QE* 7 (2020). For a thorough treatment of the distinction between credit policy and monetary policy, see CREDIT ALLOCATION TECHNIQUES AND MONETARY POLICY, PROCEEDINGS OF A CONFERENCE HELD AT MELVIN VILLAGE NEW HAMPSHIRE (June 1973). In addition, a point of nuance here is required. The above text means to urge that credit policy, driven by the Fed, is inconsistent with the purpose of the Federal Reserve Act—particularly when read against contemporary notions of central bank independence. Section 13(2), and the Reserve banks’ ability to fashion discount window policy, does, strictly speaking, afford those banks’ some legal room to maneuver credit policy.

⁷⁸ Charles Plosser, *Fiscal Policy and Monetary Policy: Restoring the Boundaries*, Speech at the U.S. Monetary Policy Forum, Initiative on Global Markets, University of Chicago Booth School of Business (Feb. 23, 2012) (noting that “When the Fed engages in targeted credit programs that seek to alter the allocation of credit across markets . . . it is engaging in fiscal policy and has breached the traditional boundaries established between the fiscal authorities and the central bank”). That being said, these 2020 facilities were done in partnership with Treasury, where Treasury provided a sizable amount of equity and took a first loss position in each of these facilities. Menand, *supra* note 51, at 106, 137-38. This point will be returned to in Part III, where the Article offers some normative views on when, if ever, activism is acceptable.

⁷⁹ Federal Reserve Act, § 10(6) (emphasis added).

Here, Congress created a statutory bulwark against Fed incursion into fiscal powers. Fast-forwarding to modern-day, Congress also expressed a wish to have the Fed remain out of credit policy when it amended the language of section 13(3) to limit that way the Fed could go about “providing liquidity to the financial system.” By requiring that all 13(3) assistance have “broad-based eligibility,”⁸⁰ Congress explicitly denied the Fed’s ability to conduct credit policy using its Section 13(3) authority.⁸¹

In addition to what Congress has said and done, the Fed itself has established informal norms against a credit role. One of the most recent statements to this effect is a 2009 joint press release by the Fed and Treasury titled “The Role of the Federal Reserve in Preserving Financial and Monetary Stability,” which included the passage:

*The Federal Reserve to avoid credit risk and credit allocation. The Federal Reserve’s lender-of-last-resort responsibilities involve lending against collateral, secured to the satisfaction of the responsible Federal Reserve Bank. Actions taken by the Federal Reserve should also aim to improve financial or credit conditions broadly, not to allocate credit to narrowly-defined sectors or classes of borrowers. Government decisions to influence the allocation of credit are the province of the fiscal authorities.*⁸²

This statement is consistent with the Fed’s postwar view that engaging in credit policy would directly conflict with its core mandate. As will be discussed in further depth below, in connection with the Fed’s Main Street Lending Facilities, since at least the 1950s, the Fed Board has recognized that financing industry is (or should be seen) to be outside the Fed’s core mandate.⁸³

In summary, the 2020 asset-purchases *qua* liquidity facilities may have flirted with but not engaged in outright activism. Yet they may well have created some precedent for increasingly creative (or political) uses of the Fed’s balance sheet that more boldly cross the line between the monetary and

⁸⁰ Dodd-Frank Act 2010, § 716.

⁸¹ See Menand, *supra* note 51, at 6. Today, Bagehot’s dictum is touted as a rule that differentiates liquidity policy from credit policy—with good security, the Fed will not be exposed to credit risk, and thus cannot be said to be engaging in any kind of credit policy. Thomas M. Humphrey, *The Lender of Last Resort: What It Is, Whence It Came, Why the Fed Isn’t It*, 30 CATO J. 333 (2010). Admittedly, however, Congress has itself muddied these waters by blessing the Fed-Treasury joint ventures in the 2020 liquidity facilities in the CARES Act; I will return to this below.

⁸² Press Release, Bd. of Governors of the Fed. Reserve Sys., Dep’t of Treasury, *The Role of the Federal Reserve in Preserving Financial and Monetary Stability*, Mar. 23, 2009.

⁸³ See *infra* notes __ - __.

fiscal domains.⁸⁴ Examples of such line-crossing, with the balance sheet and beyond, are considered in Part I.B and I.C. in regard to climate change and inequality.

2. *Foreign Exchange Swaps*

The Fed has also seemingly taken on a de facto global LOLR role, wading into what could be considered the realm of foreign aid during both the Global Financial Crisis and the COVID-19 pandemic.⁸⁵ The Fed has on various occasions opened up so-called swap lines with foreign countries to provide them with financial assistance. Swap lines work by “swapping” dollars for the foreign currency—informally, the dollars are a loan on an article of faith; not meaningfully secured.⁸⁶ Swaps are justified as support for the dollar market in a foreign country and thereby protective of the global U.S. dollar

⁸⁴ It bears noting that in 2020 and 2021, two other leading central banks have come under scrutiny as activist for their role in regard to asset purchases/quantitative easing. In Europe, that program is known as the Public Sector Purchase Program (PSPP). In May 2020, a German Constitutional Court ruled that the European Central Bank had exceeded its monetary policy authority and entered into the arena of economic policy, which the EU treaties reserve for national governments. See Adam Tooze, *The Death of the Central Bank Myth*, FOREIGN POL’Y, May 13, 2020, <https://foreignpolicy.com/2020/05/13/european-central-bank-myth-monetary-policy-german-court-ruling/>. The opinion, in German, can be found here, https://www.bundesverfassungsgericht.de/SharedDocs/Downloads/DE/2020/05/rs202005_05_2bvro85915.pdf?__blob=publicationFile&v=4. In addition, the Royal Bank of New Zealand (RBNZ) was also heavily criticized for engaging in QE on the ground that it “herald[ed] a shift into activism, where the institutional distinction between monetary and fiscal policy is degraded.” Grant Wilson, *RBNZ Puts its Credibility on the Line*, FIN. REVIEW, May 31, 2020. (<https://www.afr.com/markets/currencies/rbnz-puts-its-credibility-on-the-line-20200531-p54y3a>) See also Grant Wilson, *The Limits of Central Bank Activism May Finally be Sight*, FIN. REV., Nov. 29, 2020 (<https://www.afr.com/markets/debt-markets/the-limits-of-central-bank-activism-may-finally-be-sight-20201129-p561wb>).

⁸⁵ See Peter Conti-Brown & David Zaring, *The Foreign Affairs of the Federal Reserve*, _ J. CORP. L. _ 691-92 (2018).

⁸⁶ See Baker, *supra* note 48 at 1389-90 Technically, however, they are not loans, they are FX swaps or FX purchases and sales. The Fed’s transfer of USD to its foreign central bank counterparty are fully secured by our taking possession of an equal amount of our counterparty’s home currency. *Id.*

markets and, in turn, U.S. consumers and businesses.⁸⁷ But they can also serve as lifelines thrown to foreign allies.⁸⁸

The Fed's "swap network" with central banks around the world has roots in the Bretton Woods era, when the Fed, at the direction of the Treasury, offered swaps to its foreign counterparts as an alternative to redeeming their excess cash for dwindling US gold stock.⁸⁹ Following the collapse of the Bretton Woods system, however, the Fed began using swap lines on a more ad hoc basis, whenever it was necessary to counter "disorderly market conditions."⁹⁰ Notable examples of include the U.K. sterling crisis of 1964-67 and the Mexican peso crisis of 1994-95.⁹¹

The Fed's first foray into foreign exchange transactions (i.e., swaps)—also sometimes called "forex"—was in the early 1960s, amid mounting pressure against the dollar, trouble in the United Kingdom, and new commitments by the G-10 nations to increase their lending to the IMF.⁹² Given the political-economy of the times, one can readily see that there was pressure on the Fed to stretch an interpretation of the Federal Reserve Act that would give it some footing to lend U.S. dollars abroad. These experiences—particularly the Mexican one, in which the Fed extended swap lines worth more than \$6 billion—opened the Fed up to internal and external criticism that it was playing with fire by becoming so involved with what were in no small part political crises.⁹³

⁸⁷ As the Fed describes them, the "are designed to improve liquidity conditions in dollar funding markets in the United States and abroad by providing foreign central banks with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions during times of market stress." Bd. of Governors of the Fed. Reserve Sys., *Credit and Liquidity Programs and the Balance Sheet, Central Bank Liquidity Swaps*, https://www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm (last visited Jan. 19, 2021).

⁸⁸ See David Zaring, *The Government's Economic Response to the COVID Crisis*, July 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3662049; see also Alexander R. Perry, *The Federal Reserve's Questionable Legal Basis for Foreign Central Bank Liquidity Swaps*, 120, COLUM. L. REV. 729, 746 (2020).

⁸⁹ Michael D. Bordo, Owen F. Humpage & Anna J. Schwartz, *The Evolution of the Federal Reserve Swap Lines Since 1962*, Nat'l Bureau of Econ. Research, Working Paper, No. 20755, at 3-5 (Dec. 2014).

⁹⁰ Michael D. Bordo, Ronald MacDonald & Michael J. Oliver, *Sterling in Crisis, 1964-1967*, 13 Eur. Rev. of Econ. History 437, (2009); 52 FED. RESERVE BULLETIN 306, 316-18 (Mar. 1966), https://fraser.stlouisfed.org/files/docs/publications/FRB/1960s/frb_031966.pdf.

⁹¹ *Id.*; Edwin M. Truman, *The Federal Reserve Engages the World (1970-200): An Insider's Narrative of the Transition to Managed Floating and Financial Turbulence*, PETERSON INST. FOR INT'L ECON., Working Paper No. WP-14-5, at 32 (Aug. 2014).

⁹² See Truman, *supra*, at 106.

⁹³ See Bordo et al., *supra* note 90, at 19.

Historically, the Fed has opened swap lines on an emergency-type basis only—specifically only when necessary to counter “disorderly market conditions.”⁹⁴ Examples of “disorderly market conditions” have included the U.K. sterling crisis of 1964-1967, and the collapse of the Bretton Woods system in 1971.⁹⁵ Since that period, and before 2010, the Fed engaged in these kinds of foreign exchange interventions only a handful of other times—to buy Mexican Pesos in 1982 and 1989, Japanese Yen in 1998, and Euros in 2000; and to sell Yen in 2011.⁹⁶ But in 2010, the Fed began to ramp up its foreign affairs forex once more. That year, the Fed established temporary liquidity swap lines with five major central banks.⁹⁷ Consequently, in 1998, the FOMC retired most its swap lines, seemingly setting aside its controversial international role. However, the Fed re-instated two swap lines—with the European Central Bank and the Swiss National Bank—in 2007, after the mounting financial crisis put pressures in dollar funding markets throughout the world. Twelve more—with Japan, the U.K., Canada, Australia, Sweden, Norway, Denmark, New Zealand, Brazil, Mexico, Korea, and Singapore—followed in late 2008, with the aggregate value of swaps peaking at \$583 billion in December of that year.⁹⁸

The legal justification for these swap operations is thin. The Fed leans on section 14 of the Federal Reserve Act and its language authorizing “cable transfers” for the authority to buy and sell foreign exchange.⁹⁹ Though

⁹⁴ Federal Reserve Bank of New York, Foreign Exchange Operations, <https://www.newyorkfed.org/markets/international-market-operations/foreign-exchange-operations> (last visited Jan. 19, 2021). However, as Broadus and Goodfriend point out, that term has never been defined operationally. Alfred J. Broadus, Jr. & Marvin Goodfriend, *Foreign Exchange Operations and the Federal Reserve*, Fed. Reserve Bank of Richmond, 82 Econ. Quarterly, Winter, 1996, at 9.

⁹⁵ Federal Reserve Bank of New York, *supra* note 83.

⁹⁶ *Id.*

⁹⁷ Bd. of Governors of the Fed. Reserve Sys., Credit and Liquidity Programs and the Balance Sheet, https://www.federalreserve.gov/monetarypolicy/bst_swapfaqs.htm; Bd. of Governors of the Fed. Reserve Sys., U.S. Dollar Liquidity Swaps, Supplementary FAQs, Dec. 21, 2010, <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20100510.pdf>.

⁹⁸ Michael J. Fleming & Nicholas J. Klagge, *The Federal Reserve's Foreign Exchange Swap Lines*, 16 Fed. Reserve Bank of New York, Current Issues in Economics and Finance, Apr. 2010, at 3-5.

⁹⁹ Bd. of Governors of the Fed. Reserve Sys., *supra* note 87; Interview with Edwin M. Truman, Federal Reserve Board Oral History Project, Nov. 30, 2009 and Dec. 22, 2009, at 106, <https://www.federalreserve.gov/aboutthefed/files/edwin-m-truman-interview-20091130.pdf> (explaining that “Federal Reserve power to engage in ‘cable transfers’ was the legal basis in the Federal Reserve Act under which the Federal Reserve had operated in the foreign exchange market in the past. There was a big examination of all this history

justified under section 14, these interventions have a distinctively LOLR flavor—that is, the Fed would be stepping in to aid foreign countries with financial markets in duress. The Fed has explained the swaps lines as designed to “help improve liquidity conditions in US dollar funding markets and to prevent the spread of strains to other markets and financial centers.”¹⁰⁰

That the Fed would act as a global LOLR in this way now seems to be permanently accepted. Though the 14 swap lines created during the financial crisis were retired by early 2010, five of them—with the Bank of Canada, Bank of England, Bank of Japan, European Central Bank, and Swiss National Bank—were resurrected later that spring, once the Eurozone Crisis created new pressures in dollar funding markets abroad.¹⁰¹ And after multiple renewals, the Fed announced in 2013 that these swap lines would be made into a permanent and standing arrangement, billing them as a “prudent liquidity backstop” to “ease strains in financial markets and mitigate their effects on economic conditions.”¹⁰² And in 2020, amidst the market fallout of the COVID-19 pandemic, the Fed re-opened swap line with its nine other counterparties from the financial crisis, effectively cementing its global LOLR role.¹⁰³ It made \$60 billion available to each of the central banks in Australia, Brazil, Korea, Mexico, Singapore, and Sweden; \$30 billion was available to Denmark, Norway, and New Zealand.¹⁰⁴ The expanse of this foreign dollar aid prompted one Fed watcher to wonder: “Why is the Fed sending billions of dollars all over the world.”¹⁰⁵

in the early 1960s with memos and opinions by the Attorney General. In the end, it was concluded that the Federal Reserve did indeed have this authority, which it began to use again to a limited degree in the early 1960s”). The other possible source of authority is 14(e).

¹⁰⁰ Press Release, Bd. of Governors of the Fed. Reserve Sys., FOMC Statement: Federal Reserve, European Central Bank, Bank of Canada, Bank of England, and Swiss National Bank Announce Reestablishment of Temporary U.S. Dollar Liquidity Swap Facilities (May 9, 2010), <https://www.federalreserve.gov/newsevents/pressreleases/monetary20100509a.htm>.

¹⁰¹ See *id.*

¹⁰² Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Convert Temporary Bilateral Liquidity Swap Arrangements to Standing Arrangements, Oct. 31, 2013, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20131031a.htm>.

¹⁰³ Fed. Reserve Bank of New York, *Central Bank Swap Arrangements*, <https://www.newyorkfed.org/markets/international-market-operations/central-bank-swap-arrangements> (last visited Jan. 19, 2021).

¹⁰⁴ *Id.*

¹⁰⁵ Greg Rosalsky, *Why is the Fed Sending Billions of Dollars All Over the World*, NPR, PLANET MONEY, Apr. 21, 2020, <https://www.npr.org/sections/money/2020/04/21/839374663/why-is-the-fed-sending-billions-of-dollars-all-over-the-world>.

That section 14 authority is used to justify FX swaps, as a formal legal matter slightly obfuscates the question of whether these FX swaps are agnostic operations to support the dollar markets, as implied by section 14; or whether they are, in actuality, meant to aid a foreign economy. In the latter case, a global LOLR role is not wholly consistent with the text and purpose of section 13(3), which contemplates assistance to domestic institutions, not so much the U.S. dollar generally and still less a foreign economy. As with other forms of activism, the intended use of the intervention matters. Where swaps are simply foreign aid, such manner of LOLR activism raises structural concerns by inserting the Fed into foreign affairs, which domain should be reserved for Congress. As Professor David Zaring notes, adopting a global LOLR role “places the Fed in the position of making foreign policy determinations about which foreign central banks to favor and which to disfavor.”¹⁰⁶ Those kinds of value and political judgments are more properly for the legislature (or the President).

Even the appearance of using swaps to dispense foreign aid may burden the Fed’s leadership with unnecessary critique. It may well appear, to some, as the Fed’s selection of global winners and losers—allocating and distributing dollar largesse. This raises questions for those who are concerned about the disparate impact of globalization and the duties attendant to world economic power. For example, Professors Danny Bradlow and Stephen Park have decried the Fed for not lending more generously to developing market economies—as a means of promoting redistribution from wealthy to poorer nations.¹⁰⁷ The Fed can certainly defend its decisions based on the creditworthiness of the borrowing nation and ensuing implications for the U.S. public fisc, but this defense may well fall on deaf ears for those that would see the Fed’s role expanded as a backup IMF.¹⁰⁸ Consequently, the Fed will need defenses against the perception, that in making swaps at all, the Fed assumes responsibility for “provid[ing] dollars that the global economy needs.”¹⁰⁹

3. *Small Businesses*

The final example of LOLR expansion involves Congress’s decision to involve the Fed in small businesses (“main street”) lending in 2020. The economic impact of the Covid-19 pandemic strained not only financial

¹⁰⁶ Zaring, *supra* note _ at 38.

¹⁰⁷ Daniel Bradlow & Stephen Park, *A Global Leviathan Emerges: The Federal Reserve, Covid-19, and International Law*, 114 AM. J. OF INT’L L. 662-65 (2020).

