# The Logic and Limits of the Federal Reserve Act

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*The Federal Reserve is a monetary authority subject to minimal executive and judicial oversight. It also has the power to create money, which permits it to disburse funds without drawing on the U.S. Treasury. Since 2008, it has leveraged this power to an unprecedented extent. It has rescued teetering financial conglomerates, purchased trillions of dollars of mortgage-backed securities, and opened numerous ad hoc lending facilities to support ordinary businesses, nonprofits, and municipalities.*

*This Article identifies the causes and consequences of the Federal Reserve's expanded footprint by recovering the logic and limits of its enabling act. It argues that to understand the Federal Reserve—including its independence, expansion, and capacity—it is necessary first to understand the statutory scheme for money and banking. Congress chartered investor-owned banks to issue most of the money supply and established the Federal Reserve for a limited purpose: to administer the banking system. Congress equipped the Federal Reserve with an interrelated set of tools to achieve a specific objective: ensure that the banking system creates enough money to keep economic resources productively employed nationwide. The rise of shadow banks—firms that issue alternative forms of money without a bank charter—has impaired the Federal Reserve's tools. As the Federal Reserve has scrambled to adapt, it has taken on tasks it was not built to handle. This evolution has prompted calls for the Federal Reserve to tackle even more policy challenges. It has also undermined the Federal Reserve's ability to effectively achieve its core goals. An overloaded Federal Reserve is understandable, but not desirable. Congress should modernize the Federal Reserve Act, and the banking laws on which it depends, to improve monetary administration in the United States.*

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## Introduction

For much of American history, money was a site of social and political struggle—terrain on which Americans fought over the distribution of wealth, structure of economic activity, and conditions required to sustain democratic government.[1] Questions about money—what it is, who gets to create it, and how much of it there should be—captivated people from all walks of life. On more than one occasion, the fate of entire political parties turned on the issue. In 1828, monetary conflict gave rise to Andrew Jackson's Democratic Party.[2] Following the Civil War, money animated a series of third-party movements and fueled the failed presidential campaigns of William Jennings Bryan.[3]

If no one alive today can relate to "the passions once aroused by the cry for free silver"[4] or the despair President Franklin D. Roosevelt's Budget Director Lewis Douglas felt when Roosevelt took the country off of the gold standard ("Well, this is the end of Western Civilization"),[5] it is in part because money is now the domain of specialists and technocrats, the product of a legal-administrative process insulated from electoral contestation. At the center of this process is a government agency established in 1913[6] and reformed in 1935[7]: the Board of Governors of the Federal Reserve System (the Board).[8] The Board oversees twelve federal corporations known as Federal Reserve Banks (FRBs)[9] and thousands of banks (and bank holding companies) owned by private investors.[10]

The Board and the FRBs (collectively, the Fed) succeeded where generations of Presidents, Treasury secretaries, and congressmen failed: they took money out of partisan politics. For nearly eighty years, the production and

1. *See* IRWIN UNGER, THE GREENBACK ERA: A SOCIAL AND POLITICAL HISTORY OF AMERICAN FINANCE, 1865-1879, at 3-40 (1964); Richard Hofstadter, *Introduction to* W.H. HARVEY, COIN'S FINANCIAL SCHOOL 1-27 (Richard Hofstadter ed., Harvard Univ. Press 1963) (1894); BRAY HAMMOND, BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR (1957).

2. *See* SEAN WILENTZ, THE RISE OF AMERICAN DEMOCRACY: JEFFERSON TO LINCOLN 205-52, 360-464 (2005); HAMMOND, *supra* note 1, at 326-68.

3. *See* RICHARD BENSEL, THE POLITICAL ECONOMY OF AMERICAN INDUSTRIALIZATION, 1877-1900, at 355-456 (2000); GRETCHEN RITTER, GOLDBUGS AND GREENBACKS: THE ANTIMONOPOLY TRADITION AND THE POLITICS OF FINANCE IN AMERICA, 1865-1896, at 1-2, 47-61 (1997); JAMES LIVINGSTON, ORIGINS OF THE FEDERAL RESERVE SYSTEM: MONEY, CLASS, AND CORPORATE CAPITALISM, 1890-1913, at 90-97 (1986).

4. Hofstadter, *supra* note 1, at 1. Senator Henry Ashurst of Arizona—when pressed on his obsession with silver by President Franklin D. Roosevelt's Treasury Secretary Henry Morgenthau (who was Jewish)—replied: "My boy, I was brought up from my mother's knee on silver and I can't discuss that with you any more than you can discuss your religion with me." *Id.* (quoting JOHN M. BLOOM, FROM THE MORGENTHAU DIARIES 186 (1959)).

5. RAYMOND MOLEY, AFTER SEVEN YEARS 159-60 (1939).

6. Federal Reserve Act, ch. 6, 38 Stat. 251 (1913) (codified as amended in various sections of 12 U.S.C.). The Fed maintains a convenient compilation of the Federal Reserve Act (FRA), as amended, on its website. *See Federal Reserve Act*, BD. GOVERNORS FED. RSRV. SYS. (Feb. 25, 2019), https://www.federalreserve.gov/aboutthefed/fract.htm [https://perma.cc/LF5F-B8VK].

7. Banking Act of 1935, ch. 614, tit. II, 49 Stat. 684, 703-23.

8. Federal Reserve Act § 10, 38 Stat. at 260-61.

9. *Id.* §§ 2, 4, 38 Stat. at 251-53, 254-57.

10. *Id.* §§ 4, 9, 38 Stat. at 254-57, 259-60.

distribution of what Thomas Hobbes considered the "bloud [sic] of a Commonwealth"[11] and Jean-Jacques Rousseau called the "true bond of society"[12] slipped off center stage and out of the public consciousness.

But now conflict over money is stirring once again. Fourteen years ago, faced with a financial panic, the Fed launched a series of unprecedented initiatives to prevent the economy from collapsing into a second Great Depression. It lent $30 billion to support the Wall Street securities dealer Bear Stearns,[13] committed $123 billion to the global insurance conglomerate AIG,[14] established an alphabet soup of ad hoc lending facilities to stabilize financial markets,[15] and credited half a trillion dollars to foreign central banks so that they could backstop financial firms in Europe and Asia.[16] When the dust settled and millions of people were still out of work, the Fed went a step further: it purchased hundreds of billions of dollars' worth of bundles of home loans known as mortgage-backed securities (MBS).[17]

None of these initiatives were meant to be repeated. The country, policymakers explained, was hit by a perfect storm, a once-in-a-century disaster. The traditional playbook was of little use.[18]

Yet, within the span of barely more than a decade, the Fed did it all again. It followed up its initial asset purchase program, which the press dubbed "quantitative easing" or QE, with QE2 and QE3. In 2019, the Fed lent hundreds of billions of dollars to securities dealers to prevent a money-market breakdown.[19] A few months later, while the Fed was still supporting dealers, the onset of the COVID-19 pandemic triggered a fresh financial crisis.

In a rush to survive, Wall Street firms began dumping assets. As panic spread, the Fed reopened a slate of emergency liquidity facilities, backstopping money market mutual funds, commercial paper issuers, and asset-backed

11. THOMAS HOBBES, LEVIATHAN 174 (Richard Tuck ed., Cambridge Univ. Press rev. student ed. 1996) (1651).

12. JEAN-JACQUES ROUSSEAU, EMILE OR ON EDUCATION 189 (Allan Bloom ed., Basic Books 1979) (1762).

13. *See* PHILLIP A. WALLACH, TO THE EDGE: LEGALITY, LEGITIMACY, AND THE RESPONSES TO THE 2008 FINANCIAL CRISIS 45-56 (2015).

14. *See* ERIC A. POSNER, LAST RESORT: THE FINANCIAL CRISIS AND THE FUTURE OF BAILOUTS 81-82 (2018).

15. *See* Parinitha Sastry, *The Political Origins of Section 13(3) of the Federal Reserve Act*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., Sept. 2018, at 1, 3-4.

16. *See* ADAM TOOZE, CRASHED: HOW A DECADE OF FINANCIAL CRISES CHANGED THE WORLD 210-13 (2018).

17. *See* Diana Hancock & Wayne Passmore, *Did the Federal Reserve's MBS Purchase Program Lower Mortgage Rates?*, 58 J. MONETARY ECON. 498, 498 (2011).

18. *See, e.g.*, Timothy F. Geithner, *Are We Safe Yet? How To Manage Financial Crises*, FOREIGN AFFS., Dec. 12, 2016, at 54, 57, 63 (describing "the collapse of the financial system or a great depression" as "the equivalent of a 100-year flood," and noting that in the 2008 crisis "the conventional arsenal . . . was not enough").

19. *See* Alex Harris, *The Fed Is Entrenched in the Repo Market. How Does It Get Out?*, BLOOMBERG (Dec. 21, 2019, 7:00 AM EST), https://www.bloomberg.com/news/articles/2019-12-21/the-fed-is-entrenched-in-the-repo-market-how-does-it-get-out [https://perma.cc/5WW3-GPZJ]; Lev Menand, *The Federal Reserve and the 2020 Economic and Financial Crisis*, 24 STAN. J.L. BUS. & FIN. 295, 310 & n.51.

securities markets. It lent half a trillion dollars to broker-dealers and half a trillion dollars to foreign central banks, and it bought over two trillion dollars of financial assets in "market functioning purchases."[20]

The Fed also broke new ground. On March 27, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, authorizing the Fed to set up credit programs for medium-sized businesses, nonprofit organizations, municipalities, and large corporations—the sorts of entities that usually receive government loans from agencies in the executive branch (using money appropriated by Congress). Subsequently, the Fed opened a facility to buy up to $500 billion of state and local government debt; established a $600 billion "Main Street" program for medium-sized businesses and nonprofit organizations; and created vehicles for investing as much as $750 billion in large corporations like Apple, Walmart, and Ford.[21]

These actions sparked a debate about the Fed's expanding role. Some experts argued that the Fed's CARES Act programs involved the Fed in areas outside its proper remit and should not be repeated, but that the Fed's Wall Street lending and asset purchase initiatives were well within its mandate and bulwarks of a working monetary-financial system. These commentators are content with a largely reactive central bank that preserves the integrity of a sprawling private financial sector. Others have called for the Fed to continue and even expand its CARES Act programs. If the Fed is able to use its power to create money to rescue financial firms, why shouldn't it tackle problems directly hurting ordinary people? To these observers, the Fed should use its balance sheet to backstop "green" bonds and finance a transition to net-zero carbon emissions,[22] extend credit to municipalities at subsidized rates,[23] buy oversold securities and short expensive asset classes,[24] establish a Price Stabilization Fund to modulate the costs of essential goods,[25] and distribute cash to households during economic downturns.[26]

Who has the better argument? What is the Fed for? Why is it lending large sums of money outside of the banking system? And are there any problems the Fed *shouldn't* tackle?

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20. *See* Menand, *supra* note 19, at 323 fig.8 (2021); Lorie K. Logan, Exec. Vice President, Fed. Rsrv. Bank of N.Y., Remarks at SIFMA Webinar: The Federal Reserve's Market Functioning Purchases: From Supporting to Sustaining (July 15, 2020) [hereinafter Logan, SIFMA Remarks], https://www.newyorkfed.org/newsevents/speeches/2020/log200715 [https://perma.cc/YJ9D-A8EB].

21. Menand, *supra* note 19, at 307 fig.1.

22. *See* Adam Tooze, *Why Central Banks Need to Step Up on Global Warming*, FOREIGN POL'Y (Jul. 20, 2019), https://foreignpolicy.com/2019/07/20/why-central-banks-need-to-step-up-on-global-warming [https://perma.cc/DH6G-CWZS].

23. Robert Hockett, *Spread the Fed: Distributed Central Banking in Pandemic and Beyond*, 15 VA. L. & BUS. REV. 89, 108-15 (2020).

24. Saule Omarova, *The People's Ledger: How to Democratize Money and Finance the Economy*, 74 VAND. L. REV. 1231, 1275-76 (2021).

25. ROBERT C. HOCKETT, FINANCING THE GREEN NEW DEAL: A PLAN OF ACTION AND RENEWAL 55-58 (2020).

26. *See* FRANCES COPPOLA, THE CASE FOR PEOPLE'S QUANTITATIVE EASING 57-63 (2019).

To date, efforts to answer these questions have tended to overlook the goals of the legislators who designed the Fed and the problems they were trying to solve. Although the Fed is constituted by law and shaped by concerns about the separation of powers, individual rights, and democracy, because it has both public and private elements, public and private law scholars alike have treated it as foreign to their fields.[27] In recent years, a new specialty—financial regulation (finreg)—has attempted to fill in the gap. But finreg scholarship generally takes a narrow approach. It focuses on financial stability[28] and adopts the dominant paradigm within economics,[29] which obscures the nature of money, its construction by the state, and the role of private investors in its production and distribution. It treats the Fed as a public institution concerned with money issue and the banking system as a collection of private firms engaged in financial activities.[30] Accordingly, it depicts the Fed as a kitchen-sink agency with an amalgam of loosely related tasks and responsibilities.[31] For example, it contrasts the Fed's role as a regulator of banks, which it views as analogous to the work of agencies like the Environmental Protection Agency and the Consumer Financial Protection Bureau, with the Fed's interest rate policy, which it treats as direct public provisioning. It also puzzles over the Fed's decentralized design, the involvement of investor-owned banks in its decision-making process, and its independence from ordinary executive and judicial oversight.[32] In the finreg literature, in other words, the Fed's organization lacks coherence, the causes and

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27. For example, neither the banking system nor the Fed is featured in texts on administrative law or the separation of powers. For two recent efforts to address this gap, see Peter Conti-Brown, Yair Listokin & Nicholas R. Parrillo, *Towards an Administrative Law of Central Banking*, 38 YALE J. ON REGUL. 1, 4 & n.11 (2021), which situates Fed practices within administrative law norms; and PAUL TUCKER, UNELECTED POWER: THE QUEST FOR LEGITIMACY IN CENTRAL BANKING AND THE REGULATORY STATE (2018), which treats central banking alongside public administration more generally. This Article draws on this work at several points as noted herein.

28. *See, e.g.*, Kathryn Judge, *The First Year: The Role of a Modern Lender of Last Resort*, 116 COLUM. L. REV. 843, 859-64 (2016) (arguing that pumping liquidity into a financial system in the middle of a shortage may increase fragility and proposing alternative approaches); Dan Awrey, *Brother Can You Spare a Dollar? Designing an Effective Framework for Foreign Currency Liquidity Assistance*, 2017 COLUM. BUS. L. REV. 934, 998-1008 (2017) (considering whether the current structure of the Fed's swap lines poses moral hazard problems); Colleen Baker, *The Federal Reserve's Use of International Swap Lines*, 55 ARIZ. L. REV. 603 (2013) (examining swap lines).

29. *See, e.g.*, Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983); Charles W. Calomiris & Charles M. Kahn, *The Role of Demandable Debt in Structuring Optimal Banking Arrangements*, 81 AM. ECON. REV. 497 (1991).

30. *See, e.g.*, JOHN ARMOUR, DANIEL AWREY, PAUL L. DAVIES, LUCA ENRIQUES, JEFFREY N. GORDON, COLIN P. MAYER & JENNIFER PAYNE, PRINCIPLES OF FINANCIAL REGULATION 275-89 (2016); PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE 1-11 (paperback ed. 2017); Peter Conti-Brown & David Zaring, *The Foreign Affairs of the Federal Reserve*, 44 J. CORP. L. 665, 703-06 (2019); David Zaring, *Law and Custom on the Federal Open Market Committee*, 78 LAW & CONTEMP. PROBS. 157 (2015).

31. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 175 (arguing that the Fed performs a "mass of functions" that are "distinct").

32. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 170 ("There is simply no theory offered that justifies the legal insulation of the Fed from a variety of political pressures . . . for bank supervision."); *id.* at 173 ("Because the financial stability mandate cannot be justified by the Ulysses/punch bowl model of Fed independence, its inclusion under the same institutional umbrella confuses, rather than clarifies, the place of the Federal Reserve within government.").

implications of its recent activities are obscured, and the debates about whether it should do more (or less) going forward must be tackled piecemeal.[33]

This Article takes a different approach. Following recent work in law and macroeconomics[34] and banking,[35] it brings money back into the picture. It argues that to understand the Fed—including its place in the federal government, its initiatives since 2008, and the consequences of its expanded remit—it is necessary first to understand the U.S. monetary system. That system uses publicly chartered, investor-owned banks to issue most of the money supply. These banks are best conceptualized as public instrumentalities rather than ordinary private businesses. Over the course of the nineteenth and twentieth centuries, Congress constructed an elaborate legal regime to govern them, the purpose of which was, in large part, to sustain monetary outsourcing in the face of significant political opposition. In other work, I have termed this arrangement the American Monetary Settlement.[36]

The Fed, I argue here, is the capstone of the American Monetary Settlement. Congress built it to administer the investor-owned banking system and to stabilize it both economically and politically. Drawing on the text, structure, and legislative history of the Federal Reserve Act (FRA), as amended, I argue that today's Fed was designed to address three problems with monetary outsourcing that contemporary scholars and commentators tend to overlook, underplay, or misunderstand: monetary contraction, an uneven playing field in the banking system, and a lack of public accountability and control. I then use this understanding of the statutory scheme to answer questions left unsettled in the existing literature. First, I show that the Fed is not a kitchen-sink agency: its core statutory tools all relate to its monetary mission, as does the justification for its

33. *See, e.g.*, Peter Conti-Brown & David A. Wishnick, *Technocratic Pragmatism, Bureaucratic Expertise, and the Federal Reserve*, 130 YALE L.J. 636 (2021); Christina Skinner, *Central Bank Activism*, 71 DUKE L.J. 2 (2021). Political scientists have also examined the Fed's role as part of the government, although they have typically done so without reference to its monetary functions. *See, e.g.*, SARAH BINDER & MARK SPINDEL, THE MYTH OF INDEPENDENCE: HOW CONGRESS GOVERNS THE FEDERAL RESERVE (2017). For two monographs that center the Fed's monetary function, see SUSAN HOFFMAN, POLITICS AND BANKING: IDEAS, PUBLIC POLICY, AND THE CREATION OF FINANCIAL INSTITUTIONS (2001); JOHN T. WOOLEY, MONETARY POLITICS: THE FEDERAL RESERVE AND THE POLITICS OF MONETARY POLICY (1984).

34. *See, e.g.*, YAIR LISTOKIN, LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS (2019); TUCKER, *supra* note 27; CURZIO GIANNINI, THE AGE OF CENTRAL BANKS (2011); PERRY MEHRLING, THE NEW LOMBARD STREET: HOW THE FED BECAME THE DEALER OF LAST RESORT (2010).

