The Federal Reserve and the Management of Capitalism

A Discussion of Lawrence R. Jacobs and Desmond King's *Fed Power: How Finance Wins*

Fed Power: How Finance Wins. By Lawrence R. Jacobs and Desmond King. New York: Oxford University Press, 2016. 252p. $24.95.

In the wake of the 2008 financial crisis, political scientists have been paying more careful attention to the role of banking institutions as economic but also political institutions whose financial decisions involve the exercise of power and shape the conditions under which governmental decisions are made. Because the United States is still the world's preeminent global economic power, the U.S. Federal Reserve looms particularly large in efforts to understand the financial roots of contemporary politics. Lawrence R. Jacobs and Desmond King's *Fed Power: How Finance Wins* (Oxford University Press, 2016) is a major effort to analyze these questions, and so we have invited a cast of prominent political scientists to comment on the book as an account of "how finance wins."

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Lawrence Jacobs and Desmond King are to be congratulated for writing a work of political science that is addressed to citizens as well as to other scholars and experts. The style is engaging and their analysis of the mission creep of the US Federal Reserve, and of American financial power, is a call to action for all those concerned with democratic process. The call is refreshingly unusual in a field largely focused on reaching truths that can be tested by the laws of science rather than truths that are revealed through *n* of one analyses of what works and what fails in the messy world of politics. We are returned to classical political economy analysis and urged to move beyond liberal political science's fascination with interests and institutions to analyse what such accounts obscure—the knowledge, finance, security and production structures of the global political economy that shape outcomes in all states (see Strange 1988).

From a feminist political economy perspective, the language of the book is familiar: breaking the silence and revealing the hidden power of the Fed, the attention to "its all about relationships" (p. 47) and "non-events" in American politics. In a nutshell, Jacobs and King argue that the Federal Reserve is responsible for bringing about a "second gilded age" with income and wealth inequality in the United States akin to the early twentieth century and the era of robber barons. For Jacobs and King, the Fed is, above all, a political institution "captured" by the finance mindset, even as it poses as non-partisan and above politics. Effectively, they assert that "Fed power" and its reliance on private capital markets and "unelected technocracy" has functioned politically to shore up the interests of rich investors over small businesses, mortgagees, and workers. It has done this by bailing out the troubled assets of selected finance companies, by engaging in "quantitative easing" as a form of fiscal stimulus that privileges finance, and via long-standing regulatory inaction with respect to banking and non-banking entities.

Fed Power's core argument is cogent and the authors would likely agree that Marx's analysis of capitalism was correct. In answering the question, "why do policies consistently favour finance?" they explain, this is due to "the hard-wiring of the structures of our economy and society in a global system of private markets and asset ownership" (p. 48). However, the authors eschew theory (and certainly they are wary of the potential co-optation of both economics and political science disciplines by powerful institutions like the Federal Reserve, which both funds and publishes academic research). In turning from explicit

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theory, they become unreflexive about the standpoint of their analysis and the implicit theories of politics submerged in their analysis of the Fed. As a result, their proposed solutions fall far short of the problems, remaining within the parameters of (unlikely) pluralist, national reform.

For instance, the distributional effects of Fed power are hardly disaggregated and measures to address them are not fleshed out. At one point it is mentioned that the Global Financial Crisis (GFC) has increased the wealth inequality between white and black households from a tenfold to a thirteen-fold gap (p. 9). At another point, we learn that it's all about the "white guys with cash" (p. 47). But this is the extent of the analysis and there is a tendency to slip into abstract euphemisms such as "the average worker." Yet it is crucial to know precisely who are the winners and who are the losers of Fed power to understand the social relations generating instability and crisis, and from which a movement for a Federal Reserve that better serves the public interest might be forged.

