What Criteria Should Guide Obama in Selecting a New Fed Chair?

Joseph E. Gagnon discusses the challenges facing the US Federal Reserve in the next five years and what the President and the public should want to know about the candidates.

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Steve Weisman: Speculation is rampant about President Obama's upcoming selection of a new Chairman of the Federal Reserve Board. There are a lot of personalities at play, but we're not going to talk about that with Joseph Gagnon of the Peterson Institute, who has held several high positions at the Fed and has some insight. This is Steve Weisman. Joe, instead I want to ask you what's at stake. Tell the listener and the reader why should we care.

Joseph Gagnon: I think we should care because the Fed is the most powerful economic policymaking institution we have and the Fed is not caught up in the gridlock of divided government where the House and the Senate are different parties and the Democrats don't always agree with the President. The gridlock is not there in the Fed and it's powerful.

Steve Weisman: What are the big challenges facing the next chairman and what should be the criteria for judging qualifications of the candidates?

Joseph Gagnon: First, we still have to make sure this recovery continues, but also strengthens. But as we have had somewhat of a recovery, we're getting somewhat closer towards more normal conditions. We're not there yet, but maybe in two or three years we'll be in a situation where the Fed will need to normalize policy, raise interest rates, stop doing quantitative easing [QE], get us back on some more sort of normal times path. That's going to be a challenge because we've never had so much quantitative easing before and we've never had such a long recession under the Fed's guidance since the Great Depression. So it's a once-in-a-lifetime series of economic events that obviously raises concern just because it's so unusual.

Steve Weisman: Candidates are being discussed. Lawrence Summers and Janet Yellen are identified in the public record with support to some degree for the Fed's policy of quantitative easing. Is it appropriate for a President of the United States to ask the candidates, "What do you think of quantitative easing and what would be your plans about pulling it back?"

Joseph Gagnon: At the time that you're nominating a chairman, I think all questions about your views and policy are relevant and acceptable. This is a democracy and our elected officials should be exercising some review.

Steve Weisman: But it's a peculiar institution. It's like the Supreme Court, the President is not supposed to apply a political test or ideological or philosophical test. But everybody knows that that's exactly what a President does.

Joseph Gagnon: Well, yes. I don't want to go too far into the Supreme Court analogy, but I think that there is a similar analogy here, where I think what you'd want the President to do is ask about their views about how policy should be run in general and how it should respond in general. Not, you know, "If you were chairman tomorrow, would you raise interest rates?" It's sort of like the Supreme Court test where, you know, "How would you rule on this specific case?" Well that would not be a legitimate question but "What is your philosophy about how you would

decide in a generic case?" That's the same thing, right? You could ask, "If the economy is weak and people are unemployed and inflation's too low, do you support easy policy?" Yes, that is a natural question to ask, and then, "Do you support QE in such circumstances?" But the question about whether you should taper tomorrow I think would be inappropriate.

Steve Weisman: Let me ask about the regulatory powers of the Fed over the banking system. That's in the past not been as important an issue in the selection of the Fed chairman or members of the Fed as it is now after the great financial crisis of the last five years. What should the President be looking for there?

Joseph Gagnon: I think the President should be looking for someone who will not be too close to the banks. I think we don't want someone who has imbibed the world view of bankers, who may not see clearly their role in the economy. You want someone who is more objective, who can see the role of banks and finance in the economy from a much higher altitude rather than being down imbibing the herd mentality of Wall Street. So I think you definitely want someone who's more detached and is willing to put the public interest first.

Steve Weisman: Given the nature of the job, is it possible to have somebody who is not at all attached to Wall Street or the financial institution's private sector? I guess the current chairman has an academic background.

Joseph Gagnon: Yed, and so does Vice Chairman Yellen and some others who are considered. I think this is an issue though because those who have Wall Street background, people say, "Well, that's an unqualified advantage for them." I'm not so sure.

Steve Weisman: You do hear that.

Joseph Gagnon: Yes. I think it can be an advantage. But it can be a disadvantage and I think we have to be aware on the one hand, of course it helps to understand how markets work. But on the other hand, it is not helpful to be captured by the world view of bankers that is self-serving for bankers.

Steve Weisman: Anything else that we're leaving out about what the President should be thinking about?

Joseph Gagnon: I think we've hit the highlights, but the most important thing is I think monetary policy. How do you interpret the Federal Reserve Act as amended by Congress over the years, the law of the land, which asks you to maximize employment and achieve stable prices, and how do you view that mandate? How do you think the Fed's done? One, I think a legitimate question would be to ask, "How successful has the Fed been in achieving that mandate over time and what would you have done differently?" That might be a reasonable question.

Steve Weisman: And in the last five years, what's the answer to that?

Joseph Gagnon: I think the Fed has not done very well in achieving this mandate although it's done better than it might have done under some other chairman.

Steve Weisman: And better than perhaps the other branches of government.

Joseph Gagnon: Yes, I think you could say the economic policy run by the Fed has been better than the dismal performance of the rest of the government, but it's still short of an ideal that we should demand of the Fed.

Steve Weisman: Thanks, Joe.