35. *See, e.g.*, Dan Awrey, *Bad Money*, 106 CORNELL L. REV. 1 (2020); KATHARINA PISTOR, THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH AND INEQUALITY 77-107 (2019). Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017); MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION (2016) [hereinafter RICKS, THE MONEY PROBLEM]; Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEO. L.J. 715 (2022) [hereinafter Awrey, *Unbundling Banking, Money and Payments*]. For work on the Fed specifically, see Nadav Orian Peer, *Negotiating the Lender-of-Last-Resort: The 1913 Fed Act as a Debate Over Credit Distribution*, 15 N.Y.U. J.L. & Bus. (2019), which examines the original 1913 design of the Fed's discount window; Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757 (2018) [hereinafter Ricks, *Money as Infrastructure*], which examines the Fed's post-crisis policy framework; and Omarova, *supra* note 24.

36. Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, 74 VAND. L. REV. 951, 958-59 (2021).

substantial independence from executive oversight and judicial review. Second, I explain why the Fed's expanding activities since 2008 are largely the product of a shift in the underlying structure of the banking system: the rise of financial firms that issue alternative forms of money without bank charters. Third, I consider three downsides of the gap between the Fed's enlarged footprint and the logic animating its enabling act.

The Article proceeds in five parts. Part I provides what I believe to be the critical historical and legal context. It reconstructs the U.S. monetary framework and explains the central role played by investor-owned banks. The money these banks issue is known as deposits. People use deposits to pay their credit card bills, receive their salary, and make their rent. And although banks back deposits with a promise to pay a type of money issued directly by the government ("cash"), most people prefer deposits to cash. While roughly $2 trillion in cash is in circulation,[37] there are around $18 trillion in deposits.[38] This monetary expansion is possible because banks do not need cash to issue deposits, which they create with a keystroke.

To check the power of banks, legislators limited them in three ways: (1) separating them from "commerce," that is, from nonmonetary business activity; (2) restricting their ability to merge and branch, diffusing them geographically; and (3) subjecting them to intensive oversight by special government officials known as supervisors. These core features of banking law—separation, diffusion, and supervision—were designed to sustain outsourcing. Legislators believed that delegating the power to create money to organizations owned by private investors was worth the effort; the alternative, they thought, was government corruption, economic stagnation, and the expropriation of private property by legislative majorities.

Part II reexamines the Fed's enabling act in light of this understanding of money and banking. It argues that the Fed was not established as a "central bank" on the model of its European predecessors, which were investor owned and operated institutions engaged in a general banking business with the public. Nor was the Fed established to issue the entire money supply itself. It is a government monetary authority—a super supervisor—built to administer a decentralized system in which the power to expand and contract the money supply rests in the hands of thousands of investor-owned banks. Today's Fed is designed to perform three primary functions with respect to this system (addressing the three problems with monetary outsourcing mentioned above): (1) stimulate banks to create enough money to keep the country's economic resources fully employed;

37. *Liabilities and Capital: Other Factors Draining Reserve Balances: Currency in Circulation: Week Average*, FRED (Oct. 27, 2022), https://fred.stlouisfed.org/series/WCURCIR [https://perma.cc/8ET9-2ALK]. Not all of this cash circulates domestically; estimates vary, but a significant share is held oversees. *See* J.P. Koning, *How Much U.S. Currency is Held Overseas?*, BULLIONSTAR (July 3, 2019, 5:45 PM), https://www.bullionstar.com/blogs/jp-koning/how-much-u-s-currency-is-held-overseas [https://perma.cc/7EVZ-75TK].

38. *Deposits, All Commercial Banks*, FRED (Oct. 28, 2022), https://fred.stlouisfed.org/series/DPSACBW027SBOG [https://perma.cc/UZ34-NM86].

(2) level the playing field among banks, large and small; and (3) serve as a site of public accountability for and control over the investor-owned banking system. Although Congress charged the Fed with other tasks at various points in its history, these are the core responsibilities reflected in current law and which Congress has repeatedly reinforced.

A series of conclusions follow in Parts III, IV, and V. Part III elucidates the Fed's place within the federal government. First, it explains why the Fed's organizational structure is coherent (which is not to say optimal). Its instruments, often treated as unrelated by both practitioners and scholars, serve a unified purpose: lending, purchasing, rate setting, rule writing, supervising, and facilitating payments are all ways that Congress empowered the Fed to regulate the supply and distribution of bank deposits. Interest rate targeting (commonly known as "monetary policy") and traditional bank regulation (including both rule writing and supervision) are different sides of the same coin: both stimulate and restrain bank balance sheets. The Fed's intensive involvement in bank operations reflects the fact that in a system that relies on banks to issue most of the money supply, ensuring an adequate quantity of money requires monitoring its quality (i.e., the solvency of banks). Meanwhile, the Fed's "lender of last resort" role, often treated as another distinct function, is also a mechanism of monetary control: Congress authorized the Fed to lend to banks to stabilize the size of their balance sheets and to lend beyond banks in unusual circumstances when the banking system has broken down.

Part III also ties the logic underpinning the Federal Reserve Act to the Fed's unique institutional design. The Fed's twelve regionally controlled FRBs—most of whose directors are appointed by investor-owned banks—reflect the role of private investors in, as well as the diffuse nature of, the American banking system. The Fed's relative insulation from executive oversight and judicial review, meanwhile, reflects distinctive separation-of-powers concerns that date back to the Founding (and England's Glorious Revolution before that). Many of the legislators who championed our banking system, including the Fed, understood money issuance to be a type of *fiscal* power, an alternative to taxing or borrowing that could be used to facilitate government spending. Accordingly, they designed the Fed and the banking system to be accountable primarily to Congress rather than to the President or the Federal courts.

Part IV uses Part II's account of the Federal Reserve Act to make sense of the Fed's recent lending, borrowing, and purchasing programs. It argues that the Fed is increasingly using its statutory powers in unexpected ways to maintain order in a monetary system that has spun out of control.[39] The root problem is

39. A brief note is in order about the nature of the legal claims in this Article. My goal in this piece is not to delineate the legally permissible scope of Fed action today. Instead, it is to recover the intent of the legislators who drafted and amended the central provisions of the Federal Reserve Act, identify their overarching purposes, and describe the subsequent life of the statute. At points, I will argue that the Fed has frustrated the legislative design, interpreting its own authority in ways that are inconsistent with the best reading of Title 12. I will not, however, consider the extent to which, and in what

shadow banking: firms without banking charters (like broker-dealers, hedge funds, money market funds, and foreign financial institutions), which operate outside the confines of U.S. banking law. These firms create dollar-denominated deposit substitutes that also function as money. While these alternative forms of money are used primarily by businesses and institutional investors (not ordinary people), over the past thirty years they have come to represent an increasingly large share of the total money supply—at times more than half.[40] The Fed has responded by attempting to carry out its apex mission, monetary expansion consistent with full long-term capacity utilization, in a world that has evolved beyond the imagination of the legislators who crafted its enabling act. The Fed's post-2008 lending programs, ballooning balance sheet, and efforts to aid ordinary households and businesses are products of this shift in the composition of the money supply and the economic instability to which it gave rise.

The result—a Fed unbound, so to speak—has prompted a further crisis, one of ultimate aims and limits. Part V contributes to the debate over the Fed's proper remit by drawing on the logic of its enabling act and its place in the U.S. monetary system. The Fed was carefully constructed to carry out a complex and charged task. When the Fed deviates from the statutory scheme to accommodate the existence of monetary instruments issued by shadow banks, it threatens key legislative goals and jeopardizes the long-term political and economic durability of monetary outsourcing. The Fed's growing footprint also raises questions about its ability to carry out its activities effectively and equitably and to do so without undermining the vitality of the democratic process. Legislators, I conclude, should modernize the Federal Reserve Act and amend Title 12 of the U.S. Code to restore the structural integrity of the banking laws and improve the fit between the Fed's tools and its responsibilities.

## I. The U.S. Legal Framework for Money and Banking

The Federal Reserve is a government organization that issues paper notes used for hand-to-hand transactions. Corporations owned by private investors, meanwhile, issue deposit account balances, which are an even more common means of payment and store of value. One approach to understanding the Fed—the dominant one in recent decades—is to separate these domains and examine them piecemeal. This approach treats the Fed as a public monetary institution and banks as private financial intermediaries—profit-oriented firms that borrow government-issued money from savers and lend it out to borrowers.[41] On this view, banking is like any other commercial business and the state regulates it to address specific market failures.

circumstances, a court ought to defer to the Fed's interpretations (due to their longstanding nature or for other reasons).

40. See RICKS, THE MONEY PROBLEM, *supra* note 35, at 33-35.

41. For a leading example in the economics literature, see CHARLES GOODHART, THE EVOLUTION OF CENTRAL BANKS (1988). For examples in the finreg literature, *see* sources cited *supra* note 30.

A growing group of scholars has challenged this view of banking, noting that banks, unlike other financial intermediaries or commercial businesses, do not need government-issued money to lend; bank deposits function as a distinct form of money. But these scholars have primarily disputed the "intermediation paradigm" on conceptual grounds.[42] This Part deepens the critique by recovering the historical and legal foundations of banks as monetary institutions. It argues that American banks do not merely function as monetary institutions; they were *designed* to function as monetary institutions. Chartered banks in the U.S. are part of an outsourcing scheme for monetary expansion, and U.S. banking law is animated by concerns about delegating public power to profit-motivated investors. Recovering these political economy dimensions of U.S. banking law, the core of which I call the American Monetary Settlement, is critical to understanding the purposes and functions of the Federal Reserve, an organization that Congress created to superintend and strengthen a monetary system comprised primarily of investor-owned banks.

### *A. English and Early American Antecedents*

As with other foundational elements of the American state, the U.S. monetary system has its roots in England. There, beginning in the 1690s, Parliament, the Crown, and London business elites worked out an unprecedented economic arrangement, which included three key features.[43] The first was delegation: Parliament and the Crown repudiated their traditional role in managing the money supply. Instead, they fixed the exchange rate between government-issued money, known as pounds, and gold and silver metal, and they pledged to neither alter the exchange rate nor issue money without gold or silver backing.[44] To expand the supply of money, Parliament chartered the Bank of England, an investor-owned corporation. Parliament authorized the Bank of England to issue two new forms of money: paper notes and deposit account balances.[45] The Bank collateralized these notes and deposits with promises to

42. *See, e.g.*, Hockett & Omarova, *supra* note 35, at 1158-64; RICKS, THE MONEY PROBLEM, *supra* note 35, at 52-62.

43. For a discussion of this arrangement, see CHRISTINE DESAN, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM 296-329 (2015), which recounts the political origins of the Bank of England), and *id.* at 361-81, which recounts the decision to peg government-issued money to fixed quantities of metal measured by weight. For a political history of the Bank of England, see A. ANDRÉADÈS, A HISTORY OF THE BANK OF ENGLAND 43-127 (Christabel Meredith trans., 1909), which explains how the Bank of England emerged and secured its powers over monetary elasticity between 1694 and 1709; A.E. FEAVEARYEAR, THE POUND STERLING (1932), which describes the history of coinage and the development of paper currency in England; and J. KEITH HORSEFIELD, BRITISH MONETARY EXPERIMENTS, 1650-1710 (1960). *See also* CHARLES W. CALOMIRIS & STEPHEN H. HABER, FRAGILE BY DESIGN: THE POLITICAL ORIGINS OF BANKING CRISES & SCARCE CREDIT 90-91 (2014) (describing the note monopoly granted to the Bank of England). Calomiris and Haber—abstracting away from money as a system of governance—describe the English arrangement as the outcome of "the Game of Bank Bargains," *id.* at 85, "a political process . . . whose stakes are wealth and power," *id.* at 13, in which a country's political bodies and financial elites haggle over "[f]inancial [p]roperty [r]ights," *id.* at 38.

44. *See* DESAN, *supra* note 43, at 361-81.

45. *See* Bank of England Act 1694, 5 & 6 W. & M. c. 20, §§ 19, 27, 28, *reprinted in* 6 STATUTES OF THE REALM 483, 488, 490 (London, Record Comm'n 1819).

pay gold and silver coins denominated in pounds, but the Bank did not hold sufficient coins to make good on these promises. The notes and deposits were not bailments; they were an additional form of money that the Bank intended to keep convertible with government-issued money at par. And people for the most part treated the Bank's notes and deposits as equivalent to gold and silver coins (rather than as investments in the Bank). The Bank was not an ordinary commercial enterprise; it was a public instrumentality.[46]

It is worth dwelling briefly on the result of this arrangement. Whereas the government's ability to issue more money was constrained by the supply of gold and silver, the Bank could issue as many notes as the populace was willing to use without redeeming them for government-issued coins. It did this primarily by using them to make loans. The Bank, therefore, was in control of "monetary policy": unlike the government, it could adjust the supply of money, through lending, to spur economic expansion or contraction.

The second feature in England's innovative system was separation. To limit the Bank's power and prevent it from monopolizing ordinary trade, Parliament prohibited the Bank from engaging in commercial activities.[47] The Bank could deal in gold and silver, lend, and issue notes, but it could not compete with its nonfinancial customers. Private investors—mostly merchants—were recruited to operate the Bank. But they were not allowed to use the Bank to interfere in "private" business activities.

A third characteristic of the English model was monopoly privilege: to bolster the Bank's financial position and prevent competing entities from augmenting the money supply, Parliament pledged not to charter any other "banks of issue." It also prohibited corporations and private partnerships (consisting of six or more people) from circulating paper notes.[48] The result was a franchise system. Much private currency was snuffed out. A government-run mint ministerially supplied a base of metal-backed coins. And a government-chartered, investor-owned bank expanded the supply of money in a discretionary manner by issuing paper notes and deposits.

A century later, with each of these features firmly established in Britain, Congress set up a similar arrangement in the United States.[49] Congress

46. As Adam Smith put it many decades after the settlement was firmly entrenched, "[t]he stability of the bank of England is equal to that of the British government. . . . It acts . . . as a great engine of state." 1 ADAM SMITH, THE WEALTH OF NATIONS bk. 2, ch. 2, at 303 (Edwin Cannan ed., Methuen & Co. 1904) (1776).

47. Bank of England Act § 26; *see infra* notes 95-96 and accompanying text.

48. *See* ANDRÉADÈS, *supra* note 43, at 121-23; *see also* RICHARD D. RICHARDS, THE EARLY HISTORY OF BANKING IN ENGLAND 191-201 (Routledge 2012) (1958). The Act of 1709 did not address the practice of maintaining account balances for customers in excess of reserves of lawful money ("deposit banking"). At the time, private deposit banking was much less economically significant for a variety of reasons. This would be the loophole through which an American-style competitive banking system employing deposit-check money developed in England in the nineteenth century. *See* ANDRÉADÈS, *supra* note 43, at 258-62; RICHARDS, *supra*, at 198-99.

49. *See* HAMMOND, *supra* note 1, at 128-43; Joseph H. Sommer, *The Birth of the American Business Corporation: Of Banks, Corporate Governance, and Social Responsibility*, 49 BUFF. L. REV. 1011, 1076-85 (2001).

established a new monetary unit of account, the U.S. dollar, and fixed the price of dollars in terms of gold and silver.[50] It further pledged not to issue dollars without gold or silver backing.[51] To expand the supply of dollars, Congress chartered the Bank of the United States (BUS), a federal corporation owned primarily by private investors. Congress prohibited the BUS from engaging in ordinary business and promised that federal legislators would not charter any other banks.[52] Although Congress did not take steps to prevent states from setting up parallel quasi-governmental institutions, these state banks were subject to significant informal regulation by the BUS.[53]

But this English-inspired monetary system did not take to American soil. The central problems were political. First, the owners and managers of the BUS resembled a financial oligarchy. As one writer put it in 1819, "the congress of the United States, by the charter of the [BUS], has lost the power to control its concerns in their most essential particulars."[54] By allowing the Bank to expand the money supply, Congress lodged "vast power . . . in the hands of less than fifty individuals, who may make the whole monied capital of the United States bow to them, or suffer incalculable derangements and loses."[55] To the Bank's critics, this was "an aristocracy worthy [of] the resistance . . . an aristocracy paramount to the law of the United States, and only to be subordinated by the reserved rights of the individual states, and the force of public opinion."[56]

The second problem was that the new bankers were mostly Federalists. Partisan entrenchment, even more than the bank's oligarchic character, proved fatal. While Secretary of the Treasury Alexander Hamilton and others anticipated sustained opposition to banking from Thomas Jefferson and his allies, they did not foresee the emergence of the two-party system and the subsequent movement by Jefferson's party to charter "Republican" banks to compete with the BUS and its state cousins. As Jefferson's party took control of state governments and the number of state banks grew, so did resentment of the BUS and its de facto control over these local competitors. When the Bank's charter expired in 1811, Congress declined to renew it. Policymakers chartered a second BUS in 1816 (this time attempting partisan balance). But during the five years without a federal bank,

50. An Act Establishing a Mint, and Regulating the Coinage of the United States, ch. 16, §§ 9-20, 1 Stat. 246, 248-51 (1792).

51. *See* A. BARTON HEPBURN, A HISTORY OF CURRENCY IN THE UNITED STATES 41-45 (1915). For an overview of Congress's approach to the monetary standard over the course of the nineteenth century, see generally Hofstadter, *supra* note 1; and HEPBURN, *supra*.

52. An Act to Incorporate the Subscribers to the Bank of the United States, ch. 10, §§ 7(10), 8, 12, 1 Stat. 191, 194-96 (1791).

53. Menand, *supra* note 36, at 983.

54. Hezekiah Niles, *To Correct Abuses by the Bank*, 14 NILES' WKLY. REG. 23 (1818). President Jackson echoed Niles throughout his presidency. *See, e.g.*, Andrew Jackson, Veto Message (July 10, 1832), *reprinted in* 2 A COMPILATION OF THE MESSAGES AND PAPERS OF THE PRESIDENTS 1789-1897, at 576, 590 (James D. Richardson ed., 1899) (also available at https://www.presidency.ucsb.edu/documents/veto-message-the-re-authorization-bank-the-united-states [https://perma.cc/SLD2-3MZD]) (describing the act incorporating the Bank of the United States as an unjust law that "undertake[s] . . . to grant titles, gratuities, and exclusive privileges, to make the rich richer and the potent more powerful").

