IS THERE A POLITICAL MONETARY CYCLE?

David I. Meiselman

Economic Events and Elections

There is a large and growing literature about the relationships between economic conditions and elections. One part of this literature is devoted to the impact of economic conditions on election outcomes. Does unemployment or inflation or interest rates affect how people vote, and if so, how? If unemployment changes votes, is it the level of the unemployment rate, the change in unemployment, its duration, or composition, and so forth. I shall not deal with this area, except to note that it is widely believed that perceived economic well-being, or the lack of it, is an important determinant of elections.[1] Richard Nixon attributed his loss to John F. Kennedy in the 1960 election, not to his 5 o'clock shadow, nor his TV debate with Kennedy, nor to his personal or political failings as a candidate, but rather asserted that the October unemployment rate did him in.

Nixon's proclivity for blaming others for his own shortcomings and failures lessens the authority of his comment but there are many other bits of casual and systematic empiricism which offer support for the importance of economic events in deciding elections, particularly when economic events are unsatisfactory. Thus, the "outs" view economic events with alarm, highlighting real or imagined economic problems and attributing shortcomings to the "ins." In turn, the "ins" point with pride to economic events, highlighting economic accomplishment and cautioning against the dangers posed by the misguided policies of the "outs."

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[1]See Frey and Schneider (1978), Nordhaus (1975), and Tufte (1978).

In this context of political competition, there are strong incentives for politicians and those with control over actual events or their perceptions to try to shape actual and perceived economic and public policy events to affect election outcomes. Increased unemployment, higher real incomes, and lower inflation—especially in the months immediately preceding an election—are widely understood to benefit incumbents. To help achieve these results, there is much evidence of special favors to woo special interest groups and of increased pre-election payouts for transfer programs, such as Social Security, with deferred pay-ins of taxes. These are components of the electoral economic cycle widely labeled "the political business cycle." The myopia of voters, including those with doctorates in economics, and dependable elements of greed and self-interest make the game possible.

Erosion of Constitutional Constraints

There has been a sizable increase in the range, level and detail of government activities viewed as appropriate or permissible for at least the last 50 years. There has been a parallel weakening of traditional constitutional limitations as well as the long-standing fiscal and monetary restraints of balanced budgets, fixed exchange rates, and a fixed price of gold. One result has been an enlarged scope for fiscal actions to effect election outcomes. The secular upward drift of budgets, taxes, and regulation means that government actions more directly touch the lives of larger numbers of voters. There is a corresponding enhanced opportunity for tax and expenditure changes to influence voters. This means that politicians can more readily promise "goodies" by offering the prospect of more government intervention, or, in some instances, less. When government is small and constrained, election outcomes obviously matter less to the median voter. One of the dangers of big government is the undermining of the election process itself as governments use their coercive powers, including taxing, spending, and regulatory powers, to buy votes. But what of the Federal Reserve and the conduct of monetary policy? Is there a "political monetary cycle?"[2]

Politicization of Monetary Policymaking

By statute the Federal Reserve is independent of the Executive Branch, including the White House and the Treasury. But surely this formal legalistic independence of the Fed and the Executive Branch

[2]See Meiselman (1984).

need not be interpreted as involving a lack of interest or concern over election outcomes by either the Fed or the Executive Branch. The independence of the Fed need not imply either an inability of the Fed to affect votes or a disinclination of the Fed to do so on their own, nor does it preclude the success of attempts by the Executive Branch to influence the Fed to alter monetary policies to influence voters.

Although I do not intend to survey the literature on the political role of the Fed or to resolve alternative hypotheses, two major hypotheses can be noted. The first hypothesis, as represented by the work of Robert Weintraub (1978), posits that the Fed, like the Supreme Court, reads the newspapers and cares about election results. Weintraub's view is that it is essentially easier to forecast the broad sweep of Fed actions by knowing who occupies the White House than it is to know who the chairman of the Federal Reserve happens to be, because the Fed generally ends up taking its monetary policy leads from the Executive Branch. An alternative view, characterized by the work of Edward Kane (1980), has emphasized the Fed's independence as well as the bureaucratic nature of the Fed hierarchy and staff.

There are still other hypotheses, including the welcome application of public choice analysis to the behavior of central bankers (Shughart and Tollison 1983), but my paper is not directed at these issues. Instead, a narrow aspect of these more general concerns will be analyzed by examining what happens to money growth in election seasons, both before and after presidential elections. This analysis mainly depends on examining a set of charts showing the growth of the current M1 measure of money in each presidential term since January 1945. There have been several recent studies that have used more complex econometric models to examine the relationship between presidential elections and Fed policy (Grier 1984, Pollard 1983). Nevertheless, it is useful to begin with a simpler more direct analysis of this relation before proceeding to more complex statistical procedures.

Elections and Money Growth

Monthly money data were analyzed using seasonally adjusted averages of daily figures at annual rates, as well as three-, six-, nine-, and twelve-month averages of monthly data. A set of charts provided in the Appendix to this paper shows the six- and nine-month averages of money growth at annual rates.[3] The charts are marked to indicate

[3]See Meiselman (1984) for earlier results of examining six-month moving averages of M1 growth.

the location of both the presidential elections and midterm congressional elections. Although the charts show only the level of money growth, changes in the level of money growth—the second difference of the money stock—can be inferred from the charts.

The six- and nine-month moving averages were emphasized for two reasons. First, monthly figures are so erratic that it becomes difficult to see underlying patterns. The longer term moving averages smooth the monthly series. Second, there is much evidence and belief that changes in money growth tend to affect GNP with a lag of six to nine months. The six- and nine-month moving averages may help indicate which periods would tend to be influenced by earlier monetary change.

