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Picking the next Fed chair: Debate degenerates into a personality contest

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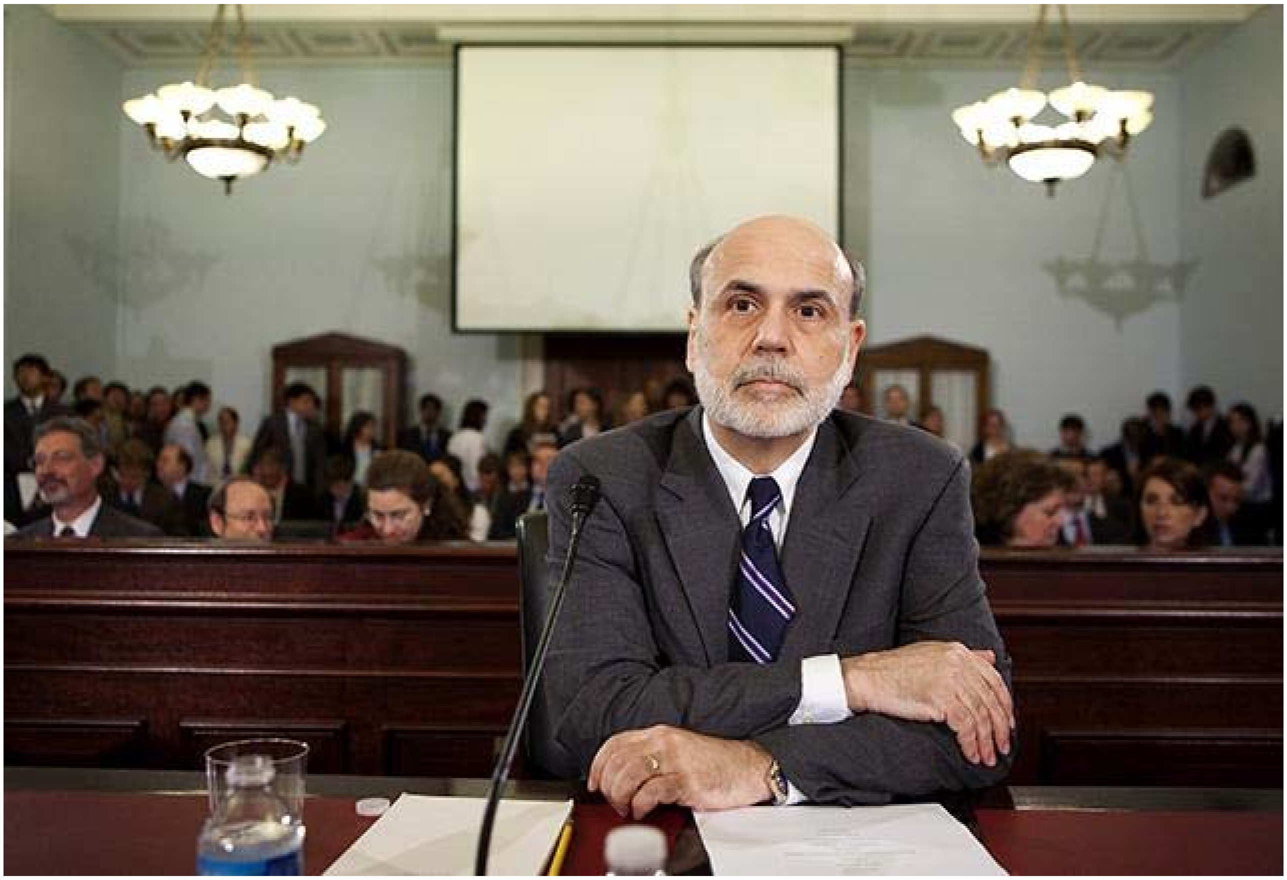
Picking the next Fed chair: Debate degenerates into a personality contest

By Louis D. Johnston | 08/07/13



Ben

REUTERS/Joshua Roberts

The top contenders to lead the Fed after Ben Bernanke, above, are Lawrence Summers and Janet Yellen.