55. Niles, *supra* note 54.

56. *Id.*

the states had multiplied their own banks (to fill the void), expanding a constituency (state bankers) who lobbied to eliminate the new federal instrumentality. In 1832, the state bankers prevailed, and President Jackson vetoed a bill to renew the federal Bank's charter.[57]

*B. The American Monetary Settlement*

Over the next forty years, amidst intense social and political struggle, a new monetary configuration emerged, what I call the American Monetary Settlement. The American Monetary Settlement still undergirds our money and banking laws today (although, as we will see, its policy aims have been seriously undermined by subsequent regulatory and financial developments). It has four key features: delegation, separation, diffusion, and supervision. This Section unpacks each of these features and their distinctive political economy. In so doing, it lays the groundwork for understanding why Congress ultimately created the Fed—to strengthen the American Monetary Settlement, and in particular to enhance supervision and preserve delegation.[58]

1. Delegation

Delegation is at the heart of the American monetary system. Specially chartered, investor-owned banks, rather than government agencies, issue most of the money in the United States.[59] Today's legal framework dates to the Civil War, when Congress passed the National Bank Act (NBA).[60] The NBA established a system of "national banks," which legislators imagined would be like a third Bank of the United States split into hundreds of parts.[61] The biggest

57. *See* HAMMOND, *supra* note 1, at 369-450; MORGAN RICKS, GANESH SITARAMAN, SHELLEY WELTON & LEV MENAND, NETWORKS, PLATFORMS, AND UTILITIES: LAW AND POLICY 828-35 (2022); *see also* Letter from John McKim, Jr. to Nicholas Biddle (Jan. 18, 1820), *in* THE CORRESPONDENCE OF NICHOLAS BIDDLE DEALING WITH NATIONAL AFFAIRS, 1807-1844, at 13 (Reginald C. McGrane ed., 1919) (noting the second BUS's policy of partisan balance).

58. The U.S. legal regime for money and banking has never been entirely coherent. For example, the role of state banks plagued federal policymakers for generations. My goal here is not to suggest contingency and confusion have played no part in the history of the U.S. monetary system. Rather, my goal is to identify important continuities—to map the aspects of the law that have endured and been repeatedly reinforced by legislators.

59. This sort of delegation—to investor-owned instrumentalities—predates what has become a common feature of industrial capitalism: legislative delegation of governance authority to administrative agencies run by public officials. *See* Jeremy K. Kessler, *A War for Liberty*, *in* 3 THE CAMBRIDGE HISTORY OF THE SECOND WORLD WAR 447, 455 & n.22 (Michael Geyer & Adam Tooze eds., 2015). The constitutionality of the latter arrangement has been under increasing scrutiny in recent years, *see* Gillian Metzger, *1930s Redux: The Administrative State Under Siege*, 131 HARV. L. REV. 1, 8-33 (2017); the constitutionality of the former, however—because banks are now conceptualized as "private" businesses—has not received sustained attention since the 1930s.

60. National Currency Act, ch. 58, 12 Stat. 665 (1863). Congress repassed the law the next year. *See* National Bank Act, ch. 106, 13 Stat. 99 (1864).

61. CONG. GLOBE, 37th Cong., 2d Sess. 616 (1862) (statement of Rep. Samuel Hooper) ("[National banks will secure] all the benefits of the old United States Bank without many of those objectionable features which aroused opposition. . . . [T]he Government enabled that bank to monopolize

issuers today include organizations like Chase, Wells Fargo, and Bank of America. These banks are federal corporations chartered administratively by the Office of the Comptroller of the Currency (OCC), a quasi-independent bureau in the Treasury Department.[62] In 1933, Congress added a series of further federal banks for special purposes. The most important of these are called savings and loan associations or "thrifts" and are designed to promote homeownership.[63] Although at several points, federal legislators aimed to wholly displace state-chartered banks, they never succeeded. Congress still permits states to charter banks, which the federal government strictly regulates through a variety of federal laws.[64]

State- and federally chartered banks (and thrifts) are designed to expand the money supply.[65] Each issues its own money in the form of deposit account balances recorded on its books.[66] Deposit account balances function as an alternative to government-issued cash—they can be used to make payments by check or wire. But they are not truly equivalent to cash, as banks do not hold cash to back them. And even though banks promise to pay their depositors cash on demand, these promises are not meant to be kept, at least not at scale. Banks generally hold very little cash and can create new deposits at a keystroke. Most transactions settle on bank books without any government cash ever changing hands.[67]

Today, the reasons why Congress delegated the power to issue money to banks are submerged. Drawing on models in financial economics, scholars tend to assume either that the government issues the whole money supply and that banks are mere intermediaries,[68] or that the system of investor-owned money issuers is the product of private ordering, with the government intervening

the business of the country. Here no such system of favoritism exists. . . . It will be as if the Bank of the United States had been divided into many parts, and each part endowed with the life, motion, and similitude of the whole . . . .").

62. *See* 12 U.S.C. §§ 1, 27 (2018).

63. Home Owners' Loan Act of 1933, Pub. L. 73-43, § 5, 48 Stat. 128, 132-34. Congress shifted supervision and chartering of thrifts to the OCC in 2010. *See* 12 U.S.C. § 5412 (2018).

64. Most notably, the Federal Reserve Act, as discussed further herein, and the Federal Deposit Insurance Act, through which most state banks have deposit insurance and are therefore subject to oversight by the Federal Deposit Insurance Corporation. 12 U.S.C. §§ 1811-1835a (2018).

65. *See* Irving Fisher, Address at the Controllers Institute of America Third Annual Dinner (Sept. 18, 1934) (transcript available in the Yale University Library, Library Shelving Facility, Nfg10 +C78m) ("Each commercial bank is a private mint."); JOHN KENNETH GALBRAITH, MONEY: WHENCE IT CAME, WHERE IT WENT 18-20 (1975) (analogizing banks to mints).

66. *See* PAUL SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 227 (13th ed. 1989) (noting that "today is the age of bank money" and "[i]f we calculate the total dollar amount of transactions, nine-tenths take place by bank money, the rest by paper money"); N. GREGORY MANKIW, PRINCIPLES OF MACROECONOMICS 347 (5th ed. 2009) ("*[B]anks create money*.").

67. Banks, of course, cannot create deposits without limits. While individual loan decisions are a matter of private ordering, as we will see, the government restricts the overall amount of money banks are able to create, influences who benefits from bank money creation, and requires banks to treat low-income and minority communities fairly.

68. *See, e.g.*, FREDERIC S. MISHKIN, THE ECONOMICS OF MONEY, BANKING & FINANCIAL MARKETS 7-8 (7th ed. 2010) (defining financial intermediaries as "institutions that borrow funds from people who have saved and in turn make loans to others"); Merton H. Miller, *Do the M&M Propositions Apply to Banks?*, 19 J. BANKING & FIN. 483, 484-86 (1995) (treating banks as intermediaries).

largely to prevent instability.[69] Either way, scholars overlook the various rationales that underpin delegation.

The first step to understanding the Fed, therefore, is to denaturalize delegation. The U.S. banking system was not the organic byproduct of market forces. It was actively constructed by the government. Delegation was a policy choice. And it implicates not only matters of efficiency and stability, but also broader issues of political economy. Delegation, for example, limits the role of the government in credit allocation and the power of political majorities to redistribute resources. It also entrenches elites, who tend to control banks and hence access to money and credit. When many of our banking laws were written, these dimensions of banking law were at the forefront of the public discussion.

It is worth examining briefly the leading arguments advanced in favor of outsourcing: (1) preventing inflation, (2) protecting property rights, (3) strengthening the government, and (4) averting public corruption.[70]

Preventing inflation was perhaps the most significant motivation. Congress delegated ownership of banks and thrifts to managers selected by private shareholders because policymakers believed that "hybrid money" was the best money.[71] Only by recruiting investors motivated by profit, the thinking went, could the state expand the money supply beyond gold and silver without undermining confidence in the currency.[72] One problem was that if the government issued paper and deposit money directly, legislators could use it to pay for current consumption.[73] Another problem was that the mere prospect of government overissue might lead people to dump dollars for foreign currency or other stores of value, depreciating the dollar and destabilizing the economy. Banks, according to their proponents, could create new money only in exchange

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69. *See* Perry Mehrling, *Essential Hybridity: A Money View of FX*, 41 J. COMP. ECON. 355, 362-63 (2013); MEHRLING, *supra* note 34, at 11-29; *see also* George Selgin & Lawrence H. White, *A Fiscal Theory of Government's Role in Money*, *in* MONEY: FREE AND UNFREE 3 (2017) (arguing that the system of investor-owned money issuers is a product of private ordering and that government intervention actually generates instability).

70. These are not legal arguments, of course. In that regard, it was long thought, even by opponents of monetary outsourcing, that the matter was settled by Chief Justice Marshall in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 409-10 (1819). *See, e.g.*, 50 CONG. REC. 4974 (1913) (statement of Rep. Charles Bartlett) ("I do not believe in the system that provides for the issuing of currency through national banks. . . . I would have the Government, and the Government alone [issue currency] . . . but this system . . . has passed the stage of discussion or action, because the Supreme Court . . . decided that such a system was constitutional in the case of McCulloch against Maryland . . . .").

71. The critical moment was in 1863 when Congress established the national banking system as an alternative to relying on direct issue. *See* Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. 1361, 1389-97 (2021).

72. *See, e.g.*, CONG. GLOBE, 37th Cong., 3d Sess. 842 (1863) (statement of Sen. John Sherman) ("[W]hy look at all to the interests of the banks; why not directly issue the notes of the Government . . . ? The only answer . . . is that history teaches us that the public faith of a nation alone is not sufficient to maintain a paper currency. There must be a combination between the interests of private individuals and the Government.").

73. *Report of the Secretary of the Treasury on the State of the Finances for the Year Ending June 30, 1862*, U.S. DEPT. OF THE TREASURY 16 (1863) [hereinafter *Report on the Finances*], https://fraser.stlouisfed.org/files/docs/publications/treasar/AR_TREASURY_1862.pdf [https://perma.cc/PFD4-D4XX] (objecting that directly issued notes would lead to "excessive expansion" and "the danger of lavish and corrupt expenditure, stimulated by facility of expansion").

for investment assets like loans (they lend new deposits into circulation). And investor-owned banks would be incentivized to make new loans only when they expected to be paid back.[74] As a result, they would issue the amount of money needed for economic flourishing and no more.[75]

Closely related to the concern about excessive monetary expansion and maintaining confidence in the value of money over time was a desire to protect private property rights. An interest in property rights was among the primary motivations for the original English arrangement in the early eighteenth century.[76] Property rights also prompted Adam Smith to criticize experiments with government-issued paper currencies in colonial America.[77] And protecting property rights led members of the First Congress to charter the BUS. Many Founders saw monetary outsourcing as a critical aspect of English liberty that they wished to retain—freedom from a state that could extract private wealth without levying taxes.[78] The present-day insulation of the monetary system from democratic politics, on this view, is not a bug; it is a feature—perhaps the most desirable feature—of an investor-owned banking system. It limits the ability of the government to issue new money to finance its activities or opaquely redistribute resources from creditors to debtors.

A third factor that drove the government to establish investor- rather than government-owned banks is harder to appreciate today: the state's need to cultivate powerful stakeholders. Delegation took root and developed in the Anglo-American legal system during moments of state formation: in the 1690s, following the Glorious Revolution; in the 1780s and 90s, following the American Revolution; and in the 1860s, amidst the Civil War. During each of these moments, the state sought assistance from wealthy citizens. By offering these citizens a say in economic governance, as well as a steady stream of rents,[79] the state gave them a reason to support it.

74. This justification for using investor-owned banks to expand the money supply dates to the 1690s. Hamilton emphasized it in his push to charter the Bank of the United States (BUS). *See* ALEXANDER HAMILTON, REPORT ON A NATIONAL BANK (1790), *in* 1 THE WORKS OF ALEXANDER HAMILTON 59, 82 (New York, Williams & Whiting 1810) (noting that direct government issuance of paper money is "liable to abuse"); *id.* at 95 (describing the dangers of government-directed credit).

75. The United States was one of many countries that delegated note issue for this reason. *See* M.H. DE KOCK, CENTRAL BANKING 26 (rev. 2d ed. 1946) ("In some countries the note issue was entrusted to banks owing to the heavy depreciation of, and the consequent loss of public confidence in, notes issued by the State . . . .").

76. *See* ANDRÉADÈS, *supra* note 43, at 14-42 (explaining the origin and development of banking in England as a response to a series of expropriations by the Crown from the Seizure of the Mint in 1640 to the Stop of the Exchequer in 1672); *see also* Douglas North & Barry Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England*, 49 J. ECON. HIST. 803, 810-15 (1989); DESAN, *supra* note 43, at 281-88.

77. SMITH, *supra* note 46, bk. 2, ch. 2, at 309-10 (describing depreciated paper currency as "a scheme of fraudulent debtors to cheat their creditors").

78. *See* HAMILTON, *supra* note 74, at 82-83 ("The stamping of paper is an operation so much easier than the laying of taxes, that a government, in the practice of paper emissions, would rarely fail in any such emergency, to indulge itself too far in the employment of that resource, to avoid as much as possible, one less auspicious to present popularity.").

79. *See Report on the Finances*, *supra* note 73, at 16 ("Notes circulating as money . . . [form] a highly accumulative species of property.").

A fourth argument in favor of delegation was also related to state building: preventing government corruption. When the federal government established the national banking system during the Civil War, policymakers worried that it would be impossible for the Treasury during normal times to provide money "in sufficient amounts for the wants of the people" merely by spending it to pay the government's bills.[80] Rather, the government would have to, on occasion, lend money into circulation, which would "convert the treasury into a government bank, with all its hazards and mischiefs."[81] "No Government," one leading congressman worried, "can perform the functions of a bank by loaning money without becoming corrupt and progressively arbitrary and despotic."[82]

2. Separation

Much of the rest of American banking law was designed to make delegation politically palatable and institutionally durable. This is especially true of separation. Separation dates to the 1690s, when Parliament chartered the Bank of England. The very first U.S. bank charters included separation provisions[83] prohibiting banks, which were considered quasi-governmental enterprises, from entering the "private" sphere of ordinary commerce.

Today, separation is codified in the NBA, among other places.[84] The NBA authorizes banks to exercise only "such incidental powers as shall be necessary to carry on the business of banking," which the law defines as issuing notes and deposits, making loans, discounting bills, and dealing in precious metals and foreign currency.[85] Congress designed the NBA to bar banks from using their power to create money to compete with nonmonetary businesses, including financial firms like securities dealers and wealth managers.[86]

During the 1930s, Congress blocked banks from skirting these restrictions by affiliating with businesses that shared ownership and management personnel.[87] It also barred everyone else from engaging in banking (i.e. issuing

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80. *Id.*

81. *Id.* at 17.

82. CONG. GLOBE, 38th Cong., 1st Sess. 1451 (1864) (statement of Rep. Hooper).

83. An Act to Incorporate the Subscribers to the Bank of the United States, ch. 10, §§ 7(10), 8, 1 Stat. 191, 194-95 (1791); An Act to Incorporate the Stockholders of the Bank of New York, 1791 N.Y. Laws 237, 240 ( "[The bank] shall not, directly or indirectly, deal or trade, in buying or selling, any goods, wares, merchandize, or commodities whatsoever").

84. For example, the FRA prevents state-chartered banks that are member of the Federal Reserve System from securities dealing. Federal Reserve Act § 9, para. 20, 12 U.S.C. § 335 (2018).

85. 12 U.S.C. § 24(Seventh) (2018). Proponents of a more expansive reading of this provision argue that the list is merely demonstrative (and that the phrase "the business of banking" represents a separate grant of power that is flexible and open to interpretation). The Supreme Court endorsed a version of this reading in *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*, 513 U.S. 251 (1995). For a critique of this decision, see Menand & Ricks, *supra* note 71, at 1397-1406.

86. There are exceptions. For example, banks serving communities with less than 5,000 residents can act as insurance agents. Federal Reserve Act § 13, para. 11, 12 U.S.C. § 92 (2018). Banks have also often attempted to enter other businesses, with and without the approval of their regulators.

87. Banking Act of 1933, ch. 89, sec. 20, 48 Stat. 162, 188-89; Federal Reserve Act § 23A, 12 U.S.C. § 371c (2018) (originally added by the Banking Act of 1933 sec. 13, § 23A, 48 Stat. at 183).

deposits) without government authorization.[88] In 1956, to close further loopholes, Congress passed the Bank Holding Company Act (BHCA), which it strengthened in 1966 and 1970 to prevent evasion.[89] Although regulators and courts weakened these statutory barriers, especially from the 1980s on,[90] legislators have only once significantly liberalized separations: in 1999, Congress authorized "Financial Holding Companies," affiliations of banks, securities dealers, and insurers under a single corporate umbrella.[91]

Although the "separation of banking and commerce" has attracted increasing attention since the 2008 financial crisis, this attention focuses on a stability rationale, a relatively recent reason for limiting the activities of banks and their affiliates.[92] This rationale also tends to take the distributional politics out of monetary system design.[93] Until the Great Depression, the animating legislative purpose behind separation was to prevent unfair trade practices and the undue concentration of private power.[94]

The concern that, wielding their monetary privileges, bankers would infringe on commercial liberty is coeval with the decision to delegate monetary powers to investor-owned banks. Parliament wrote into the law its reason for barring the Bank of England from the "buying or selling of any Goods Wares or Merchandizes": it did not want the Bank to "oppress[]" the merchants it was designed to assist.[95] This purpose is unsurprising. The Whigs who forged the English monetary framework (and championed the Bank of England) were trying to protect commercial freedom from what they considered an extractive and

88. Banking Act of 1933 sec. 21(a)(2), 48 Stat. at 189 (codified as amended at 12 U.S.C. § 378(a)(2)).

89. Bank Holding Company Act of 1956, ch. 240, 70 Stat. 133 (codified as amended at 12 U.S.C. §§ 1841-1850); Act of July 1, 1966, Pub. L. No. 89-485, 80 Stat. 236; Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760.

90. *See* Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 U. MIA. L. REV. 1041, 1050-1052, 1051 n.37 (2009). Although banks today conduct a range of nonmonetary financial and nonfinancial businesses with the express approval of both bank regulators and federal courts, *see NationsBank*, 513 U.S. at 251; Menand & Ricks, *supra* note 71, at 1399-1401, banks remain unable to conduct most forms of business, and most businesses, especially nonfinancial ones, steer clear of "shadow banking,".

91. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, secs. 101-109, 113 Stat. 1338, 1341-62 (1999). This law also authorized national banks to underwrite certain municipal bonds. *Id.* sec. 151, 113 Stat. at 1384 (amending 12 U.S.C. § 24(Seventh)).

92. *See* Robert C. Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787, 814-16 (1979).

93. *But see* ARTHUR E. WILMARTH, JR., TAMING THE MEGABANKS: WHY WE NEED A NEW GLASS-STEAGALL ACT (2020) (tracing the stability rationale for separations and assessing it in distributional terms).

94. S. REP. NO. 100-19, at 2 (1987) ("At the foundation of American financial law is a longstanding tradition of separating banking and commerce. This separation has served to preserve the equal availability of credit in the United States and minimize the concentration of financial and economic power."). *See* Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265, 274-78 (2013).