To influence some aspects of the economic environment, especially those related to changes in aggregate demand, money growth must pick up well before an election in order for the usual lags to come into play. The good news of faster money growth typically comes first, as more nominal money initially leads to more real output and employment. (There is a mirror image for declines in money growth.) Later, perhaps after a year or more, comes the bad news as rising prices replace the initial increase in output. After full adjustment, beyond two or more years, there is no permanent real improvement of output and employment. Only the price level is permanently higher.

If these differential lags hold, they also offer some potential for monetary policy to affect election outcomes by increasing money growth in the period before elections. This opportunity must be balanced against the risk of speeding up inflation. However, the difference in the two lagged effects of higher money growth, shorter for real effects, longer for inflation effects, presents the possibility of timing monetary growth to achieve the initial "good" effects before elections while the later "bad" inflationary effects hit the fan after the election votes are in, too late for voters to change their minds.

This process requires a high degree of myopia on the part of the voters. Alternatively, because only unsystematic surprises can systematically affect real variables, this process may also depend on a high level of ignorance and uncertainty—both about Fed policies and also about the effects of monetary change—in order for nominal money to affect real variables, even temporarily.

The 1948, 1952, and 1956 Elections

Consider first the elections in the early postwar period. As Figures A1–A3 show, in the months immediately before the 1948, 1952, and 1956 elections, M1 growth was relatively flat. In the year or so before

these elections, six- and nine-month money growth generally declined, particularly before the 1948 and 1952 elections. Prior to the 1956 election, money growth had declined sharply throughout 1955 and was relatively flat in 1956 at about 1 percent growth.

Thus, for these three presidential elections there seems no clear evidence of a political monetary cycle at work. In this period the Fed may have been focusing attention on pegging interest rates while simultaneously maintaining fixed exchange rates and a $35 per ounce price of gold. If so, Fed activities were already so overdetermined and/or inconsistent that they could not easily add an election-cycle money-supply variable to their list of targets and goals, even if the Fed had wished to do so.

The 1960–80 Elections

There is evidence of complex presidential election-related cycles starting with the 1960 election (see Figures A4–A9). Indeed, there seems to be a repetitive cycle surrounding five of the next six elections in the period starting in 1960. As Figure A10 shows, the 1984 election started out conforming to the general pattern but did not carry through in the crucial months immediately before November 1984. Nor did the former pattern resume after the 1984 election. (The nine-month averages, also on the same charts, lag the six-month averages, so some of the lags using the nine-month averages are bound to differ somewhat.)

There are three distinct phases of money growth in five of the six periods surrounding the elections between 1960 and 1980. In Phase I, there was a marked deceleration of money starting about a year and a half before presidential elections. The Phase I deceleration typically lasts about two quarters. It is a prelude to the Phase II speeding up of M1 growth in the months preceding elections. The Phase II acceleration of money growth typically starts early in the year of the election itself. There is some variation in this turning point. Before the 1972 and 1976 elections the turning point occurred in the December preceeding the elections and in 1980 it occurred several months later in April. For Phase I and Phase II, it does not seem to make any difference which political party controls the White House.

The pre-election speed-up of money growth ends in the neighborhood of the November election, and there is a tendency for the six-month money growth to hit a peak at that time. There is small variation in this overall regularity. In 1960 the peak was reached two months earlier, and in 1968 and 1972, one month later.

Prior to the 1976 election, there was a sharp deceleration of money starting the third quarter of 1975. This followed the same general pattern for Phase I decelerations. Phase II also started out the same way, with a sharp acceleration of money in the period ending the first quarter of 1976. Thereafter, six-month money growth was relatively flat, with some tendency to slow immediately prior to November 1976.[4]

The regularities over this span of six elections do not end with the elections themselves. There is a marked tendency for the Phase II pre-election speed-up of money to be followed by a Phase III post-election slowdown of money as the Fed changes direction again. However, there seems to be a difference in Phase III post-election money growth, depending on which political party has won the election. As in 1960 and in 1964, when a Democrat occupied the White House, the Phase III post-election slowdown of money is temporary. Soon, money growth speeds up, and within a year is higher than on election day. This was especially so after the Lyndon Johnson election of 1964. It was also a prelude to reigniting inflation in the later years of the Johnson administration.

By contrast, after Republicans won presidential elections, as in 1969, 1973, and 1981, the Fed stepped on the monetary brakes and kept them down, leading to recessions later in each of these three years. Indeed, although the pre-election patterns of money growth before the 1952 and 1956 Eisenhower elections did not follow the later regularities, there was also a marked post-election slowdown of money growth after these Republican victories, leading to recessions in 1954 and 1958, as well.

In the last stage, Phase III, of the apparent regularities over the 1960–80 period, there was an initial retardation of money growth and the only apparent difference in Fed behavior related to which political party was in power. When the Democrats occupied the White House, the Fed relented after the initial period of slowing money growth and soon resumed faster money growth. By contrast, when the Republicans were in the White House the initial tight money was maintained. One possible explanation for the post-election slowing of money growth is that it may be nothing more than an attempt to mop up some of the pre-election excess money, with differences between the Fed's later behavior of money reflecting responses to the fundamental differences between the two major political parties

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[4]As noted elsewhere, Ford, the incumbent, lost the election (see Meiselman 1984). One ironic consequence was that Chairman of the Fed, Arthur Burns, was not reappointed by Jimmy Carter.

and the influence of the White House on the Fed's decisions affecting the money supply.

Two years ago, when I first started to examine election-related changes in money, I mentioned some of these patterns to William Niskanen, then a member of the President's Council of Economic Advisors. After I noted the tendency for a Republican presidential victory to be followed by tight money and recession, Niskanen pointed out to me that there had been a recession in the year of every off-year congressional election since 1930 when a Republican was in the White House. These include 1930 under Hoover, 1954 and 1956 under Eisenhower, 1970 under Nixon, 1974 under Ford and more recently, 1982 under Reagan. Republicans lost seats in every one of these six off-year congressional elections, as well. We shall see whether 1986 follows this pattern, or breaks it.