¹⁰⁸ See, e.g. *id.*

¹⁰⁹ Barry Eichengreen, *It’s May be Our Currency, but It’s Your Problem*, Feb. 2011, https://www.ineteconomics.org/uploads/papers/BWpaper_EICHENGREEN_040811.pdf.

institutions but also businesses and households. But, on their face, the Fed's liquidity assistance tools did not stretch that far—again, 10B is limited to banks and 13(3) to the provision of liquidity to the “financial system” only. Small and medium-sized businesses are not financial firms. To get around these obvious limitations in the Fed's LOLR powers, Congress authorized the Fed in the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act to offer assistance to small and medium sized business through a (one time only?) expanded reading of 13(3).¹¹⁰ Accordingly, and under 13(3), the Fed created its Main Street Lending Program, which operated through five separate lending facilities.¹¹¹ Perhaps not surprisingly, these facilities exposed the Fed to a tremendous amount of political pressure to assist one sector of the real economy or another.

There is certainly some historical dissonance in the Main Street Lending Program. The Fed, for a time, did have the power to lend to industry under section 13(b) of the Federal Reserve Act.¹¹² But most historical accounts of 13(b) recognize it as a mistaken attempt to position the Reserve banks as pseudo-commercial lenders, during a decades-long confusion among the Reserve banks (and Congress) regarding these banks' identify and proper role within the Federal Reserve System. As David Fetting of the St. Louis Fed explains, this confusion was mostly resolved by 1957. At that point, the then-Fed Chair William McChesney Martin had “exorcised most of the demons of Section 13(b)” by informing the Senate Banking and Currency Committee that the Board has eschewed “small business financing” out of:

concern . . . from the belief that it is good government as well as good central banking for the Federal Reserve to devote itself primarily to objectives set for it by the Congress, namely, guiding monetary policy and credit policy so as to exert its influence toward maintaining the value of the dollar and fostering orderly economic growth.¹¹³

¹¹⁰ CARES Act, 134 Stat. 474, Pub. L. No. 116-136, § 4003(c)(3)(D)(ii) (authorizing the Fed to use section 13(3) to establish a “Main Street Lending Program”).

¹¹¹ Bd. of Governors of the Federal Reserve Sys., Main Street Lending Program, <https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm> (last visited Mar. 24, 2021).

¹¹² See HACKLEY, *supra* note 37, at 177.

¹¹³ David Fetting, *Lender of More than Last Resort*, Fed. Reserve Bank of Minneapolis, Dec. 1, 2002; see also William McChesney Martin, Jr. Papers, FRASER, <https://fraser.stlouisfed.org/archival-collection/william-mcchesney-martin-jr-papers-1341>. In any case, by that point, the Fed's 13(b) program had become moribund.

Congress removed 13(b) from the Federal Reserve Act the following year.¹¹⁴ In the pointed words of the late economist Anna J. Schwartz, 13(b) has gone down in history as “a sorry reflection on both Congress’s and the Fed’s understanding of the System’s essential monetary control function.”¹¹⁵

It seemed unthinkable that industrial lending would come back onto the Fed’s lending menu. Indeed, on March 15, 2020, Fed Chair Jay Powell disavowed a modern role for the Fed in supporting the businesses of the real economy. In a press conference, Powell remarked,

We don’t have the tools to reach individuals and particularly small businesses and other businesses and people who may be out of work... we don’t have those tools... this is a multifaceted problem and it requires answers from different parts of the government and society... I think fiscal policy is a way to direct relief to particular populations and groups... we do think fiscal responses are critical.¹¹⁶

Either oblivious or unconcerned with the history with 13(b), a few days later, Congress put the Fed back into this confusing fiscal role of allocating credit to non-financial, small business.

While the congressional authorization in CARES somewhat mutes activism concerns, it does not obviate them—it simply demonstrates that legislatures can themselves create the conditions for the Fed to engage in activism.¹¹⁷ Congress did not, after all, make it clear—even with the CARES Act—that small business lending was an appropriate task for the Fed to do.¹¹⁸

¹¹⁴ *Id.*; see also William McChesney Martin, Jr. Papers, FRASER, <https://fraser.stlouisfed.org/archival-collection/william-mcchesney-martin-jr-papers-1341>. In any case, by that point, the program had become moribund.

¹¹⁵ Anna J. Schwartz, *The Misuse of the Fed’s Discount Window*, ST. LOUIS FED., Sept./Oct. 1992, at 61, https://files.stlouisfed.org/files/htdocs/publications/review/92/09/Misuse_Sep_Oct1992.pdf.

¹¹⁶ Transcript, *supra* note 61.

¹¹⁷ See Menand, *supra* note 51 at 157-58 (noting that in sub silentio overriding the Federal Reserve Act, Congress leaves many questions unanswered).

¹¹⁸ The main concerns the Board of Governors harbored about 13(b) throughout the 1950s were that: (1) lending directly to small businesses forced the Fed to work with long-term interest rates and equity-like assets, both of which were far removed from the short-term rates and Treasury bills the Fed has expertise in working with, see Martin, *supra* note 75, and (2) lending extensively to the real economy could undermine monetary discipline, creating inflationary pressures, see Fetting, *supra* note 84. Congress appeared to concur with these concerns when it repealed 13(b) in 1958 – but when it re-tasked the Fed with lending to the real economy through the CARES Act, it made no effort to explain why these “demons of 13(b)” were no longer of concern. In fact, there was no acknowledgement of this legislative history at all.

For one, Congress did not resolve the “unusual and exigent” proviso in section 13(3). So questions of interpretation remain. For instance, does “unusual and exigent” circumstances equal “recession like” conditions?¹¹⁹ Furthermore, section 13(3) requires, in its text, that a borrower demonstrate it cannot obtain adequate financing elsewhere. But the main street lending facilities appeared—at least initially—to permit a lower standard.¹²⁰ Did Congress bless this sub silentio?

Outside of the Main Street facilities, the Fed also supported the real economy more indirectly by lending to that banks that would provide small business loans—the Fed incentivized the banks to make those loans by agreeing to take the small business loans (which were government guaranteed) as collateral.¹²¹ Though collateral requirements are a gray area, some may well wonder whether stretching collateral eligibility requirements in this way—that is, accepting good collateral but with a clear fiscal policy purpose in view—could be considered somewhat activist.¹²²

On the whole, Congress may have prodded the Fed into activism by asking it too vaguely to develop and administer the Main Street Lending Program. Congress instructed the Fed to act beyond its mandate but did not in fact amend or suspend the law in the Federal Reserve Act. As a result,

¹¹⁹ Thomas L. Hogan, *Small Business Lending in Not the Fed's Job*, AM. INST. FOR ECON. RESEARCH, Apr. 24, 2020, <https://www.aier.org/article/small-business-lending-is-not-the-feds-job/>.

¹²⁰ For eligibility requirements, see 13 CFR 120.111. The original term sheets for the Main Street Lending Program required eligible borrowers to attest that they “require[d] financing” due to the covid-29 pandemic; but that requirement was dispensed with in subsequent term sheets. *Compare* Main Street New Loan Facility, Apr. 9, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a7.pdf> *with* Main Street New Loan Facility, Apr. 30, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430a1.pdf>.

¹²¹ The Paycheck Protection Program Liquidity Facility (“PPPLF”) was viewed as an important step in supporting the Paycheck Protection Program, administer by the Small Business Authority, given that smaller banks were more likely to reach a broader swath of underserved communities. PPPLF involved ensuring that smaller originators could get funding on attractive terms; that there would be a favorable regulatory treatment for the PPP loans. It works by allowing financial institutions to borrow money while pledging PPP loans as collateral, and giving zero risk weight to any PPP loans pledged to the PPLF. <https://libertystreeteconomics.newyorkfed.org/2020/05/the-paycheck-protection-program-liquidity-facility-ppplf.html>

¹²² See *infra* Part II.B (discussing collateral policy in the 1920s; the Reserve banks have considerable discretion here).

Congress may have muddied the LOLR waters, thereby setting the stage for future bouts of activism that we may not foresee today.¹²³

B. Inequality

In 1977, Congress added section 2A to the Federal Reserve Act, which confers a so-called dual mandate on the Fed. In particular, 2A requires the Fed to fashion monetary policies that pursue price stability (i.e., guard against inflation¹²⁴) and maximum employment.¹²⁵ Starting in the mid-1990s, the Fed unofficially pursued a target of 2% inflation per year;¹²⁶ and that 2% target was formalized in 2012.¹²⁷ And since the 1990s, the world's leading central banks have built consensus around that 2% inflation target.¹²⁸ In 2020, the Fed overhauled its monetary policy framework for the first time in decades.

In an August 2020 press announcement, Chair Powell announced that no longer would the FOMC be targeting a 2% inflation rate, but rather, it would target an *average* inflation rate of 2%.¹²⁹ The difference may seem subtle but it is tremendously substantive. It means that no longer will the Fed take steps to cool down economic activity when inflation reaches 2%. Instead, the Fed

¹²³ Menand, *supra* note 51, at 157-158 on file with author) (arguing that CARES *sub silentio* overruled section 13(3) of the Federal Reserve Act, but it remains unclear to what permanent effect).

¹²⁴ “**Inflation** is a general, sustained upward movement of prices for goods and services in an economy. (Think overall prices—not the price of a single good.)” Kristie Engemann, *The Fed’s Inflation Target: Why 2 Percent?*, Fed. Reserve Bank of St. Louis, Jan. 16, 2019, <https://www.stlouisfed.org/open-vault/2019/january/fed-inflation-target-2-percent>.

¹²⁵ The Fed is notably distinct among other of the world’s leading central banks, most of which have a price stability mandate but not one that regards employment.

¹²⁶ James Bullard, *What is the Best Strategy for Extending the U.S. Economy’s Expansion*, James Bullard, Presentation of CFA Society Chicago, Sept. 12, 2018, https://www.stlouisfed.org/-/media/Files/PDFs/Bullard/remarks/2018/Bullard_CFA_Chicago_12_Sept_2018.pdf?la=en.

¹²⁷ Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Issues FOMC Statement of Longer-run Goals and Policy Strategy, Jan. 25, 2012) (“The Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve’s statutory mandate.”)

¹²⁸ See John Ammer, Bd. of Governors of the Fed. Reserve Sys., Inflation Targeting in the 1990s: The Experiences of New Zealand, Canada, and the United Kingdom, International Finance Discussion Papers No. 473, June 1994, <https://www.federalreserve.gov/pubs/ifdp/1994/473/ifdp473.pdf>.

¹²⁹ Speech, Jerome H. Powell, Chair, Bd. of Governors of the Fed. Reserve Sys., *New Economic Challenges and the Fed’s Monetary Policy Review*, Aug. 27, 2020, <https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm>.

has committed to taking a wait-and-see approach; now, the Fed will not automatically move to raise interest rates when inflation reaches 2%. Rather, it will only decide to “liftoff” when the FOMC has also satisfied itself about employment.¹³⁰ In essence, this policy of average inflation targeting commits the Fed to keeping “interest rates low for as long as it takes to employ as many people as possible.”¹³¹

As explained and on its face, this methodological shift was a reaction to real developments in the U.S. and global economies over the past few decades.¹³² In view of these economic shifts, the adoption of average inflation targeting (“AIT”) may well have been an effort to avoid an unnecessary tightening of monetary policy thereby reducing the secondary, socially undesirable distributional impacts of the higher rates that characterize such tightening. Such policy fine-tuning would certainly be a Pareto improvement— at least some groups gain and no one loses. Still, the 2020 overhaul was structured in a way that affords ample opportunity for activism down the road. In particular, given its relative open-endedness, there is the question of whether AIT can morph into a more offensive use of monetary policy measures to reduce inequality by equating employment with equality. That could be legally and economically problematic.

Congress did not give the Fed a mandate to use monetary policy to mitigate inequality in section 2A (or elsewhere). The first time that Congress contemplated a Federal role in employment was in the Employment Act of 1946.¹³³ In that piece of legislation, the government committed to the principles of Keynesian economics, which was ascendent in the 1930s and 1940s. Accordingly, in the context of the period, the Employment Act’s references to the term “full employment” imported the Keynesian logic that

¹³⁰ *Id.*; see also Speech, Richard H. Clarida, Vice Chair, Bd. of Governors of the Fed. Reserve Sys., *The Federal Reserve’s New Framework: Context and Consequences*, Nov. 16, 2020, <https://www.federalreserve.gov/newsevents/speech/clarida20201116a.htm> (noting that “at the time of liftoff, in addition to inflation reaching 2 percent (on an annual basis), labor market conditions must have also reached levels consistent with the Committee’s assessments of maximum employment”).

¹³¹ Victoria Guida, *An Activist Central Bank? Dems Push the Fed to Fight Racial Inequality*, POLITICO, Aug. 29, 2020.

¹³² See Bd. Of Governors of the Fed. Reserve, Annual Report to Congress (Feb. 2021) (monetary policy report); Speech, Richard H. Clarida, Vice Chair, Bd. of Governors of the Fed. Reserve Sys., *U.S. Economic Outlook and Monetary Policy*, Jan. 8, 2021, <https://www.federalreserve.gov/newsevents/speech/clarida20210108a.htm>.

¹³³ The Employment Act of 1946 ch. 33, section 2, 60 Stat. 23, codified as 15 U.S.C. § 1021.

the point of frictional unemployment is also the point of optimal economic growth.¹³⁴

The term “maximum employment” thus considered full employment and economic growth as two sides of the same coin. Eventually, the employment goals of the Employment Act found their way into section 2A of the Federal Reserve Act (by way of the Humphrey Hawkins Act).¹³⁵ Given the settled meaning of “maximum employment,” as traced back to the Full Employment Act, it makes sense that “until recently the [FOMC] had been cautious not to state its policy objectives in terms of either full employment or the unemployment rate, preferring instead to state its dual mandate in terms of price stability and *economic growth*.”¹³⁶ On this broader view, it seems that since at least 1946, Congress has equated “employment” with “economic growth”—not necessarily equality.¹³⁷

But at least some of the current Fed Governors would appear to favor such interpretive slippage. As Fed Governor Lael Brainard has explained the 2020 revamp, “[t]he deep and disparate damage caused by the pandemic, coming just over a decade after the financial crisis, underscores the vital importance of full employment, particularly for low- and moderate-income workers and those facing systemic challenges in the labor market.”¹³⁸ More directly from Fed Chair Powell:

With regard to the employment side of our mandate, our revised statement emphasizes that maximum employment is a broad-based and inclusive goal.

¹³⁴ See RUTH ELLEN WASEM, *TACKLING UNEMPLOYMENT AND THE LEGISLATIVE DYNAMICS OF THE EMPLOYMENT ACT OF 1946*, at 1-45 (2013); see also PERRY MEHLING, *THE NEW LOMBARD STREET: HOW THE FED BECAME THE DEALER OF LAST RESORT* 52-53 (2011) (discussing Employment Act); Bradford J. De Long, *Keynesianism, Pennsylvania Avenue Style: Some Economic Consequences of the Employment Act of 1946*, 10(3) J. OF ECON. PERSPECTIVES 41 (1996) (generally discussing this period).

¹³⁵ See Full Employment and Balanced Growth Act, Pub. L. 95-523, 92 Stat. 1887.

¹³⁶ Daniel L. Thornton, *The Dual Mandate: Has the Fed Changed Its Objective*, 94(2) FED. RESERVE BANK OF ST. LOUIS REV., Mar./Apr. 2012, at 117, <https://files.stlouisfed.org/files/htdocs/publications/review/12/03/117-134Thornton.pdf>; Daniel L. Thornton, *What Does the Change in the FOMC’s Statement of Objectives Mean?*, FEDERAL RESERVE BANK OF ST. LOUIS ECONOMIC SYNOPSES, 2011, No. 1, at 2 (noting that between 1977 and 2010, there was virtually no mention of the Fed’s “employment” target in any FOMC minutes).

¹³⁷ See Aaron Steelman, *The Federal Reserve’s “Dual Mandate”: The Evolution of an Idea*, Fed. Reserve Bank of Richmond, ECON. BRIEF, Dec. 2011, at 5 (generally discussing the dual mandate and its origins).

¹³⁸ Speech, Lael Brainard, Governor, Bd. of Governors of the Fed. Reserve Sys., *Full Employment in the New Monetary Policy Framework*, Jan. 13, 2021, <https://www.federalreserve.gov/newsevents/speech/brainard20210113a.htm>.

This change reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities.¹³⁹

Against the legislative backdrop, it does seem that the Fed would need additional instruction from Congress to equate its employment mandate with a mandate for equality.

It might also be activist for the Fed to elevate the employment arm of the 2A mandate over the price stability arm. Since 1977, the Fed's monetary policy authority has hinged on an economic understanding that stable prices maximize utility and in turn social welfare.¹⁴⁰ Particularly after the 1970s, such rationale more directly came to provide the "justification for central bankers' traditional concern for price stability."¹⁴¹

During that decade, that theoretical connection between price stability and the aggregate welfare had been borne out empirically.¹⁴² The U.S. economy suffered greatly from a period of "stagflation" at that time—that is, years of intractable inflation and very high unemployment.¹⁴³ Until that point, economists and policymakers believed that an economy could always dig its way out of an unemployment rut by accepting some more inflation—this Keynesian view of the economy theorized that programs of government spending would be likely to reduce the relative value of the dollar but, on the plus side, such programs would also increase labor demand and thus employment.¹⁴⁴ But in practice, it did not work. Eventually, Paul Volcker arrived as Chairman of the Fed in 1979 with a winning-strategy for beating

¹³⁹ Powell, *supra* note 129. Politico reporter Victoria Guida has put it in less veiled terms: "It's an acknowledgment that rate hikes in previous business cycles, intended to head off inflation, have caused some people to miss out on the benefits of economic growth. Disproportionately, those people have been minorities." Guida, *supra* note 131.

¹⁴⁰ Prices that varied in sporadic and unpredictable weighs would give rise to deadweight losses. Michael Woodford, *Inflation Stabilization and Welfare*, NBER Working Paper 8071, Jan 2001, 12-14. "A deadweight loss is a cost to society as a whole that is generated by an economically inefficient allocation of resources within the market. Deadweight loss can also be referred to as 'excess burden.'" Prateek Agarwal, *Deadweight Loss*, *Intelligent Economist*, Mar. 18, 2020, <https://www.intelligenteconomist.com/deadweight-loss/>.