95. Bank of England Act 1694, 5 & 6 W. & M. c. 20, § 26, *reprinted in* 6 STATUTES OF THE REALM 483, 489-90 (London, Record Comm'n 1819).

arbitrary government; they certainly did not want to escape oppression by the Crown only to find themselves oppressed by the Bank.[96]

Following America's first "bank war" in 1787, Pennsylvania copied Parliament's language almost verbatim into the charter of the country's first bank, the Bank of North America.[97] Similar concerns motivated separations provisions in the 1790s, 1810s, 1830s, as well as at each critical moment when current law was enacted: 1863, 1933, 1956, and 1966.[98] As Congressman William Bourke Cockran put it in 1895, bank money "is not issued for the benefit of the banks, but principally for the benefit of the depositors. Banks can not absorb all the profits of industry. *They are the servants, not the masters of commerce*."[99]

Relatedly, Congress restricted bank activities to preserve political liberty by checking the power and influence of the people who run banks. Again, the concern goes all the way back to the creation of the Bank of England. As one London merchant wrote in 1707:

> It's impossible to foresee all the Mischiefs that may happen by a Confederacy of such as are Directors both of [the East] *India* Company and Bank of *England*; for what cann't Two so Powerful Bodies by their United Force bring about? What cann't they Promote or Obstruct in Parliament, wherein they Interest themselves? . . . Especially having the Nation's Purse at their Girdle . . . we can never again hope to retrieve the Fatal Oversight, since those that have got the Power will never part with it . . . .[100]

This same concern—the possibility that private power could corrupt representative government—features in U.S. legislative debates from the 1790s to the 1980s.[101] And it is reflected in current law, which authorizes the

96. Nonetheless, from the start, London merchants complained that Bank of England directors had conflicts of interest. *See* HORSEFIELD, *supra* note 43, at 140 (explaining that a common accusation was that the Bank was controlled by a small ring of self-interested, related families); *see also* A MERCHANT OF LONDON, THE REASONS OF THE DECAY OF TRADE AND PRIVATE CREDIT ¶¶ 16-17, at 10-11 (London, J. Morphew 1707) ("Many of the Directors of the *East-India* Company are Chief Directors in the Bank, and have very great [wealth] of their own . . . and therefore . . . have different Interests in view; so that the Interest of the Company is not always the Interest of *those Directors*, who, having the Power of Issuing out both Bonds in the *East-India* Company, and Bills in the Bank, (as being Leading Men in both) will unquestionably do it in Favour of their Separate Interest; and that this is so in Fact, many Instances may be given.").

97. An Act to Revive the Incorporation of the Bank of North America, ch. 1267, § 5, 2 Pa. Smith's Laws 399 (1787), https://www.palrb.gov/Preservation/Smith-Laws/View-Document/17001799/1787/0/act/1267.pdf [https://perma.cc/87H9-UP74].

98. For a detailed account of why American legislators incorporated separations provisions into bank charters in the early republic, see Sommer, *supra* note 49.

99. 27 CONG. REC. app. at 177 (1895) (statement of Rep. W. Bourke Cockran) (emphasis added). President Wilson echoed this line when he pushed Congress to create the Federal Reserve Board. *See infra* note 225.

100. A MERCHANT OF LONDON, *supra* note 96, ¶¶ 43, 47, at 33, 37-38.

101. *Bank Holding Company Legislation: Hearings on H.R. 10668 and H.R. 10872 Before the H. Comm. on Banking & Currency*, 88th Cong. 5-6 (1964) (Statement of Hon. Robert King High, Mayor, City of Mia., Fla.) (citing a front-page article from the Miami Herald explaining that the Du Pont Estate,

government to block acquisitions of bank shares not only when officials conclude that it "is necessary to prevent . . . decreased or unfair competition [or] conflicts of interest" but also if they determine that it is needed to prevent the "undue concentration of resources."[102]

Stability is by comparison a rather recent rationale for separating banking and commerce. It arises for the first time in the 1930s, in response to evidence that banks affiliating with securities dealers can reduce the integrity of the money supply.[103] It appears again in the legislative history of the BHCA.[104] And it features heavily in contemporary debates about reversing the fusion of banking and various financial businesses in the 1980s and 1990s.[105] For example, in 2010, Congress rolled back banks' authority to deal in swaps (a type of financial derivative).[106] Proponents of these measures did not justify them as necessary to prevent banks from monopolizing these markets, even though banks were, in fact, monopolizing them. Instead, they argued that separations were required to protect taxpayers from losses that banks might incur through these activities.[107]

3. Diffusion

Separation alone proved insufficient to sustain delegation in the United States.[108] Following a tumultuous period of experimentation that culminated in the Civil War, Congress adopted a new approach to money that New York pioneered in the 1830s and that over a dozen states later implemented

Florida's largest landowner, banker, and taxpayer, was "Florida's most powerful economic-political force, strong enough to elect Governors and Senators and influential enough to achieve or block all sorts of State public works projects").

102. 12 U.S.C. § 1843(a)(2) (2018).

103. *See, e.g.*, S. REP. NO. 72-584, at 9 (1932) (explaining that "a large factor . . . in the dangerous use of the resources of bank depositors for the purpose of making speculative profits and incurring the danger of hazardous losses, has been furnished by perversion of the national banking and state banking laws" so that banks can affiliate with or engage in underwriting operations, stock speculation, and market making).

104. H.R. REP. NO. 84-609, at 16 (1956) ("[B]anks are prohibited from engaging in any other type of enterprise . . . because of the danger to the depositors which might result where the bank finds itself in effect both the borrower and the lender. . . . [I]n critical times the holding company which operates nonbanking businesses may be subjected to strong temptation to cause the banks which it controls to make loans to its nonbanking affiliates even though such loans may not at that time be entirely justified . . . .").

105. Omarova, *supra* note 94, at 275-76; Saule T. Omarova & Margaret E. Tahyar, *That Which We Call A Bank: Revisiting the History of Bank Holding Company Regulation in the United States*, 31 REV. BANKING & FIN. L. 113, 120-29 (2012).

106. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 716, 124 Stat. 1376, 1648-51 (2010) (codified as amended at 15 U.S.C. § 8305).

107. *See* Menand & Ricks, *supra* note 71, at 1400-01, 1401 n.228 (explaining how commercial banks went from playing no role in derivatives markets to dominating them and recounting the fight over the 2010 changes to the law). One problem with the stability rationale for diffusion is that substantial evidence suggests that at least some conglomeration *improves* stability. *See* Howell E. Jackson, *The Expanding Obligations of Financial Holding Companies*, 107 HARV. L. REV. 507, 572-82 (1994).

108. One problem, of course, was that separation rules were often evaded. For an account of the de facto interrelation of banks and ordinary businesses, see NAOMI R. LAMOREAUX, INSIDER LENDING: BANKS, PERSONAL CONNECTIONS, AND ECONOMIC DEVELOPMENT IN INDUSTRIAL NEW ENGLAND (1994). For an example of how these interrelations persisted even after the New Deal legal reforms restricted bank affiliations, see RICKS ET AL., *supra* note 57, at 844.

successfully: diffusion.[109] Congress enabled anyone to apply for a charter to open a national bank[110] and created a special government bureau, the OCC, to process applications.[111] The idea was to eliminate the special privileges associated with legislative chartering, as well as to disperse the power to expand the money supply across many different people and geographic regions. To that end, Congress sought also to prevent conglomeration.[112] For most of U.S. history, this meant no branching—banks were limited to one location.[113] While Congress reversed many of the federal restrictions in the 1990s,[114] leading to the emergence of large, complex banking organizations,[115] the U.S. banking system remains highly diffuse compared to other countries.[116]

Today, scholars take the core principles of diffusion for granted. But multiplying banks and reducing their size was a major policy shift in the early republic. Indeed, many at the time viewed it as irresponsible,[117] as they believed that diffusion would lead to excessive competition, which would weaken banks, increase the chances of bank failure, and undermine stability. Policymakers have generally cited four reasons for running these risks: (1) democratizing money creation; (2) preventing corruption; (3) checking private power; and (4) promoting accountability.[118]

Democratizing money creation was New York's original impetus for adopting administrative chartering in 1838. A political movement, which catapulted Andrew Jackson to the White House and nearly splintered the

109. In earlier work, I referred to this element as "open access," Menand, *supra* note 36, at 958, but "diffusion" better captures the relevant goal. Legislators sometimes sought to achieve diffusion through open access. But at other points they restricted access and furthered diffusion through restrictions on size and scope.

110. 12 U.S.C. § 21 (2018).

111. 12 U.S.C. §§ 26, 27 (2018).

112. *See* McFadden Act, ch. 191, 44 Stat. 1224 (1927) (authorizing national banks to branch, but only to the extent permitted by state law and only within the state in which the bank is situated); Bank Holding Company Act of 1956, ch. 240, § 3, 70 Stat. 133, 134-35 (codified as amended at 12 U.S.C. § 1842) (prohibiting, among other things, a company that owned a bank in one state from acquiring a bank in another state).

113. *See* H.R. REP. NO. 63-69, at 13 (1913) (explaining that if branching were allowed "it would practically . . . have entailed the contracting of the number of independent banks in the United States, [the expansion of large national institutions], and a corresponding limitation of the perfect freedom of competition which exists to-day").

114. *See* Riegle-Neal Interstate Banking and Branching Efficiency Act, Pub. L. No. 103-328, 108 Stat. 2338 (1994). These changes followed extensive branching deregulation at the state level.

115. *See* Lev Menand, *Too Big to Supervise: The Rise of Financial Conglomerates and the Decline of Discretionary Oversight in Banking*, 103 CORNELL L. REV. 1527, 1551-58 (2018).

116. *2011 Annual Report*, FIN. STABILITY OVERSIGHT COUNCIL 57, 58 chart 5.2.9 (2011), https://home.treasury.gov/system/files/261/FSOCAR2011.pdf [https://perma.cc/PNT9-8WV5].

117. *See, e.g.*, Letter from Alexander Hamilton to William Seton (January 18, 1791), *in* HENRY W. DOMETT, A HISTORY OF THE BANK OF NEW YORK: 1784-1884, at 43 (New York, G.P. Putnam's Sons 1884) ("[T]hree great banks in one city must raise such a mass of artificial credit as must endanger every one of them, and do harm in every view.").

118. A fifth reason—facilitating market discipline by ensuring that no bank is "too big to fail"—has animated policymakers since the 2008 financial crisis but has not resulted in any significant statutory reforms designed to promote diffusion. For a proposal to break up big banks so that "failure is an option," see Jonathan R. Macey & James P. Holdcroft, Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L. J. 1368 (2011).

Democratic Party, held that money creation should not be a privilege reserved for a select few, but freely available to all. "It is but justice and good policy," President Jackson explained in his message vetoing the recharter of the second BUS, "to let each in his turn enjoy an opportunity to profit by our bounty."[119] According to Jackson, the government should pursue "equal protection, and, as Heaven does its rains, shower its favor alike on the high and the low, the rich and the poor."[120] If Congress insisted on delegating its control over monetary expansion to private actors, it had to do so on principles of open access.[121] The alternative, Jackson and others argued, offended the Constitution.[122]

These advocates were also concerned with preventing corruption, as the history of legislative chartering in the country was rife with scandal.[123] Officials hoped that diffusion would eliminate bribes and other foul play and that administrative chartering would free the legislature from both the appearance of picking winners as well as the unsavory dealing involved in passing private bills, two significant problems in antebellum politics.[124]

Additionally, diffusion was designed to split apart the power to issue money to such an extent that no single bank enjoyed too much stature and importance. As President Franklin D. Roosevelt explained when he called on Congress to prevent banks from conglomerating through holding company structures, "the liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than their democratic state itself."[125] Moreover, in a system dominated by one bank, like the BUS, balance sheet expansion faces few exterior constraints—when the bank makes new loans, it knows that any cash it pays out to borrowers will find its way back to the bank after the borrowers spend it. In a system with many banks, by contrast, banks check each other, disciplining overissue. A diffuse system also offers people a choice over which bank's money they hold, which incentivizes banks to be responsive to deposit holders, reduces oligopoly abuses, and opens new avenues to access bank credit.

Finally, diffusion was meant to increase accountability. In a system where banks are small and numerous, bankers are local.[126] The BUS, which loomed as a bugbear in American money matters well into the twentieth century, was a distant and alien power to most Americans. The National Bank Act created a

119. Jackson, Veto Message, *supra* note 54, at 578.

120. *Id.* at 590.

121. *See* FRITZ REDLICH, THE MOLDING OF AMERICAN BANKING: MEN AND IDEAS pt. 1, at 189 (photo. reprt. 1968) (1951) (quoting Edward Curtis advocating the "rights of the people to compete with the incorporated banks in dealing in money and credit").

122. *See* Jackson, Veto Message, *supra* note 54, at 583-84; *see also* Joseph Fishkin & William E. Forbath, *The Anti-Oligarchy Constitution*, 94 B.U. L. REV. 669, 675 (2014).

123. *See, e.g.*, HAMMOND, *supra* note 1, at 161-64.

124. *See* Jane Manners, Congress and the Problem of Legislative Discretion, 1790-1870, at 16-21 (2018) (Ph.D. dissertation, Princeton University), https://ssrn.com/abstract=3344925 [https://perma.cc/SY2X-524L].

125. S. DOC. NO. 75-173, at 1 (3d Sess. 1938).

126. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 35, 110-12 (1994).

system in which bankers tended to live in the communities they served,[127] enhancing their legitimacy and increasing the likelihood that their communities would prevent them from abusing their franchise. To quote President Roosevelt again: private "power [over banking resources] becomes particularly dangerous when it is exercised from a distance."[128]

4. Supervision

Diffusion necessitated a further innovation: a new form of technocratic administration to manage a dispersed monetary system. With the government no longer handpicking its franchisees, and with so many franchisees spread about the country, legislators commissioned officials to coordinate banks to ensure that they worked together and in the public interest. Known as "supervision," the mode of governance that emerged is distinct from modern rulemaking and adjudication (as well as the common agency practice of issuing general statements of policy and other guidance). It is "extensive and informal."[129] It proceeds through iterative, ongoing, *firm-specific* engagement. It tends not to involve any final agency action at all. Through ongoing examination, dialogue, and confidential letters, supervisors share their concerns with banks, and banks adjust their activities.[130] This practice of comment and response is rooted in (and takes place in the shadow of) "capacious [statutory] approval powers, monitoring rights, and remedial authorities."[131] These authorities permit agencies to discipline banks not only when bankers break bright-line legal rules, but whenever, "*in the opinion of* [the agencies]," bankers are engaging in, have engaged in, or are about to engage in "unsafe or unsound practice[s]."[132] ("Although there is in fact an iron hand within the velvet glove of the banking authorities, the glove is seldom removed."[133])

New York and Massachusetts laid the groundwork for supervision in the 1830s and '40s when they first began to diffuse the banking franchise. During the Civil War, Congress imported some state supervisory practices as part of the National Bank Act. Congress later enhanced supervision in the 1930s and reinforced it at least once each decade beginning in the 1960s.[134] In the late 1990s

127. The law requires a majority of a national bank's directors to live in the state, territory, or district in which the bank is located or within one hundred miles of the bank's office, and to do so for at least one year prior to their election. 12 U.S.C. § 72 (2018).

128. S. DOC. NO. 75-173, at 8.

129. *In re* Subpoena Served Upon the Comptroller of the Currency, 967 F.2d 630, 633-34 (D.C. Cir. 1992).

130. *Id.*

131. Menand, *supra* note 36, at 953-54 (footnotes omitted).

132. 12 U.S.C. § 1818(b) (2018) (emphasis added); *see also id.* § 1831p-1 (enabling rulemaking). In the case of cash advances, even this finding is not required; the Fed can cut banks off for no reason at all. *Id.* § 347b(b)(4).

133. ATT'Y GEN.'S COMM. ON ADMIN. PROC., *Federal Control of Banking: Comptroller of the Currency and Federal Deposit Insurance Corporation*, *in* ADMINISTRATIVE PROCEDURE IN GOVERNMENT AGENCIES, S. DOC. NO. 76-186, pt. 13, at 18 (1940).

134. Menand, *supra* note 36, at 1003-12.

and early 2000s, as the financial sector conglomerated, supervisors disarmed, and supervision as a distinct mode of governance fell out of the legal imagination.[135] But following the 2008 crisis, officials revived supervisory oversight and its statutory purposes have received renewed attention.[136] These purposes include (1) protecting the public interest in, among other things, monetary stability, (2) promoting confidence in the money supply, and (3) checking the power of bankers.

As in any franchisor-franchisee relationship, the government-banker relationship is fraught with conflicts of interest.[137] To protect the public, policymakers decided that banks ought to be "supervise[d] [by the government] to see to it that they conform to certain high standards."[138] To this end, three federal banking agencies alongside state regulators write and fill gaps in regulatory rules, promote sound bank money, and manage the government's financial exposure to bank balance sheets. Using stress testing, examinations, and continuous dialogue, supervisors ensure that banks hew to their public purposes and do not take advantage of their special privileges to extract rents.

Supervisors also promote confidence in banks. Since each bank issues its own money, each bank is vulnerable to runs by depositors and other short-term creditors who lose confidence in its operations. Supervisors offer an official stamp of approval.[139] One role that supervisory stress tests have played in recent years, for example, is signaling to market participants that bank money is just as good as cash, and that the government stands behind it.

Finally, as with separation and diffusion, supervision mitigates concerns about overmighty bankers. Supervisors limit banker discretion and uncover abuses. When faced with instability or scandal in the banking system, Congress has invariably responded by both blaming supervisors[140] and enhancing their power.[141] It was during one particularly turbulent period that Congress decided

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135. *See* Menand, *supra* note 115, at 1564-73.

136. *See, e.g.*, Menand, *supra* note 36, at 964-80; Menand, *supra* note 115, at 1541-87; Daniel K. Tarullo, *Bank Supervision and Administrative Law*, COLUM. BUS. L. REV. 279, 286-314 (2022); Da Lin & Lev Menand, *The Banker Removal Power*, 108 VA. L. REV. 1, 10-27 (2022); Thomas Eisenbach, Andrew Haughwout, Beverly Hirtle, Anna Kovner, David Lucca & Matthew Plosser, *Supervising Large Complex Financial Institutions: What Do Supervisors Do?*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., Feb. 2017, at 57, 72-73 (2017).

137. *See* Lin & Menand, *supra* note 136, at 10-14, 55-71.

138. *See* Franklin D. Roosevelt, Draft Address to the American Bankers Association 3 (Oct. 24, 1934) (available from the Franklin D. Roosevelt Presidential Library, File No. 745), https://catalog.archives.gov/catalogmedia/lz/presidential-libraries/roosevelt/577534/msf00766.pdf [https://perma.cc/9H79-JZ6D].

139. *See* RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF FINANCIAL INSTITUTIONS 344 (6th ed. 2017) (explaining that before deposit insurance, "supervision played a crucial role in preventing runs" and that, in that regard, "[p]erception mattered as much as reality" because "[i]f people believed that banks were strictly supervised, they would be less likely to lose confidence in a bank at the first ugly rumor of problems").

