This book examines how the president and the Senate influence monetary policy by appointing Federal Reserve members. The book answers three questions about the appointment process and its effects. First, do politicians influence monetary policy through Federal Reserve appointments? Second, who influences the process—the president alone or both the president and the Senate? Third, what explains the structure of the Federal Reserve appointment process?

The analysis shows the conditions under which the president alone, both the president and the Senate, or neither may influence monetary policy with Federal Reserve appointments. The structure of the process reflects historical political battles between the Democrats and Republicans regarding the centralization of authority to set monetary policy within the Federal Reserve System.

The study extends the analysis to the European Central Bank and shows that the Federal Reserve process is more representative of society than the European Central Bank process.

Kelly H. Chang is currently the Chief Currency and Political Strategist at UBS Private Banking. Prior to her current position, she was an Assistant Professor of Political Science and Public Affairs at the University of Wisconsin-Madison and a Robert Wood Johnson Scholar in Health Policy at the University of Michigan. While holding a National Science Foundation Graduate Research Fellowship, she received a Ph.D. and M.A. in political science and M.A. in economics from Stanford University. She has written and published a number of articles on political economy centering around central banks and political appointments.
POLITICAL ECONOMY OF INSTITUTIONS AND DECISIONS

Series Editors
Randall Calvert, Washington University, St. Louis
Thrainn Eggertsson, Max Planck Institute, Germany, and University of Iceland

Founding Editors
James E. Alt, Harvard University
Douglass C. North, Washington University, St. Louis

Other Books in the Series
Alberto Alesina and Howard Rosenthal, Partisan Politics, Divided Government, and the Economy
Lee J. Alston, Thrainn Eggertsson, and Douglass C. North, eds., Empirical Studies in Institutional Change
James E. Alt and Kenneth Shepsle, eds., Perspectives on Positive Political Economy
Jeffrey S. Banks and Eric A. Hanushek, eds., Modern Political Economy: Old Topics, New Directions
Yoram Barzel, Economic Analysis of Property Rights, 2nd edition
Robert Bates, Beyond the Miracle of the Market: The Political Economy of Agrarian Development in Kenya
Peter Cowhey and Mathew McCubbins, eds., Structure and Policy in Japan and the United States
Gary W. Cox, Making Votes Count: Strategic Coordination in the World’s Electoral System
Jean Ensminger, Making a Market: The Institutional Transformation of an African Society
Clark C. Gibson, Politics and Poachers: The Political Economy of Wildlife Policy in Africa

Continued on page following index
APPOINTING CENTRAL BANKERS

The Politics of Monetary Policy in the United States and the European Monetary Union

KELLY H. CHANG
## Contents

### List of Figures
- \[\text{page} \, \text{x}\]

### List of Tables
- \[\text{xi}\]

### Acknowledgments
- \[\text{xiii}\]

1. Introduction
   - 1.1 The Book’s Main Questions \[\text{1}\]
   - 1.2 Question 1: Do Politicians Influence Monetary Policy through Appointments? \[\text{3}\]
   - 1.3 Question 2: Who Influences Appointments? \[\text{4}\]
   - 1.4 Question 3: What Explains the Structure of Federal Reserve Appointments? \[\text{10}\]
   - 1.5 Implications \[\text{14}\]
   - 1.6 The Plan of the Book \[\text{17}\]
2. A Formal Model of the Appointment Process
   - 2.1 An Informal Description of the Appointment Process \[\text{20}\]
   - 2.2 The Appointment Process Model \[\text{21}\]
     - 2.2.1 Assumptions and Definitions \[\text{21}\]
     - 2.2.2 The Sequence \[\text{25}\]
     - 2.2.3 An Example \[\text{26}\]
     - 2.2.4 Possible Outcomes \[\text{27}\]
     - 2.2.5 Actual Outcomes: Adding the President and the Senate \[\text{31}\]
   - 2.3 An Extension of the Model to Multiple Appointments \[\text{33}\]
   - 2.4 Summary \[\text{34}\]
   - 2.5 Appendix: The Board of Governors \[\text{35}\]
3. Estimating Monetary Policy Preferences
   - 3.1 The Basic Problems \[\text{37}\]
     - 3.1.1 Problem 1: Economic Conditions \[\text{37}\]
## Contents

3.1.2 Problem 2: Comparisons across Time and Institutions 38
3.2 The Preference Estimation Model 39
3.2.1 Assumptions 39
3.2.2 The Model 41
3.2.3 The αs as Ideal Point Estimates 42
3.3 Data, Estimated Model, and Results 43
3.3.1 The Data 43
3.3.2 The Estimated Model 46
3.4 Summary 54
3.5 Appendix: A Comparison with NOMINATE 55