¹⁴¹ Woodford, *supra* 130. at 3.

¹⁴² The Article returns to lessons from the 1970s, *infra* Part II.C.

¹⁴³ See Brian W. Cashell & Marc Labonte, *Understanding Stagflation and the Risk of Its Recurrence*, CRS Report for Congress, 1-5 Mar. 31, 2008, [https://congressional-proquest-com.proxy.library.upenn.edu/congressional/result/pqpresultpage.gispdfhitspanel.pdflink/\\$2fapp-bin\\$2fgis-congresearch\\$2f4\\$2fa\\$2f5\\$2f9\\$2fcrs-2008-gvf-0297_from_1_to_17.pdf/entitlementkeys=1234%7Capp-gis%7Ccongresearch%7Ccrs-2008-gvf-0297](https://congressional-proquest-com.proxy.library.upenn.edu/congressional/result/pqpresultpage.gispdfhitspanel.pdflink/$2fapp-bin$2fgis-congresearch$2f4$2fa$2f5$2f9$2fcrs-2008-gvf-0297_from_1_to_17.pdf/entitlementkeys=1234%7Capp-gis%7Ccongresearch%7Ccrs-2008-gvf-0297).

¹⁴⁴ For a short primer on Keynes, see Sarwat Jahan et al., *What is Keynesian Economics*, 51 FINANCE & DEVELOPMENT 53 (2014), <https://www.imf.org/external/pubs/ft/fandd/2014/09/pdf/basics.pdf>.

stagflation—he got inflation in check, without worrying about employment.¹⁴⁵

The Volcker Fed adopted a price-stability-first policy.¹⁴⁶ This was not because unemployment was not concerning, but rather, as economists had come to realize, employment could not be increased without price stability. As Paul Volcker explained before becoming Chair,

I don't think that we have the choice in current circumstances—the old tradeoff analysis—of buying full employment with a little more inflation. We found out that doesn't work, and we are in an economic situation in which we can't achieve either of those objectives immediately. We have to work toward both of them; we have to deal with inflation.¹⁴⁷

In a similar vein, Volcker reported to Congress that:

I do not want to suggest or claim other factors are not relevant in the inflationary process, but I do believe that moderation in monetary growth is a necessary condition for the restoration of reasonable price stability, and that progress in that direction, far from conflicting with growth and employment goals, will over time prove a prerequisite to continued and orderly growth. Put another way, I think the experience of recent years strongly suggests that a resurgence of inflationary pressure would be damaging to our employment goals and to the purpose of sustaining the expansion.¹⁴⁸

Ultimately, the Volcker Fed was correct on the merits. With considerable tightening of interest rates, the “Great Inflation” of that era eventually came under the Fed’s control.¹⁴⁹ To avoid future economic “disarray,” the Fed continued to be disciplined about inflation targeting (until August 2020).¹⁵⁰

Against this background and history, one can see why elevating the employment side of the mandate—in this case, to strive for more equality—would divorce the economic logic behind the Fed’s monetary authority from the legal power in section 2A, with potentially problematic macroeconomic effect.

¹⁴⁵ Thornton, *supra* note 136, at 28.

¹⁴⁶ See William Poole, *President's Message: Volcker's Handling of the Great Inflation Taught Us Much*, Fed. Reserve Bank of St. Louis, Jan. 1, 2005, <https://www.stlouisfed.org/publications/regional-economist/january-2005/volckers-handling-of-the-great-inflation-taught-us-much>.

¹⁴⁷ Thornton, *supra* note 136, at 28.

¹⁴⁸ *Id.*

¹⁴⁹ See *id.*

¹⁵⁰ See Marvin Goodfriend, *How the World Achieved Consensus on Monetary Policy*, NBER Working Paper 13580, at 24-25 (2007), <https://www.nber.org/papers/w13580>.

Now, to be sure, the global economy has changed significantly since the Volcker days. Among these changes, r^* (real interest rates) has declined and the Phillips curve—which assumes a tradeoff between inflation and employment—seems flatter.¹⁵¹ But those economic shifts do not necessarily mean monetary policy should become sanguine about inflation. An expansive monetary policy—driven forward by efforts to reduce inequality by pressing too hard on employment—could usher in a period of inflation reminiscent of the 1970s or the post-War periods. This prediction will become more likely if and as the government’s budget deficit grows.¹⁵²

As with other forms of activism there would be larger structural costs were the Fed to use its new framework to proactively pursue equality. For one, by interpreting section 2A in this way, the Fed would be making a value judgment—that society should accept higher inflation (less stable prices) in favor of more employment.¹⁵³ But, as will be discussed in full below, that should be Congress’s decision. Moreover, to the extent the Fed now shoehorns inequality into “employment,” it appears a reaction to political, popular, and international pressure.¹⁵⁴ Yet seeming malleable against pressure opens the door to future trade-offs for political gain. A Fed that is tied to a 2% mast maintains a valuable political-economy buffer—self-constrained as such, the Fed had principled grounds for resisting

¹⁵¹ See Kristie Engemann, What is the Phillips Curve (and Why Has It Flattened)?, Open Vault Blog, Fed. Reserve Bank of St. Louis, Jan. 15, 2020, <https://www.stlouisfed.org/open-vault/2020/january/what-is-phillips-curve-why-flattened>.

¹⁵² See Kate Davidson, *U.S. Ran Record \$1.9 Trillion Budget Deficit in First Seven Months of Fiscal Year*, WALL ST. J., May 12, 2021; Anita Kumar, *Biden Begins Selling his \$4T Spending Plans*, POLITICO, Apr. 29, 2021; see Congressional Budget Office, *The 2021 Long-Term Budget Outlook* (Mar. 21) (estimating that at this rate, debt-to-GDP ratio will exceed 200% by 2051). Modern monetary theorists (“MMT”) essentially believe that government spending is benign and should be used toward progressive ends. See Alex J. Pollock, *Inflation Comes for the Profligate*, Law & Liberty, Mar. 2, 2021, <https://lawliberty.org/inflation-comes-for-the-profligate/>. As one writer noted, “[s]ounding the alarm about inflation is out of vogue.” Michael D. Bordo & Mickey D. Levy, *The Short March Back to Inflation*, WALL ST. J., Feb. 3, 2021.

¹⁵³ This statement is premised on a non-vertical Phillips curve. It remains to be seen whether the Phillips curve is permanently or temporarily flattened. See Michael Ng, David Wessel & Louise Sheiner, *The Hutchings Center Explains: The Phillips Curve*, Brookings, Aug. 21, 2018 (explaining the natural rate hypothesis); Olivier Blanchard, *Should We Reject the Natural Rate Hypothesis*, Peterson Inst. for Int’l Econ., Nov. 2017, <https://www.piie.com/system/files/documents/wp17-14.pdf> (suggesting the long-run curve could be sloped).

¹⁵⁴ See, e.g., Guida, *supra* note 131; Niels-Jakob Hanen, Alessandro Lin & Rui Mano, *Monetary Policy for All? Inequality and the Conduct of Monetary Policy*, IMF Working Paper No. 20/196, <https://www.imf.org/en/Publications/WP/Issues/2020/09/25/Should-Inequality-Factor-into-Central-Banks-Decisions-49756>.

presidential pressure to, for example, run a ‘hot’ economy at the expense of price stability¹⁵⁵ By unmooring itself from the 2% anchor, the Fed may well have invited in such pressure going forward and weakened its defenses against politics.

C. *Climate Change*

The final case study of contemporary activism looks into 2021 and beyond in regard to climate change.¹⁵⁶ In recent years, central banks worldwide have begun to consider how their array of monetary policy, regulatory, and supervisory tools might be expanded to mitigate climate change.

In broad strokes, the movement endorses a variety of policy measures geared toward making the economy greener. In regard to monetary policy, for example, some central banks now consider whether a green version of quantitative easing could be adopted, whereby central banks commit to buying “green bonds” — not for purposes of mitigating economic crisis — but instead for the purpose of facilitating more green business.¹⁵⁷ Other policy suggestions involve using regulation and supervision to deter banks from lending to “brown” business while incentivizing them to lend to green ones.¹⁵⁸ Prominent ideas for this kind of regulation include increasing risk-based capital requirements in regards to certain kinds of non-green loans, thereby disincentivizing their origination.¹⁵⁹ Informally, supervisory priorities and pronouncements could accomplish much the same effect.

¹⁵⁵ See Salib & Skinner, *supra* note 24 at 960-68 (discussing those presidents that did inappropriately lean on Fed Chairs to inflate the economy in order to gain political popularity associated with a strong economy); see also Allan H. Meltzer, *Origins of the Great Inflation*, 87(2) FEDERAL RESERVE BANK OF ST. LOUIS REVIEW, March/April 2005, at 145-75 (“Politicians elected for four- or five-year terms put much more weight on employment— jobs, jobs, jobs— than on a future inflation.”)

¹⁵⁶ For a comprehensive account of the Fed’s legal power to address climate change, see generally Skinner, *supra* note 5.

¹⁵⁷ See, e.g., Bank for Int’l Settlements, BIS Launches Second Green Bond Fund for Central Banks, Jan. 25, 2021, <https://www.bis.org/press/p210125.htm>; Yanis Dafermos et al., *Climate Change Challenges for Central Banks and Financial Regulators*, 8 NATURE CLIMATE CHANGE 462 (2018); Speech, Benoît Cœuré, Eur. Central Bank, Member, Exec. Comm., *Monetary Policy and Climate Change*, Nov. 8, 2018.

¹⁵⁸ See Skinner, *supra* note 5 at 7, 40-41, 45-47 (describing these ideas in depth); see also Graham Steele, *A Regulatory Green Light: How Dodd-Frank Can Address Wall Street’s Role in the Climate Crisis*, THE GREAT DEMOCRACY INITIATIVE, Jan. 2020, at 14-20; Conny Olovsson, *Is Climate Change Relevant For Central Banks*, RIKSBANK, ECON. COMMENTARIES, Nov. 13, 2018, at 5-6.

¹⁵⁹ Regulators increase capital requirements for a certain kind of loans, it tends to disincentivize such lending relative to other kinds of assets. It is well understood that

Numerous central banks are moving in such direction.¹⁶⁰ For the most part, central bankers have framed the climate conversation in stark, but not necessarily legal, terms. As Chair of the Board of Directors for the Bank for International Settlements remarked in January 2021, “climate change presents a challenge for all humanity. . . . Therefore, every institution is right to ask itself what contribution it can make to mitigating climate change within the remit of its mandate.”¹⁶¹ Awash in pressure to do something about the climate, the Fed has also taken early steps. First, in a November 2020 financial stability report, it indicated a view that climate change could be a financial stability risk, thus opening the door to a certain set of policy tools in a fight against climate change.¹⁶² Then, in December 2020, the Fed joined the Network for Greening the Financial System (“NGFS”)—a group of central bankers and bank supervisors that are committed to using central

increases in capital requirements have an inverse relationship to lending because higher capital requirements “make it harder for businesses and individuals to obtain loans, raise the cost of loans, lower the interest rates offered to depositors and other suppliers of funds, and reduce the market value of the common stock of existing bank.” Douglas J. Elliott, *Quantifying the Effects on Lending of Increased Capital Requirements*, BROOKINGS, Sept. 24, 2009, <https://www.brookings.edu/research/quantifying-the-effects-on-lending-of-increased-capital-requirements/>. This empirical observation motivated the now famous Modigliani-Miller theorem. Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261, 291 (1958) (positing that corporations should be indifferent between funding themselves with debt versus equity under certain conditions). See also See, e.g., Harry DeAngelo & Rene M. Stulz, *Liquid-Claim Production, Risk Management, and Bank Capital Structure: Why High Leverage is Optimal for Banks*, ECGI Working Paper No. 356, Oct. 2014, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2254998 (discussing the reasons why it is more efficient for a bank to finance its credit investments (i.e., loans) with debt than equity).

¹⁶⁰ See, e.g., NETWORK FOR GREENING THE FIN. SYS. (NGFS), A CALL FOR ACTION: CLIMATE CHANGE AS A SOURCE OF FINANCIAL RISK 13-17 (Apr. 2019), https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf; Bank of England, Climate Change, <https://www.bankofengland.co.uk/climate-change> (last visited Jan. 21, 2021); Eur. Central Bank., Climate Change and the ECB, <https://www.ecb.europa.eu/ecb/orga/climate/html/index.en.html> (Jan. 21, 2021).

¹⁶¹ Jens Weidmann, *What Role Should Central Banks Play in Combating Climate Change*, Online-Conferences “Green Banking and Green Central Banking: What are the Right Concepts, Goethe University Frankfurt, Jan. 25, 21, <https://www.bis.org/review/r210128a.pdf>.

¹⁶² BD. OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL STABILITY REPORT 58-59 (Nov. 2020) (implicating that climate change may pose financial stability risks).

banking tools to mitigate climate change—a group from which the Fed had abstained for several years.¹⁶³

For the Fed, most climate initiatives sit well outside its mandate and would therefore require activist central banking.¹⁶⁴ Consider monetary policy first. Green QE is most assuredly outside the Fed’s section 2A power. A such program of non-crisis-era asset purchases, like green QE would be, would thus necessarily fall to section 14 of the Federal Reserve Act, which, provides authority for open-market operations in normal times.¹⁶⁵ But section 14 does not expressly allow for purchasing private corporate bonds of any kind, including those that are green.¹⁶⁶ While corporate bond purchases might skate through section 13(3) on a crisis basis, it is another matter altogether to use section 14 as a hook for making finance greener.¹⁶⁷ Notably, unlike the European Central Bank and the Bank of England, the Fed does not have a “secondary mandate” in its constitutive statute which directs the central bank to “have regard” to the environmental goals of the government.¹⁶⁸ The Fed lacks such political cover.

Regulatory efforts to deter brown lending would also smack of activism.¹⁶⁹ Risk weights must be tied to concrete, verifiable, objective evidence that a particular asset class is truly riskier than another. By that measure, safe assets (like cash and Treasuries) carry a zero risk-weight, while a junk bond (rated BBB or lower) would receive a risk weight of 76 to 100%.¹⁷⁰ But much is still uncertain about the physical and transition risks associated with climate change, such that accurately specifying what incrementally

¹⁶³ Press Release, *Federal Reserve Board Announces It Has Formally Joined the Network for Greening the Financial System, or NGFS, as a Member*, Dec. 15, 2020, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201215a.htm>.

¹⁶⁴ See Skinner, *supra* note 5 at 57-58.

¹⁶⁵ Federal Reserve Act, § 14.

¹⁶⁶ That provision provides a list of the debt securities that the Fed “shall have the power” to buy. It includes gold, Treasury bonds, bonds guaranteed by a government agency (i.e., MBS from the GSEs), municipal bonds, and bonds issued by the now defunct Home Owners’ Loan Corporation. Federal Reserve Act, § 14(2)(b).

¹⁶⁷ The justification being that the bond purchases are necessary to ease credit conditions after a financial crisis.

¹⁶⁸ Consolidated Version of the Treaty on the Functioning of the European Union art. 127, Oct. 26, 2012, 2012 O.J. (C326) 102; Bank of England Act, §§ 2A, 9C.

¹⁶⁹ The Fed has legal authority under various pieces of banking legislation—most recently, the Dodd-Frank Act of 2010—establish set capital requirements for the bank holding companies that it oversees. Dodd-Frank Act 2010; see Joseph G. Haubrich, *A Brief History of Bank Capital Requirements in the United States*, Econ. Commentary, No. 2020-05, Feb. 28, 2020, at 2-5. Still, this may reflect more practice than law.

¹⁷⁰ DavisPolk, U.S. Basel III Final Rule: Standardized Risk Weights Tool, <http://usbaseliii.com/tool/index.html> (last visited Jan. 29, 2021).

higher risk-weight would be appropriate for “brown assets” (relative to others) seems beyond the Fed’s present expertise.¹⁷¹ Moreover, and perhaps more importantly, the legislative purpose of capital requirements is to safeguard the solvency of a bank.¹⁷² But today, banks’ exposure to carbon-intensive industries is a small—and steadily decreasing—aspect of their balance sheets.¹⁷³ As an accounting matter, it appears unlikely that any of the large banks to fail as a result of their carbon-rich loans gone sour—an examination of bank financial shows that even if 100 percent of big U.S. banks’ wholesale loan exposure to automatable and oil and gas companies failed, these institutions’ tier 1 equity capital would be four to five times more than necessary to absorb those cumulative losses.¹⁷⁴

Without sufficient grounding in financial risk, the use of regulation to deter banks from lending to certain kinds of business would be an activist move for the Fed to make. And it would appear political.¹⁷⁵ Without clear evidence that climate change will impact financial assets in ways that banks are unable to withstand, new climate-related regulation would force the Fed to make subjective value judgments about which industries and companies should win or lose in the new green versus brown equation. Again, such value judgments are for the political branches and especially for Congress.

Finally, what of supervision? Fed supervision has always been flexible, discretion-bound, and woolly.¹⁷⁶ General language surrounding a bank’s

¹⁷¹ For a collection of Fed papers on climate and uncertainty, see Douglas Clement, *Uncertainty, Asset Prices, and Policy: Brief Reviews of Seven Conference Papers*, Fed. Reserve Bank of Minneapolis, Jan. 9, 2019, <https://www.minneapolisfed.org/article/2019/uncertainty-asset-prices-and-policy>.

¹⁷² See Bank Holding Company Act, 12 U.S.C. § 1841, et seq (grounding capital requirements in goals of bank safety and soundness).

¹⁷³ Skinner, *supra* note 5, at 18-19.

¹⁷⁴ For a collection of this data, see Skinner, *supra* note 5 at 18. As I acknowledge in this related work, “Of course, there is always also the possibility of Knightian uncertainty: the unknown unknown; or, as Mervyn King and John Kay refer to it, “radical uncertainty.” See JOHN KAY & MERVYN KING, *RADICAL UNCERTAINTY* (2020). “*Id.* at 22.