140. *See, e.g.*, *Modernizing Bank Supervision and Regulation, Part II: Hearing Before the S. Comm. on Banking, Hous. & Urb. Affs.*, 111th Cong. 17 (2009) (statement of Sen. Richard Shelby) ("You would have to give them an 'F' if you were a teacher on their ability to regulate the banks.").

141. *See, e.g.*, Menand, *supra* note 36, at 1003-13 (detailing the expansion of supervisory powers in 1933, 1966, 1978, 1989, 2001, and 2010).

to expand government control over banking through the creation of a new and more powerful supervisor: the Federal Reserve.

## II. The Forgotten Logic of the Federal Reserve Act

When Congress created the Federal Reserve in 1913, the key features of U.S. banking law were over fifty years old. Thousands of investor-owned banks—legally separated from commercial enterprises, largely controlled by local executives, and subject to close oversight by special state and federal officials—issued most of the money in the United States. Yet monetary outsourcing remained politically and economically unstable. With each bank operating for profit, no bank had an incentive to look out for the system as a whole. When moments of economic uncertainty emerged, bank counterparties lost confidence in the value of bank assets, which produced monetary contractions and severe economic depressions. During these periods, Americans were exposed to the private power of prominent bankers and bankers' associations located in big cities like New York and Chicago.[142] With each passing year, these actors became stronger, leaving southern and western regions starved for money and credit, especially during downturns.[143] Limited in their regulatory tools, supervisors were unable to mount an effective response. Meanwhile, grassroots movements and Democratic Party leaders agitated for government control of the money supply, unwilling to accept the role investor-owned banks played in economic and public life.[144]

This Part shows how Congress designed the Federal Reserve to respond to these challenges: periodic deflations, an uneven playing field among banks, and insufficient public accountability and control. It contends that separation, diffusion, and supervision as they existed at the turn of the century were not sufficient to sustain delegation in the United States. Congress established the Federal Reserve Board in 1913 as a "super supervisor" to administer the banking

142. *See* HENRY PARKER WILLIS, THE FEDERAL RESERVE SYSTEM: LEGISLATION, ORGANIZATION, AND OPERATION 109 (1923) (explaining that members of Congress concluded that the management of the New York Clearing House Association was "unjust to the smaller banks, possessed enormous power, was unincorporated and unregulated, [and] had usurped functions foreign to its usual object"); *Money Trust Investigation: Investigation of Financial and Monetary Conditions in the United States Under H.R. Res. 429 and H.R. Res. 504 Before a Subcomm. of the H. Comm. on Banking & Currency*, 62d Cong. 115-23 (1912).

143. *See* ELIZABETH SANDERS, ROOTS OF REFORM: FARMERS, WORKERS AND THE AMERICAN STATE, 1877-1917, at 239 (1999); RITTER, *supra* note 3, at 200-01, 201 n.96; REDLICH, *supra* note 121, pt. 2, at 287 (explaining that when the majority of New York banks no longer needed loose money, they tightened monetary conditions "without due regard for weaker, though solvent, banks"); O.M.W. SPRAGUE, HISTORY OF CRISES UNDER THE NATIONAL BANKING SYSTEM, S. DOC. NO. 61-533, at 148 (1910) (noting that western and southern banks were "hardly able to satisfy the requirements of local borrowers"); Matthew Jaremski, *The (Dis)advantages of Clearinghouses Before the Fed*, 127 J. FIN. ECON. 435, 439 (2018) (explaining that banks that were not members of a clearinghouse, predominately small-town institutions, were much more likely to close during downturns).

144. *See, e.g.*, RITTER, *supra* note 3, at 90-109, 178-99, 262-65; SANDERS, *supra* note 143, at 236-66 (1999).

system. Not satisfied with the initial results, Congress later amended the law on several occasions to better address these same problems.

Drawing on legislative debates, committee reports, statutory text, public speeches, private correspondence, and newspaper accounts, I argue that current law—the product primarily of bills passed in 1913, 1933, 1935, 1977, 1978, 1980, and 2010—reflects three overarching legislative purposes: (1) to promote full capacity utilization in the economy by stimulating bank monetary expansion over time; (2) to ensure a nationwide, level playing field in the investor-owned banking system; and (3) to enhance public accountability and control over monetary conditions.[145] Read *in pari materia* with the other statutes governing money and banking, the Federal Reserve Act is both a technical fix for a malfunctioning monetary system and a rebalancing of the American political economy toward public control over macroeconomic and financial conditions.

In recovering the Fed's core statutory purposes, this Part also addresses a series of what I believe to be misconceptions and omissions in the economic and legal literatures. First, it argues that the common view that the Fed is meant to trade off maximum employment and price stability as two independent goals[146] is ahistorical and legally ungrounded. The legislators who wrote and revised the Federal Reserve Act were primarily concerned with ensuring monetary expansion sufficient to achieve full capacity utilization in the economy over the long term. For them, overissue of money by banks was troubling insofar as it led to economic instability, subsequent monetary collapse, and job loss. But combatting price level appreciation in the short or medium term caused by factors like supply shocks was not understood to be a primary objective of Fed policy. Second, I draw attention to insufficiently appreciated infrastructural aspects of the Federal Reserve Act. The Fed is not just a macroeconomic steward. It is also an institutional framework for counteracting the regional concentration

145. The Fed has had other purposes in its history. For example, the Fed was originally designed to administer a monetary system anchored by the Gold Standard with its tools initially limited in ways that favored commercial businesses (through what was known as the Real Bills Doctrine). *See* Peer, *supra* note 35, at 408. The functions that Congress has removed (or modified) are not my focus here. Rather, this Part examines the continuities in the law as it exists today.

One of the statutory goals I do not discuss was internationalizing the dollar and, relatedly, improving the financial position of U.S. exporters. J. Lawrence Broz argues that these aims were a "but for" cause of the initial law. *See* J. LAWRENCE BROZ, THE INTERNATIONAL ORIGINS OF THE FEDERAL RESERVE SYSTEM 5-7 (paperback ed. 2009) (1997). Although I do not find the strong version of this argument persuasive, Broz offers an excellent account of the provisions of the Act that bankers hoped would further this goal—in particular, provisions in section 14 that authorize the Fed to buy and sell foreign currencies and gold as well as bankers' acceptances, then an instrument of international trade finance. *Id.* at 50, 52 tbl.1.2, 53 tbl.1.3. The importance of these provisions faded in the 1930s with the collapse of the Gold Standard and the Banking Act of 1935.

146. *See, e.g.*, *Making Sense of the Federal Reserve: The Fed and the Dual Mandate*, FED. RSRV. BANK ST. LOUIS, https://www.stlouisfed.org/in-plain-english/the-fed-and-the-dual-mandate [https://perma.cc/5XRF-EQVG] (describing the Fed's two "economic goals" and explaining that there are times when the goals "are not complementary"); Frederic S. Mishkin, Governor, Fed. Rsrv. Sys., Monetary Policy and the Dual Mandate, Remarks at Bridgewater College (Apr. 10, 2007), https://www.federalreserve.gov/newsevents/speech/mishkin20070410a.htm [https://perma.cc/WLY9-UQZR] (explaining how the Fed seeks to promote two coequal objectives and that sometimes a temporary tradeoff may exist).

of money and credit, as well as certain types of abuses within the banking system. To this end, the Fed is designed to facilitate interbank payments—clearing checks, processing wires, and operating an automated checking electronic transfer network. Finally, I emphasize the Fed's novelty. With the Fed postdating institutions like the Bank of England, Bank of France, and Reichsbank by decades and in some cases centuries, many scholars treat the United States as a copycat.[147] By contrast, I see the Fed as the first of its kind: a public monetary authority that administers bank monetary expansion to advance public purposes.[148] When the Fed was established, its counterparts like the Bank of England were investor-owned banks, nationalized only decades later. When it comes to what today is considered "central banking"—that is, the discretionary management of monetary conditions by public officials—America led the world, not the other way around.[149]

### *A. Maintaining Bank Balance Sheet Expansion*

A kitchen-sink approach to the Fed—one that treats bank regulation, lending, and interest rate policy as various, unrelated responsibilities—obscures the Fed's primary purpose throughout its history: counteracting the banking system's tendency toward monetary contraction. This pathology was the impetus

147. The "copycat" theory of the Federal Reserve is a byproduct, at least in part, of the myth that big city bankers were primarily responsible for the Federal Reserve Act. Proponents of this view emphasize the Aldrich Plan, the meeting on Jekyll Island, the National Monetary Commission, and the multi-year campaign by the banking industry to create a European-style central bank. These accounts downplay the aspects of the Federal Reserve Act that were crafted by Democrats and that bankers opposed such as the Federal Reserve Board—a public regulatory body. *See, e.g.*, MURRAY N. ROTHBARD, A HISTORY OF MONEY AND BANKING IN THE UNITED STATES: THE COLONIAL ERA TO WORLD WAR II 183-259 (2005); William G. Dewald, *The National Monetary Commission: A Look Back*, 4 J. MONEY CREDIT & BANKING 930, 931 (1972) (describing the Federal Reserve Act as "basically the same, and identical in many respects" to the Aldrich Bill—a remarkable claim given that the former included an independent commission (on the model of the Interstate Commerce Commission) to regulate banks and the latter was to be a private corporation run by the most powerful bankers in the country). These scholars would have us believe that Nelson Aldrich—who, in October 1913, described the Federal Reserve Act as "revolutionary, socialistic, and unconstitutional" (none of which he thought was a good thing), *Aldrich Sees Bryan Back of Money Bill*, N.Y. TIMES, Oct. 16, 1913, at 13—"deserves equal billing with Carter Glass as a cofounder of the Fed," ELMUS WICKER, THE GREAT DEBATE ON BANKING REFORM: NELSON ALDRICH AND THE ORIGINS OF THE FED, at ix (2005), and that it would be "only slight exaggeration" to say that the Aldrich Plan and the Federal Reserve Act were "fundamentally the same," George Selgin, *New York's Bank: The National Monetary Commission and the Founding of the Fed* 22 (Cato Inst., Policy Analysis No. 793, 2016), https://www.cato.org/sites/cato.org/files/pubs/pdf/pa-793.pdf [https://perma.cc/7T62-E8YN]; *see also* BROZ, *supra* note 145, at 201 (describing the FRA as "in broad sympathy with the Aldrich plan" in "most important areas"). Never mind the fact that the American Bankers Association opposed the bill and that most pro-banker Republicans voted against it.

148. This was, incidentally, how contemporaries understood the Federal Reserve Act in 1913. Nelson Aldrich, who, as Chairman of the National Monetary Commission from 1908 to 1911 spent years championing central bank legislation on a European model, condemned the Owen-Glass Bill, as it was then known, opining two months before its passage that "[i]f the bill should be enacted into law . . . Mr. [William Jennings] Bryan will have achieved the purpose for which he has been contending for a decade." *Aldrich Sees Bryan Back of Money Bill*, *supra* note 147 (quoting Aldrich).

149. In making this argument I follow economic historians who note that the framers of the FRA were trying *not* to create a "central bank" on the model of the Bank of England. *See* ALLAN H. MELTZER, 1 A HISTORY OF THE FEDERAL RESERVE 1-3, 63-68 (2003). But I take the distinction a step further: even today the Fed has a very different statutory remit and design from central banks in other countries.

for the original Federal Reserve Act. It also triggered the two most significant amendments to the law—the Banking Act of 1935[150] and the Federal Reserve Reform Act of 1977 (FRRA).[151] The latter statute articulated an explicit mandate for the Fed: "maintain[ing] long run growth of the monetary and credit aggregates commensurate with the economy's long run potential . . . so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."[152] This mandate is misunderstood today as a "dual mandate" to manage two competing goals: maximum employment and price stability. But the law in fact charges the Fed with a single goal: promoting full capacity utilization in the economy by ensuring adequate monetary expansion over time. It comes from a New Deal-era law, the Employment Act of 1946, and is a refinement on the Fed's initial stabilization remit.

1. The Initial Stabilization Remit

If one adopts a model of banks as private intermediaries (that merely pass along money created by the government) then monetary policy will appear to be a function only of the federal funds rate, which is an overnight interest rate that banks charge each other for cash and which varies based on the size of the Fed's balance sheet. But this is not how many of the legislators who designed the banking system thought about banks. As discussed in Part I, U.S. legislators established banks to create money as well as to lend it. And when they outsourced this power to expand the money supply to investor-owned banks, they hoped to avoid politically motivated overissue.[153] What many experts eventually came to recognize is that the investor-owned banking system was also prone to periods of chronic *underissue*—sometimes as a result of exogenous economic shocks, other times as a reaction to destabilizing periods of overissue (i.e., inflationary bubbles) induced by banks' drive for profit.[154] These monetary contractions were extremely disruptive. They led otherwise viable businesses to fail and threw

150. Banking Act of 1935, ch. 614, 49 Stat. 684.

151. Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, 91 Stat. 1387.

152. Federal Reserve Act § 2A, 12 U.S.C. § 225a (2018) (original version added by Federal Reserve Reform Act, sec. 202, § 2A, 91 Stat. at 1387).

153. *See supra* notes 71-75 and accompanying text.

154. American society was hit by panic-induced contractions in 1873, 1884, 1890, 1893, 1896, and 1907. H.R. REP. NO. 63-69, at 4 (1913). The 1893 retrenchment was unusually severe, destabilizing the Democratic Party, which had the misfortune of controlling the federal government at the time, and prompting numerous proposals to augment private monetary elasticity with new forms of public money. *See, e.g.*, HARVEY, *supra* note 1 (arguing for Congress to re-monetize silver); K. L. ARMSTRONG, THE LITTLE STATESMAN: A MIDDLE-OF-THE-ROAD MANUAL FOR AMERICAN VOTERS 73, 91 (Chicago, Schulte Publ'g Co. 1895) (arguing for postal banking); H.R. 7463, 53d Cong. § 2 (2d Sess. 1894) (requiring the Treasury to issue paper money to finance public improvements); WILLIAM J. BRYAN, THE FIRST BATTLE: A STORY OF THE CAMPAIGN OF 1896, at 199-206 (Chicago, W.B. Conkey Co. 1896) (arguing for Congress to abandon the Gold Standard). In the years that followed, banking and business interests became increasingly concerned about these proposals and developed alternative reforms. *See* LIVINGSTON, *supra* note 3. This process went into overdrive following a Wall Street-led economic and financial collapse in 1907. *Id.* at 172-74.

millions of people out of work.[155] Preventing such contractions was one of the main reasons legislators supported the FRA in 1913.[156]

The Fed's expansionary function is clear in the legislative history. As the Senate Banking Committee put it: "The chief purpose[] of the banking and currency bill [i.e., the FRA] is to give stability to the commerce and industry of the United States, prevent financial panics or financial stringencies; . . . [and to] put an end to . . . the use of [bank] reserves for gambling purposes on the stock exchange."[157] Or in the words of the House Banking Committee: "A general tendency toward stringency evidently exists," as the current banking system "fails to afford any safeguard against panics . . . or any means of alleviating them."[158] According to the Committee, "the public has been put to great inconvenience and loss upon such occasions."[159] The burden of these stringencies, they recognized, is not shared equally: it falls primarily on the poor and on debtors—people who owe a nominal amount of monetary units on a loan or other obligation.

The law's key supporters, including Secretary of State William Jennings Bryan,[160] President Wilson,[161] Chair of the Senate Banking Committee Robert Owen,[162] and Chair of the House Banking Committee Carter Glass,[163] all sought to correct the contractionary tendency of the system of investor-owned banks. To Senator Owen—who considered the FRA "the most important measure that

155. *See, e.g.*, H.R. REP. NO. 63-69, at 4 (1913); 50 CONG. REC. 4642 (1913) (statement of Rep. Carter Glass) ("Five times within the last 30 years financial catastrophe has overtaken the country under this system; and it would be difficult to compute the enormous losses sustained by all classes of society—by the banks immediately involved; by the merchants whose credits were curtailed; by the industries whose shops were closed; by the railroads whose cars were stopped; by the farmers whose crops rotted in the fields; by the laborer who was deprived of his wage."). For contemporary analyses of the economic costs of monetary contractions see RICKS, THE MONEY PROBLEM, *supra* note 35, at 102-42; Ben S. Bernanke, *The Real Effects of Disrupted Credit: Evidence from the Global Financial Crisis*, BROOKINGS PAPERS ON ECON. ACTIVITY, Fall 2018, at 251 [hereinafter Bernanke, *Real Effects of Disrupted Credit*]; and Ben S. Bernanke, *Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression*, 73 AM. ECON. REV. 257 (1983) [hereinafter Bernanke, *Nonmonetary Effects*].

156. *See* S. REP. NO. 63-133, at 4, 7 (1913).

157. *Id.* at 7. (The ellipses omit goals that relate to ensuring fair access to money and credit. These goals are discussed below.)

158. H.R. REP. NO. 63-69, at 5, 6.

159. *Id.* at 4.

160. *See* SANDERS, *supra* note 143, at 247-48, 251; *see also* William Jennings Bryan, *The Government Should Issue Notes and Guarantee Bank Deposits*, 5 J. ACCT. 366 (1908) (opposing reliance on investor-owned banks to provide monetary elasticity).

161. President Woodrow Wilson, Address to a Joint Session of Congress on the Banking System (June 23, 1913) [hereinafter Wilson, Address on the Banking System], https://www.presidency.ucsb.edu/documents/address-joint-session-congress-the-banking-system [https://perma.cc/EH5G-FD4C] ("[O]ne of the chief things business needs now . . . is the proper means by which readily to vitalize its credit . . . . We must have a currency, not rigid as now, but readily, elastically responsive to sound credit."); *see also* ARTHUR S. LINK, WILSON: THE NEW FREEDOM 202, 214 (1956) (describing Wilson's aims).

162. *See infra* note 164 and accompanying text.

163. 50 CONG. REC. 4642 (1913) (statement of Rep. Glass) ("The [existing] system literally has no reserve force. The currency based upon the Nation's debt is absolutely unresponsive to the Nation's business needs. The lack of cooperation and coordination among the more than 7,300 national banks produces a curtailment of facilities at all periods of exceptional demand for credit. This peculiar defect renders disaster inevitable.").

has been presented to the country since the Civil War"—the act was "intended to correct the chief defects in our system," the "principal" one being "no adequate protection against panics."[164]

The initial statute reflected the Fed's stabilization mandate in three ways. First, it authorized the Fed to issue a new currency of "Federal reserve notes" to provide "elasticity" to the monetary system, directly checking the deflationary tendencies of the investor-owned banking system.[165] Second, it empowered the Fed to lend to banks (allowing officials to combat monetary contraction by alleviating pressure on banks to shrink their balance sheets).[166] Third, it structured the Fed to check speculative banking practices that policymakers thought drove overissue and ultimately triggered panics.[167]

### 2. The Depression-Era Reforms

Monetary contractions continued after the Fed's founding, due to a combination of faulty institutional design, misguided policy decisions, and widespread deposit money creation by state-chartered banks and trusts operating outside of the Fed's ambit.[168] In the 1930s, when the system collapsed, Congress revisited the FRA to provide the Fed with additional tools to combat contractions. In 1932, Congress empowered the Fed to expand the money supply even when banks are unable or unwilling to lend.[169] In 1934, Congress gave the Fed the power to limit leverage in securities markets, aiming to reduce speculative overissue of money, which might result in asset price bubbles and ultimately trigger contractions.[170] In 1935, Congress diminished the influence of investor-owned banks within the Fed itself,[171] as policymakers argued that public officials

164. 50 CONG. REC. 5992 (1913) (statement of Sen. Robert Owen).