In *Scandalous Economics: The Politics of Gender and Financial Crises* (Hozic and True eds. 2016) we focus not merely on who benefits and who loses from the GFC and by association, from Fed power, but also "who defines and narrates the crises" and "who is *becoming* through the crisis," which is ongoing (p. 13). Who is becoming is revealed by the paradox in *Fed Power:* that an institution whose negligence has been found to be one of the key factors in the GFC used the crisis as an opportunity to significantly expand its power well beyond its original mandate of lender of last resort. This growth in Fed power is scandalously obscured in the details of recovery programs and by economic jargon ("quantitative easing" as a case in point). But it is also masked by Jacobs and King's narrative of *Fed Power* which overlooks the submerged story of the female whistle-blowers and regulators, many of them with law backgrounds, and the male financiers, most of them with finance/economics backgrounds. As a result, the book misses the opportunity to interrogate the professional socialisation and gender norms that support "group think" and unchecked financial power and knowledge. All women mentioned in the book are either insider, political, or scholarly critics of the Federal Reserve's exceptional governance: Think Sheila Bair, Elizabeth Warren, Carmen Segarra, Gillian Tett . . . and even Janet Yellen, mentioned solely for her concern for, though limited power to address, inequality. There is something to be studied here with respect to the relationship between knowledge, financial power, and gender.

This is important because, after the GFC, one of the major institutional responses of banks and firms in light of perceptions of excess risk and moral failure has been to increase the gender diversity of their governance boards. Women are called on to "clean-up" and to provide ethical leadership. Some research indicates that finance corporations with a better gender balance on their boards recovered more rapidly after the GFC. However, with a critical lens we can see that such measures to address the *legitimacy* of finance institutions, a major concern for Jacobs and King, are unlikely to remove the systematic bias toward the already wealthy and powerful (disproportionately white and male persons) embedded in the formal and informal institutions of global finance.

The GFC has created an opportunity for contesting the normal, masculine ways of governing the (global) economy. But that opportunity has largely been concealed by populist scandals and the diversion of our attention to blameworthy individuals, corporations and institutions, such as the Fed, and away from the globalized structures and processes of political economy. Jacobs and King's analysis may replicate this same problem. Blaming the Fed, it lacks an account of the transnational power of finance in relation to equally transnational security, knowledge and production structures. Power within all these structures is mobilized by gender, race and class-specific subjectivities that are constituted without regard to national citizenship and have an impact well beyond the boundaries of American politics and democracy. Attention to these subjectivities and forms of agency is therefore an important corrective and complement to the project of *Fed Power*. Such a project has never been more important for American political science – now that a poster boy for capitalist excess is in the White House and an ex-Goldman Sachs banker, dubbed a "foreclosure king" for buying up distressed mortgages and evicting thousands of homeowners after the GFC, heads the US Treasury.

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Crises seem to fall outside the purview of our understanding of how things work. They appear as exceptions and black swans; they require quick action and unprecedented responses that throw overboard careful planning and democratic procedure. Not understandable as a regular phenomenon, the global financial crisis, when it broke, similarly was treated as a singular occurrence, unique in its enormity. Yet plenty of writers have sought to make sense of the crisis in its aftermath. They have explained it as an unintended outcome of the complexity of financial instruments, as a result of masculine greed and animal spirits getting the better of reasonable conduct, and as a perhaps not so exceptional event emerging from the contradictions of internationalized finance capitalism. *Fed Power* injects into these efforts a distinctive interpretation, one that draws on core concepts of Political Science, and in particular the concept of power. It does so in a hard-hitting and colloquial style that makes for great reading, offering a new understanding of the crisis as linked to normal, humdrum politics.

The star villain of the book is the Federal Reserve Bank of the United States. The Fed was the main player in the rescue of the financial industry after the collapse of Lehman Brothers. But unlike Congressional actions such as the Troubled Assets Relief Programme (TARP), its interventions have garnered little critique. Instead, the Fed has emerged as a heroic, technical entity that rescued the economy in the face of looming disaster. Jacobs and King destroy this understanding of the Fed as a neutral agency transcending politics. While it may be true that the Fed was able to act quickly in the face of crisis in a way that Congress could not have, the authors show that its interventions were profoundly biased, favoring those with disproportionate wealth and income and deepening further existing inequalities. They take the Fed to task for the preferential treatment of finance and the rich after the crisis while throwing homeowners and holders of consumer credit to the dogs. But more so, they hold the Fed responsible for creating the crisis.