¹⁷⁵ Notably, when the OCC passed a final rule prohibiting banks from categorically declining credit to certain industries, without a risk-based assessment, in January 2021, there was significant public outcry concerning the interference of the OCC in banks’ decisionmaking process. OCC, *Fair Access to Financial Services*, 12 CFR Part 55, <https://www.occ.gov/news-issuances/federal-register/2021/nr-occ-2021-8a.pdf>; see, e.g., Jesse Hamilton, *Banks Blast Rule That Would Force Lending to Oil, Gun Firms*, Bloomberg, Jan. 5, 2021, <https://www.bloomberg.com/news/articles/2021-01-05/banks-blast-u-s-rule-that-would-force-lending-to-oil-gun-firms>.

¹⁷⁶ See Statement of Margaret E. Tahyar, Comm. on Banking Housing and Urban Affs., U.S. Senate, *Guidance, Supervisory Expectations, and the Rule of Law: How Do the Banking Agencies*

“safety and soundness” provides the basis for most microprudential supervision of bank balance sheets, governance, and operations.¹⁷⁷ Meanwhile, general references to “financial stability” and “systemic risk” in Titles I and II of the Dodd-Frank Act (combined with the Fed’s historic role as “lender of last resort”) are thought to provide an implied mandate to the Fed to mind the financial stability of the system as a whole (and thus to engage in macroprudential forms of banking system supervision).¹⁷⁸ It is an open secret among Fed experts and lawyers that these statutes, so broadly worded, give the Fed considerable latitude to exercise its judgment as to whether any given bank activity or investment will implicate its ‘safety and soundness’ or ‘financial stability’ overall.

Thus, the risk of supervisory activism toward climate change exists. While supervision may properly monitor credit risk and the banks’ efforts to adapt to emerging climate risks,¹⁷⁹ it also has potential to mask efforts to deter politically unpopular kinds of loans through the use of informal supervisory scolding or “Dear CEO” letters that can punish or intimidate.¹⁸⁰ Going forward, to avoid a charge of activism, the Fed will have some burden of showing that its supervision of climate-related risks is narrowly tailored to the risk at hand—and not an exercise in partisan or politically driven sorting.

* * *

By this point, the Article has sketched the landscape of central bank activism in its various forms. These three case studies of contemporary and potential Fed activism have suggested some indicia of the phenomenon. In its hallmark train, activism features a disconnect between the statutory power (in text and purpose) and a novel application of the power. In addition to that disconnect, activism upsets some structural dynamic, either by:

Regulate and Supervise Institutions?, Apr. 30, 2019, <https://www.banking.senate.gov/imo/media/doc/Tahyar%20Testimony%204-30-19.pdf> [hereinafter Tahyar testimony]. The word “supervision” does, however, appear in the preamble to the Fed [5]

¹⁷⁷ Banking Holding Company Act 1956, 12 U.S.C. 1844(c).
¹⁷⁸ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 780).
¹⁷⁹ See Letter from Jerome H. Powell, Chair, Bd. of Governors of the Fed Reserve Sys., to Hon. Brian Schatz, Apr. 18, 2019, <https://www.schatz.senate.gov/imo/media/doc/Chair%20Powell%20to%20Sen.%20Schatz%204.18.19.pdf> (conceding that the Fed supervises all manner of credit risk, including climate risk).
¹⁸⁰ See Tahyar testimony, *supra* note 176 (noting the power of suasion supervisors have over banks).

- (i) a re-allocating power between the Fed, Congress, and the Executive branch (i.e., the Treasury);
- (ii) creating opening for political pressure going forward; or
- (iii) assuming value-judgment-making that is otherwise reserved for elected officials in the political branches.

The next Part builds on this descriptive analysis by situating contemporary central bank activism in historical context.

II. CENTRAL BANK ACTIVISM IN U.S. HISTORY

As central bank activism looms, lessons once learned from past episodes of political and monetary activism are now dulled or wholly forgetting. Revisited, these stories caution against the revival of activist policies or structures today. This Part considers several significant cases of central bank activism that transpired between America's Founding and 2010, dusting off their lessons. Accordingly, whereas the cases in Part I allowed us to induce some indicia of central bank activism—what might it look like today?—the historical cases in Part II provide some further color on the economic and political consequences of, and conditions conducive to, activist institutional behavior.

A. *First and Second Banks of the United States*

Alexander Hamilton was the first to experiment with central banking in the United States. The U.S. had significant economic problems immediately after winning the War for Independence against the British. The first leaders of the nation were faced with a slew of financial problems, “reestablishing commerce and industry, repaying war debt, restoring the value of the currency, and lowering inflation.”¹⁸¹

Inspired by the Bank of England, Hamilton made a proposal to Congress for a national bank. Like other public or proto-central banks of the era, the national bank Hamilton envisioned would be an institution to support public finance—it would issue paper money, provide a place to store money, act as the government's fiscal agent, and offer banking facilities for commercial parties.¹⁸² But it would also have private elements.¹⁸³ Congress chartered the

¹⁸¹ Fed. Reserve Bank of Philadelphia, *The First Bank of the United States: A Chapter in the History of Central Banking*, Fed. Reserve History at 1 (June 2009).

¹⁸² *Id.* at 2.

¹⁸³ *Id.*

Bank of North America in 1781 (justified as a war exigency)¹⁸⁴—and Hamilton declared it to be “the best expedient” for the national cause.¹⁸⁵ This bank, however, ran into legal problems involving the legitimacy of its charter and was reduced to a local Philadelphia bank by the mid-1780s.¹⁸⁶

Once appointed Treasury Secretary in 1789, Hamilton realized his dream for a full-fledged national bank—which, in his view, was a “necessary auxiliary . . . [and] indispensable engine in the administration of finances.”¹⁸⁷ Hamilton’s plan clearly envisioned the Bank of the United States to be a public finance institution, along the lines of contemporaneous central banks. Historian Paul Kahan refers to a letter written by then-Secretary of the Treasury, Alexander J. Dallas in 1815. The letter, though referring to the Second Bank of the United States, “capture[d] the essence of Hamilton’s vision” for these public finance institutions.¹⁸⁸ In particular, the Bank of the United States:

¹⁸⁴ MORGAN, H. WAYNE. *THE ORIGINS AND ESTABLISHMENT OF THE FIRST BANK OF THE UNITED STATES* 473, 476 (1956). Hamilton billed the bank as a war measure, writing to the new Superintendent of Finance, Robert Morris, that “[a]ll we have to fear is that want of money may disband the army, or . . . create in the people a general disgust and alarm . . . But if a judicious administration of our finances, assisted by a bank takes place . . . no convulsion is to be apprehended . . . Tis by introducing order into our finances . . . not by gaining battles, that we are finally to gain our object”—independence.” Hamilton, “To Robert Morris.” Notably, appeals to the exigencies of war were also made by Congress in connection with the National Bank Acts of 1863 and 1864 which would establish a national banking system for the express purpose of maintaining a stable currency and bolstering civic confidence in that currency. But by that time, the First (and Second) Banks of the United States ceased to exist (they had not been re-chartered after their terms expired), and the U.S. Federal Reserve System had not yet been created. So in this intervening period, Congress turned to private banks to play this role. As scholars of the era have remarked, viewing the national banking system as created to aid the nation in combatting this emergency puts the National Banking Act in his “proper historical bearing.” John Wilson Million, *The Debate on the National Bank Act of 1863*, 2 J. POL. ECON. 251, 258 (1894); see also Office of the Comptroller of the Currency, *Founding of the OCC & the National Banking System*, <https://www.occ.treas.gov/about/who-we-are/history/founding-occ-national-bank-system/index-founding-occ-national-banking-system.html> (last visited Dec. 14, 2020).

¹⁸⁵ DAVID COWEN AND RICHARD SYLLA, *ALEXANDER HAMILTON ON FINANCE, CREDIT, AND DEBT* 48, 153 (2018).

¹⁸⁶ JJ Knox, *The History of Banking in the United States* 29-32 (190032); see also BURTON KNOKLE, *THOMAS WILLING AND THE FIRST AMERICAN FINANCIAL SYSTEM* 1937 (chapters XI-XIV).

¹⁸⁷ COWEN & SYLLA, *supra* note 185 at 70. See generally Joseph H. Sommer, *The Birth of the American Business Corporation: Of Banks, Corporate Governance, and Social Responsibility* 49 *BUFF. L. REV.* 1011 (2001).

¹⁸⁸ PAUL KAHAN, *THE BANK WAR* 7 (2016)

Ought not to be regarded as a commercial bank. It will not operate upon the funds of the stockholders alone, but much more upon the funds of the nation. Its conduct, good or bad, will not affect corporate credit alone, but must much more the credit and resources of the government. In fine, it is not an institution created for the purposes of commerce and profit alone, but much more for the purposes of national policy, as an auxiliary in the exercise of some of the highest powers in government.¹⁸⁹

In his *Report On A National Bank*, Hamilton explained the role he envisioned for the Bank. For one, the Bank would control the money supply—in his view, the federal government—“of a nature so liable to abuse” — should not have the power to issue money. Rather, a national bank, he thought, would have the prudence that was necessary for adequate restraint.¹⁹⁰ The Bank would also play some fiscal roles and support the government. It would act as the government’s fiscal agent, storing and transporting specie free of charge, facilitating payments on and subscriptions for national debt, and even handling payroll for government employees.¹⁹¹ In addition, the Bank would issue loans to the government, therein creating public debt,¹⁹² and help finance taxes.¹⁹³

But the Bank would have a private ownership and governance structure. The bank would have \$10 million of capital; 20 percent of subscriptions would be held by government and the other 80 percent by private shareholders. In terms of governance, Hamilton also preferred private over public control: he believed that private directors would have better incentives flowing “[f]rom the influence of . . . a desire of enhancing [the bank’s] profits . . . ” and be “more apt to overcome faculties.”¹⁹⁴ And he distrusted governmental motives, asking “what Government ever uniformly consulted its true interest, in opposition to the temptations of momentary exigencies? What nation was ever blessed with a constant succession of upright and wise

¹⁸⁹ *Id.*

¹⁹⁰ Hamilton, Alexander, *Report on a National Bank* (1791).

¹⁹¹ COWEN & SYLLA, *supra* note 185 at 120.

¹⁹² The bank would give “greater facility to the Government in obtaining pecuniary aids, especially in sudden emergencies” by perpetually standing ready with a pool of capital that could be mobilized *Id.*

¹⁹³ “Those who are in a situation to have access to the Bank can have the assistance of loans to answer with punctuality the public calls upon them ... [and all taxpayers benefit from] the increasing of the quantity of circulating medium and the quickening of circulation.” *Id.*

¹⁹⁴ Hamilton, *supra* note _

Administrators?"¹⁹⁵ Here, Hamilton appears to have identified the time-inconsistent nature of public policy, stemming from political and electoral cycles. He understood that the fruits of the bank's labor, like monetary stability, were public goods that had to be produced by a government institution but governed by actors with the right incentives.¹⁹⁶ Importantly, the Bank would also be designed to serve these private interests. In particular, it would be tasked with assisting "trade and industry" with the "the augmentation of the active or productive capital of a country," by enabling "more effective utilization of capital by which scattered and otherwise idle amounts are concentrated and made to serve the uses of business."¹⁹⁷

The First Bank opened on December 12, 1791 and had a twenty-year charter. But Congress voted not to renew its charter in 1811 and the First Bank closed.¹⁹⁸

Alas, America sorely missed a public finance institution during the War of 1812. As Larry White explains, "by early 1815, much like it had at the end of the Revolutionary War, the U.S. found itself heavily in debt after fighting a war with England and the economy was in a slump."¹⁹⁹ And so a Second Bank of the United States was chartered in 1816, again for twenty years.²⁰⁰ The Second Bank performed similar functions as the First Bank (and even engaged in rudimentary monetary policy) and maintained the same mostly private ownership structure.²⁰¹ However, the Second Bank was considerably

¹⁹⁵ Hamilton, *supra* note 1. Hamilton did, however, reserve certain powers for the Treasury Secretary, such as the power to inspect the bank's books. Interestingly, this role for the Treasury Secretary in the central banks' affairs held over in the original Federal Reserve Act of 1913 and was not removed until 1935.

¹⁹⁶ See Kahan, *supra* note 206, at 9 (noting that, what had always made the banks' attractive, in Hamilton's view, "was that it sidestepped what he saw as the downside of representative government, namely, that politicians would be unwilling to make necessary but politically difficult decisions in times of crisis or that they would be tempted to manipulate the money supply for short-term political gain. . .").

¹⁹⁷ Hamilton, *Report on a National Bank*; HOLDSWORTH, *THE FIRST BANK OF THE UNITED STATES* 14 (1910).

¹⁹⁸ *Id.* at 10.

¹⁹⁹ Larry White, *Alexander Hamilton, Banking Mercantilist*, ALT-M, Dec. 30, 2015, <https://www.alt-m.org/2015/12/30/alexander-hamilton-banking-mercantilist/>.

²⁰⁰ For a history of the Second Bank, see, e.g., JAY COST, *THE PRICE OF GREATNESS* (2018); KAHAN, *supra* note 2; FED. RESERVE BANK OF PHILA., *THE SECOND BANK OF THE UNITED STATES: A CHAPTER IN THE HISTORY OF CENTRAL BANKING* (2010), <https://www.philadelphiafed.org/-/media/frbp/assets/institutional/education/publications/second-bank-of-the-united-states.pdf>.

²⁰¹ See sources cited *supra* n. 202.

larger and more powerful²⁰²: it had \$35 million in capital and eighteen branches nationally, compared to the eight possessed by the First Bank.²⁰³

But like the First Bank, the Second Bank's charter was not renewed upon its expiration and, indeed, became the subject of considerable political acrimony.

Specifically, the election of Andrew Jackson to the presidency was fateful for the Second Bank.²⁰⁴ In the so-called "Bank War," Andrew Jackson crossed political swords with the then-President of the Second Bank, Nicholas Biddle. For Jackson, defeating the Bank became part of his populist, anti-bank, anti-elitist dogma—and he went to great lengths to bring the Second Bank to its knees, particularly during his second term in office.²⁰⁵ Jackson regularly spoke out against the Bank and, in a final blow in 1833, removed all federal deposits from the Bank and transferred them to state banks.²⁰⁶ Later, Jackson would order the Secretary of War to demand that the Bank stop paying pensions to the Revolutionary War veterans.²⁰⁷

Biddle, for his part, fought back by inducing a recession (by contracting the money supply) and refusing to comply with the pensions cessation order. But he was no match for Jackson's anti-bank fervor. To gain a sense of just how committed Jackson was to destroying the Bank, historians refer to one particularly illuminating conversation between Jackson and Martin Van Buren in the summer of 1832: "The bank," Jackson began, "is trying to kill me *but I want to kills it.*"²⁰⁸ Jackson wanted to turn the question of the Bank's

²⁰² By 1829, "the bank originated one out of every five bank loans in the nation and emitted approximately one-fifth of the country's bank notes. More impressive, the bank held one third of the nation's specie reserves, making it the most important financial institution in the United States. . . its operations touch virtually every aspect of the nation's economic life." KAHAN, *supra* note 202, at 55.

²⁰³ See KAHAN, *supra* note 206, at 20.

²⁰⁴ Kahan references a contemporary observer, remarking in 1836, "If any man but Andrew Jackson had been at the head of the government, the Bank of the United States would still have been in existence." KAHAN, *supra* note 206, at 28.

²⁰⁵ Jackson also firmly believed that the Bank was unconstitutional, on the grounds that Congress lacked express authority in the Constitution to charter a national bank. Of course, the Supreme Court had already settled that question earlier, in *Marbury v. Madison*. Still, Jackson persisted in his belief and declared it his duty, as Executive, to pronounce something unconstitutional as he saw it, and so explained in his message vetoing the Bank. Andrew Jackson, Bank Veto, July 10, 1832, <https://millercenter.org/the-presidency/presidential-speeches/july-10-1832-bank-veto>.

²⁰⁶ COST, *supra* note 202, at 157.

²⁰⁷ KAHAN, *supra* note 202, at 65.

²⁰⁸ *Id.*

existence into a popular referendum on the people versus what he saw as a technocratic elite.²⁰⁹

For students of contemporary central bank activism, the story of the First and Second Banks offer two cautionary tales. The first is about the perils of private credit allocation undertaken by a public finance institution. Both Banks competed with state-chartered banks and effectively controlled credit conditions in ways that could benefit their private stockholders. Tellingly, in 1782, Robert Morris called the bank “a mere private Thing in which any Man may be interested who chuses to purchase Stock.”²¹⁰ The Second Bank made loans to private individuals; and, because it received all of the government’s deposits, had a significant competitive advantage over those state banks in its capacity to make more loans.²¹¹ Writing today, historian Jay Cost analogizes the First and Second Bank to government-sponsored entities, Fannie Mae and Freddie Mac; like the GSEs, the two Banks benefited (perhaps even more so) from the government’s explicit backing.

The very notion that the Bank could exercise public functions while serving, and being governed by, private interests, nettled republican ideals and worried James Madison greatly. Among other things, Madison warned that “The power of granting charters” . . . “is a great and important power.”²¹² Madison further noted in this regard that “Public Affairs in Europe” had shown that such a public-private corporation had the potential to become a ‘powerful machine . . . competent to effect objects on principles, in a great measure independent of the people.’²¹³

In the end, Madison’s fears of corruption and profligacy became manifest most pointedly in the Second Bank. The Second Bank opened amidst the economic boom that followed the war of 1812—but “promptly discredited itself by speculation, stockjobbing, and, at some branches, outright fraud.”²¹⁴ And it did a terrible job managing the panic of 1819. Worried about regional drains of capital, the then-President of the Bank, William Jones, ended the practice whereby notes of one branch could be redeemed at any other; the consequence was that Western and Southern branches had to reduce their

²⁰⁹ *Id.*

²¹⁰ Letter from Robert Morris to John Wendell (May 1, 17782), in 5 *The Papers of Robert Morris* at 95.

²¹¹ PHILA. FED., *supra* note 202.

²¹² *Id.* at 65.