165. Federal Reserve Act, ch. 6, § 16, 38 Stat. 251, 265-68 (1913) (authorizing note issue); *id.* § 1, 38 Stat. at 251 (naming the full title of the FRA as "An Act . . . to furnish an elastic currency").

166. *Id.* § 13, 38 Stat. at 263-64.

167. *Id.* § 4, 38 Stat. at 255 (permitting FRBs to extend to member banks only such loans "as may be safely and reasonably made"); *id.* § 13, 38 Stat. at 263-64 (permitting the Fed to discount only debt arising out of actual commercial transactions and empowering the Fed's Board to restrict and regulate the rediscounting of bills and acceptances); *id.* § 19, 38 Stat. at 271 (empowering the Fed to write regulations regarding withdrawal of bank reserves and to assess penalties for noncompliance).

168. Federal Reserve Board (FRB) presidents (as well as early Board appointees) were also creditor friendly, preferring tight money policy and disappointing many of the law's original supporters. *See, e.g.*, ROBERT OWEN, STATEMENT WITH REGARD TO THE CAUSES OF THE RECENT AND EXISTING INDUSTRIAL DEPRESSION—REPUBLICAN PARTY LARGELY RESPONSIBLE FOR DEFLATION OF CREDIT AND CURRENCY AND THE SEVERITY OF THE INDUSTRIAL DEPRESSION (Sept. 22, 1922), https://fraser.stlouisfed.org/files/docs/historical/owen/owen_19220922.pdf [https://perma.cc/B4K6-G6CT].

169. Federal Reserve Act § 13(3), 12 U.S.C. § 343(3) (2018) (original version added by Emergency Relief and Construction Act of 1932, ch. 520, sec. 210, 47 Stat. 709, 715).

170. Securities Exchange Act of 1934, ch. 404, § 7, 48 Stat. 881, 886-88; s*ee also* Banking Act of 1933, ch. 89, sec. 3(a), 48 Stat. 162, 163 (requiring the Fed to "keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for" speculative purposes and empowering the Fed to suspend such banks from access to Fed credit facilities).

171. *See* Banking Act of 1935, ch. 614, sec. 205, 49 Stat. 684, 705-706 (shifting the power to control open market operations from the boards of the twelve Federal Reserve Banks, a majority of whose

would manage monetary conditions more effectively.[172] For the first time, Congress also wrote explicit instructions into the law, charging the Fed with exercising its power to purchase financial assets "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country."[173]

Another important change that resulted from the Great Depression came a decade later when Congress enacted a landmark law: the Employment Act of 1946. The Employment Act put a much finer point on the Banking Act's charge to expand the money supply to accommodate commerce and business. It required every part of the federal government, including the Fed, "to use all practicable means consistent with its need and obligations and other essential considerations of national policy . . . to promote maximum employment, production, and purchasing power."[174] The Employment Act, inspired by Keynesian economic theory, represented a remarkable, explicit commitment on the part of the state to foster broad-based economic growth.

The Federal Reserve embraced the Employment Act, and played a significant role in its development.[175] In a remarkable document from 1937, the Board expressly rejected arguments that the Federal Open Market Committee (FOMC) should target "price stability."[176] The "broader objective of maximum sustainable utilization of the nation's resources cannot be achieved by attempting to maintain a fixed level of prices," the Board explained, and "therefore, price

members are appointed by investor-owned banks, to a new committee, a majority of whose members are appointed by the President with the advice and consent of the Senate); *id.* sec. 201, 49 Stat. at 703 (requiring that presidents of the Federal Reserve Banks be appointed with the approval of the Board). Congress also established a permanent system of federal deposit insurance, *id.* sec. 101, 49 Stat. at 684-703, and empowered the Fed's Board to adjust reserve requirements "to prevent injurious credit expansion or contraction," *id.* sec. 207, 49 Stat. at 706 (amending section 19 of the FRA). These changes led to a shift in the Fed's focus from backstopping deposits through discounting and rediscounting to controlling the total supply of deposits in the system through open market operations and adjusting reserve requirements. *See infra* Section III.A.

172. 79 CONG. REC. 11778-79 (1935) (statement of Sen. Carter Glass) (describing and arguing against the prevailing view that the Board should be given control over open market operations since the Federal Reserve Banks, which were in part controlled by investor-owned member banks, had failed to effectively manage monetary conditions); *Banking Act of 1935: Hearings on H.R. 5357 Before the H. Comm. on Banking & Currency*, 74th Cong. 181-83 (1935) (statement of Hon. Marriner S. Eccles, Governor, Fed. Rsrv. Bd.) (proposing to put control over monetary expansion in the hands of the Board, as it "can be held accountable by the Congress and the Nation for the conduct of this matter that is of national importance").

173. Federal Reserve Act § 12A(c), 12 U.S.C. § 263(c) (2018) (added by Banking Act of 1933, ch. 89, sec. 8, § 12A(c), 48 Stat. 162, 168). The 1935 changes were championed by then-Roosevelt-advisor Marriner Eccles, who was explicit that the "banking system creates money," HOFFMAN, *supra* note 33, at 1 (quoting Eccles), that the monetary system is "artificial in character," constructed by "rules and regulations," *id.* at 134 (quoting Eccles), and that the Fed's purpose must be to actively manage monetary conditions by administering the banking system, *see id.* at 135-40.

174. Employment Act of 1946, ch. 33, § 2, 60 Stat. 23, 23.

175. *See* Letter from Marriner S. Eccles, Chairman, Bd. of Governors, Fed. Rsrv. Sys., to Hon. Robert F. Wagner, Chairman, S. Comm. on Banking & Currency (June 16, 1945), *in* S. COMM. ON BANKING & CURRENCY, 79TH CONG., SUMMARY OF FEDERAL AGENCY REPORTS ON FULL EMPLOYMENT BILL (Comm. Print 1945).

176. Bd. of Governors of the Fed. Rsrv. Sys., Objectives of Monetary Policy (July 29, 1937), *in Monetary Authority Act: Hearings on S. 1990 Before a Subcomm. of the S. Comm. on Agric. & Forestry*, 75th Cong. 10 (1937).

stability should not be the sole or principal objective of monetary policy."[177] The proper goal—"economic stability"—entails "as full employment of labor and of the productive capacity of the country as can be continuously sustained."[178] According to the Board, "[t]here are situations in which changes in the price level would work toward maintenance of stability; declining prices resulting from technological improvements, for example, may contribute to stability by increasing consumption." But there are also "situations when the restoration and maintenance of relatively full employment may be possible only with an advance in prices."[179] Inflation, in other words, might be an acceptable cost, indeed a desirable one, if it resulted in greater sustainable employment. It was only price appreciation that led to economic instability and subsequent contractions, reducing employment, that policymakers sought to avoid.

3. The 1970s Amendments

Remarkably, Congress reaffirmed the Fed's role in facilitating monetary expansion and maximum employment in 1977—during a period of economic stagnation characterized by record high inflation. The text of the current mandate, codified as section 2A of the Federal Reserve Act, derives from an episode in 1975. That year, despite persistent depreciation of the dollar, Congress took the unprecedented step of directing the Fed to increase the money supply. Prominent legislators believed that the Fed's policy was too tight and had therefore increased unemployment and exacerbated the worst economic crisis since the Great Depression.[180] In March, rebuffing pressure from the Fed and the administration,[181] Congress approved House Concurrent Resolution 133, which instructed the Fed to "pursue policies in the first half of 1975 so as to encourage lower long term interest rates and expansion in monetary and credit aggregates appropriate to facilitating prompt economic recovery."[182] The resolution further stated that the Fed should "maintain long run growth of monetary and credit

177. *Id.* at 11. Price stabilization, it explained, is at best "a means toward a more important end, namely, the lessening of booms and depressions and the increase in the national output and well-being." *Id.*

178. Bd. of Governors of the Fed. Rsrv. Sys., *supra* note 176, at 11. *See also* Letter from Marriner S. Eccles to Robert F. Wagner, *supra* note 175, at 47 (arguing that an "over-all guide or mandate by the Congress is desirable" and that "formal declaration by the Congress of a broad objective of policy would make for better coordination and would help to develop the basic criteria by which to judge whether given acts and policies should or should not be pursued").

179. *Id.*

180. As Chairman Proxmire put it in colloquy with Fed Chairman Arthur Burns: "[U]nemployment is getting worse. And it is very, very bad. It is worse than it has been, as you know, since the Great Depression." *Monetary Policy Oversight: Hearings on S. Con. Res. 18 Before the S. Comm. on Banking, Hous. & Urb. Affs.,* 94th Cong. 57 (1975) [hereinafter *Monetary Policy Oversight Hearings*] (statement of Sen. William Proxmire, Chairman, S. Comm. on Banking, Hous. & Urb. Affs.).

181. *See, e.g.*, *To Lower Interest Rates and the Credit Allocation Act of 1975: Hearing on H.R. 3160 and H.R. 3161 Before the H. Comm. on Banking, Currency & Hous.*, 94th Cong. 13 (1975) (statement of Rep. Fernand J. St Germain) (refusing to be "buffaloed or scared by the dire predictions of the high priests of this administration," preferring instead to focus on "the plight of the people in my district and the country, those who work for a living and produce the goods and services of our Nation").

182. H.R. Con. Res. 133, 94th Cong., 89 Stat. 1194 (1975).

aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long term interest rates."[183]

There was nothing new in 1975 about this mandate. Policymakers saw it as redundant with the Employment Act so far as its goals were concerned.[184] When Congress subsequently incorporated it into the FRRA in 1977, the key figures similarly understood the text to be merely "reaffirming the objectives of the Employment Act."[185] Although the Fed's Chairman, Arthur Burns, told Congress that the Fed did not need any further instruction—"we believe that our Nation is benefiting from a monetary policy that . . . is faithful to the objectives of the Employment Act"[186]—legislators disagreed.[187] Senator William Proxmire said that while the provision was "mother and apple pie and the Fourth of July [and] also the law of the land, clearly implicit in the 1946 Employment Act," it is "essential that the Congress reassert this principle because in [the Fed's] more than 60-year history, the erratic fluctuations in the money supply . . . ha[ve] deepened recessions or depressions and aggravated inflations."[188] Proxmire thus invoked the widely held view about the Fed's expansionist purpose when explaining the FRRA. The Fed's job was not to combat inflation per se—it was to ensure that banks create enough money to keep the nation's productive resources fully utilized over the long term, which meant pursuing maximum employment.

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183. *Id.*

184. *Monetary Policy Oversight Hearings*, *supra* note 180, at 41 (statement of Arthur F. Burns, Chairman, Bd. of Governors, Fed. Rsrv. Sys.) (noting that the text "adds nothing new to the objectives of Federal Reserve policy as already defined by statute [in the Employment Act]").

185. *To Promote the Independence and Responsibility of the Federal Reserve System: Hearing on H.R. 12934 Before the H. Comm. on Banking, Currency & Hous.*, 94th Cong. 28 (1976) (statement of Chairman Burns).

186. *Id.* at 24. Describing the dual mandate as "the proposal requiring monetary policy to be governed by the objectives of the Employment Act," Burns elaborated:

> Need I say again that we fully observe the Employment Act in formulating our policies? This is what we work at every day. All of our energies are devoted to it. We could not be more mindful of it. Moreover, the statement of the Employment Act . . . is carefully worded and there is no need to repeat it in summary form in new legislation.

*Id.* at 41.

187. House Banking Committee Chairman Henry Reuss said the bill would "require that the Federal Reserve take into account in its monetary policy formulation the goals of the Employment Act, namely maximum employment, production and purchasing power, with the latter specifically defined as price stability, something the Federal Reserve has been urging for years." Transcript, H. Comm. on Banking, Currency & Hous., 94th Cong., Mark-Up of H.R. 12934: The Federal Reserve Reform Act 11 (Apr. 27, 1976), HRG-1976-BCH-0029 (ProQuest Congressional); *see also* H.R. REP. NO. 94-1073, at 3 (1976) (noting that the bill "requires the Federal Reserve to pursue the goals of the Employment Act of 1946 which call for maximum employment, maximum production, and maximum purchasing power—defined as maximum price stability").

188. *Monetary Policy Oversight Hearings*, *supra* note 180, at 2 (statement of Sen. William Proxmire, Chairman, S. Comm on Banking, Hous. & Urb. Affs.); *see also id.* at 10 (statement of Sen. Hubert H. Humphrey) ("Might I just allude here to the Employment Act of 1946 which is the law of this country . . . ? That law calls upon the [government] to establish policies which will promote maximum employment, maximum production, and maximum income. I submit that that law has not been given much attention.").

To be sure, "price stability" was one of the outcomes that Congress thought an economy operating at full potential entailed, along with "moderate long term interest rates," the oft-ignored third prong of section 2A. But legislators did not expect the Fed to trade off price stability for employment,[189] taking steps to reduce employment to put downward pressure on prices.[190] Instead, they charged the Fed with ensuring that a lack of money (or an excess of it) was not standing in the way of these outcomes (themselves products of an economy operating at its full potential) over the long run.[191] That is the Fed's sole mandate.[192]

At the time the law was enacted, the mandate's long run focus, monetary nature, and emphasis on employment was recognized even by those at the Fed who opposed the legislation like Arthur Burns. After stepping down from the Board, Burns, in a well-known speech, explained why he had not taken more aggressive steps to stabilize prices during the 1970s—a period when rising inflation was, in his view, largely a product of nonmonetary factors.[193] Burns expressly cited section 2A. Elaborating, he said: if the Fed had "sought to create a monetary environment that fell seriously short of accommodating the upward

189. *See, e.g.*, H.R. REP. NO. 95-774, at 4 (1997) ("In your committee's judgment, these goals [maximum employment, stable prices, and moderate long-term interest rates] are mutually compatible.").

190. Indeed, in 1978, Congress expressly rejected overreliance on monetary policy to manage price appreciation: "The Congress finds that sole dependence upon fiscal or monetary policies or both to combat inflation can exacerbate both inflation and unemployment. The Congress finds that the coordinated use of fiscal and monetary policies in conjunction with specific target policies are necessary to combat inflation." Full Employment and Balanced Growth Act of 1978, Pub. L. No. 95-523, sec. 109, § 8(b), 92 Stat. 1887, 1898) (codified at 15 U.S.C. § 1022e(b)). Congress also considered and rejected charging the President with establishing an annual "inflation goal" for the federal government. S. REP. NO. 95-1177, at 15-16 (1978) ("[T]here are times when prices should go up and unemployment down [such as the mid-1930s] . . . . There are times when the unemployment rate and price trends should and must move in opposite directions. When the Arab oil actions a few years ago led to a doubling of an already excessive inflation rate in the United States, . . . hardly anyone would have proposed that the efforts to reduce unemployment should have been aborted, or that the acceptable unemployment rate should have been moved upward to comport with the inflation rate. If it is necessary to accept some increases in inflationary pressures at times, then it is the unavoidable responsibility of the President and the Congress to reduce other inflationary pressures in a manner designed to facilitate the needed movement toward full employment, or to press that movement in any event for reasons set forth above.").

191. By giving the Fed an explicit monetary mandate, the FRRA differs from the Employment Act, which provided a mandate for government agencies generally to pursue maximum employment, production, and purchasing power.

192. The idea that the Fed has a "dual mandate" that involves price stability and maximum employment as a general matter (as opposed to as a byproduct of the appropriate rate of monetary expansion over time) does not emerge until the mid-1990s. It appears to originate in debates about whether Congress should replace section 2A with a price stability mandate. *See, e.g.*, Transcript, Meeting of the Federal Open Market Committee 52 (Jan. 31-Feb. 1, 1995) (statement of Governor Alan S. Blinder), https://www.federalreserve.gov/monetarypolicy/files/FOMC19950201meeting.pdf [https://perma.cc/WA4B-HRAJ] ("We have a dual objective . . . ."); *id.* at 53 (statement of Governor Lawrence B. Lindsey) ("Governor Blinder probably incorrectly characterized Humphrey-Hawkins as giving us a dual objective; it does not. . . . [T]here is a paragraph of objectives."); *see also* Alan S. Blinder, Central Banking in a Democracy, Speech at the Federal Reserve Bank of Richmond (Sept. 26, 1996), *in* FED. RSRV. BANK OF RICH. ECON. Q., Fall 1996, at 1, 5 ("[T]he phrase is often called the Fed's 'dual mandate' because the interest rate objective is considered redundant. Price stability will almost certainly bring low long-term interest rates in its wake.").

193. Arthur F. Burns, Per Jacobsson Lecture: The Anguish of Central Banking (Sept. 30, 1979), *in* 73 FED. RSRV. BULL. 687 (1987); *see* BEN S. BERNANKE, 21ST CENTURY MONETARY POLICY: THE FEDERAL RESERVE FROM THE GREAT INFLATION TO COVID-19, at 24-30 (2022).

pressures on prices that were being released or reinforced by governmental action, severe difficulties could be quickly produced in the economy." "Not only that," he continued, "the Federal Reserve would be frustrating the will of the Congress, to which it was responsible . . . ."[194] It was the legislature's intent that Fed officials *prevent* recessions resulting from monetary tightening, not induce them.

### *B. Leveling the Playing Field Among Banks*

Although the Fed's explicit statutory mandate is monetary expansion sufficient to ensure full capacity utilization in the economy,[195] legislators also cared deeply about how the Fed went about achieving this goal. Congress structured the Fed to manage the money supply in a way that strengthens local and regional banks and limits abuses by large institutions in major cities. Legislators, in other words, were not merely concerned with how much money the banking system created, but also where it was being created and who benefited from its creation. In particular, they were worried that a handful of banks might wield excessive power over the rest of the banking system through their control of interbank payment utilities known as clearinghouses. As with the Fed's expansionary purpose, the Fed's level-playing-field function dates to the Progressive Era and the problems created by delegation that prompted the Fed's founding. In 1980 and 2010, Congress made further changes designed to reinforce this function in response to changes in the structure of financial activity and in the relationship between the Fed and the banking system.