Both before and after the 1976 Carter election, the three-stage pattern of monetary growth in election seasons was different. For the six-month span of money growth, there was no tendency for money growth to speed up in the seven months before the November 1976 election. Then, after the election, instead of a slowing of money growth, it speeded up in early 1977 and remained high throughout all of 1977 and 1978. This fast money growth, combined with successful efforts to drive down the foreign exchange value of the dollar to "improve" the trade balance led to double-digit inflation and double-digit interest rates in the last two years of the Carter presidency.

Monetary growth immediately prior to midterm congressional elections exhibited no clear path before the 1946 elections. However, there was rising money growth before the 1950, 1954, and 1958 elections, declining growth prior to the 1962, 1966, and 1974 elections, and essentially flat growth before the 1970 and 1978 elections. Prior to the 1982 elections six-month money growth was so erratic that it is difficult to generalize a clear change in direction, whereas money growth measured over a nine-month span was relatively flat. All in all, there is no immediately apparent general pattern of money growth prior to—or for that matter, subsequent to—midterm congressional elections.

The 1984 Election

What happened to money over the 1984 election cycle? As Figure A11 shows, six-month money growth hit a peak of close to 15 percent in early 1983. Thereafter, it slowed almost steadily until the November election. Money growth speeded up for a short period in early 1984, which was consistent with the Phase II expansion mentioned earlier. However, the higher money growth proved temporary, as the

slowdown resumed and continued until October 1984. Then, instead of the Phase III slowdown of money growth there was a marked acceleration of money throughout most of 1985. Thus, the 1960–80 pattern (excepting 1976) did not hold, either before or after the 1984 election.

Can the Fed Consistently Create a Political Monetary Cycle?

These events, especially since 1960, raise several questions. First, as a theoretical matter, even if the Fed wished to do so, can the Fed *consistently* use its monetary powers to change the economic environment in election seasons? Second, were the patterns of monetary change prior to elections consistent with influencing economic conditions in a way that could reasonably affect election outcomes?

Turning to the first question, can a central bank consistently use its control over the stock of money to alter interest rates, aggregate demand, and the real variables that may influence voters? From an efficient markets perspective, it is clear that consistently repetitive and hence certain and predictable changes in money growth, including changes in money dependably tied to elections, have results similar to other certain and predictable changes in money. Neither interest rates nor real variables are affected by such known and hence discounted changes in the money stock. This means that if the Federal Reserve or other central banks consistently attempted to pursue policies aimed at affecting the financial and economic environment prior to elections, the efforts would fail once such monetary intervention was discovered. Intervention dependably linked to known constitutionally mandated elections would easily become widely known if central bankers consistently tried the same tricks before, or after, each election.

To work, such central bank intervention must come as a surprise. This means that, even if central bankers wished to intervene to influence elections, they cannot pursue the same strategy in every election, the way cherry blossoms and tulips dependably respond to the weather cycle in April of each year. Uncertainty and surprise must be retained for such policies to work at all, to say nothing of protecting the central bank from adverse actions by political parties and economic interests harmed by such intervention. This suggests that even if Fed officials wished to play the game, they cannot act consistently and predictably in each and every election season. Instead, they must make strategic choices when and how to play. Reflecting their own long-term interests and the interests of the Fed as an

institution, the 14-year tenure of governors and the even longer tenure of many of the staffs of the Board of Governors and district banks would seem to afford sizable potential for such strategic choices.

In any event, this reflects a more general phenomenon: that if a central bank acts in a predictable way, it has little or no effect on financial or real variables. Only the price level is permanently changed. This means that monetary uncertainty and the inability to forecast and predict Fed behavior is a necessary condition for the Fed to alter financial markets, output, and employment that influence voters or serve other ends, including economic stabilization. In turn, it also means that the usual search for empirical regularities related to actual (not unanticipated) changes in the stock of money, including the testing of hypotheses using measured and actual monetary magnitudes, may not be appropriate—precisely because the Fed cannot act dependably on average if it wishes to be effective in specific circumstances.

Thus, analyzing only actual monetary phenomena in different elections using standard statistical tests may not represent an operational of meaningful test of intended or actual Fed intervention directed to election results. Even if, from time to time, the Fed, in fact, tries to use its monetary powers for political ends, a convincing test or proof may require more detailed and explicit information about explicit intentions on a more micro level, including who said and did what to whom.

These considerations and qualifications make the task of isolating, identifying, and testing for the component of money growth potentially related to election seasons quite difficult. There is a paucity of fruitful results from the work of a generation of researchers trying to determine the Fed's objective function. Isolating its election component may be even more difficult. And, even if isolated from evidence of past elections, there would seem to be little basis for confidently predicting the same role in future elections. Indeed, the same understanding is equally applicable to predicting other components of the Fed's objective function, if there is one.

Before evaluating the specific evidence of monetary change in past political cycles, recall the by now conventional norms for describing the typical lagged effects of money. First, when money growth speeds up, GNP increases two to three quarters later. At first, the change in GNP is in real variables as output and employment increase. Later, as the initial gains in employment erode, prices begin to rise. The inflation impact is felt in about a year; the peak inflation effect of a once-for-all change in money is two years later. In the end, all real

gains erode, replaced by permanently higher prices. There is a mirror image of this process when money growth declines.