²¹³ *Id.*

²¹⁴ Daniel Feller, *King Andrew and the Bank*, NATIONAL ENDOWMENT FOR THE HUMANITIES, Jan./Feb. 2008, Vol. 29, <https://www.neh.gov/humanities/2008/januaryfebruary/feature/king-andrew-and-the-bank>.

credit straining those regions.²¹⁵ At the same time, Jones required state banks to resume redeeming notes for specie, which forced those banks to call in existing loans and reduce new lending.²¹⁶ When Biddle took over as President of the Second Bank in 1822, he wrote to Monroe: “The Bank is of vital importance of the finances of the govt. and an object of great interest to the community. That it has been perverted to selfish purpose cannot be doubted—that it may—& must —be renovated is equally certain.”²¹⁷

But even under Biddle, the institution’s power to further private interests was too great to resist. As historians at the Philadelphia Fed remarked, “Biddle also wasn’t above allowing the bank to make loans to his friends while denying loans to those who were deemed not so friendly.”²¹⁸ In 1826, for example, Biddle used the Bank’s economic power to crush a financial empire that had been built by Jacob Barker when Biddle became worried that Barker’s institutions had grown too large.²¹⁹ Ultimately, it seems that the power to dispense credit selectively, for private or political interests, became a rallying cry for the Bank’s opponents: most formidably, President Andrew Jackson.

The second lesson to be drawn from the First and Second Banks regards the dangers that presidential populism poses for a technocratic central bank. Though many ideological battles were waged during the Bank War, perhaps the most fundamental clash came over the Bank’s inclination (and ability) to respond to popular forces. Hamilton never intended the Banks to be overly responsive to the changing tides of popular or presidential opinion—to the contrary, he designed the Banks as “a hedge against the unpredictability of democracy.”²²⁰ Biddle, who firmly grasped the role of the Bank in American public life—at least as far as its public policymaking was concerned—was a steadfast believer in technocracy. But Jackson, and those most loyal to him, preferred a national bank that would appear popularly accountable while dispensing political patronage to Executive devotees.²²¹ The fact that the Bank had the power to cater to private interests may well have created a toehold for Jackson to socialize the idea that the Bank could, and should, be meeting popular demands of the day. Madison had recognized that danger early on. This basic lesson in republican theory and central banking—that

²¹⁵ KAHAN, *supra* note 202, at 25.

²¹⁶ *Id.*

²¹⁷ *Id.* at 47.

²¹⁸ Phila. Fed., *supra* note 202, at 14.

²¹⁹ *Id.* at 55.

²²⁰ KAHAN, *supra* note 202, at 9.

²²¹ *See id.* at viii, 61-62.

credit allocation and populism erode technocratic neutrality of a central bank—may well resonate today and at intervals in the future.

B. The 1920's: Discretionary Monetary Policy

It was not long after the Federal Reserve System was created that various organs of the System would engage in monetary policy activism. The original Federal Reserve Act of 1913 had empowered the Fed as first and foremost a bank supervisor and currency manager.²²² At the outset of the 1920s, the macroeconomic effects of the money supply were still not yet well understood; and the expansion and contraction of credit were thought to be automatically managed by the flow of gold.²²³ Monetary policy, as it were, was a passive feature of the System.

But throughout the 1920s, the Federal Reserve Bank of New York, under the leadership of its President Benjamin Strong, actively evolved the System's objectives and its policy tools. In particular, Strong believed that the System should steer monetary conditions toward price stability and aid European economic reconstruction.²²⁴ Strong's activist policies, deployed to achieve those objectives, shaped the System throughout the 1920s in ways that would bring it closer to the modern conception of the Federal Reserve System than its framers had originally designed.²²⁵ By 1924, Strong and other senior System officials had developed an intellectual and policy framework that would (or already had) inspired and justified proactive uses of monetary policy.²²⁶

²²² See, e.g., Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 *VANDERBILT L. REV.* 101, 150-52 (2021).

²²³ MELTZER, *supra* note 66, at 136-90; see also THOMAS M. HUMPHREY & RICHARD H. TIMBERLAKE, *GOLD, THE REAL BILLS DOCTRINE, AND THE FED* (2019) (providing an account of the use of the real bills doctrine in the 1920s and 1930s).

²²⁴ In a Letter from Benjamin Strong to Professor Sprague, Nov. 3, 1922 – Strong recounts his realization that the System “could not escape either responsibility for monetary conditions or the necessity of exercising broad discretion.” LESTER V. CHANDLER, *BENJAMIN STRONG, CENTRAL BANKER* 198 (1958).

²²⁵ As Strong's only biographer recounts, ““No other peacetime period in the history of the System has witnessed a faster development of both Federal Reserve thinking and policies than that starting around the end of 1921 and culminating in 1924. At the beginning of this period, Federal Reserve officials were confused and uncertain as to both ends and means. They were questioning old objectives and policy guides but had not yet developed new ones; they neither understood the instruments at their disposal nor were skilled in their use.” CHANDLER, *supra* note 229, at 188-89.

²²⁶ The goals identified and pursued included: “high and stable levels of business activity and employment, stability of price levels, and European monetary reconstruction.” *Id.* “Theirs had now become a philosophy or positive regulation, and they were consciously

Strong also created the institutional and governance structure to implement his novel policies. He innovated a “Governors’ Committee”—a sort of proto-FOMC—that was a consortium of Reserve bank presidents that would be tasked with cohering policy around open-market operations and giving the Board policy advice.²²⁷ Fortuitously for Strong, the System had newly acquired access to the raw material with which it could conduct such offensive monetary policy. Thanks to the Treasury’s wartime bond programs, there were more government debt assets in circulation than ever before, at levels now sufficient to enable the System’s first efforts at open market operations.²²⁸ The Committee experimented with open-market operations to “prevent undesirable effects” on the economy, from things such as gold movements or currency outflows, and also “dynamically” to effectuate changes in the money market.²²⁹

As noted, Strong turned to proactive monetary policy to solve at least two major economic issues of the day—one domestic and one abroad. At home, gold inflows had created the potential to adversely impact price levels. Between 1920 and 1924, monetary gold stock in the U.S. rose 70 percent, sparking fears of inflation and subsequent deflation. To counter inflationary pressures, the New York Fed “responded affirmatively and aggressively” to defend the gold reserve ratio.²³⁰ Strong’s “formula” was to “sterilize” gold inflows.²³¹ This is to say that the System would “offset” gold inflows by taking other money out of circulation (e.g., by buying government securities,

using their powers to promote high and stable levels of business activity and employment, stability of price levels, and European monetary reconstruction.” *Id.*

²²⁷ *See id.* 187, 216.

²²⁸ *Id.* at 205, 208 (discussing Strong’s early discovery, experimentation, learning curve with open market operations).

²²⁹ *Id.* at 234. The reader may be interested to know that Strong’s committee was disbanded in 1923 while he was in Colorado recuperating from tuberculosis, in an exertion of power by the Fed Board. So it would not have played a role in monetary policy decisions after that time.

²³⁰ Priscilla Roberts, *Benjamin Strong, The Federal Reserve, and the Limits to Interwar American Nationalism: Part I: Intellectual Profile of a Central Banker*, 82/2 FED. RESERVE BANK OF RICHMOND, ECON. QUARTERLY, Spring 2000, https://www.richmondfed.org/~media/richmondfedorg/publications/research/economic_quarterly/2000/spring/pdf/roberts.pdf.

²³¹ Leland Crabbe, *The International Gold Standard and U.S. Monetary Policy From World War I to The New Deal*, FED. RESERVE BULL., June 1989, at 423, <https://fraser.stlouisfed.org/files/docs/meltzer/craint89.pdf>. At least one scholar, however, doubts whether Strong was acting to stabilize the price level. *See* David Glassner, *The Great, but Misguided, Benjamin Strong Goes Astray in 1928*, *Uneasy Money*, June 24, 2015, <https://uneasymoney.com/2015/06/24/the-great-but-misguided-benjamin-strong-goes-astray-in-1928/>.

bankers acceptances, or reducing discount window lending).²³² The use of open-market operations to pursue this rudimentary form of price stability expanded the then-common understanding of section 14 of the Federal Reserve Act. As one former Fed official has remarked, “the provisions of the Federal Reserve Act permitting Reserve Banks to acquire government securities were little more than an after-thought” to the Act’s framers.²³³

Strong’s correspondence suggests that not only was his initiative to sterilize gold activist from a legislative purpose point of view, it also seemed to push the boundaries of the Fed Board’s own policy. In a June 28, 1923, letter to Professor Charles J. Bullock, Strong explained:

If I were Czar of the Federal Reserve system I’d see that the total of our earning assets did not go much above or below their past year’s average, after deducting an amount equalling from time to time our total new gold imports. This is the song I’ve been singing in Washington since April 1922 with but moderate success. Most of them don’t see the point about gold!

Activism was not an accidental byproduct of the law, in Strong’s opinion. It was a benefit. Indeed, Strong expressed distaste with the prospect that Congress would formalize these new price stability objectives with a legislative mandate. Congress had, at various intervals, tried to legislate a price stability mandate for the Fed during much of the 1920s. But the bills met with considerable resistance from various Fed members,²³⁴ including and especially Benjamin Strong. In Strong’s words: “If you will let me alone, I will try to do the best I can, but if you make me do by law what I am trying to do without legislative control, I will be so afraid that I cannot fill the bill that I will not accept responsibility.”²³⁵ Strong appeared to prefer the statutory silence that would give him more autonomy for activism.

²³² David C. Wheelock, *Conducting Monetary Policy Without Government Debt: The Fed’s Early Years*, FED. RESERVE BANK OF ST. LOUIS, May/June 2002, at 6. Sterilization works as follows: when gold flows in, the System can sell assets in the open market, which will reduce the money supply thereby offsetting the increase in the money supply that the additional gold will have created.

²³³ *Id.* at 6. Strictly speaking, the original intention behind section 14 was to allow the Fed to invest excess cash in government securities. See Parinitha Sastry, *The Political Origins of Section 13(3) of the Federal Reserve Act*, FRBNY ECON. POL’Y REV., Sept. 2018, at 6, https://www.newyorkfed.org/medialibrary/media/research/epr/2018/epr_2018_political-origins_sastry.pdf.

²³⁴ Testimony from the Fed board members contributed to the failure of a 1928 bill that would formally add price stability as a goal. MELTZER, *supra* note 223, at 187-91.

²³⁵ Irving Fisher, Letter to Clark Warburton dated July 23, 1946 (unpublished); see also Roberts, *supra* note 242, at 9 (noting that “Strong doggedly resisted attempts to pass legislation demanding that the Federal Reserve System employ rate policy and open market operations to ensure price stability, preferring that Federal Reserve officials should

The second policy program Strong addressed with active monetary policy was European economic reconstruction. He, like other members of the New York financial elite at the time, believed in “internationalist” central banking policies and particularly those which would support a postwar international economic order with America and England at the helm.²³⁶ He viewed it as an obligation of the System to aid the allies in their postwar rehabilitation. However, discerning this role for the Fed this required an activist interpretation of the Federal Reserve Act. To that end, Strong, along with Fed architect Paul Warburg, “waged a persistent battle as to whether Federal Reserve regulation should be framed and interpreted in such a way as to facilitate the Allies’ ability to finance their war purchases in the American market.”²³⁷

Perhaps most concretely, Strong used a monetary policy tool already at his disposal—the discount rate—to aid Britain’s return to the Gold Standard.²³⁸ Britain was facing a balance of payments problem that inhibited its ability to restore the prewar parity it so desired.²³⁹ Strong wanted to assist Britain and the Bank of England by lowering the Reserve Banks’ discount rate, which would make the “dollar and sterling respectively less and more attractive,” thereby driving up the value of sterling.²⁴⁰ Yet the System was divided. From a domestic standpoint, many in the Fed wished to tighten rates in order to dampen what seemed to be an impending equity bubble fueled by rampant speculation in the stock market.²⁴¹ Ultimately, the New York Reserve Bank and eight others lowered rates by .5 percent, while the Chicago, San Francisco, Minneapolis, and Philadelphia banks split out of fear of fanning the flames of speculation.²⁴² Many in the System saw these rate reductions as activist insofar as the decision broke with settled

be allowed to use their discretion in attaining this objective, it was a goal he broadly shared”).

²³⁶ Roberts, *supra* note 242, at 63-64.

²³⁷ *Id.* at 72.

²³⁸ For Britain, the ability to return to pre-war parity was a matter of economic and national pride and prestige. *See id.* at 9.

²³⁹ Leland Crabbe, *The international gold standard and U.S. monetary policy from World War I to the New Deal*, Federal Reserve Bulletin, Board of Governors of the Federal Reserve System (U.S.), issue June, at 423-440.

²⁴⁰ *See id.* at 430-31; Roberts, *supra* note 242, at 78-79.

²⁴¹ LIAQUAT AHAMED, *LORDS OF FINANCE: 1929, THE GREAT DEPRESSION, AND THE BANKERS WHO BROKE THE WORLD* 291-303 (2009).

²⁴² For an account of these events, *see* https://www.richmondfed.org/~media/richmondfedorg/publications/research/economic_quarterly/2000/spring/pdf/roberts.pdf.

understanding of when the Fed should seek to ease credit conditions. Specifically, it

irritated members of the Fed Reserve Board, who believed that the committee of governors had overstepped its authority. Several members of the Board also opposed open market purchases, especially in 1927, on economic grounds. Most members of the Board, and officials of some Reserve Banks, believed that the Fed Reserve credit should be extended only at the initiative of member commercial banks through the rediscounting of commercial and agricultural loans. Otherwise, those official argued, the Fed risks contributing to speculative activities that could prove harmful to the economy.²⁴³

There may well have been legitimate reasons to ease credit conditions that were separate from foreign affairs. After all, the United States had been recovering from a mild recession in 1926.²⁴⁴ Yet it does certainly seem that Strong was principally influenced by financial unease abroad and, in particular, the Bank of England's crisis.²⁴⁵ Strong believed it a crucial duty of the Fed to ensure that Britain's could recommit to the gold standard and restore prewar parity to the pound.²⁴⁶ In 1931, Russell Leffingwell wrote to Thomas W. Lamont, that "Monty" had "called upon Ben to defend [her gold] by making it cheaper in America. This Ben did for Monty consistently and persistently, and successfully until the return of France to the gold standard in 1927" ²⁴⁷

²⁴³ Wheelock, *supra* note _ at 6-7.

²⁴⁴ At a 1926 meeting of Reserve Bank governors, "Should we go into a business recession while the member banks were continuing to borrow . . . we should consider taking steps to relieve some of the pressure which this borrowing induces by purchasing Government securities and thus enabling member banks to reduce their indebtedness." MELTZER, *supra* note 223, at 212-13. See also MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES, 1857-1960*, at 269 (1963) (agreeing with others that "concluded that foreign considerations were seldom important in determining the policies followed but were cited as additional justification for policies adopted primarily on domestic grounds whenever foreign and domestic considerations happened to coincide").

²⁴⁵ See Letter from Benjamin Strong to Mr. Harrison, Papers of Benjamin Strong, Jr., Foreign Countries: Trip to Europe, Pt. 1, May-Step. 1926, <https://fraser.stlouisfed.org/archival-collection/papers-benjamin-strong-jr-1160/foreign-countries-473581>; Letter from Benjamin Strong to Mr. Harrison, Papers of Benjamin Strong, Jr., Foreign Countries: Trip to Europe, Pt. 1, July 29, 1926, <https://fraser.stlouisfed.org/archival-collection/papers-benjamin-strong-jr-1160/foreign-countries-473617>.

²⁴⁶ Timothy Cogley, *Monetary Policy and the Great Crash of 1929: A Bursting Bubble or Collapsing Fundamentals?*, FEDERAL RESERVE BANK OF SAN FRANCISCO ECONOMIC LETTERS, 1999. See generally BENJAMIN M. ANDERSON, *ECONOMICS AND THE PUBLIC WELFARE* (1949).

²⁴⁷ Roberts, *supra* note 242, at 88.

Still, it became a widely held belief that Strong's decision to lower rates in 1927 damaged the U.S. economy in the years that followed. In 1931, Adolph Miller, a then member of the Fed Board, would testify that he believed the 1927 open market operations were the

greatest and boldest operation ever undertaken by the Federal Reserve System, and, in my judgment, resulted in one of the most costly errors committed by it or any banking system in the last 75 years . . . This was a time of business recession. Business could not use and was not asking for increased money at that time.²⁴⁸

Others joined in Miller's assessment, with the view that Strong's 1927 open market operations, and the rate reduction they occasioned, did in fact contribute to the speculative bubble that would become the great Stock Market Crash of 1929.²⁴⁹

In summary, the story of the Fed's 1920 activism mainly features Benjamin Strong, whose visions of price stability and internationalism led him to push wider the text of sections 14 and 13(2). In regard to Strong's discount window policies, the discretion in those provisions' language makes it difficult to know fully the reasons behind the 1924 and 1927 rate reductions. That opacity has been unhelpful to his legacy. Some judge Strong's policies as those that were ultimately guided by a sense of "economic nationalis[m]"; yet a good many others lay the Great Depression at his feet.²⁵⁰ The 1920's story may, as such, provide a lesson for both Congress and Fed leaders in the urgency of coupling robust mechanisms for transparency and accountability alongside broad grants of discretion. This period may also be seen as a warning shot across the bow concerning Reserve Banks' discretion over discount window policy, and collateral especially.

But Strong was not the only source of Fed activism in the 1920s. The Board also, in at least one example, turned to monetary policy activism in an effort to tramp down on stock market speculation. As stock speculation mounted in the mid-to-late 1920s, the Board grappled with what to do in regard to the growing stock of loans made by banks and brokers that were used to finance stock purchases in the context of rising stock prices.²⁵¹ The Board tried to stem the flow of Reserve Bank credit to banks that were

²⁴⁸ Memo, "Italian Stabilization," Papers of Benjamin Strong, Jr., Foreign Countries: Secret Trip to London, 1927, Dec. 14, 1927, <https://fraser.stlouisfed.org/archival-collection/papers-benjamin-strong-jr-1160/foreign-countries-2168>; Wheelock, *supra* note 232, at 10.