#### 1. A Public Clearinghouse for Member Banks

Banking is a system: a single bank cannot operate for long if other banks do not accept its notes and deposits as money.[196] Prior to the Fed's founding, the government played only a minor role in coordinating this system (although policymakers increasingly recognized its importance). Most of the work was done by the banks themselves. Smaller banks in less populated parts of the country developed relationships with larger banks in "money centers" like New York and Chicago. These money center banks cleared payments between banks in the periphery, allowing customers to write checks drawn on their accounts and use them to pay for goods and services. Money center banks also lent cash to smaller banks to help them manage short-term spikes in customer

194. Burns, *supra* note 193, at 692.
195. Federal Reserve Act § 2A, 12 U.S.C. § 225a (2018).
196. *See* CONG. GLOBE, 37th Cong., 2d Sess. 616 (1862) (statement of Rep. Hooper).

withdrawals.[197] As the money center banks grew increasingly powerful, they were able to influence the availability of credit in distant cities and towns.[198]

Money center banks also played a prominent role in the private clearinghouse associations that bankers built to settle interbank payments of checks. Clearinghouses policed their members by examining them. These practices led smaller banks to allege abuse by the larger firms that dominated the management of the clearinghouses.[199] Clearinghouses also issued a form of emergency currency known as loan certificates. These certificates were secured by the assets of the clearinghouse members and served as a source of elasticity when banks were forced by uncertainty or withdrawals to shrink their balance sheets.[200] In a crisis, access to certificates from the clearinghouse could determine whether a bank lived or died. For example, the Panic of 1907 began in earnest when the Bank of Commerce, a money center bank dominated by J.P. Morgan, stopped clearing payments for a depository institution called the Knickerbocker Trust Company. The panic subsided when Morgan and his associates, after letting several otherwise solvent firms fail,[201] authorized the New York clearinghouse to issue loan certificates to assist depository institutions facing runs.[202]

Public concern with the power of Morgan and other large firms grew in the aftermath of the Panic. The outrage reached a fever pitch in 1912 during the Pujo Hearings, which according to the Senate Banking Committee, revealed "a vast concentration of power in the hands of a few men over the credit system of the United States."[203] In pressing Congress to pass the FRA, President Wilson asked: "What will it profit us to be quit of one kind of monopoly [Standard Oil and the like] if we are to remain in the grip of another and more effective kind?"[204] To

197. *See* John A. James & David F. Weiman, *From Drafts to Checks: The Evolution of Correspondent Banking Networks and the Formation of the Modern U.S. Payments System, 1850-1914*, 42 J. MONEY CREDIT & BANKING 237 (2010); Redlich, *supra* note 121, pt. 2, at 236-42; *see also* JAMES G. CANNON, CLEARING-HOUSES: THEIR HISTORY, METHODS AND ADMINISTRATION (1900) (describing the emergence and functioning of privately organized bank cooperatives known as clearinghouses).

198. See sources cited *supra* note 143.

199. H.R. REP. NO. 63-69, at 31 (1913) (noting "complaint on the ground, however unjustified, that [clearinghouse] examinations were unfairly carried on or were in some way used for the benefit of individual banks or bankers").

200. *See* Gary Gorton, *Clearinghouses and the Origin of Central Banking in the United States*, 45 J. ECON. HIST. 277, 280-82 (1985).

201. *See The Fed Explained: What the Central Bank Does*, BD. OF GOVERNORS OF THE FED RSRV. SYS. 87 box 6.1 (Aug. 2021), https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf [https://perma.cc/MC9Q-5LF8] ("[1907:] Many banks and clearinghouses refuse to clear checks drawn on certain other banks, leading to the failure of otherwise solvent banks.").

202. ROBERT F. BRUNNER & SEAN D. CARR, THE PANIC OF 1907: LESSONS LEARNED FROM THE MARKET'S PERFECT STORM 87-142 (2007); *see also* Ida M. Tarbell, *The Hunt for a Money Trust: III. The Clearing House*, AM. MAG., July 1913, at 44-47 (examining the role of J.P. Morgan and the New York Clearing House in the Panic of 1907).

203. S. REP. NO. 63-133, at 6 (1913). At the dawn of the twentieth century, for example, less than half of banks in New York City were members of its clearinghouse, although nearly all required access through a member in order to actually operate its business. STEFANO UGOLINI, THE EVOLUTION OF CENTRAL BANKING: THEORY AND HISTORY 80 (2017).

204. Wilson, Address on the Banking System, *supra* note 161.

Wilson, the creation of the Fed was a question of commercial freedom. As Wilson's advisor Louis D. Brandeis explained, banks must function as "public service corporations," not purely private enterprises, and a few large banks must not be allowed to overly influence the operation of all the others.[205]

The Fed provided a public-oriented infrastructure to stitch together the banking system on nondiscriminatory terms. This infrastructure was intended to address the problem of private power by supplementing and largely displacing the investor-dominated clearinghouse associations and money center banks as pivot points in the payments system.[206] In the original vision, the Fed was to ultimately attain universal membership—which would also make the then highly fragmented system more efficient for all participants.[207]

First, banks were authorized to borrow from regional Federal Reserve Banks and these FRBs would be required to lend without favor.[208] Unlike private clearing associations, FRBs were "always prepared to furnish [banks] with accommodation at a reasonable rate of interest."[209]

Second, the FRA was drafted to strengthen smaller banks by freeing them from the grip of money center institutions and tying their ability to expand their balance sheets, and hence the money supply, to the size of their regional FRBs. According to the Senate Banking Committee, this was one of the chief purposes of the FRA: to "make available effective commercial credit for individuals engaged in manufacturing, in commerce, in finance, and in business to the extent of their just deserts."[210] Legislators thought the new system would make much of the existing regime obsolete, dramatically weakening the power of large banks (especially those implicated in the Pujo Hearings).[211]

205. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 63-67 (1914). According to Brandeis, the directors of the country's deposit banks exercise "a function no less important to the country's welfare than that of the judges of our courts, the interstate commerce commissioners, and departmental heads." *Id.* at 67.

206. *See* 50 CONG. REC. 5993 (1913) (statement of Sen. Robert Owen, Chair of the Banking Committee) (explaining that in 1907 "a few men . . . enriched themselves . . . at the expense of the Nation"); ROGER LOWENSTEIN, AMERICA'S BANK: THE EPIC BATTLE TO CREATE THE FEDERAL RESERVE 191-94 (2015) (describing the influence on the FRA of Samuel Untermyer's 1913 report revealing inside dealing among New York banks); HOFFMAN, *supra* note 30, at 122. For an argument that central banks like the Fed are a natural extension of private clearing houses, see GOODHART, *supra* note 41, at 29-46 (1988). *See also* UGOLINI, *supra* note 203, at 80-84 (describing the role of the clearinghouses and their relationship with the Fed).

207. UGOLINI, *supra* note 203, at 81.

208. *See* Federal Reserve Act, ch. 6, § 4, 38 Stat. 251, 265 (1913) (codified as amended at 12 U.S.C. § 301) (directing the FRB boards to "administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks").

209. S. REP. NO. 63-133, at 10 (1913).

210. *Id.* at 7.

211. H.R. REP. NO. 63-69, at 31 (1913) (the FRA will "largely if not wholly obviate any necessity for the clearing-house examinations"); *id.* at 32 ("The existing banks [which provide banking services to banks] do it for profit, and when opportunity offers make exorbitant returns for themselves on the transactions they enter into. The proposed reserve banks are to be cooperative institutions, rendering their service for the good of all the banks that are stockholding in them, as well as for that of the public, while the Government is to get the excess profits of the institutions."); *id.* ("[T]he new system of placing all such examinations under authorized control and supervision will eliminate many possibilities of

Third, the FRBs offered banks a way to clear payments and borrow to cover liquidity needs without paying premiums. (Initially, the FRBs cleared checks and processed wires. Today they also operate an automated checking system and are developing a real time funds transfer service for retail transactions.[212]) No longer could large money center banks and the clearinghouses they controlled exert as much power over smaller banks outside the big cities. Policymakers hoped that the result would be reduced rent extraction, redounding to the benefit of households and businesses.[213]

2. Equal Treatment for Nonmember Banks

As the number of banks outside of the Federal Reserve System grew (known as nonmember banks), Congress revisited the FRA to ensure that the communities these banks served—typically people in rural, less developed parts of the country—were also able to access the money and payment system on equal terms. In 1980, Congress passed the Monetary Control Act, requiring the Fed to offer its services not just to its member banks but to all depository institutions regardless of their membership status.[214] It further required that the Fed price its services at cost, to charge the same price to all depository institutions, and to publish its prices publicly.[215] And perhaps most importantly, it changed how the Fed's reserve requirements were calculated, alleviating burdens on smaller institutions.[216]

3. Treatment of Nonbanks

Congress reinforced the FRA's neutrality mandate again in 2010 in the wake of the 2008 financial crisis. As we will examine further in Part IV, during the crisis, the Fed intervened at several points to support individual financial firms facing classic bank runs—saving some, while allowing others to fail. Title XI of the Dodd-Frank Act of 2010 amended the Fed's nonbanking lending power, requiring that it only extend credit through facilities with "broad-based

criticism or attack that lurk in the present system and may at times give rise to prejudice and specious assertions of favoritism.").

Although this Article is primarily about the design of the FRA, it bears mention that the design often failed to achieve its ends. For example, the New York money center banks remained dominant in the 1920s because the FRA failed to reduce the pyramiding of reserves in New York banks. This failure was due, among other things, to the fact that the Federal Reserve Banks were not authorized to pay interest on reserve balances and their discount window reduced the likelihood that New York banks would suspend payments increasing their appeal to country bank correspondents. *See* Selgin, *supra* note 147, at 23-27.

212. *The Fed Explained*, *supra* note 201, at 89-95.

213. *See, e.g.*, CARTER GLASS, ADVENTURES IN CONSTRUCTURE FINANCE 313 (1927) ("[The Fed] has saved millions of dollars to business through its par payment system for check collection.").

214. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, sec. 105, 94 Stat. 132, 140-41 (1980) (amending Federal Reserve Act § 13, para. 1, 12 U.S.C. § 342).

215. *Id.* sec. 107, § 11A (adding section 11A to the FRA, codified at 12 U.S.C. § 248a).

216. H.R. REP. NO. 96-263, at 3 (explaining that the bill treats all depository institutions of equal size alike and "ends the discrimination between Federal Reserve member banks and non-member banks as to their obligation to maintain reserves for purposes of monetary control").

eligibility."[217] This meant the Fed could not lend in ways "structured to remove assets from the balance sheet of a single and specific company,"[218] as it had in 2008 to aid the merger of the independent broker-dealer Bear Stearns with the financial conglomerate J.P. Morgan Chase.[219] Nor could the Fed "assist[] a single and specific company [to] avoid bankruptcy, resolution . . . , or any other Federal or State insolvency proceeding,"[220] as the Fed had done for the insurance conglomerate AIG. Title XI thus reduces the likelihood that the Fed's crisis fighting programs replicate the problems with the old clearinghouse system: favored treatment for large institutions headquartered in New York, less support for smaller banks (which over time would likely result in further conglomeration), and reduced access to credit for the customers smaller banks serve.

### *C. Offering Public Accountability for the Banking System*

A third problem with monetary outsourcing, related to the two just described, is inculcating public accountability. Although this problem was at its most severe in the decades preceding the Fed's founding, Congress initially gave the Fed relatively limited powers to check banks. After problems with public control reappeared in subsequent years, Congress amended the Federal Reserve Act, most notably in 1935, 1978, and 2010, to ensure that the Fed served as an adequate site of public accountability for the monetary system.

#### 1. The Fed's Board as a Public Monetary Authority

The Federal Reserve Act was a compromise between the political and business establishment and a movement of Greenbackers, populists, and progressive democrats who fought for fifty years to reverse delegation and replace the national banking system with government-issued currency.[221] This movement objected to the fact that the most important decisions about monetary conditions were made behind closed doors in bank boardrooms and clearinghouses—decisions, moreover, that often seemed to benefit private interests more than advance the public welfare.[222] By 1913, the Democratic Party was no longer willing to accept a system in which "the lifeblood of commerce" was in the hands of for-profit enterprise. As one legislator explained, money is

217. Federal Reserve Act § 13(3)(A), 12 U.S.C. § 343(3)(A) (2018) (amended by Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 1101(a), 124 Stat. 1376, 2113-15 (2010)).

218. 12 U.S.C. § 343(3)(B)(iii) (2018).

219. WALLACH, *supra* note 13, at 45-56.

220. 12 U.S.C. § 343(3)(B)(iii) (2018).

221. *See* SANDERS, *supra* note 143, at 236-59; *see also* RITTER, *supra* note 3 (examining the movement to reverse delegation).

222. *See, e.g.*, W. A. Peffer, *Government Control of Money*, *in* THE FARMERS' ALLIANCE HISTORY AND AGRICULTURAL DIGEST 262, 264 (N.A. Dunning ed., Washington, D.C., Alliance Publishing Co. 1891) ("The making and issuing of money is the exercise of a sovereign power, in the common interest of the people.").

"the yardstick by which all products of labor are measured. The control of this standard of value should be in the hands of the Government. . . . Any power that can control the volume of money, increasing it or decreasing it arbitrarily to serve selfish interests, has the power of life and death over American business and industry."[223]

Congress's response to this problem was to create the Federal Reserve Board, a public monetary authority designed to administer the system of investor-owned banks.[224] The Board is the keystone of the Federal Reserve Act. It not only serves as a site of accountability for the banking system but actively influences and limits the power of shareholder-appointed executives who issue most of the money in the country. As President Wilson explained, "the control of the system of banking . . . must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative."[225] Or as one member put it during debate over the bill,

> [T]he great power of banking and currency, probably the mightiest tool of the people, an instrument designed to carry on the business of trade and commerce, is secured to the Government by this section . . . . I can not understand how men at all familiar with the principles of government can hesitate in deciding to place [the power] with the Government and not with the banks, because the power over the expansion and contraction of currency and credit is so great and so absolutely controls all business that as a power it must be abused if it is permitted to be exploited by selfish men or still more selfish corporations. And when abused under the form of law this power becomes tyranny and oppression.[226]

In 1913, no other major country had a monetary system led by government officials. All had "central banks" on the model of the Bank of England—investor-owned, quasi-monopolies running a general banking business. The clients of these national champions included other banks, nonbank financial firms, businesses, and even individuals. To the policymakers who wrote the

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223. 50 CONG. REC. 4885 (1913) (statement of Rep. M. Clyde Kelly).

224. The Fed was understood this way by scholars at the time. *See, e.g.*, H. PARKER WILLIS, THE THEORY AND PRACTICE OF CENTRAL BANKING: WITH SPECIAL REFERENCE TO AMERICAN EXPERIENCE 1913-1935, at 9 (1936) (central banking "is a system for the control, regulation and direction of banking as a social function").

225. Wilson, Address on the Banking System, *supra* note 161; *see also* LINK, *supra* note 161, at 211-12 (quoting Wilson's statement to a reporter) ("With government control, there is created a force which, while it will not attempt to run the business of the banks, will be clothed with some authority to prevent injustice from the banks to the general public."). In arguing against banker representatives on the Board, Wilson is said to have asked Rep. Carter Glass and a group of bankers during a meeting, "Which of you gentlemen think the railroads should elect the members of the Interstate Commerce Commission?" Gerald T. Dunne, *A Christmas Present for the President*, BUS. HORIZONS, Winter 1963, at 43, 53.

226. 50 CONG. REC. 5018 (1913) (statement of Rep. James Manahan); *see also* LINK, *supra* note 161, at 212 (quoting a letter from Louis Brandeis to Woodrow Wilson) ("The power to issue currency should be vested exclusively in Government officials, even when the currency is issued against commercial paper. The American people will not be content to have the discretion necessarily involved vested in a Board composed wholly or in part of bankers . . . . The conflict between the policies of the Administration and the desires of the financiers and of big business, is an irreconcilable one.").

FRA, the Fed was decidedly *not* a "central bank": "The Federal reserve board, technically speaking, has no banking function. It is strictly a board of control, properly constituted of high Government officials, doing justice to the banks, but fairly and courageously representing the interests of the people."[227] Money creation, to these statesmen, was not an obscure, technocratic challenge; it was a political matter, managed in response to the social movements that propelled and challenged the monetary system from the founding up until that point. Money creation was an act of governance.[228]

In 1935, following the Board's failure to prevent a severe monetary contraction, Congress strengthened the Board's control over the System and created a single policy committee to manage open market operations. It also reduced the influence of investor-appointed bank managers on Fed decisions and on the course of U.S. monetary conditions.[229] In centralizing power, legislators made the Fed function more like a public version of its foreign counterparts. President Roosevelt hoped that these reforms—which he paired with repairs to aspects of the American Monetary Settlement that had deteriorated in the 1920s such as separations and supervision[230]—would satisfy critics of monetary outsourcing and quell renewed calls to institute a fully government-issued money supply.[231]

2. The Full Employment and Balanced Growth Act of 1978

The New Deal reforms worked for many decades. However, in the 1970s, a new problem—major supply shocks—caused unemployment to reach exceptionally high levels with price indices also rising. In response, Congress amended the FRA to dial up avenues for political influence and reduce the Fed's insulation from legislative jawboning and public scrutiny. As previously mentioned, in 1975, Congress reminded the Fed of the primacy of full capacity utilization over the long term, directing the Board to stimulate banks to expand the money supply. Congress also required the Fed to file periodic reports with House and Senate committees, including the agency's planned targets for monetary aggregates for the coming year (a requirement that legislators left in place until 2000).[232] The push for transparency culminated in the Full

227. 50 CONG. REC. 4645 (1913) (statement of Rep. Glass).

228. *See, e.g.*, BRANDEIS, *supra* note 205, at 64 (quoting Senator Robert Owen, chief sponsor of the Federal Reserve Act, explaining that "a bank is a public utility institution and cannot be treated as a private affair" and "[a]ll banks in the United States, public and private, should be treated as public-utility institutions, where they receive public deposits").

229. See sources cited *supra* note 171.

230. *See* Menand, *supra* note 36, at 1003-07 (supervision); WILMARTH, *supra* note 93, at 15-34, 129-40 (separations).

231. *See* HELEN BURNS, THE AMERICAN BANKING COMMUNITY AND NEW DEAL BANKING REFORMS, 1933-1935, at 97-100 (1974).

232. Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, sec. 202, § 2A, 91 Stat. 1387, 1387. Legislators removed the reporting requirement in its entirety in 2000 (presumably to increase the Fed's monetary policy independence). American Homeownership and Economic Opportunity Act of 2000, Pub. L. No. 106-569, sec. 1003, 114 Stat. 2944, 3028.