4 Empirically Testing the Model’s Predictions 59
4.1 The Data on Appointments 59
4.2 The Procedures for Testing the Model 62
4.2.1 Identifying PRED 63
4.2.2 Identifying ACTUAL 64
4.2.3 Comparing PRED to ACTUAL 65
4.3 Hypothesis Tests – FOMC 66
4.3.1 Hypothesis Tests 1: Political Influence on Monetary Policy? 66
4.3.2 Hypothesis Tests 2: Who Influences? 71
4.4 Hypothesis Tests – BOG 78
4.4.1 Hypothesis Tests 1: Political Influence on Monetary Policy? 78
4.4.2 Hypothesis Tests 2: Who Influences? 83
4.5 Policy Effects 86
4.6 Summary 90

5 Appointments to the European Central Bank 91
5.1 A Comparison of the United States and European Monetary Union Monetary Systems 93
5.1.1 The Appointing Actors 94
5.1.2 The Institutions of Monetary Policy 96
5.2 The Model 99
5.2.1 The Model’s Assumptions 99
5.2.2 Sequence 101
5.2.3 Possible Outcomes 101
5.2.4 Actual Outcomes: Adding the Heads of States 103
5.2.5 Extensions and Comparisons to the Fed 106
5.3 A Prediction 108
5.3.1 Ideal Points 109

© Cambridge University Press

www.cambridge.org
### Contents

5.3.2 May 1998: The Game, Equilibrium, and Policy Outcome

5.3.3 The Enlargement of the European Monetary Union

5.4 Summary

6 The Origins of the Federal Reserve Appointment Process

6.1 The Theoretical Framework

6.1.1 Assumptions and Definitions

6.1.2 The Theory: Relating Centralization and Appointment Power

6.2 Background

6.2.1 The Pre–Federal Reserve Banking System

6.2.2 The Actors Behind Banking Reform

6.3 The Creation of the Federal Reserve

6.3.1 The First Legislative Attempts: The Republican Plans

6.3.2 Bigger and Better Republican Plans

6.3.3 The Advent of the Federal Reserve System: The First Democratic Plan

6.3.4 Restructuring the Federal Reserve: The Second Democratic Plan

6.4 Summary

7 Conclusions

Bibliography

Index
List of Figures

2.1 Example
2.2 Range 1
2.3 Range 2
2.4 Range 3
2.5 Range 4
3.1 Ideal Points and Cutpoints
4.1 Graph of President, Senate, and FOMC Ideal Points
4.2 FOMC Hypothesis Tests 1, Graph of the Results
4.3 The FOMC Median and the Real Federal Funds Rate
4.4 The BOG Median and the Discount Rate
5.1 Example 1, Case 1
5.2 Example 2, Case 1
5.3 The ECB Game in May 1998
5.4 The New Governing Council after May 1998
List of Tables

<table>
<thead>
<tr>
<th>Table Number</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>The Structure of the Federal Reserve System</td>
<td>11</td>
</tr>
<tr>
<td>2.1</td>
<td>Acronyms, Variables, and Other Notations</td>
<td>22</td>
</tr>
<tr>
<td>3.1</td>
<td>Notation</td>
<td>40</td>
</tr>
<tr>
<td>3.2</td>
<td>Summary Characteristics of the Data</td>
<td>43</td>
</tr>
<tr>
<td>3.3</td>
<td>Definitions of the Variables</td>
<td>48</td>
</tr>
<tr>
<td>3.4</td>
<td>Estimated Coefficients on the Macroeconomic Variables</td>
<td>49</td>
</tr>
<tr>
<td>3.5</td>
<td>Marginal Effects of the Macroeconomic Variables</td>
<td>50</td>
</tr>
<tr>
<td>3.6</td>
<td>FOMC Members – Ideal Point Estimates</td>
<td>52</td>
</tr>
<tr>
<td>3.7</td>
<td>Senate Banking Committee Members – Ideal Point Estimates</td>
<td>53</td>
</tr>
<tr>
<td>3.8</td>
<td>Presidents – Ideal Point Estimates</td>
<td>54</td>
</tr>
<tr>
<td>4.1</td>
<td>The Data on Appointments</td>
<td>60</td>
</tr>
<tr>
<td>4.2</td>
<td>Table of Predictions</td>
<td>64</td>
</tr>
<tr>
<td>4.3</td>
<td>FOMC Hypothesis Tests 1, Data for the Hypothesis Tests</td>
<td>69</td>
</tr>
<tr>
<td>4.4</td>
<td>FOMC Hypothesis Tests 1, Results</td>
<td>70</td>
</tr>
<tr>
<td>4.5</td>
<td>FOMC Hypothesis Tests 2, Regression Results</td>
<td>73</td>
</tr>
<tr>
<td>4.6</td>
<td>FOMC Hypothesis Tests 2, Data for the Hypothesis Tests</td>
<td>74</td>
</tr>
<tr>
<td>4.7</td>
<td>FOMC Hypothesis Tests 2, Results</td>
<td>75</td>
</tr>
<tr>
<td>4.8</td>
<td>FOMC Hypothesis Tests 2, Regression Results</td>
<td>77</td>
</tr>
<tr>
<td>4.9</td>
<td>BOG Hypothesis Tests 1, Data for the Hypothesis Tests</td>
<td>79</td>
</tr>
<tr>
<td>4.10</td>
<td>BOG Hypothesis Tests 1, Results</td>
<td>80</td>
</tr>
<tr>
<td>4.11</td>
<td>BOG Hypothesis Tests 1, Regression Results</td>
<td>82</td>
</tr>
<tr>
<td>4.12</td>
<td>BOG Hypothesis Tests 2, Data for the Hypothesis Tests</td>
<td>83</td>
</tr>
<tr>
<td>4.13</td>
<td>BOG Hypothesis Tests 2, Results</td>
<td>84</td>
</tr>
<tr>
<td>4.14</td>
<td>BOG Hypothesis Tests 2, Regression Results</td>
<td>85</td>
</tr>
<tr>
<td>5.1</td>
<td>Voting Weights in the European Union</td>
<td>95</td>
</tr>
<tr>
<td>5.2</td>
<td>The Structure of the European System of Central Banks</td>
<td>98</td>
</tr>
<tr>
<td>5.3</td>
<td>Inflation Rates for European Union Countries</td>
<td>110</td>
</tr>
</tbody>
</table>
List of Tables