The core of Jacobs and King's argument is based on institutionalism. The Fed has acquired its strength and autonomy as a result of historical decisions that have put it on the path to become the behemoth it is today, accountable to nobody. Designed as a supposedly-neutral arbiter to overcome the raucous, populist clashes over monetary policy in the late nineteenth century, the private sector played a key role in its founding. From the beginning, the legislation setting up the Fed institutionalized the inclusion of private banks in making decisions about monetary policy; and indeed, they participate to this day in the Fed's Open Market Committee. After the Great Depression the Fed was given emergency powers to intervene as it deems appropriate "in unusual and exigent circumstances" (p. 30), powers it used for the first time in 2008–2009.

A second strand of argument identifies the way in which the rules by which the Fed operates function to exercise power. Jacobs and King call it "the Fed's favoritism." They identify in particular three practices: the revolving door between Wall Street and the Fed; its capture by lobbyists and by shared mindsets ("cultural capture"); and the Fed's interest in the success of Wall Street deriving from the fact that it generates income from investing there to cover its expenses. The Fed thus emerges as a deeply-biased institution, which affects its policies and its conduct as it puts out the fires of a crisis.

All this, Jacobs and King tell us, works only through a process of what Hoziç and True have called "scandalous obfuscations" (*Scandalous Economics: Gender and the Politics of Financial Crises*, 2016): the concealment of advantage, complicit silences that suffocate scrutiny (such as withholding information from Congress as it discussed the Dodd-Frank reforms), and the cooptation of researchers who benefit from their association with the Fed. As a result, the Fed today suffers from a profound problem of legitimacy. Moreover, having had its wings clipped through the Dodd-Frank act, it has lost its capacity for decisive intervention in the next crisis, which the authors already see on the horizon. Their vision for reform is inspired by the Canadian model, which divides responsibilities for managing the money supply and regulating the financial sector between the Bank of Canada and the Office of the Superintendent of Financial Institutions (OSFI). The results have been much stricter financial regulations, a crisis much less severe, and the continued trust of Canadians in their financial regulators.

Rather than seeing the Fed as the solution to financial instability and periodic crises, the authors thus identify it as the problem. In doing so, they demonstrate that crises are not outside comprehension. Rather, crises are part of a normal politics produced by the biases of institutions; and indeed they may aggravate such a biases in the name of providing technical solutions.

The book makes visible the ugly extremes of these solutions, lifting obfuscations, and recalling key moments that enabled institutional pathways. It provides persuasive evidence of the Fed as at once deeply influential and profoundly biased in complex ways. And yet the insistent pointing at one culprit makes one wish for a little more modesty in the claims made. Can the responsibility for the crisis and its scandalous solutions really be laid on the

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doorsteps of just one rogue institution? What may not get enough attention in this explanation is, on the one hand, the force of ideology, the power of a hegemonic form of hawkish expertise founded in an orthodox economics that agrees on "the fundamentals." On the other hand, the focus on institutions may underestimate the imbalance of power in society, the predominance of finance capital in its masculinist and classist dimensions not just in the Fed State but in the American polity more broadly.

Nevertheless, Jacobs and King do a huge service by making visible the pernicious aspects of a particular form of technocratic governance, i.e., Fed power. And in so doing, they help us think about crises in a new way, as an outcome of institutional processes—perhaps not intended, but certainly also not unmoored from familiar, everyday power politics.

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A study by two prominent political scientists of the Federal Reserve's position of power in the American state is much to be welcomed. As they note, not only the APSA's 2005 report on *Inequality and American Democracy* (co-edited by one of the authors here), but even some of the most celebrated recent studies of the "American government's lopsided favoritism of business and the superrich" (p. 34), have neglected the Fed's role in this. Arguing that the Fed's "administrative resources, independence, and mission were constructed and reshaped in reaction to financial crises, institutional self-interest to exploit opportunities for reinvention, pressures from well-connected banks and investors, and the shifting circumstances of the global economy" (p. 54), Jacobs and King contend that the Fed's ever-more direct public interventions "became increasingly incongruous by the twenty-first century with its claims to independence and serving the public good, as opposed to serving Wall Street" (p. 89).