In the context of these lags, consider the actual patterns of monetary change during presidential election seasons. Note especially the lagged effects of actual changes in money during five of the six elections between 1960 and 1980 where there appears to have been a complex three-stage cycle. Recall that in Phase I of the cycle, typically starting about six quarters before the November presidential election, there was a slowdown of money growth. This monetary slowdown could serve two purposes. First, given the lagged effect of money on prices, early slowing of money growth could slow inflation immediately prior to the presidential election, which is generally viewed as favorable to the incumbent's political party. Second, the temporary slowing of money growth may also enhance the "good"effects of the more rapid growth during election years—because it appears to be the *change* in money growth rather than money growth itself that influences output and employment, and later controls the inflation rate. Thus, temporarily slowing money growth retards later inflation and increases the impact of the subsequent rapid money growth on real variables during election years. One problem with the Phase I monetary slowdown, however, is that it comes two quarters too late for maximum impact on later inflation. Still, the retardation is early enough for the later real output effects of faster money.

Turning to Phase II, the acceleration of money growth in the two to three quarters before the election would tend to improve real output before elections. The problem is that this turn comes too late for maximum output effect. It would seem to take a longer, more sustained period of high or rising money growth to improve economic circumstances before elections, especially given the delayed response of employment and unemployment to changes in real output. In addition, the delay in reporting and recognizing any actual improvement in economic and business circumstances suggests that the acceleration of money should come even earlier.

Although there is evidence of money growth peaking during Phase II at or close to elections, single-minded control of money directed toward influencing election results should have resulted in the speed-up starting earlier than it did. Thus, the monetary evidence from Phase II alone is mixed and at best may be inconclusive. Alternatively, the monetary evidence should be examined jointly with interest rate and other data for more complex hypotheses beyond the scope of this paper.

Conclusion

In my judgment there is some evidence of a political monetary cycle since the 1960 presidential election. This is consistent with the findings of several other studies, namely those of Grier (1984) and Pollard (1983). The major finding of my analysis, however, is not empirical but theoretical. It is that the usual empirical tests may not uncover clear evidence of a systematic, repetitive monetary cycle matching the constitutionally mandated elections even if there is a political monetary cycle. The reason is simple: to be effective in specific instances, monetary policies that are intended to influence elections cannot be systematically and dependably followed in every election episode. The Fed must choose when not to play in order to be able to use their control of money to influence financial and real variables at other times, including elections. The resulting uncertainty and absence of dependability necessary for the successful pursuit of political monetary cycle goals thereby impairs the periodic and/or systematic empirical regularities that the usual regression analysis and other operational tests depend on.

There are more general and important implications of this analysis. Because surprises, which by definition are unanticipated events, are required to alter markets and market results, uncertainty and the absence of dependability are a necessary condition if the central bank is to affect financial markets and real variables. To influence economic events and to achieve political power, the Fed must maintain uncertainty about its policies. Successful economic forecasting requires both good information about the market's anticipations of future monetary policies as well as the ability to forecast future Fed policies. The elusiveness of dependable information about anticipations plus the Fed's need to maintain or to create uncertainty about its actions explains why the Fed's erratic and unpredictable policies lead to such poor financial and economic forecasts on average by even the best of the forecasters. One related result of the "keep 'em guessing" policy is enhanced instability and economic waste; another is the widely observed variability of the lags in the effects of measured changes in the stock of money.

Appendix: M1 Growth and Elections

Each of the following charts shows the relationship between the six- and nine-month growth rates for M1 (seasonally adjusted at annual rates) and a specific presidential election, as well as a midterm election. The money growth rates cover the six- and nine-month periods ending in the month noted. The charts cover the entire postwar era.

FIGURE A1
SIX- AND NINE-MONTH GROWTH RATES, 1945–48
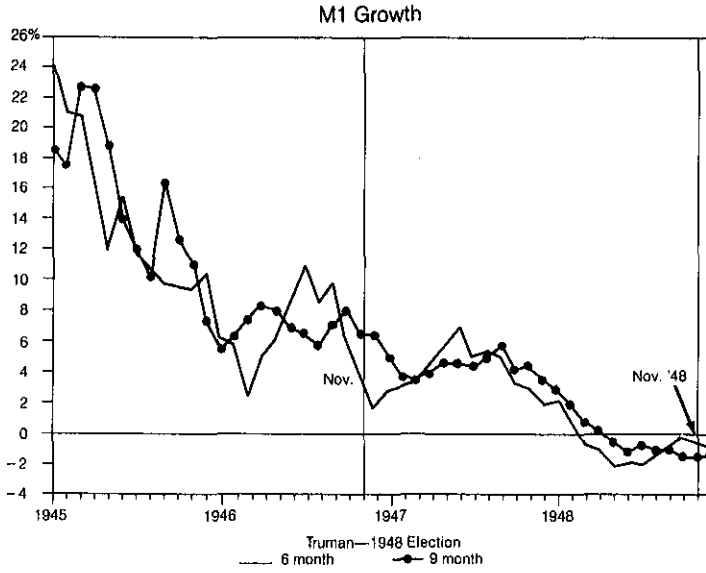### (SEASONALLY ADJUSTED AT ANNUAL RATES)

M1 Growth

Truman—1948 Election
—— 6 month —●— 9 month

FIGURE A2
SIX- AND NINE-MONTH GROWTH RATES, 1949–52
(SEASONALLY ADJUSTED AT ANNUAL RATES)