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.4</td>
<td>Voting Weights on the Council of Ministers</td>
<td>113</td>
</tr>
<tr>
<td>6.1</td>
<td>Configuration of Interests in Banking Reform – Prior to 1913</td>
<td>123</td>
</tr>
<tr>
<td>6.2</td>
<td>Relative Comparisons of Significant Banking Reform Bills</td>
<td>129</td>
</tr>
<tr>
<td>6.3</td>
<td>Configuration of Interests in Banking Reform – 1935</td>
<td>133</td>
</tr>
</tbody>
</table>
Acknowledgments

This book is based on my doctoral dissertation, “Their People = Their Policy: The President, Congress, and Appointments to the Federal Reserve.” It is impossible to thank everyone who helped me over the years from the dissertation stage through the book process, but here’s an attempt.

At Cambridge, Randy Calvert, the series editor, deserves an enormous amount of credit for suffering through several versions of the manuscript and always providing me with thoughtful and insightful comments. His comments, along with those of two anonymous referees, transformed the manuscript from a dissertation to the book as it stands today. The manuscript improved significantly through this process. I would also like to thank Lew Bateman, the political science editor, for supporting the manuscript and for patiently answering my many questions.

At Stanford University, my committee members deserve special credit. I am especially indebted to my principal advisor, Barry Weingast, for his patience and honesty. Despite his impossibly busy schedule as the Department Chair, Barry always made time to comment on a paper or to advise me on my career plans. I am also greatly indebted to Doug Rivers, who provided invaluable advice and help on the empirical sections in addition to his excellent suggestions on technical writing. I have also benefited greatly from John Ferejohn’s encouragement, interest, and last but not least, his Pizza and Politics seminar series which must have one of the world’s toughest crowds. Speaking of tough crowds, Terry Moe’s willingness to carefully and frankly criticize the main arguments crucially helped to improve the work. Roger Noll, my oral defense chair, also provided important comments on everything – for example, the formal models, the empirical analysis, and the presentation of the work.

I would like to thank Heather and Susan Havrilesky and Ed Tower at Duke University for help in obtaining Thomas Havrilesky’s SAFER xiii
Acknowledgments

dataset of presidential signaling. Thanks also to Rudy Espino, Sarah Keim, and Doug Long, who provided careful and painstaking research assistance.

I am also grateful to the following people for their help and support: Oliver Adler, Norma Alvarez, Mike Bailey, Matt Bartels, Heather Basarab, Jenna Bednar, Erik Berglof, Dina Boomla, Lawrence Broz, Maria Cancian, Brandice Canes-Wrone, David Canon, Julie Cullen, Rui de Figueiredo, Charles Franklin, Rob Franzese, Bruno Frey, Geoff Garrett, Kurt Gaubatz, Ed Green, Michael Herron, Dan Kelemen, Laurie Koloski, Myong Lee, Dave Leheny, Dave Lewis, Bart Lipman, Tani Maher, Nolan McCarty, Irwin Morris, Peter Moser, Scott Page, Jonathan Parker, Andy Rutten, Larry Samuelson, Bill Sandholm, Anne Sartori, Heiner Schulz, Chuck Shipan, Ken Shortts, Ravi Singh, the Stanford Cycling Club (too many to mention individually), John Taylor, Shawn Treier, Isabelle Vautravers, Craig Volden, Chris Way, Scott Wilson, and Alan Wiseman. I would also like to thank the many seminar participants over the years.

I would finally like to acknowledge financial support from the following institutions: the Federal Reserve Bank of Minneapolis, the National Science Foundation, the Robert Wood Johnson Foundation, UBS AG, the University of Michigan, and the University of Wisconsin-Madison. At the University of Wisconsin, Dave Trubek at the European Union Center and Don Nichols at World Affairs and the Global Economy deserve special mention for their financial support of the European Monetary Union portion of this book.