The book's historical analysis along these dimensions is rather more informative for the early Fed, before it was a major player either domestically or internationally, than it is for the crucial decades after World War II, or even for the period marking the Fed's ascendancy after the 1979 Volcker shock. While priding themselves on paying particular attention to the Fed's development of "national and international administrative and monetary capacity" (p. 192), the polemical style of much of the argument renders the actual coverage of this rather thin in comparison with many other critical studies. To be fair, the book's main concern is with the 2008 financial crisis and its aftermath. While Jacobs and King go out of their way to distance themselves from those "peddlers of goblins" (pp. 26–7) calling for the Fed's abolition, the tone of their criticism is often equally harsh, from excoriating the Fed for its "cluelessness" in ignoring the warning signs before 2008 (p. 13) to calling the Fed's "insulated decision-making" on quantitative easing afterwards nothing less than "diabolical" (p. 36).

In fact, it might be said that with the public transcripts of the monthly meetings of its Open Market Committee, the Fed is less secretive about differences among senior policy makers than any government department. Nor it is ever really clear why the Fed is especially singled out for blame, since it always acts in very close concert with the Treasury. The strong denunciation of the Fed here for having usurped the right to make fiscal policy through the practice of quantitative easing is rendered moot by the Treasury's active encouragement of this, and Fed's own lamentations about having to offset congessionally-imposed fiscal restraint.

Indeed, the very close collaboration of the Treasury and the Fed since the latter was created in 1913—crucially reinforced by their 1951 "Accord" and their mutually-supportive roles ever since in the making and reproduction of financialized capitalism—calls for a broader theory of the state, which would need to encompass but also go beyond the specific institutional make-up of the Fed itself. Jacobs and King also have little to offer on the political economy of financialized capitalism, treating finance merely as a self-serving interest group and retreading conventional nostrums on it undermining manufacturing, while ignoring how far industrial corporations rely on Wall Street's financial services.

Despite often quoting many inflation-obsessed monetary hawks to sustain their criticisms, Jacobs and King themselves endorse the substance of the Fed's quantitative easing, without which the effects of the crisis would have been much worse. In fact, given the very radical tone of their critique, the modesty of their "agenda for reform" is remarkable. They mainly want to restore the legitimacy of the Fed by distancing it from the direct influence of bankers which "fuels hostility across the ideological spectrum" (p. 183). Neither Bernie Sanders' call for breaking up the banks too big to fail, nor Neel Kashiri's even more radical proposal, as the president of the Minnesota Fed, for turning the large banks into public utilities, rate a mention. Jacobs and King's call for "a broader set of informed perspectives on the Fed's Board of Governors" and for the appointment of the head of the New York Fed from the White House seem particularly weak in light of their very harsh judgements of the Fed Reserve Chairs that heretofore had been appointed by successive presidents.

Rather than subjecting the Fed to more Congressional and judicial oversight, or dispersing authority across disparate agencies as Dodd-Frank tends to do, the agenda for reform here centers around calling for a new consolidated regulatory authority that would allow for "some degree of prudent independence for central bank decisions" (p. 185). Having at the outset invoked the constitutional wisdom of "inviting separate branches of government to obstruct, delay and block each other" as the basis for showing "how the Fed slipped Madison's net accountability" (p. 11), the end of the book suddenly embraces Woodrow Wilson's view that the system of checks and balances is "the most radical defect in our federal system" since it "fritters away useful powers . . . of marshalling authority and capacity for public purposes" (pp. 184–5).

Their model here is Canada, which is repeatedly praised for not having had to bail out its banks, even

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though it is admitted in a note at the end that "Canadian banks benefited from liquidity supplied by their government as well as some US support after 2008" (p. 236). For a book that claims to be above all concerned with bankers' power, this admiration for my country is especially bewildering, given the overwhelming economic and political dominance of just five massive banks with intimate relations with the Bank of Canada from 1935 until today. The European Central Bank is also contrasted favourably with the Fed, despite its imposition of the most drastic austerity on democratically-elected governments. The ECB's allegedly greater transparency than the Fed in terms of naming the banks from which it has purchased bonds is stressed, yet its complicity in hiding the massive liquidity the Fed directly provided, as the effective world central bank, to European banks in 2007 and 2008 is ignored, as is the extent to which the Fed's quantitative-easing policies afterwards ensured that European banks would continue to obtain overnight loans from Wall Street. A classic case of missing the forest for the trees.