Truman—1952 Election
—— 6 month —●— 9 month
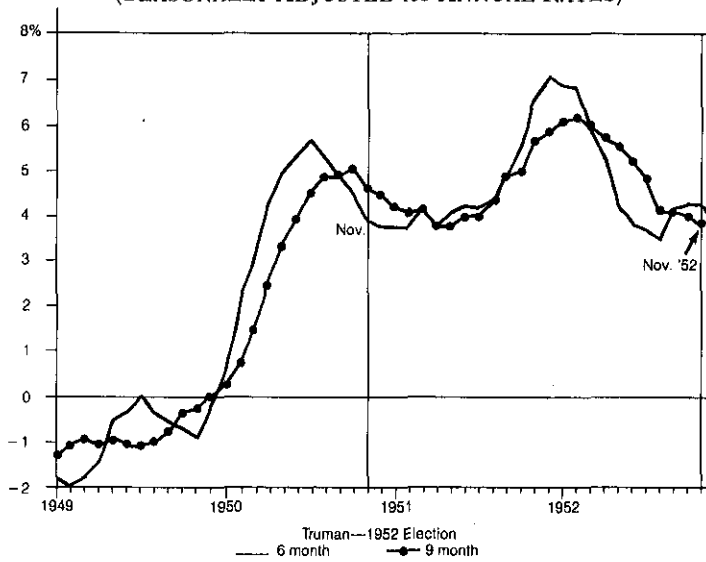
FIGURE A3
SIX- AND NINE-MONTH GROWTH RATES, 1953–56
(SEASONALLY ADJUSTED AT ANNUAL RATES)
M1 Growth

Eisenhower—1956 Election
——— 6 month   —•— 9 month
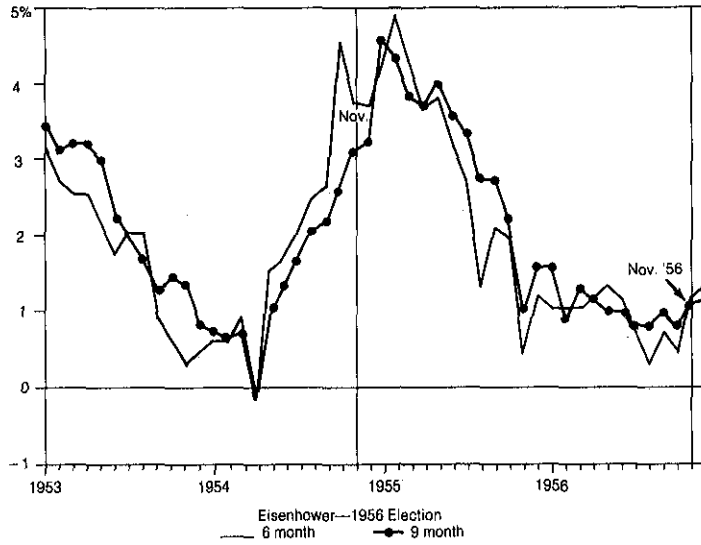
FIGURE A4
SIX- AND NINE-MONTH GROWTH RATES, 1957–60
(SEASONALLY ADJUSTED AT ANNUAL RATES)

Eisenhower—1960 Election
——— 6 month   —•— 9 month

575
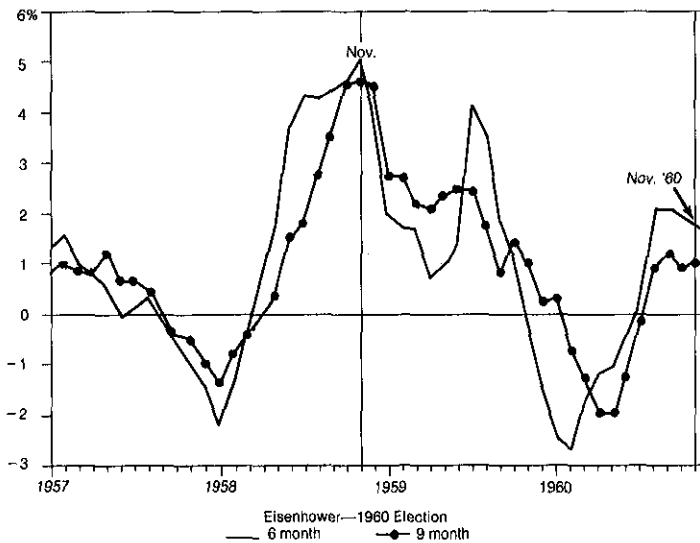
FIGURE A5
SIX- AND NINE-MONTH GROWTH RATES, 1961–64
(SEASONALLY ADJUSTED AT ANNUAL RATES)

M1 Growth

Kennedy/Johnson—1964 Election
—— 6 month   —•— 9 month
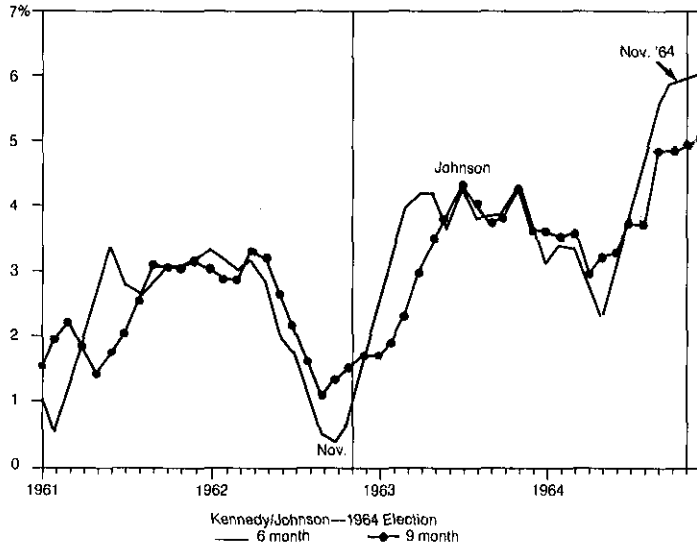
FIGURE A6
SIX- AND NINE-MONTH GROWTH RATES, 1965–68
(SEASONALLY ADJUSTED AT ANNUAL RATES)