²⁴⁹ Wheelock, *supra* note 232 at 10.

²⁵⁰ Compare Roberts, *supra* note 242, at 97 with *id.* at 77-78 (noting the President Hoover repeatedly blamed the Great Depression on Strong's policies of discount rate reduction).

²⁵¹ Wheelock, *supra* note 232, at 7.

engaged in speculation or speculative lending with a policy of “direct action.”²⁵² The goal was to deter Reserve Bank borrowing from member banks that were in turn extending credit for speculation. Accordingly, the Board signaled to Reserve Banks that it wished for the discount window to be more difficult to access by banks that would be borrowing from the Reserve Banks for speculation themselves *or* by those banks that had speculative loans on their balance sheets.

A Federal Reserve Board letter of February 2, 1929 set out that policy:

The Federal Reserve Act does not . . . contemplate the use of the resources of the Federal Reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.²⁵³

There were both legal and political problems. In the former sense, this policy put additional restrictions on access to the discount window that went beyond the text of section 13(2), suggesting a highly activist reading.²⁵⁴ In the latter case, the direct action edits from the Board opened the door to perverse and selective use of the discount window at various Reserve Banks.²⁵⁵

Congress noticed. A 1929 *Wall Street Journal* article reported on a speech given by Louis T. McFadden, then chairman of the House Committee of Banking and Currency, regarding the “excessive use of authority” at the Federal Reserve banks.²⁵⁶ This provoked the congressman’s ire, warning that “the Federal Reserve System [should] be on its guard against overstepping the bounds of authority vested in it . . . Beyond the Federal

²⁵² *Id.*

²⁵³ *Id.* at 8.

²⁵⁴ The authority for the present day discount window, section 10B, would not be added until 1932.

²⁵⁵ For example, “The Governor of one of the Reserve Banks stated that borrowing to buy automobiles was one of the most extravagant things they had to cope with and that people were buying cars who could not afford them. One Reserve Bank refused to discount paper arising from the sale of pleasure automobiles, on the basis that the industry was over-extended.” Clay J. Anderson, *Evolution of the Role and Functioning of the Discount Mechanism*, Fed. Reserve Bank of Phila., Prepared for the Steering Comm. for the Fundamental Reappraisal of the Discount Mechanism Appointed by the Bd. of Governors of the Fed. Reserve Sys., Nov. 1966, at 26, https://fraser.stlouisfed.org/files/docs/historical/federal%20reserve%20history/discountmech/evolrole_ander.pdf.

²⁵⁶ *McFadden Raps Federal Reserve: Sees Danger in Bureaucratic Tendency to Overstep Authority – Question of Trust Power Revocation*, Jan 17, 1929.

Reserve policy of credit, all questions of general banking policy have been reserved by Congress."²⁵⁷

A scholar writing contemporaneously also noted these various "abuse[s] of rediscounting privileges" and offered an ominous—yet prescient—warning about future Fed attempts to pass off credit policy as discount window policy :

If the reserve bank which increases rediscounts cannot be made to defend such course on the ground that it is necessary to unlock unused productive resources or to meet an enlarged seasonable demand; if production statistics cannot later be employed to justify the validity of the bank's pleas, there is no possibility of a scientific regulation of rediscounts. And if the desired solution cannot be found along these lines it is difficult to understand how the desire for sectional or factional advantage can prevent the employment of political power, with the danger that the whole matter of reserve bank policy shall become a football in the arena of politics. At the present time there are many evidences of such a danger. It may be that ahead of the reserve system lie times as troublous as those which witnessed the dissolution of both the First and Second United States Banks.²⁵⁸

Direct action, it seems, was the Fed Board's first foray into credit policy.²⁵⁹ Notably, Strong disliked direct action—he would have preferred using the discount rate to influence the volume of credit in the economy.²⁶⁰ According to his biographer, Strong felt that "[a] rate control of the volume of credit has a variety of advantages. One is that it is democratic. It applies to all alike and it requires little, if any, expostulation and remonstrance to make it effective."²⁶¹

²⁵⁷ *Id.*

²⁵⁸ Harold L. Reed, *The Work of the Federal Reserve Board*, 29 J. POL. ECON. 59 (1921).

²⁵⁹ Earlier, in the later part of 1918, the Money Committee in the System had experimented with a requirement that banks require larger margin requirements for stock exchange loans. It was successful in reducing the supply of credit for stock loans but "resulted in a serious complaint and the committee finally became convinced that it was a discrimination of a character which they felt unwilling longer to be responsible for, and . . . abandoned the requirement after some months of experience with its operation." CHANDLER. *supra* note 229, at 158.

²⁶⁰ As Strong evolved his understanding of open-market operations, so too did the sophistication of his understanding of the interplay between open market operations and discount policy. "When the Federal Reserve sold securities and extracted money from bank reserves, more banks were forced to borrow from the Reserve Banks, and those already borrowing were forced more deeply into debt. Since banks had to pay interest on their borrowings and did not like to remain continuously in debt, they tended to lend less liberally, which raised interest rates in the market." CHANDLER. *supra* note 229, at 235, 239.

²⁶¹ *Id.* at 235.

This bout of activism may have impacted the Fed Board's tenuous independence from the political branches, and the Treasury in particular. As discussed above, during the years between 1920 and 1951, the Fed labored under the Treasury's thumb at least more than half the time.²⁶² While the Treasury pressured the Fed to sustain artificially low rates after both World Wars, it undermined the Fed's responsibility to maintain economic stability.²⁶³ Though speculative to suggest, it bears questioning whether the Fed's willingness to foray into credit policy during this same period—for unrelated reasons—had weakened its defenses against the Treasury's parallel incursions into its independence.

C. *The 1970's: Stop-and-Go Inflation*

Fast-forwarding fifty years, the Fed's attention to presidential and popular pressure in the early 1970s may also, in that sense, be seen as a period of activism. The period between 1965 and 1982 is now referred to as "The Great Inflation"; inflation peaked above 10 percent in 1974 and again in 1980.²⁶⁴ The decade warrants careful study as the only "peaceful outburst of inflation" that had occurred at the time.²⁶⁵ What role did activism play in contributing to the "disarray" in monetary policy that could not—or would not—curb inflation?²⁶⁶

There were various pressures in the political-economy of the day that took the Fed's attention away from fighting inflation. For one, on a theoretical level, anti-inflationary sentiment had gone out of fashion among those in a position to influence policy. As John Taylor points out, Milton Friedman seemed to be alone among professional economists urging inflation as a "disease" that needed to be reduced.²⁶⁷ Meanwhile, others in the field of

²⁶² 1 Allan H. Meltzer, *A History of the Federal Reserve: 1913-1951*, at 4 (2003).

²⁶³ See Salib & Skinner, *supra* note 24 at 960-63 (recounting this history).

²⁶⁴ See Michael Bryan, *The Great Inflation: 1965-1982*, FED. RESERVE HISTORY, <https://www.federalreservehistory.org/essays/great-inflation#:~:text=The%20Great%20Inflation%20was%20the,Fed%20and%20other%20central%20banks>.

²⁶⁵ J. Bradford DeLong, *America's Peacetime Inflation: The 1970s*, in REDUCING INFLATION: MOTIVATION AND STRATEGY 247, 247 (Christina D. Romer & David H. Romer eds., 1996).

²⁶⁶ Marvin Goodfriend, *How the World Achieved Consensus on Monetary Policy*, 21 J. Econ. Perspectives 47, 47 (2007); see also Athanasios Orphanides, *Monetary Policy Rules and the Great Inflation*, Division of Monetary Affairs, Bd. of Governors of the Fed. Reserve Sys. 1 (Jan. 2002), <https://www.federalreserve.gov/pubs/feds/2002/200208/200208pap.pdf> (noting that With the exception of the Great Depression of the 1930s, the Great Inflation of the 1970s is generally viewed as the most dramatic failure of macroeconomic policy in the United States since the founding of the Federal Reserve).

²⁶⁷ DeLong, *supra* note 297, at 279.

professional economic snickered at the thought. At the 1974 White house Economics Conference on inflation, economists dismissed idea of constraining economic activity in the interest of reigning in inflation: Paul Samuelson quipped that the U.S. did not need a “Winston Churchill” style “blood, sweat, tears, program to reduce inflation.”²⁶⁸

Instead, it had become much more popular to focus on employment. In retrospect, however, the desire to “squeeze” more than was structurally possible on that front (i.e., driving employment to below 3 percent) may have been a significant contributing factor to inflation.²⁶⁹ As Brad Delong writes, it took most of the 1970s “to persuade economists and policymakers that ‘frictional’ and ‘structural’ unemployment were far more than 1-2% of the labor force . . . and that the political costs of even high single-digit inflation were very high.”²⁷⁰ The popularity of an economic thought, rather than measures of pure technocracy, may have influenced Fed policy.

Setting economic fashions to one side, overt political pressure also played a role. Under the leadership of Fed Chair Arthur Burns, the Fed appeared to respond, with monetary policy, to popular opinion and the wishes of President Nixon. As regards the latter, the Fed’s policy seemed to fluctuate in response to the public’s “shifting” concern between inflation and unemployment. In particular, the Fed adopted a so-called “go-stop” monetary policy,²⁷¹ toggling between policies aimed at employment and those at inflation. The Fed would press “go” on monetary loosening, until popular concerns about inflation mounted; it would then pump the brakes to “stop” inflation from rising with “aggressive interest rate policy.”²⁷² But, because the public would not support interest rate increases once employment begins to rise, the Fed found itself in a political trap of facilitating creeping inflation.²⁷³

Naturally, this kind of waffling monetary policy skewed expectations about inflation, which in turn, drove inflation up further. Problematically,

[w]age and price setters learned to take advantage of tight labor and product markets in the ‘go’ phrase of the policy cycle to make increasingly inflationary demands, which neutralized the monetary stimulus. As a result, central banks became ever more expansionary in the pursuit of low unemployment. . . By pursuing low unemployment and fighting inflation

²⁶⁸ *Id.*

²⁶⁹ *Id.*

²⁷⁰ *Id.* at 251.

²⁷¹ Goodfriend, *supra* note 299, at 48.

²⁷² *Id.* at 48.

²⁷³ *Id.* at 48-49.

only when it became the predominant public concern, central banks then increased the volatility of both inflation and output.²⁷⁴

Precisely as this Fed Board researcher concludes, “had policymakers concentrated their efforts on safeguarding price stability alone, better outcomes for both employment and price stability would have been likely.”²⁷⁵

Moreover, the Fed’s then Chair—Arthur Burns—directly accommodated President Nixon. Tapes between Nixon and Burns feature Nixon pressuring Burns into running an expansionary monetary policy to boost his reelection prospects.²⁷⁶ Burns often agrees to the President’s requests. As one example of these interactions, in a December 10, 1971 tape, Nixon and Burns are recorded conversing as follows:

Burns: “I wanted you to know that we lowered the discount rate . . . got it down to 4.5 percent.”

Nixon: “Good, good, good . . . You can lead ‘em. You can lead ‘em. You always have, now. Just kick ‘em in the rump a little.”

Burns: “Time is getting short. We want to get this economy going.”²⁷⁷

In another, Nixon chuckles at Fed independence. To Burns, he says, “I know there’s the myth of the autonomous Fed . . . [short laugh] and when you go up for confirmation some Senator may ask you about your friendship with the President. Appearances are going to be important, so you can call Ehrlichman to get messages to me, and he’ll call you.”²⁷⁸

Burns’ leadership certainly seems to teach a lesson in the wisdom of staying an apolitical course—popular or presidential pressure may be a palliative for Fed leaders in the short-term, but it is a dangerous monetary cocktail for the long-term.²⁷⁹ It also highlights once again how the Fed’s broad grants of

²⁷⁴ *Id.* at 49.

²⁷⁵ Orphanides, *supra* note 228, at 8.; see generally GEORGE P. SHULTZ & JOHN B. TAYLOR, CHOOSE ECONOMIC FREEDOM: ENDURING POLICY LESSONS FROM THE 1970S AND 1980S (2020) (discussing the economic policy failures of that era). Interestingly, though, Burns very much wanted Nixon to let monetary policy alone, and try doing something on the economic policy front to tackle stagflation. See Letter from Arthur Burns to President Nixon, June 22, 1971 (reprinted in *id.* appx. B).

²⁷⁶ See Burton A. Abrams, *How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes*, 20 J. ECON. PERSP. 177, 178 (2006).

²⁷⁷ *Id.* at 181.

²⁷⁸ DeLong, *supra* note 297, at 259.

²⁷⁹ The dynamic of conflicting interests between elected politicians and monetary policy is a timeless one. As Holland has described, “Driven by election timetables or other short-term goals, [politicians] will splash too much of what feels like free cash around the economy.

discretion can may make it difficult to detect policy decisions that are more political than technocratic.²⁸⁰ Now, to be fair, the Fed did not gain a formal mandate to maintain price stability until 1977—so it did not shirk a legal obligation when it let stable prices slide.²⁸¹ Nevertheless, for the Fed to have shaped its policy in view of economic groupthink, popular opinion, or presidential priorities does check the box for activism—at least as far as its structural indicia go.

* * *

Activism, as Parts I and II have shown, is not a monolithic concept—the cases do not all fit one tidy archetype. Sometimes activism happens in ‘wartime’ (crisis mode) while in other cases activism has or could transpire in during a ‘peacetime’ transformation of the Fed. Still, these cases all hang together by their trademark characteristics and structural impacts: by pushing text, purpose, or conventional usage of a power—in response to popular, political, or international pressure—activism enlarges the Fed’s role relative to the job that Congress gave it. Still, normative judgments of these cases may well vary. As the final Part discusses, we can evaluate activism along a spectrum—with crisis-era action on the one end and social policymaking on the other.

III. ASSESSING CENTRAL BANK ACTIVISM

By now the Article has set out a range of examples where the Fed (or actors within the institution) have or might engage in “activism.” These studies have indicated a Fed policy as “activist” when it breaks from statutory text, purpose, or historical usage of a power; and disrupts structural divisions between the Fed and more democratically responsive actors. The lessons learned were broad. Part II demonstrated that the practical dangers of Fed activism range from monetary policy failures to popular antipathy, reminding us that politics and central banking do not go well together.

This Part addresses the sticky normative questions that follow. What are the reasons why central bank activism should generally be constrained? Could central bank activism ever be justifiable? And, of key importance,

History is full of examples, from the Weimar Republic a century ago to Latin America today, of the disastrous effects of losing monetary discipline.” Holland, *supra* note 279.

²⁸⁰ Indeed, “this period is often cited as a prime example of the dangers associated with discretion.” Athanasios Orphanides, *Monetary Policy Rules and the Great Inflation*, Bd. of Gov. Of Fed. Reserve Sys., Jan. 2002, at 1.

²⁸¹ So DeLong suggests that Fed Chair Arthur Burns, who will be discussed momentarily, did not believe he had the authority to quickly bring inflation down. *Id.* at 250-51.

what guardrails should we seek for navigating between modernizing adaptation or wartime agility on the one hand, and activism that overreaches on the other?

A. Legitimacy Concerns

The Article has thus far mainly wrestled with the question of what the law empowers the Fed to do. Yet, to understand fully the problems with the practice of activism, one must consider the ancillary question of legitimacy, which speaks to the Fed's authority to push on the edges of the law or go beyond them.

As scholars have elsewhere discussed at length, legitimacy matters a great deal for central banking power. Former Deputy Governor of the Bank of England, Paul Tucker, studies the question of central bank legitimacy at length in his book, *Unelected Power*.²⁸² So, too, have Professors Rosa Lastra and Charles Goodhart in exploring the nexus between populism and legitimacy.²⁸³ In all of these scholars' views, legitimacy is a first-order question for any adjunct of the state that exercises power on a delegated and independent—and thus attenuated—basis, as most central banks do. Legitimacy forms the basis for societal "acceptance" of any given power.²⁸⁴ As Tucker has explained, acceptance means that people will "go along with the decisions and with the right of the central bank to make them . . . [and] not systemically get in the way of the implementation of agency policy . . . or otherwise seek to undermine" the institution.²⁸⁵ Acceptance thus becomes necessary for a central bank to sustain its grip on power and a linchpin for the efficacy of its policy.

But in some cases, Fed activism could be at odds with its continued legitimacy. To see why, it is useful to lean again on Paul Tucker's analysis. In explaining the conditions necessary for the legitimate exercise of power, Tucker refers to the work of British social scientist David Beetham. The Tucker-Beetham view sets up three conditions necessary to "justify" as

²⁸² TUCKER, *supra* note 22 at 402-403.

²⁸³ Rosa Lastra & Charles Goodhart, *Populism and Central Bank Independence*, 29 OPEN ECONOMIES REV. 49, (2018).

²⁸⁴ As Tucker explains, legitimacy thus allows the coercive power of the state to fade into the background, and it also makes it possible to explain how the central bank may effect its purpose without extracting some moral duty to obey from people.

²⁸⁵ TUCKER, *supra* note 22, at 155.

legitimate any given exercise of power:²⁸⁶ that it be “established and exercised” (1) “by legally valid means”; (2) “under laws, norms, and conventions that conform to a society’s deep values and normative beliefs about governance;” (3) pursuant to some “collective acceptance” of the practice.²⁸⁷

The first condition is straightforward enough to consider where activism is concerned. Whether the Fed is acting within the bounds of what the law says and what it intended is a question of, what Lastra and Goodhart refer to as, “formal legitimacy.”²⁸⁸ Activism, in its strongest forms, cannot comport with this condition. Even in its milder versions, activism seems generally at odds with the notion that any use of power has been established through “legally valid means.” Activism, after all, comes about from subtle (or, sometimes overt) aggrandizements of power that result from the Fed’s specific efforts to expand a flexible, broadly worded mandate. While Congress allows administrative agencies to interpret their own mandates to some extent, there is always a line that once crossed violates the limits to how far any agency can go in this regard.²⁸⁹

For example, efforts to re-tool monetary policy to offensively reduce climate change would, if that came to pass, fall on the other side of that line. Again, it is difficult indeed to establish that Congress had climate mitigation in mind with section 2A; accordingly, in the absence of congressional instruction to “have regard” to climate policy of the government (as the ECB and Bank of England have),²⁹⁰ a Fed initiative to take on climate change would seem inconsistent with this first condition of legitimacy.²⁹¹

As regards the second condition, activism may also come in conflict with the well-established principle of democratic governance that only elected

²⁸⁶ *Id.* at 147 (quoting moral philosopher Bernard Williams for the principle that “The Basic Legitimation Demand implies . . . the states . . . hav[ing] to offer a justification of its power to each subject”).