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Fred Block

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The publication of *Fed Power: How Finance Wins* represents an important step forward for the social sciences. Up until quite recently, the Federal Reserve Board existed in a nether world that was rarely visited by scholars. To be sure, economists often discuss whether Fed decisions to loosen or tighten monetary policy were appropriate, but they have largely ignored studying the Fed as an institution. In fact, that task has been left almost entirely to dissident journalists such as William Greider, author of the classic book, *Secrets of the Temple*.[1] So it is an important event that two accomplished political scientists, Lawrence Jacobs and Desmond King, have teamed up to produce this analysis of the Federal Reserve.

There is much that is valuable in this study. From the start, Jacobs and King make clear that the United States needs a central bank and that the libertarian project pushed by Ron Paul and others to abolish the Fed and return to the gold standard is a reactionary fantasy. Jacobs and King favor reforming the Fed so that it would be more accountable to the public and less oriented to enhancing the profits of giant banks and other Wall Street interests. For them, the policies that the Fed pursued in the months after the collapse of Lehman Brothers in fall 2008 are the key indicators of the Fed's improper priorities. On the one side, the Fed made staggeringly large lines of credit available to major financial institutions in the United states and abroad at extremely favorable interest rates. On the other side, the Fed made no effort—either direct or indirect—to help the millions of homeowners who were left with negative equity in their homes as housing prices fell. This policy choice was both morally and economically disastrous because the epidemic of foreclosures from 2009 to 2014 made it much more difficult for the U.S. economy to recover from the deep recession triggered by the Wall Street collapse.[2]

While Jacobs and King deserve enormous credit for what should be a pioneering study that stimulates a major new research focus for political scientists, sociologists, historians, and economists, there are elements of their approach that are problematic. First, their primary metaphor for understanding the Fed is that of a bureaucratic behemoth that has steadily increased its autonomy and scope of action since at least the 1930s. The problem is that this analysis conflates two separate issues. The first is the idea that the Fed is just too big and too powerful, which is an argument that echoes, for example, right-wing critiques of the Internal Revenue Service. The second is the idea that the Fed uses its autonomy for the wrong purpose, which is to protect giant financial institutions rather than the public. Would they be complaining about the excessive power of the Fed had it used its authority from 2000 onward to halt the financial bubble that drove real estate prices and mortgage lending through the roof?

A closely-related problem is that the "bureaucracy gone wild" view of the Fed ends up obscuring the dynamics of financialization from Reagan onward that resulted in a handful of highly-leveraged financial institutions that were both too big to manage and too big to fail. The Fed alone does not bear responsibility for this outcome; multiple government agencies worked to encourage consolidation and concentration in the financial industry. There was a consensus in both Republican and Democratic administrations that this consolidation was desirable as a way to meet the competitive threat posed by European and Japanese banks.[3]

Moreover, this effort was tightly linked to the broader strategy of U.S. policymakers in shaping the global economy. As Greta Krippner has shown, U.S. officials discovered in the early 1980s that even if the United States ran huge current account deficits, other nations would lend the necessary funds to cover the shortfall.[4] So the United States simply gave up trying to limit the size of its balance of payments deficit. This policy put Wall Street firms in the catbird seat since foreign governments now had little choice but to transact with them to purchase hundreds of billions of dollar-denominated securities each year. Over twenty-five years, the enormous profits generated by these transactions accelerated the process of financialization. And as we know, this culminated in the Global Financial Crisis since financial institutions across the world purchased billions of dollars of collateralized mortgage obligations that were suddenly worth only a fraction of their purchase price.

Their neglect of this global dimension is a particular problem because their key example of an effective central bank is Canada's. It is certainly true that Canada weathered the global financial crisis far better than most other developed nations, but Canada is very different than the United States. It is not a major global power and its financial sector is small and it is organized around a handful of major banks. The project of creating an effective and democratically-responsive central bank for the United States is far more complicated than simply imitating our Northern neighbors.

Nevertheless, *Fed Power* deserves a broad readership. It is written in a lively and engaging style and it opens up the debate we need to have over a deeper restructuring of our financial system than what was achieved in the Dodd-Frank legislation. As they suggest, the

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fundamental question is whether the financial system and the Federal Reserve work for all of us or are simply instruments to continue expanding the wealth of the 1 percent.

Notes

1 Greider 1987.
2 Gemici 2016.
3 Christophers 2013.
4 Krippner 2011.

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