Johnson—1966 Election
—— 6 month   —•— 9 month

FIGURE A7
SIX- AND NINE-MONTH GROWTH RATES, 1969–72
(SEASONALLY ADJUSTED AT ANNUAL RATES)
M1 Growth

FIGURE A8
SIX- AND NINE-MONTH GROWTH RATES, 1973–76
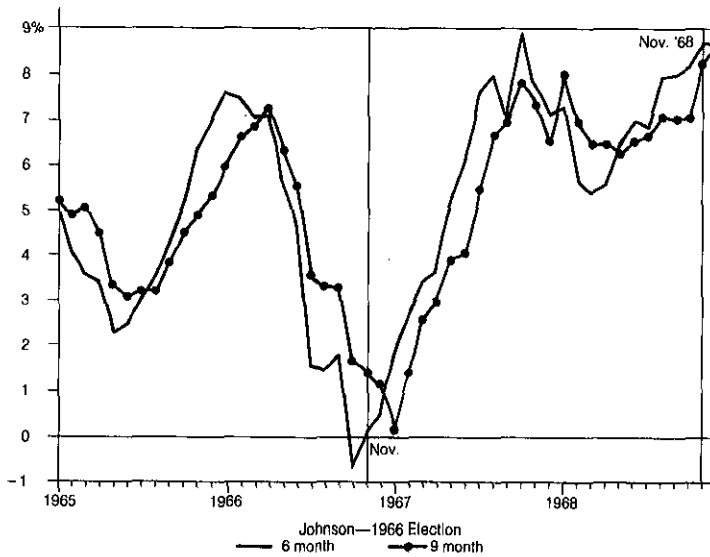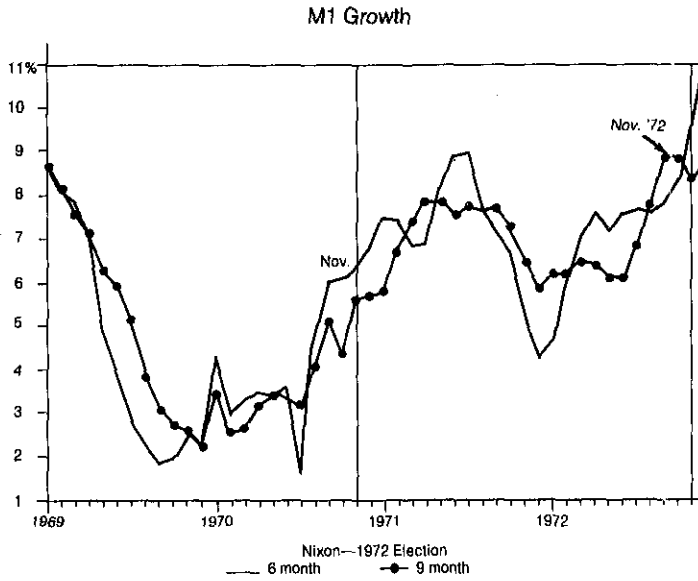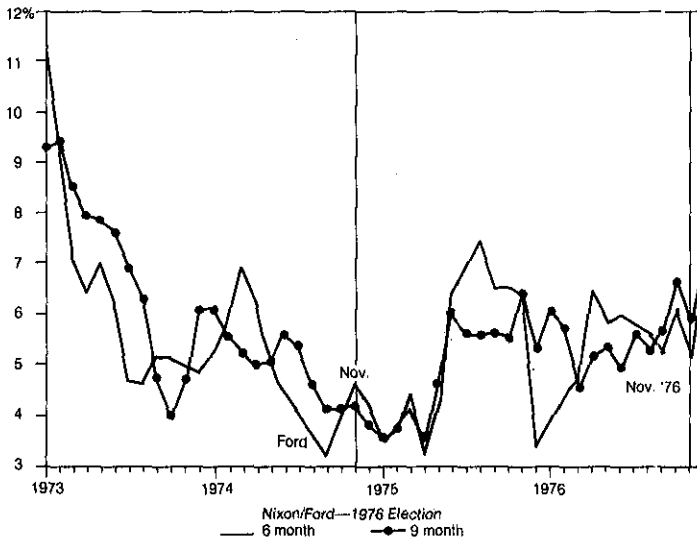(SEASONALLY ADJUSTED AT ANNUAL RATES)

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FIGURE A9
SIX- AND NINE-MONTH GROWTH RATES, 1977–80
(SEASONALLY ADJUSTED AT ANNUAL RATES)
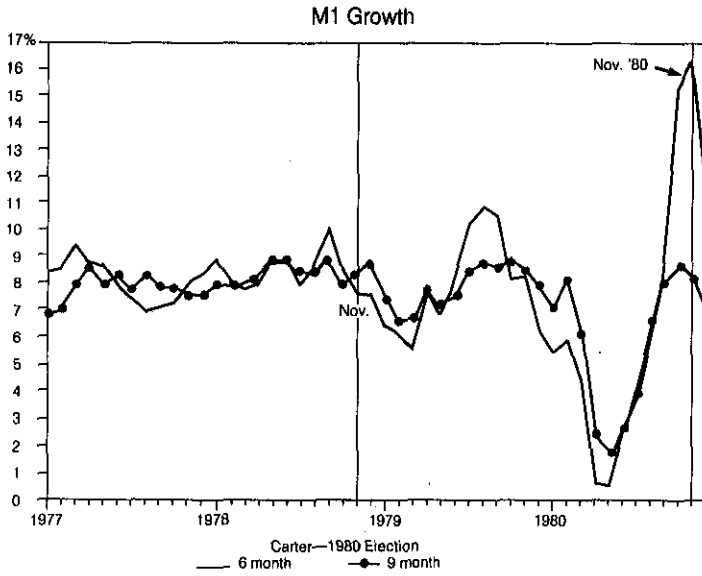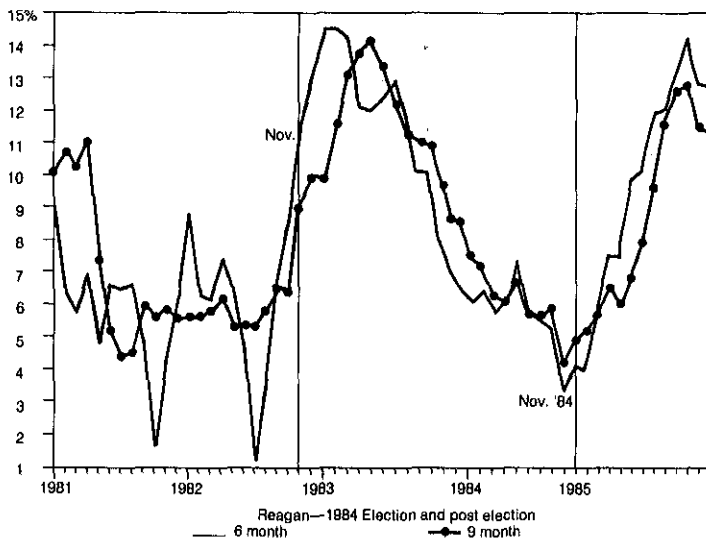
M1 Growth