²⁸⁷ *Id.* at 159-60. This conception thus combines legal legitimacy with notions of democratic legitimacy.

²⁸⁸ Lastra & Goodhart, *supra* note 283 at 54.

²⁸⁹ *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

²⁹⁰ *See, e.g.*, Rosa M. Lastra & Kern Alexander, *The ECB Mandate: Perspectives on Sustainability and Solidarity*, EUR. PARL., MONETARY DIALOGUE PAPERS 11-13 (June 2020), [https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/648813/IPOL_IDA\(2020\)648813_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2020/648813/IPOL_IDA(2020)648813_EN.pdf).

²⁹¹ As Lastra and Goodhart point out, this can also be problematic for accountability reasons. If the Fed decides for itself what goals to pursue, how can one know whether they “are on the right track”; instead, society must default to deference to their expert technocracy. Lastra & Goodhart, *supra* note 283, at 55-56.

leaders decide which goals the government pursues, and establishes laws that seek those ends.²⁹² But when a central bank engages in activism it substitutes its unelected power—to borrow Tucker’s term—for the power of the legislature to decide what law should be (and its design). Several of the case studies above demonstrate how the Fed’s broadly worded legal authorities render it susceptible to popular or political pressure to sidestep an inert or indecisive Congress.²⁹³

Take the recent monetary framework overhaul for example. Several weeks prior to the Fed’s announcement, the House of Representatives had introduced a bill that would have given the Fed a clear mandate to allow the economy to run “hotter” (i.e., let inflation creep) in the interest of allowing lower-paid workers to reap the benefits of high inflation—by capturing higher wages—as a way targeting racial disparities.²⁹⁴ That bill did not become the law, yet the outcome could be much the same: by interpreting its mandate under section 2A of the Federal Reserve Act, the Fed announced just a few weeks later that it would, indeed, allow inflation to rise above 2% to allow lower income populations to reap the wage-related benefits of an expanding economy.²⁹⁵ To be fair, the Fed’s new monetary policy framework did appear to have bipartisan support in Congress. Still, the Fed does not itself share legislative power with Congress where its own mandate amendments are concerned. Congress should not put the Fed in the uncomfortable position of acting like a supra-legislature, as it forces the

²⁹² See generally VILE, *supra* note 20. The notion that “people . . . being able to shape and challenge (or contest) public policy” reflects a republican ideal of government, with roots in “Rome, the late-medieval Italian city-states, English seventeenth-century debates, and America’s founding fathers . . . Power is to be dispersed, office held temporarily, and officeholders accountable.” TUCKER, *supra* note 22, at 147, at 165. Translating these republican notions to central banking terms, as Ben Bernanke has remarked, there is “[a] broad consensus” “around the world that the goals of monetary policy should be established by the political authorities, but that the conduct of monetary policy in pursuit of those goals should be free from political control.” Ben S. Bernanke, *Central Bank Independence, Transparency, and Accountability*, Speech at the Institute for Monetary and Economic Studies International Conference, Bank of Japan, Tokyo, Japan, May 25, 2010, <https://www.federalreserve.gov/newsevents/speech/bernanke20100525a.htm>. This second prong of legitimacy also implies some requirement of political independence for the Fed, which will be discussed in further depth below.

²⁹³ See *supra* notes 124-155 (discussing the Fed’s new monetary policy framework).

²⁹⁴ H.R. 7946, Federal Reserve Racial and Economic Equity Act, 116th Cong., 2d Sess., Aug. 4, 2020 (“The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall exercise all duties and functions in a manner that fosters the elimination of disparities across racial and ethnic groups with respect to employment, income, wealth, and access to affordable credit, including actions in carrying out.”).

²⁹⁵ See *supra* Part I.B.

central bank to substitute unelected judgment for that of Congress and to make political decisions about where scarce governmental resources should be allocated.

Quite often, activist policies will require significant value judgments, further clashing with condition two. Where green polices are concerned, for instance, the Fed would need to make decisions about which companies classify as “brown” or “green” for purposes of adjusting risk-based capital requirements, chastising banks for holding certain assets, or for engaging in green QE. Meanwhile, the new policy framework invites the FOMC and Board to make a number of such decisions—answering, for example, how far past 2% inflation will the economy be permitted to go and how will the FOMC satisfy itself that employment conditions are sufficiently strong (and for which segments of the population?) before it allows liftoff to occur? Will this be a moving target?²⁹⁶ It bears repeating, politicization of the discount window has been difficult to sustain in periods before.²⁹⁷ Of course, the active exercise of discretion is not a litmus test for activism. But discarding a monetary policy rule in favor of a capacious standard certainly opens the door wider to eventual activist applications.

The third condition of “collective acceptance” is more difficult to pin down against central bank activism. One may well point to the popular desire to tackle climate change and inequality, and to foster collegial relations with our allies, as goals so important as to justify Fed intervention even absent law. While tempting at first blush, it puts the cart before the horse. That initial question of what society deems important should not be up to the Fed’s perception of social mores of the time. This circles back to conditions one and two. Yet the notion that there is a ‘collective’ will driving the Fed forward seems to be the implicit rationale for much of the central bank’s (potential) activism today. So in summary, as measured against these three criterion, certain versions of central bank activism would not often appear to meet the conditions necessary for legitimacy.²⁹⁸

²⁹⁶ See Tyler Powell & David Wessel, *What Do Changes in the Fed’s Longer-Run Goals and Monetary Strategy Statement Mean?*, Brookings, Sept. 2, 2020, <https://www.brookings.edu/blog/up-front/2020/09/02/what-do-changes-in-the-feds-longer-run-goals-and-monetary-strategy-statement-mean/> (noting that these kinds of questions remain ambiguous).

²⁹⁷ See Charles W. Calomiris, *Is the Discount Window Necessary? A Penn Central Perspective*, FED. RESERVE BANK OF ST. LOUIS, May 1994, at 31, https://files.stlouisfed.org/files/htdocs/publications/review/94/05/Discount_May_Jun1994.pdf; Schwartz, *supra* note 283.

²⁹⁸ Lastra & Goodhart, *supra* note 283, at 58 (“The ‘goal constraint’ restricts *ex ante* what the central bank can and cannot do. Few central banks have goal independence.”)

Of course, a central bank can muddle through periods of low legitimacy. Take the activist monetary policy of the 1970s as one example—those policies were soon seen as clearly ineffective; but the institution carried on.²⁹⁹ But when activism mixes with the wrong political-economy, it can pose a more existential threat. This was the lesson of the Second Bank of the United States³⁰⁰—and indeed, the Fed is not immune to such popular hostility today.³⁰¹

In turn, the popular antipathy that can result from low legitimacy can create problems for transparency. If central banks become unduly worried about public censure, their leaders may have incentives to obfuscate their actions to conceal the weak basis of their power.³⁰² Indeed, the decisions of erstwhile New York Fed President Benjamin Strong typify this point. Recall that Strong resisted clear lines from Congress, or open deliberation, in the interest of his ability to retain the autonomy to be activist.³⁰³ Such opacity is, of course, inversely related to accountability. Activism can thus create a spiral of diminishing legitimacy, reduced transparency, weakening accountability—and ultimately, the erosion of authority.

²⁹⁹ See *supra* notes 275-277.

³⁰⁰ Referring to the founding of the National Bank system in 1864, one scholar reflected on the First and Second Banks and the danger of politicization, noting, “As compared with the Second Bank of the United States, the system now to be inaugurated looked very formidable. If the Second Bank was discontinued for fear of its becoming a dangerous political weapon, how much more ought on to hesitate before the inauguration of a similar system on a much larger scale.” John Wilson Million, *The Debate on the National Bank Act of 1863*, 2 J. OF POL. ECON. 251, 274 (1894).

³⁰¹ In 2013, knee-deep in QE, the Fed’s popularity was quite low. See Gallup, *Americans Sour on IRS, Rate CDC and FBI Most Positively*, May 23, 2013, <https://news.gallup.com/poll/162764/americans-views-irs-sharply-negative-2009.aspx> Additionally, there have been repeated calls—on the left and right of the political spectrum—for greater transparency at the Fed. See, e.g., Fed. S. 148, Federal Reserve Transparency Act (commonly known as “audit the Fed”). Other government officials, like the former FDIC chair, have also called for a reckoning of the Fed, on the ground that it has amassed too much power and exercises that power beyond its capabilities. See Sheila Bair, Op-Ed, *Overreliance on the Fed is Compromising the Future for Millennials*, CNBC, Apr. 14, 2020, <https://www.cnbc.com/2020/04/13/op-ed-overreliance-on-the-fed-is-compromising-millennials-future.html?&qsearchterm=shiela%20bair> (opining that “our elected officials have ceded too much responsibility for the economy to the Federal Reserve. But the Fed is not well equipped for this role. It is essentially a big bank, primarily configured to lend to other big banks”).

³⁰² Former Fed Vice Chairman Alan Blinder remarked in 1996 that “in a democracy, a central bank should be fully accountable for the policies it pursues and that transparency is necessary for accountability.” Alan S. Blinder, *Central Banking in a Democracy*, 82(4) FEDERAL RESERVE BANK OF RICHMOND ECONOMIC QUARTERLY, 1–14 (1996).

³⁰³ See *supra* note 235 and accompanying text.

Finally, and shifting gears, aside from the relationship between activism and legitimacy, activism can also affect a central bank's independence—both operational and political. Today, most central banks enjoy a significant degree of political independence—that is, a sustained commitment from the political branches (especially the Executive Branch) to abstain from pressuring the central bank to fashion policies for the purpose of supporting the government's popularity or prerogatives more broadly.³⁰⁴ However, when the Fed engages in activism, it breaches the conventional barriers between branches. As discussed above, by too actively interpreting a mandate—so as to enlarge it in substance and scope—the Fed adopts a legislative role. Benjamin Strong did this in the 1920s by innovating a price stability role, fifty years before Congress would give the Fed that job.³⁰⁵ Also at times with activism, the Fed can cross into the Executive's arena, by playing an outsized fiscal role.³⁰⁶

Playing fast and loose with the separation-of-powers stands to make the Fed vulnerable to political or partisan pressure in the future. Heading too far—and too often—down fiscal roads could return the Fed to its pre-1951 role that was highly subservient to Treasury. As will be recalled, prior to the Fed-Treasury Accord of 1951, the Treasury was successful, again and again, at pressuring the Fed to manipulate interest rates to serve the government's need for generous war financing—even well beyond both World Wars had ended. Falling back into such rhythm could happen easily where the Fed plays a consistent fiscal role.³⁰⁷ The Federal Reserve Act, after all, cautions the

³⁰⁴ See, e.g., Skinner & Salib, *supra* note 24 at 908-909; Rosa Maria Lastra, *The Independence of the European System of Central Banks*, 33 HARV. INT'L L.J. 475 (1992). It bears emphasizing again that the Fed has a relatively much stronger political independence than several European counterparts, like the ECB and the Bank of England; as those foreign central banks are explicated mandated to have regard to government policy. See *supra* note 168.

³⁰⁵ Looking ahead, should the Fed pursue green policies, it would again usurp lawmaking power.

³⁰⁶ Allocating credit, along the lines of a permanent QE, is the prime example. Notably, there is also practical significance to political pressure to allocate credit selectively, as the government has done at various periods in history in regard to, for example, the Penn Central Corporation (1970), New York City (1975)—it makes monetary policy less effective. See Wheelock, *supra* note 232.

³⁰⁷ As preeminent twenty-first century economist Anna Schwartz writes, alongside Walker Todd, this breed of activism also misallocates scarce government resources. As these authors write:

“For the Fed to lend directly to the Treasury, to government agencies, or even to private entities that the Treasury otherwise would have to fund through the regular congressional appropriations process, is a slippery slope. The costs of doing so are politicization of the money supply process. As a general principle, the Fed's charter wisely prohibits such

Fed that the Treasury “shall” “supervis[e] and control” the Board of Governors if and as their powers overlap.³⁰⁸ Congress, for its part, may have already indicated some irreverence for Fed independence by reducing the Fed to a national piggybank with the 2020 CARES Act. And activism caters to the image of a Fed that is subservient to the Treasury or a lackey of the Congress, thus increasing the chances that these practices become new custom.³⁰⁹

Just as legitimacy links to accountability, so too does independence. Where the Fed steps fluidly—but unpredictably—into fiscal and legislative roles, neither Congress nor the public can be sure which master the Fed is serving, when, and why. Such questions beg another: what interests is the Fed taking into account when fashioning new policy.

Ultimately, these rule-of-law problems create practical challenges for the central bank. In a world in which political pressure might be inevitable, central banks’ mandates are their commitment devices. It is long-established that the Fed needs to be able to credibly anchor the public’s expectations about what it will—or will not—do, to assure the public that it will make technocratic expert judgments about the economy, or the financial system, absent political considerations. The public’s ability to trust the Fed’s commitment is crucial to its legitimacy, as articulated above, but also to its ability to effectively transmit its policies.³¹⁰

This is to say that the public must be able to trust that the Fed will keep its word, and not be swayed by politics or the desire to multi-task. Only if the

lending. Discount window accommodations to insolvent institutions, whether banks or non-banks, misallocate resources. Political decisions in those cases are substituted for market decisions. Institutions that have failed the market test of viability should not be supported by the Fed’s monetary issues, and the Fed’s discount window lending expands banking reserves just as much as open-market operations do.”

Anna J. Schwartz & Walker F. Todd, *Why a Dual Mandate is Wrong for Monetary Policy*, 11:2 INT’L FIN. 167, 171 (2008).

³⁰⁸ Federal Reserve Act, § 10(6).

³⁰⁹ Paraphrasing George Selgin, one financial reporter referred to CARES as an instance in which “Congress [is] using the Fed balance sheet as a ‘slush fund’ to juice the economy without the political consequences.” Jeff Cox, *The Fed’s Main Street Problem: Worries Rise that Money Won’t Go Where It’s Most Needed*, CNBS, Apr. 15, 2020, <https://www.cnbc.com/2020/04/15/feds-main-street-problem-worries-that-money-wont-go-where-its-needed.html>.

³¹⁰ The Fed requires commitment devices due to the so called time-inconsistency problem—the awareness that central banks can always promise something in the short-run (i.e., to pursue low inflation, to stress test banks) to achieved a desired reaction; but could then renege in the longer-term after the intended impact of their statement has been realized. See Goodfriend, *supra* note 150, at 12.

Fed behaves reliably, and with such credibility, can it expect to elicit an economic reaction from its pronouncements about interest rates or the banking system's overall resilience.³¹¹ As such, it is only by sticking to the boundaries of its mandates, and its informally established rules and norms for exercising power,³¹² can the Fed maintain the credibility required for effective policy execution.

B. Activism Falling on a Spectrum

By this point, the Article has described a range of historical, current, and potential forms of activism. It has also considered the various threats to principles of classical republicanism that activism might pose. In view of these cases and their implications for American society, the Article now develops a spectrum of legitimacy along which various forms of activism might fall in view of: (i) how explicit is the Fed's legal authority address a particular *problem*; (ii) how much expertise the Fed has with respect to that problem; (iii) how robust are the mechanisms for holding the Fed accountable for explaining to the public and the legislature points one through three.

Activism is at the far end of the spectrum—high legitimacy—when the Fed evolves policy tools to address a financial crisis. The Fed has clear, multiple, and longstanding authority to stymie financial crisis in its LOLR capacity and with the use of its monetary policy tools. The Fed has over a century of expertise in this regard and a wide-range of nuanced tools that can readily be evolved. There is also a significant amount of built-in accountability where these facilities are concerned. They are statutorily time limited (“unusual and exigent circumstances”) and Congress keeps a watchful eye through regular hearings while the facilities are in use.³¹³ As

³¹¹ Both in issuing forward guidance about interest rates, and releasing public information about stress tests, does the Fed use its word and assurances to the public as a means of influencing the economy.

³¹² The “Taylor rule” may be a good example of this.

³¹³ The CARES Act created a Congressional Oversight Commission to act as a watchdog for the Fed and Treasury's use of appropriations. For the COC hearings and reports see: Cong. Oversight Comm'n, <https://coc.senate.gov/reports> (last visited May 15, 2021); Cong. Oversight Comm'n, Hearings, <https://coc.senate.gov/hearings> (last visited May 15, 2021). Additionally, the Fed Chair appears in front of the House Financial Services Committee & Senate Banking Committee on a quarterly basis to report current state of response. See Bd. of Governors of the Fed. Reserve Sys., Testimony of Fed. Reserve Officials, <https://www.federalreserve.gov/newsevents/testimony.htm> (last visited May 15, 2021). The Fed, furthermore, publishes monthly reports on state of emergency lending facilities

such, the Fed’s use of a new tool (like market-based LOLR facilities) to combat an extreme or novel crisis (like in 2008 and 2020) may be nominally activist but nonetheless acceptable provided the use of those tools is transparent and time-limited to emergency situations.³¹⁴ On the other hand, use of the Fed’s balance sheet to ‘fight’ crises in ways not clearly contemplated by the Federal Reserve Act—and seem more properly the role of fiscal authorities (like lending to small business) is less clearly tolerable from a legitimacy perspective. It may be more difficult for the public (and Congress) to scrutinize the Fed’s decisions when its lending steps outside the financial system.

Policy frameworks also sometimes evolve—when it is activism? Examples fall on two different ends of the spectrum. On the high-legitimacy side are moves to modernize monetary policy taken in reaction to observed changes in the domestic or global economics. This would cover some of Strong’s efforts at price stability in the 1920s, as well as the ostensible reasons for the August 2020 revamp. But on the low-legitimacy side of the spectrum is the use of monetary policy tools to achieve political or social policy objectives. This would be the case were the Fed to use its balance sheet to try to make the financial system greener or to use the employment arm of its mandate to effectuate greater income or gender equality. Championing certain causes or acting as the first institutional mover in structural transformation of the economy is more activism than agility or adaption.