Bernanke's term as chairman of the Board of Governors of the Federal Reserve expires Jan. 31, 2014. President Obama will name a new chair sometime this fall and much speculation is swirling around potential nominees. Unfortunately, press coverage degenerated over the past two months into a personality contest instead of a useful discussion of what the Fed does, where it is going, and what type of person is best suited to lead it.

The Federal Reserve's most important job is to make monetary policy for the United States. The meaning of "monetary policy" has changed over time but today it primarily means setting the level of short-term, nominal interest rates in order to promote low inflation and stable employment. (See my earlier piece for a discussion of the Fed's structure and how it's actions affect interest rates.)

In addition to monetary policy, the Fed is deeply involved in regulating banks, in particular, and policing financial markets more generally. (See this link for specifics.) For instance, starting in the summer of 2007, the Fed worked with the Treasury Department to shore up and, in some cases, promote mergers among investment banks and commercial banks. During September 2008 financial crisis, the Federal Reserve aided money market mutual funds by temporarily guaranteeing their deposits just like the Federal Deposit Insurance Corporation (FDIC) insures commercial bank deposits.

Is this what the Fed should be doing? Should the Fed focus on monetary policy and leave regulation to other agencies? Should regulatory functions be more concentrated at the Fed and other regulatory bodies closed? The appointment of a new Fed chair is an opportunity for the press, Congress and the public at large to ask these questions.

Leading candidates

The top contenders to lead the Fed are Lawrence Summers and Janet Yellen. They have had remarkably similar careers: Both are economists who earned doctorates from Ivy League schools (Summers at Harvard, Yellen at Yale), became professors in top-ranked economics programs (Summers at MIT and Harvard, Yellen at Harvard and the University of California, Berkeley), and were economic policymakers in the Clinton administration (Summers as treasury secretary, Yellen as chair of the Council of Economic Advisors). Since the early 2000s their paths have diverged; Summers served as president of Harvard University from 2001 to 2006 and director of the National Economic Council and assistant to the president for economic policy under Obama, while Yellen served as president of the Federal Reserve Bank of San Francisco from 2004 to 2010 and is currently vice chair at the Fed.

Besides having comparable career arcs, Summers and Yellen have very similar views about the role of monetary policy in stabilizing the economy. Specifically, they believe that central bankers should have wide latitude in carrying out monetary policy and that they should not be bound by rules that tie their decisions about interest rates to specific targets regarding inflation or unemployment.

This view contrasts with those who advocate a rule-based approach to monetary policy. For example, John Taylor of Stanford University developed a rule the Fed should follow when setting short-term interest rates; he based the rule on what he observed the Fed actually doing from the mid-1980s onward under Alan Greenspan. Taylor argues that one reason the most recent recession was so long and deep was because the Fed strayed from this rule under Greenspan (starting in 2002) and then Bernanke, and that either Summers or Yellen would continue this type of policy.

‘Sex, Money and Gravitas’

We've not had much discussion of rule-based policy versus discretionary policy nor very much exploration of the role the Fed should play in regulating and monitoring the financial system. Instead, the selection of a Fed chair has degenerated into a debate over "Sex, Money and Gravitas," as Paul Krugman put it in a recent column.

This is unfortunate. The Fed faces many challenges in moving away from its current low-interest-rate policy and implementing the new responsibilities it was given under the Dodd-Frank financial regulations.

One way to bring the conversation back to these tasks would be to consider candidates other than Summers and Yellen. My suggestion is to consider Charles Evans, the president of the Federal Reserve Bank of Chicago. Evans was the intellectual leader of the Fed's current policy of keeping interest rates low until unemployment falls below 6.5 percent and would be an ideal person to implement the move away from low interest rates. As a regional Fed president, Evans has experience working directly with financial institutions on a regular basis and thus is a better position than either Summers or Yellen to tackle the Fed's regulatory responsibilities.

We need to have a clear discussion of what the Fed should do in the coming months and years, not a personality contest about the chair. Considering other candidates is a good way to do it.

ABOUT THE AUTHOR:

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Louis Johnston writes Macro, Micro, Minnesota for MinnPost, reporting on economic developments in the news and what those developments mean to Minnesota. He is Joseph P. Farry professor in the Eugene J. McCarthy Center for Public Policy and Civic Engagement at Saint John's University. He is also a professor of economics at the university.