Carter—1980 Election
_____ 6 month   •—•— 9 month

FIGURE A10
SIX- AND NINE-MONTH GROWTH RATES, 1981–85
(SEASONALLY ADJUSTED AT ANNUAL RATES)

Reagan—1984 Election and post election
_____ 6 month   •—•— 9 month

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FEDERAL RESERVE HEGEMONY AND MONETARY SURPRISES

David I. Fand

David Meiselman (1986) has written a very interesting paper in which he uncovers a kind of Heisenberg uncertainty principle; it states that if Fed policy is going to be effective, it cannot be predictable. This means that if anybody discovered what the Fed is doing, the Fed would have to change its policy. This paper, however, presents difficulties for a commentator because of the struggle between two different theses that I call Meiselman I and Meiselman II. In Meiselman I, the author is seeking to describe and analyze the political monetary cycle. In Meiselman II, the author concludes that the only way the Fed can be effective in affecting the economy is to follow policies that are not predictable.

The implication of Meiselman II is that investigators will not discover stable, or predictable, patterns of policy and, therefore, Meiselman I is looking for something that cannot be found. Nevertheless, both Meiselman I and Meiselman II may be correct.

The Political Monetary Cycle

Let us look first at Meiselman I. The political monetary cycle thesis presented in the first half of the paper is in the tradition of what is referred to as the political business cycle literature. It starts with the assumption that the Fed serves the incumbent President. Meiselman isolates three different phases of the political monetary cycle: Phase I, the monetary deceleration phase that begins approximately 18 months before the presidential election; Phase II, the monetary acceleration phase that begins approximately six to nine months before the presidential election; and Phase III, the monetary deceleration phase that follows the election. If the monetary authorities time their actions properly in Phase II, Meiselman I expects to observe

declining inflation and rising income, output, and employment during the election. However, for Phase III, he notes a difference between Democrats and Republicans, and suggests that this difference may explain why the Republicans lost House seats in every midterm election since 1930.

Heisenberg Uncertainty and Fed Behavior

In Meiselman II, we follow a different route and discover a Heisenberg type principle. This principle posits that what is being observed changes as a result of being observed. If the Fed follows a steady policy, participants in the market will soon discover it; only monetary *surprises* are effective in influencing output decisions. If the Fed wants to keep its power, it must confound the public. The Fed cannot accept any monetary rule; if it is to retain its enormous power, influence, and prestige, it must not relinquish its ability to confound the market. For this reason, the Fed prefers to maintain its hegemony through crisis management instead of adopting a constitutional approach. And not surprisingly, Chairman Volcker, who is a very able and effective crisis manager, has increased the already large influence of the Fed.

Public Choice and Monetary Economics

There is clearly a contradiction between Meiselman I and Meiselman II but I think both of them are correct, and the problem in reconciling the findings of Meiselman I and Meiselman II leads us to public choice theory. Economists of the public choice school have made an important contribution to monetary economics. In this connection, I note that Milton Friedman has modified his monetary rule after 25 years, in part, because of the findings of public choice research.

I find three different hypotheses in the public choice literature that might help resolve the conflict between Meiselman I and Meiselman II: a hypothesis I associate with Robert Weintraub (1978); a hypothesis I associate with William Niskanen (1971); and a hypothesis I associate with George Stigler (1971) and Edward Kane (1980, 1982). All three hypotheses concern the *modus operandi* of bureaus and regulatory agencies.

Weintraub's Hypothesis

The Weintraub hypothesis is that the President gets the monetary policy he wants, as Meiselman notes; that is, the Fed serves the incumbent. There is much evidence to support this view. For example, in a memorandum to President Johnson, transmitted through

Joseph Califano, CEA Chairman Gardner Ackley noted in reference
to the 1965 discount rate increase:

> In addition to Chairman Martin, two other members will surely vote
> to approve a discount rate increase; three will surely be opposed.
> The key vote will be cast by Gov. Dewey Daane. . . .
>
> Daane represents the administration in a number of international
> forums including the Group of Ten. Secretary Fowler could point
> out to Daane that it would be inappropriate for him to continue to
> represent the administration if he votes against a clear administra-
> tion policy position. . . . If you should decide to meet with the
> quadriad on Friday, you might be able to persuade Chairman Martin
> to vote against the discount rate increase at this time. However,
> because he is already on record with his colleagues as prepared to
> vote in favor, I believe that it is prudent to take out insurance by
> working on Gov. Daane.[1]