Of course, the cases in the Article are not exhaustive. Other problems and pressures will confront the Fed. But the traits are generalizable: activism arises from popular or political pressure to do more than Congress has instructed and often involves credit allocation (that is not sector neutral) or use of discretion to pursue new objectives that are not set out in the Fed’s

as required under 13(3). See Bd. of Governors of the Fed. Reserve Sys., Reports to Congress Pursuant to Section 13(3) of the Federal Reserve Act in Response to Covid-19, <https://www.federalreserve.gov/publications/reports-to-congress-in-response-to-covid-19.htm> (last visited May 15, 2021).

³¹⁴ See Salib & Skinner, *supra* note 24 at (accepting, even, an executive power of override in times of crisis or emergency); see also Speech, Christopher J. Waller, Governor, Bd. of Governors of the Fed. Reserve Sys., *Treasury-Federal Reserve Cooperation and the Importance of Central Bank Independence*, Mar. 29, 2021 (remarking that “in times of crisis, coordination allows policies to be implemented quickly and forcefully to set the stage for a strong path of recovery. But for this arrangement to work, the political independence of the Federal Reserve is essential—it is the best way for the Federal Reserve to meet its congressional mandate and allow policymakers to meet the longer-term needs of the American people”).

statutes. The overarching lesson to remember is that populism does not mix well with Fed technocracy.³¹⁵

Regardless of where activism falls along this spectrum guardrails are important. Whether activism is ultimately judged as inevitable adaptation or agility or *ultra vires* action (or something in between) may well come down to how well the Fed communicates its new endeavors to the public and to Congress.³¹⁶

C. *Installing Guardrails*

This Section briefly considers how the Fed might distinguish adaption of or flexibility in its existing tools—to address new financial risks or macroeconomic emergency—from activism that poses problems for its legitimacy. It suggests a framework the Fed might use to communicate to the public. Specifically, the framework would invite the Fed to elaborate (and perhaps with opening for public comment) on four questions.

1. *What does the law say regarding the Fed's ability to target a new objective with supervisory, regulatory, or monetary policy tools?*
2. *How will a new policy be operationalized, as a matter of law and policy fact?*
3. *How will the new framework or regime interface with existing Fed law and policy regimes?*
4. *What guardrails are already or will be put in place to prevent legally inappropriate mission creep?*

What follows is a brief explanation of how each prong might be developed into a broader set of tools for the Fed to use in justifying a new policy action as adaption versus activism.

1. *How does the law support the novel form of monetary policy, regulation, or supervision?* The first question to be asking is whether the possible policy target is a problem for the Fed. Inevitably, there will be a range of important social and economic issues that may stand to implicate the real or financial economies; and yet, they may not all be the lawful targets of Fed power. As

³¹⁵ For a general discussion of central bank populism, see POPULISM, ECONOMIC POLICIES AND CENTRAL BANKING (2002).

³¹⁶ The Fed's ability to communicate the significance of its policy moves along a spectrum of adaption should be able to satisfy the requirements of *Chevron* deference. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

argued, establishing a legal basis for policy action is a necessary ingredient for the Fed to legitimately exercise its power.³¹⁷

Within this prong, there are two questions to be answered. The first is what mandate does the Fed have to engage in a new kind of policy activity. How, precisely, and with what concrete and verifiable facts, does the Fed see this new manner of policy intervention as required to fulfil its legal mandates? What kinds of data and evidence could or should the Fed marshal to make an intervention case? Should a new policy intervention implicate the Fed's macroprudential powers (like stress testing, for example), the Fed should similarly be called upon to demonstrate a sufficiently concrete—not speculative—link to a financial stability risk.³¹⁸ Likewise should the intervention bear on monetary policy, what presently manifest link is there to price stability—or how will the intervention impact the Fed's ability to keep prices stable.

The second question within this prong is of a micro-legal nature—one that regards the Fed's reliance on legal terms of art. Statutes such as the Dodd-Frank Act—and the academic literature subsequently interpreting that law and the events around it—spawned a new set of terminology that now occasion policy responses. In particular, terms like “contagion” and “financial stability” risk and “systemic risk” are byproducts of the 2008 global financial crisis and the crisis legislation.³¹⁹ However, while these terms have not been more specifically defined in statute or regulation, they now operate as triggers for regulatory or supervisory scrutiny and the development of new policy regimes.³²⁰ Should these terms be more clearly understood—and cabined to certain facts—if they are to be the basis for expanded Fed interventions?

2. *How will the new policy be implemented?* The second question is a mixed examination of fact and law. Here, the Fed would be called upon to answer how a newly proposed or considered policy regime accomplishes the goals it has set out.

³¹⁷ Given that the legal framework governing the banking sector has become much more complex, the work of the examination staff has become more legally infused and yet the supervisory culture has become increasingly unmoored from the legal framework itself.” Tahyar testimony, *supra* note 176 at 15.

³¹⁸ *Id.* at 17, n.68.

³¹⁹ The phrase “systemic risk” appears 39 times in the Dodd-Frank Act. Pub. L. 111-203, 124 Stat. 1377 (July 21, 2010). Important scholars, theorizing the mechanism of systemic risk, soon coined the phrase “contagion.” See, e.g., Gary B. Gorton, *Some Reflections on the Recent Financial Crisis*, Nat'l Bureau of Econ. Research, Working Paper No. 18397 (Sept. 2012).

³²⁰ See, e.g., Dodd-Frank, § 113 (providing authority for heightened prudential and supervisory requirements for financial institutions that post a threat to the stability of the financial system, e.g., a systemic risk).

a. *Transmission channels.* The big-picture issue for Fed policymakers to grapple with is the nature of the transmission channel from policy to the mitigation of any given risk. One could envision various ways that the Fed might go about analyzing this question. For instance, the Fed could choose to explain how the novel policy fits within existing assessments of banking sector vulnerability which evaluate banks' capital, fire-sale, liquidity, and run vulnerability vis-à-vis a certain kind of risk.³²¹

b. *Design choices.* It would also be beneficial for the private sector and public to know, and have some input into, the design choices involved in the development of a new policy apparatus. There are standard options to be sure. But to the extent other options are considered or suggested, the Fed may also do well to make those details known and invite conversation about feasibility, costs, and benefits.

c. *Informal norms.* In addition to spelling out the basic mechanism of the new approach, the Fed would also need to make plain—to the extent it can anticipate—any soft law or conventions that might influence the application of the regime, around the edges of what is designed. In the realm of supervision, for example, supervisors around the globe dialogue for the purposes of sharing ideas and best practices.³²² This is a healthy and productive process that certainly should continue. Yet, to the extent other central banks can and do influence the Fed, at least some of that should be transparent as it can lead to shifts in policy direction.

d. *Communication strategy.* A question for the Fed to understand internally is how this strategy will be communicated to the public and, in turn, how the public will come to understand that the Fed has been transparent in its decisionmaking process regarding each of the issues laid out above. This kind of framework would assist the Fed in communicating to the public, specifically, by explaining how it comports with current academic and policy conversations about central bank transparency.³²³ Explaining the basis for

³²¹ Blickle et al., *How Has Covid-19 Affected Banking Sector Vulnerability*, LIBERTY ST. ECON., Nov. 16, 2020 <https://libertystreeteconomics.newyorkfed.org/2020/11/how-has-covid-19-affected-banking-system-vulnerability.html>.

³²² See, e.g., Ben S. Bernanke, *Lessons of the Financial Crisis for Bank Supervision*, Speech at the Fed. Reserve Bank of Chicago Conference on Bank Structure and Competition, May 7, 2009, <https://www.federalreserve.gov/newsevents/speech/bernanke20090507a.htm>.

³²³ That literature generally conceptualizes central bank transparency in terms of reasons why the central bank would relinquish some of its privately held information (about the real economy or the credit cycle) in the interest of enhanced welfare. For post-financial crisis burst of interest in communicating financial stability objective, see David M. Arseneau, *Central Bank Communication with a Financial Stability Objective*, Fed. Reserve Bd., Finance & Econ. Discussion Series, 2020-087,

new policy action would thus become an effort in transparency that is used to shore up the accountability of the Fed's decisions. Such rationale—increasing transparency in the interest of accountability—has driven the Fed's decision to publish Financial Stability Reports as well as to increase the amount of public information concerning the models and scenarios behind stress testing.

3. *How does the new policy regime interoperate with other central banking frameworks?* Third, it is important for the public—and the banks—to understand the expected impact on other areas of central bank activity. As the Fed expands its role in our economy, as well its range of policy tools, this question of interoperability becomes increasingly important. Some scholars, for example, have begun to study the interaction between monetary and prudential policy—noting, for instance, the trade-offs between 'lean against the wind' policies and inflation; and between capital and liquidity requirements and inflation targeting.³²⁴ Will a new kind of policy program be a complement, a substitute, or a distraction to other related central bank interventions?

Externally, there are similar questions to be answered. Will the new policy regime implicate the fiscal authority of the Treasury? One can see above how certain kinds of policy actions that seek aims similar to, for instance, credit policy, give rise to Fed-Treasury tensions or uncertainty. As well, it would be critical to understand the extent to which the policy is likely to deter lending to certain kinds of borrowers, thereby impacting bank credit intermediation, and, one step removed, any "pass through" effects of the new regime that could affect other parts of the financial system (i.e., nonbanks) and their ability and appetite to serve as financial intermediaries.³²⁵

<https://www.federalreserve.gov/econres/feds/files/2020087pap.pdf>; Benjamin Born, Michael Ehrmann & Marcel Fratzscher, *Communicating About Macroprudential Supervision—A New Challenge for Central Banks*, 15 INT'L FIN. 79 (2012). For historical literature on monetary policy and communication, see Matthew B. Canzoneri, *Monetary Policy Games and the Role of Private Information*, 75 AM. ECON. REV. 1056 (1985); Alex Cukierman & Allan H. Meltzer, *A Theory of Ambiguity, Credibility, and Inflation Under discretion and Asymmetric Information*, 54 ECONOMETRICA 1099 (1986); Petra M. Geraats, *Central Bank Transparency*, 112 ECON. J. F532 (2002).

³²⁴ Bussière et al., *The Interaction Between Macroprudential Policy and Monetary Policy: Overview*, Staff Working Paper No. 886, Bank of England (Oct. 2020), <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2020/the-interaction-between-macroprudential-policy-and-monetary-policy-overview.pdf?la=en&hash=BoECD6DFD19C04651ED6074151A2357E7D19D770>

³²⁵ See Nina Boyarchenko et al., *How Has Post-Crisis Banking Regulation Affected Hedge Funds and Prime Brokers*, FED. RESERVE BANK OF NEW YORK, LIBERTY ST. ECON., Oct. 19, 2020,

Here, the overarching question is one of proportionality—this framework asks the Fed to consider whether its novel policy regime is proportional to the risk at issue.

4. *What are the checks against overreach and mission creep?* To be sure, the Fed—like all central banks—will be called upon at certain intervals to modernize its approach and understanding of new financial risks.³²⁶ But critical to the public's acceptance of a modernizing central bank is its ability to demonstrate the checks in place. What and how will the supervisor be supervised, the regulator regulated? Many of the guardrails that could be offered up likely exist already; but clearly explaining them to the public and to banks will make them more robust—and, if need be, the process will expose any shortfall in protections against inappropriate aggrandizement of power. As a start, this framework would press the Fed to consider matters of due process and public participation: is there a means for the public and regulated parties to disagree with the Fed about its assessment of "safety and soundness" or "systemic risk" in connection with a newly identified threat? What voices have been included? Second and related, where does the Fed gather its data, develop its models for risk-assessment and transmission, and has the process been inclusive of the private sector parties that will be impacted by those analyses? Finally, what rights are there for the affected parties—the financial institutions—to appeal the accuracy of the application of any new policy regime?³²⁷

D. *What role for Congress?*

In the end, perhaps we cannot place too much blame with the Fed for being activist. Today, the Fed faces constant pressure from politicians, people, and the press. As in the case with all agencies, actors within the institution have rational incentives to increase—or at least retain—their power and remain relevant.³²⁸ Thus, against a backdrop of broadly worded mandates to pursue "price stability," "financial stability," and "safety and

<https://libertystreeteconomics.newyorkfed.org/2020/10/how-has-post-crisis-banking-regulation-affected-hedge-funds-and-prime-brokers.html>.

³²⁶ See, e.g. JAMES, *supra* note 6; Conti-Brown & Wishnick, *supra* note 13.

³²⁷ Traditionally, there has been little—if any—judicial review of the Fed's actions, and most assuredly not its monetary policy actions.

³²⁸ There is a substantial literature on public choice theory, which essentially lays out incentives for those in positions of regulatory power to retain or enlarge power by finding ever-new things to regulate. See generally JERRY L. MASHAW, GREED, CHAOS, & GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW (1999); RANDY T. SIMMONS, BEYOND POLITICS (1994).

soundness,” is it any wonder that the architects and leaders of America’s central banks can succumb to activism?

Inasmuch as Congress seeks to hold the Fed accountable, it may also be partially at fault. This final Section briefly proposes ways that Congress could act to reduce opportunity for activism or stipulate conditions under which activism might be acceptable—but render it containable. These ideas, curating suggestions made by other scholars that study power in the administrative state, cannot be fully developed here. Rather, they are offered to give a sense of where responsibility for activism fully lies and, of course, to plant the seeds for future research on the role of the Fed in contemporary U.S. society.

First, and most fundamentally, Congress would do well to ‘clean up’ the Federal Reserve Act.³²⁹ Since the first founding of the Fed in 1913, Congress has, to be sure, revised this constitutive document a handful of times—yet each of these revisions was ad hoc and reacting to a particular political-economy and (naturally) interest groups.³³⁰ (As this Article has identified, activism seems to blossom at fifty-year intervals. As such, a review of these statutes every thirty-years might be a rough and ready guide to follow.)³³¹

Second, Congress may also wish to acknowledge statutorily that sometimes activism will be inevitable. In particular, times of national crisis are most conducive to such behavior. This is understandable. Central banks’

³²⁹ On this score, the judiciary also has a part to play in scrutinizing the breadth of delegations. See Lastra & Goodhart, *supra* note 288 at 62-65, calling for greater judicial review of central bank decisions); see also *Gundy v. United States*, 695 Fed. Appx. 639 (2019) (Gorsuch, J., dissenting) (urging that “the framers understood, too, that it would frustrate the system of government ordained by the Constitution if Congress could merely announce vague aspirations and then assign others the responsibility of adopting legislation to realize its goals”). As one former Fed official noted in 1993, “the Fed does not now have, and it never has had, a clear congressional mandate to stabilize the price level. Consequently, the Fed’s success in stabilizing the price level in at least some periods of its history has been and continues to be a function largely of: 1) prevailing general economic conditions 2) the strength of the Federal Reserve’s leaders 3) old fashioned luck.” Broaddus, Jr., *supra* note _.

³³⁰ Going even further than periodic review, Paul Tucker would have legislatures fundamentally re-evaluate the purpose and role of central banks: “Advanced economies need a money-credit constitution—one that makes clear what central banks are for, and recognizes our broader constitutionalist values.” Tucker, *supra* note 2. It should be noted that Roberta Romano has elsewhere suggested sunset provisions in crisis legislation for political economy reasons. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1595 (2005).

³³¹ Paul Tucker would not, however, favor this manner of ex post control if it were exercised at too regular an interval. As he explains, doing so would undermine the “purpose of [independent agency] regimes being for the legislature to tie society to its desire mast.” TUCKER, *supra* note 22, at 125.

original purpose was to stymie economic crisis; their tools are designed to fight such wars. In these moments, where national exigencies arise, we must assume that the Fed's political independence will cede to the government's requirements at hand—be that supporting the Treasury's emergency economic policy or rescuing American small business.³³²

Congress can legislate for these realities, blunting the impact of these periods of activism on the Fed's legitimacy and its independence. There are two legislative measures in particular that could operationalize this notion. For one, the Fed could possibly benefit from a formalized power of Executive "override," where, as in the United Kingdom, the Treasury gains a formal power to direct the monetary policy operations of the Fed (or generally) during periods of crisis.³³³ Provided these overrides were "transparent, subject to legislative scrutiny, constrained by clear criteria, and in practice rare,"³³⁴ they could obviate the appearance of and concerns with activism. A second idea, proposed by David Zaring, is to legislatively convert what are today ad hoc facilities (like, the "Term Asset Lending Facility," "TALF") into permanent Fed facilities, triggered upon certain kinds of pre-defined events and perhaps a Presidential proclamation.³³⁵ Notably, each gives the Executive branch more power over the Fed in times of crisis, but does so within a clearly established legal framework that the public and legislature can scrutinize and debate.

CONCLUSION

As this Article has shown, central bank activism is an age-old problem with some hallmark characteristics. Activism is enabled by broadly worded legal mandates. And activism is reactive—arising in moments of broad political and popular pressure on the Fed to solve new categories of problems with its existing (too narrow) tools. Consequentially, activism impacts our democratic structure, blurring lines of authority between the Fed, the Congress, and Executive. By thus upsetting traditional separation—and balance—of power between and among these branches, activism may be expedient, but carries long-term social costs. This Article ultimately points to Congress as the original source of Fed activism, and the most viable solution.

³³² See Waller, *supra* note 268.

³³³ See Skinner & Salib, *supra* note 24 at 977-78.

³³⁴ TUCKER, *supra* note 22, at 125.

³³⁵ Professor David Zaring has proposed Congress should legislatively convert what are today ad hoc facilities (like, the "Term Asset Lending Facility," "TALF") into permanent Fed facilities, triggered upon certain kinds of pre-defined events and perhaps a Presidential proclamation. See Zaring, *supra* note 88, at 6.

Only when Congress speaks clearly and deliberately, can society properly debate its ideal role for the Fed in America today and over time.