Another example of monetary politics is the following letter to
President Johnson from CEA Chairman Walter Heller:

> A man who works closely with the Fed's economists tells me: they
> are now convinced that Bill Martin is "running for re-election."
> They judge this mainly from the fact that he is pushing so hard for
> further monetary ease even to the point of expressing dissatisfaction
> with the last open market committee decision of "no change" until
> the next meeting; he would have preferred slight easing. Also, he
> has been telling his staff that some "dramatic" move, such as cutting
> the discount rate, or the reserve ratio for time deposits, is needed
> to signal the Fed's determination to keep on easing. (By the way,
> this may happen in a couple of days.)[2]

Robert Auerbach (1985, p. 48) offers further support for the Wein-
traub hypothesis, using the behavior of Fed Chairman Arthur Burns
under President Nixon:

> In the secrecy of the FOMC meetings, and despite his public image
> at the time as an inflation fighter, Burns argued for and received fast
> money growth before the 1972 Nixon election. Burns' actions were
> strong support for the Weintraub hypothesis. The growth rate in the
> money supply during 1972 was the fastest for any entire year since
> World War II. For the whole Nixon presidency, the growth rate of
> the money supply was more than 6 percent.

A final example of the impact of presidential politics on Fed behav-
ior is the conduct of monetary policy under Paul Volcker, who is now
generally regarded as "Mr. Anti-Inflation." The truth is that for most
of his professional life, if a choice was necessary, Volcker typically

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[1]Memorandum dated 29 November 1965. Reprinted in Woolley (1984, p. 123).
[2]Memorandum dated 25 February 1967. Reprinted in Woolley (1984, p. 116).

opted for an expansionist monetary policy; and it remains to be seen if the double-digit growth of M1 over the past 18 months will translate into accelerating inflation.

Niskanen's Hypothesis

Public choice theory has benefited from Niskanen's seminal work on bureaucracy. His hypothesis is that bureaucracies are nonprofit monopoly firms in which bureaucrats seek to maximize their utility. Within a nonprofit environment, bureaucrats will attempt to further their self-interest by engaging in such activities as expanding their staffs, enlarging their budgets, and rewarding themselves with non-pecuniary benefits. Niskanen's hypothesis yields three interesting implications when applied to Fed behavior.

One implication is that Fed chairmen come and go, but key staff people continue and that these key staffers push for policies to enlarge, broaden, and enhance the powers of the bureaucracy. Milton Friedman (1984, 1986) appears to hold this view. Another implication is associated with the work of Mark Toma (1982). He develops a supply-side theory of Federal Reserve behavior. In particular, he builds on the fact that although the Fed receives no budget from Congress, it "may keep, as 'earnings,' interest payments on the portfolio of federal securities it acquires through open market operations" (p. 164). Toma draws out the connection between this institutional factor and infla-tion. A third implication of Niskanen's hypothesis is associated with the work of William Shughart and Robert Tollison (1983) who focus on the kind of perquisites and amenities that the Fed staff obtains. Other implications undoubtedly can be derived by focusing on dif-ferent components of the utility function of Fed bureaucrats and may yield further insights into the link between institutional structures (including the political setting) and monetary policy.

Stigler-Kane Hypothesis

The third hypothesis is associated with the work of George Stigler and Edward Kane. Stigler (1971) views the Congressional Oversight Committee as the key player for the Fed. Using his approach, one would examine very carefully the composition of the banking com-mittees, especially the Senate Banking Committee, to determine the crucial influences on Fed behavior. Kane (1980, 1982) has used Stig-ler's insight to develop a Scapegoat theory of the Fed-congressional relation. In Kane's view, the Fed is not only working closely with the Congressional Oversight Committee, but is also involved with the President and influential money-center banks. In his model, he assumes that there is a consensus among the major governmental

participants that monetary policy must be protected from the short-run pressures of political processes. The relationship between the Federal Reserve and the administration is seen largely as one of agreement—where congressional participation in monetary policy is discouraged in order that the President may use the Federal Reserve as a scapegoat. Congress also welcomes the fact that there is an independent Federal Reserve that can be blamed for economic difficulties.

Given this arrangement, some independent action by the Fed bureaucracy may be welcomed by the Congress and the administration. The President is pleased to have a central bank that can respond to the needs of the economy without congressional interference, and Congress is pleased to be able to blame an independent central bank for unpopular policies. The result is private agreement and public disagreement. That is the sort of model Kane uses to rationalize the actions of the Fed.

It is fair to say that while public choice research has been very important in monetary economics, it is still in its infancy. Thus, at this point it is not possible to extract from public choice analysis a reasonably complete and convincing model of the Federal Reserve.

Conclusion

How then can we reconcile Meiselman I and Meiselman II? How can we accept a political monetary cycle and at the same time accept the uncertainty principle as applied to Fed behavior? Public choice theory suggests the following.

I believe that we are dealing with an evolutionary process and that the Fed may have been far more active in influencing elections, say, 20 years ago than it is now. Moreover, while the markets have discovered many things about the Fed, and while some of the econometric models may have discovered other things, we will not obtain a pattern of Fed behavior that can be readily predicted. Here, I think that the Heisenberg uncertainty principle seems to be valid. I think the Fed desperately seeks leeway to be able to surprise markets in order to maintain its hegemony. And since the Fed wants power, one may conclude that the Fed is committed to crisis management; it is the only way it can maintain its powers.

Therefore, if there is any policy conclusion from the public choice approach to Fed behavior, it is that if one believes that it is desirable to eliminate erratic money management—a roller-coaster monetary policy and crisis management—then one must necessarily move toward the adoption of a constitutional rule to limit Fed discretion.[3]

[3]See Buchanan (1983).

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