Employment and Balance Growth Act of 1978, also known as Humphrey-Hawkins, which mandates to this day that the Fed's Chair testify before Congress semiannually.[233] The FRA also requires that the Fed's decision-making bodies file numerous reports to Congress.[234] Although agency reporting requirements are common, and agency officials often testify to Congress, legally required hearings are rare. These hearings and reports not only allow Congress to influence Fed decision making but legitimate monetary outsourcing by subjecting the Fed's oversight of the banking system to public participation and regular legislative interrogation.[235]

#### 3. The Dodd-Frank Act of 2010

Congress reaffirmed the Fed's role as a site of public accountability in 2010. Most notably, the Dodd-Frank Act requires the Fed to file detailed reports on its lending activities;[236] creates a Fed official responsible for bank oversight;[237] and requires that official to testify regularly before Congress.[238] In the years since the Act's passage, in response to political pressure, the Fed has increasingly opened up its own decision-making processes and released more information to the public. The result is a system that—as the House Banking Committee put it in 1913—"retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine."[239]

## III. The Federal Reserve and Administrative Law

Part II explained what federal legislators built the Fed to do—stimulate the expansion of monetary aggregates, promote a level playing field among investor-owned banks, and provide a site of public accountability for the bank-based monetary system. This Part explains how Congress designed the Fed to accomplish these goals. In so doing, this Part sheds light on aspects of the Fed's

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233. Full Employment and Balanced Growth Act of 1978, Pub. L. No. 95-523, sec. 108, 92 Stat. 1887, 1897 (the current version of the testimony requirement is codified at 12 U.S.C. § 225(b)).

234. Federal Reserve Act § 10, para. 7, 12 U.S.C. § 247 (2018) (requiring the Fed to "annually make a full report of its operations to the Speaker of the House of Representatives"); *id.* § 10(10), 12 U.S.C. § 247a (requiring the Fed to keep a complete record of all its policy activities and the reasons underlying its decisions and to include a full account of its actions in its annual report to Congress); *id.* § 2B(b), 12 U.S.C. § 225b(b) (requiring the Fed to submit monetary policy reports to Congress); *id.* § 2B(c), 12 U.S.C. § 225b(c) (requiring the Fed to publish reports on its activities). Several of these requirements date to the 1920s and '30s.

235. Mandatory public hearings are another area in which the United States led other advanced economies. *See Monetary Policy Oversight Hearings*, *supra* note 180, at 50 (statement of Arthur F. Burns) ("Did you know, Senator, that I am the only central banker in the world who appears before legislative committees?").

236. Federal Reserve Act § 13(3)(C)-(D), 12 U.S.C. § 343(C)-(D) (2018) (added by Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 1101(a), 124 Stat. 1376, 2113-15 (2010)).

237. *Id.* § 10, para. 2, 12 U.S.C. § 242 (amended by Dodd-Frank sec. 1108(a), 124 Stat. at 2126).

238. *Id.* § 10(12), 12 U.S.C. § 247b (amended by Dodd-Frank sec. 1108(b)).

239. H.R. REP. NO. 63-69, at 18-19 (1913).

design that often puzzle administrative law scholars, including the Fed's mix of seemingly unrelated responsibilities,[240] its significant policy independence (including its power to make major economic decisions with little to no oversight ex ante from the President or risk of ex post judicial review[241]), and its close ties to investor-owned banks.

Section III.A starts with the Fed's toolkit, cataloguing and explicating the ways that Congress empowered the Fed to administer the banking system. Section III.B turns to the Fed's bespoke institutional structure, explaining how it too reflects the Fed's overarching purposes and role within the banking system. My goal throughout is descriptive: not to justify the Federal Reserve Act, but to make sense of it within our legal and constitutional tradition.

### *A. The Instruments of Monetary Administration*

Scholars who draw a sharp line between the Fed and the rest of the banking system treat the Fed as a kitchen sink agency that performs a wide range of functions brought together by little more than historical happenstance and political expediency. This Section suggests a more unified understanding. It argues that each of the Fed's core authorities—to (1) operate the interbank payments system; (2) modulate the price of reserves (by buying and selling financial assets, lending to banks, and paying interest to banks); (3) promulgate rules, supervise individual banks (and bank holding companies), and enforce prudential requirements; and (4) lend in unusual and exigent circumstances to nonbank financial firms—are designed to address the problems with monetary outsourcing described in Parts I and II. Each empowers the Fed to regulate the quantity and quality of deposit money issued by banks.

#### 1. Regulating by Clearing and Settling Interbank Payments

Much of the Fed's regulatory toolkit masquerades as a suite of banking services. One of the most important of these is clearing and settling interbank payments. Formally and operationally, the Fed is a bank for banks.[242] Over five thousand banks maintain accounts at one of the twelve FRBs.[243] These accounts

240. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 9 (speaking of "the Fed's many missions" and "the Fed's varied missions"); *id.* at 127 (discussing "The Five Hundred Hats of the Federal Reserve"); *id.* (speaking of the Fed's "diverse missions" that "extend far beyond the maintenance of price stability"); ARMOUR ET AL., *supra* note 30, at 324-32 (discussing the Fed as lender of last resort); ARMOUR ET AL., *supra* note 30, at 391-408 (discussing the Fed's payments role); ARMOUR ET AL., *supra* note 30, at 579-86 (discussing the Fed's supervision function).

241. Gillian E. Metzger, *Through the Looking Glass to a Shared Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 LAW & CONTEMP. PROBS. 129, 133 (2015); Thomas W. Merrill, *A Comment on Metzger and Zaring: The Quicksilver Problem*, 78 LAW & CONTEMP. PROBS. 189, 198-99 (2015); Zaring, *supra* note 30, at 172-76.

242. 50 CONG. REC. 5995 (1913) (statement of Sen. Owen) (explaining that the FRBs are "banks for banks; bankers' banks; and not a public bank competing with the banks for business").

243. *Credit and Liquidity Programs and the Balance Sheet*, BD. GOVERNORS FED. RSRV. SYS. (Nov. 15, 2021), https://www.federalreserve.gov/monetarypolicy/bst_frliabilities.htm [https://perma.cc/

are called "reserve accounts" or "master accounts," and the balances in them are called "reserves" or "settlement balances." Banks can withdraw cash or coin from these accounts (and that is how all cash and essentially all coin enter general circulation), but most of the time, banks use reserves as a special type of money to make payments to each other. Banks do this using a service called Fedwire. Fedwire allows banks to clear and settle in real time by instructing the Fed to adjust the balances in their respective accounts.[244] The Fed also helps banks calculate the amounts they owe to each other (and net these amounts) by operating a nationwide check-clearing system and an electronic service known as FedACH, which processes payments drawn on banks by depositors of other banks.[245]

The Fed provides these payment services not as a subsidy for banks and their investors, but to regulate bank money issuance. The goals should be familiar—I touched on them in Part II. First, the Fed uses its pivot position to promote monetary expansion, in particular by encouraging households, businesses, and banks to treat bank deposits as fungible with each other and with cash (in good times and bad).[246] The Fed does this in several ways. Most directly, it clears and settles interbank payments without regard for profit, replacing an investor-run interbank clearing and settlement infrastructure that was prone to abuse. For example, while the Fed is still subject to improper influence, it is less likely to cut banks off to gain a competitive advantage or to avoid short-term losses.[247] It is also more likely to provide intraday credit during turbulent periods, reducing the prospects of failed payments. And because clearing and settling interbank payments through the Fed is far more centralized, it is more efficient, reducing the number of uncollected checks outstanding at any time and addressing what H. Parker Willis, one of the Fed's key architects, called "a continual menace to the safety and liquidity of the banking system."[248]

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PY26-W35Y]; *see also* Federal Reserve Act § 13, para. 1, 12 U.S.C. § 342 (2018) (authorizing the Fed to maintain accounts for depository institutions).

244. *See The Fed Explained*, *supra* note 201, at 95-97.

245. *Id.* at 89-93. Bank-owned associations and banks that specialize in settling payments also tally up and clear transactions, but these platforms all use Fed master accounts for final settlement. *See* Awrey, *Unbundling Banking, Money and Payments*, *supra* note 35, at 736 fig.2, 746-47; Morten L. Bech, Antoine Martin & James McAndrews, *Settlement Liquidity and Monetary Policy Implementation—Lessons from the Financial Crisis*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., Mar. 2012, at 1, 3 (mapping the connections between Fedwire and the major privately owned wholesale clearing and settlement networks).

246. This was long recognized by specialists as a reason for creating central banks. *See* CHARLES F. DUNBAR, THE THEORY AND HISTORY OF BANKING 101-02 (4th ed. 1922) ("The practice of making settlements between banks on the books of a central bank greatly reduces the withdrawals of cash during a crisis. . . . The mere presence of a central bank removes the danger that other banks will adopt the short-sighted policy of hoarding their reserves . . . ."); *see also* UGOLINI, *supra* note 203, at 29.

247. For example, a clearinghouse controlled by investor-owned banks induced the Panic of 1907 by terminating clearing relationships with firms they suspected of being in poor financial health. Depositors at the terminated firms immediately withdrew their deposits and the terminated firms rapidly shrunk their balance sheets. *See* BRUNNER & CARR, *supra* note 202, at 65-83. The panic precipitated a widespread monetary contraction and sharp drop in economic output.

248. WILLIS, *supra* note 224, at 346.

Fed payment services also promote monetary stability indirectly by providing Fed officials with valuable information about the operation and the liquidity of the banking system, which they can use to inform their efforts to regulate the size and composition of bank balance sheets using their other tools (see *infra*).[249] To quote Willis again, central bank clearing "is not only a means of economizing cash and capital, but is also a means of testing at any time the degree of liquidity which the community is maintaining,—a matter which is essential for the central bank to know from day to day."[250]

Second, by facilitating interbank payments the Fed, in theory and at least to a certain extent in practice, levels the playing field among banks. No matter the size, location, or business model of a bank—and no matter the race or religion of its owners or managers—banks have a statutory right to clear their payments at the Fed.[251] Because the Federal Reserve Banks are largely under public control, investor-appointed bank executives are limited in their ability to interfere with this critical economic infrastructure to create frictions or compete unfairly.[252] Before the Fed's creation, rural banks and smaller banks incurred substantial costs to plug into the interbank payments system. By operating a nationwide infrastructure with nondiscriminatory pricing based on overall cost, the Fed strengthens peripheral banks and their customers. As one expert explained, the Fed's establishment quickly "cut in half the time required to collect checks" and "greatly reduced the 'interest charge' which some banks make for the use of funds represented by uncollected checks."[253]

### 2. Regulating by Modulating the Price of Reserves

The Fed's prominent "monetary policy" tools leverage its position as payments pivot and are also regulatory: they are means to stimulate (or impede) bank balance sheet expansion. Today, there are three: (a) buying and selling financial assets through "open market operations," (b) lending to banks through the "discount window," and (c) administering "interest on reserves." The first two were the Fed's traditional levers; they rely on the fact that banks settle payments between each other using reserves issued by the Fed, and the Fed has

249. For recognition of this point by a leading expert during the period when the Federal Reserve's core structures were established, see DE KOCK, *supra* note 75, at 140-43.

250. WILLIS, *supra* note 224, at 359.

251. *See supra* notes 214-215 and accompanying text.

252. *See supra* notes 196-213 and accompanying text. As with many of the problems that legislators established the Fed to combat, this problem persisted even after the Fed's creation. For example, it is likely that antisemitism and anti-immigrant prejudice at the Fed (and other major banks) played a significant role in the failure in 1930 of one of the largest banks in the country, a failure which had extremely damaging consequences for monetary stability and the minority customers and proprietors of the bank that failed. *See* Rebecca Korbin, *Too Big to Fail in 1930: The Failed Bank of United States and the Long Shadow of East European Jewish Immigrant Banking*, 103 AM. JEWISH HIST. 457 (2018).

253. WARREN BURGESS, THE RESERVE BANKS AND THE MONEY MARKET 105 (rev. ed. 1936) (1927). As Stefano Ugolini explains, the "foremost priority of [the FRA in 1913] was to create a unified national clearing system, definitively eliminating internal exchange rate variability and the risk of new disruptions [in the payment system]." UGOLINI, *supra* note 203, at 81.

the power to create reserves "out of thin air" by writing up or down a bank's account balance on its books. As, with few exceptions,[254] only banks use reserves, when the Fed adds reserves to a bank's master account, it is giving the bank permission in the form of a ledger entry (or "settlement balance") to expand its balance sheet, that is, to make new loans by adding deposits to the accounts of its customers.[255]

Creating settlement balances has this regulatory effect for two reasons. First, and most straightforwardly, Congress gave the Fed the power to require banks to hold a certain level of settlement balances.[256] Banks cannot create new deposits (by making new loans) if they do not have enough reserves to meet these requirements. Second, and more importantly, banks need reserves, independent of these requirements, to settle their debts to each other resulting from the checks their customers write payable to customers of other banks.[257] If a bank extends more loans, all else equal, it will need more reserves. The ability and willingness of banks to expand the supply of deposits by originating new loans is a function of the cost of borrowing reserves overnight.

(a) *Regulating by Buying and Selling Financial Assets.* One way that the Fed can adjust the cost of borrowing reserves is by buying short-term Treasury securities, using reserves it creates with a keystroke, or by selling securities that it previously purchased, writing down the account of the buyer.[258] These "open market operations" affect the rate at which banks lend reserves to each other, a rate known as the federal funds rate. To raise the federal funds rate, the Fed reduces the size of its balance sheet (by selling Treasury securities) until the price that banks are paying to lend each other reserves overnight increases to the desired level. In other words, it reduces the supply of reserves. To lower the federal funds rate, the Fed does the opposite. It goes without saying the Fed could also adjust the federal funds rate by changing the volume of reserves that each bank is required to maintain, thereby changing the demand for reserves, but to

254. Most notably, the U.S. Treasury Department has a reserve account. Federal Reserve Act § 15, para. 1, 12 U.S.C. § 391 (2018).

255. Former Fed Governor and economist Jeremy C. Stein makes this point. *See* Jeremy C. Stein, *Monetary Policy as Financial Stability Regulation*, 127 Q. J. ECON. 57, 59 (2012) (describing reserves as "tradeable permits" for "private money creation"); *see also* RICKS, THE MONEY PROBLEM, *supra* note 35, at 228, 241. Except for a period in the 1980s when the Fed expressly targeted monetary aggregates, Fed officials have generally focused policy on the price, not the quantity, of money.

256. Federal Reserve Act § 19(b), 12 U.S.C. § 461(b) (2018). The Fed's implementing rules are codified at 12 C.F.R. pt. 204 (2022) ("Regulation D"). In March 2020, the Board lowered all reserve requirements to zero for the first time. *See* Regulation D: Reserve Requirements of Depository Institutions, 85 Fed. Reg. 16525 (Mar. 24, 2020). For a comprehensive overview of the Fed's use of reserve requirements, see Joshua N. Feinman, *Reserve Requirements: History, Current Practice, and Potential Reform*, 79 FED. RSRV. BULL. 569; and U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-117, FEDERAL RESERVE: OBSERVATIONS ON REGULATION D AND THE USE OF RESERVE REQUIREMENTS (2016).

257. *See Senior Financial Officer Survey*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. 3, 8 (Sept. 2018), https://www.federalreserve.gov/data/sfos/files/senior-financial-officer-survey-201809.pdf [https://perma.cc/8UCF-XK3U]. Note that a bank's demand for settlement balances may increase at a declining rate since the customers at big bank often pay each other (allowing their bank to settle those payments internally).

258. *The Fed Explained*, *supra* note 201, at 36-37.

do so would might require the Fed to engage in notice-and-comment rulemaking[259] (whereas open market operations bypass that process).[260]

(b) *Regulating by Lending to Banks.* The Fed can also affect the level of reserves through lending. If a bank is unable to borrow reserves in the federal funds market, perhaps because other banks have doubts about its financial condition, the bank can turn to the Fed at any time and borrow at the "discount window."[261] Although the Fed relied on the discount window to conduct monetary policy in its early years, today the Fed uses the discount rate only as a backstop.[262] When Fed policymakers "raise rates," they raise their target for the federal funds rate and simultaneously set the price they quote banks for discount window loans to an even higher level, so that in the normal course when a bank originates new loans and expands its balance sheet it acquires any extra reserves it needs by borrowing from other banks rather than by borrowing from the Fed.[263]

In an emergency, of course, when depositors demand cash and the interbank lending market becomes stressed or frozen, the Fed acts as the "lender of last resort," preventing panic-induced declines in the money stock by lending reserves to banks so they can meet depositor withdrawals.[264] The point of this lending is not to invest in banks—to lend to banks in the way that ordinary people or banks themselves lend. Rather, it is to regulate the amount of money in the economy by ensuring that deposits trade at par with cash.[265]

(c) *Regulating by Paying Interest on Reserves (IOR).* Starting in 2008, Congress amended the Federal Reserve Act to give the Fed an additional tool to

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259. It would also require the Fed to set the requirements above the level of reserves that banks otherwise demand; otherwise changing the requirements would have no effect.

260. Generally, the FOMC issues directives to the Federal Reserve Banks, which are a type of rule under the Administrative Procedure Act, but which the FOMC finds "good cause" to promulgate without notice and comment. 12 C.F.R. § 272.5 (2022). The Fed's Board could also claim "good cause" to adjust reserve requirements without notice or comment, which it did to lower requirements in response to the pandemic, *see* Regulation D, 85 Fed. Reg. at 16525-26, but such action is subject to challenge by investor-owned banks. The FRBs, which vote on the FOMC and are closely tied to the Board, have never challenged an FOMC directive in court.

261. The window gets its name from the way that the Fed used to lend: by purchasing a debt instrument from the bank at a discount to par. The bank endorses the debt instrument so that if the issuer defaults, the bank is still on the hook to the Fed. Although the Fed is still authorized to lend in this manner, *see* Federal Reserve Act § 13, para. 2, 12 U.S.C. § 343 (2018), "discount window" loans today generally take the form of advances against collateral, *see* Federal Reserve Act § 10B, 12 U.S.C. § 347b (2018).

262. Former Fed Board General Counsel Howard Hackley dates the decline of discount window lending as a primary monetary policy tool to 1959. HOWARD H. HACKLEY, LENDING FUNCTIONS OF THE FEDERAL RESERVE BANKS: A HISTORY 4 (1973).

263. *See* Mark Carlson & Jonathan D. Rose, *Stigma and the Discount Window*, BD. GOVERNORS FED. RSRV. SYS.: FEDS NOTES (Dec. 19, 2017), https://www.federalreserve.gov/econres/notes/feds-notes/stigma-and-the-discount-window-20171219.html [https://perma.cc/J677-DCGZ].

264. *See* R. G. HAWTREY, THE ART OF CENTRAL BANKING 116 (Frank Cass & Co. 1962) (1932) ("The exclusive responsibility for seeing that the supply of currency in the community is adequate, and no more than adequate, devolves upon the central bank. . . . The Central Bank is the *lender of last resort*. That is the true source of its responsibility for the currency.").

265. *See* Thomas M. Humphrey, *The Classical Concept of the Lender of Last Resort*, FED. RSRV. BANK RICH. ECON. REV., Jan.-Feb. 1975, at 2, 5 (1975); Menand, *supra* note 19, at 305-07.

regulate bank balance sheet expansion: interest on reserves.[266] When the Fed sought the authority to pay interest on reserves (and Congress authorized it), policymakers did not intend to use these interest payments as an alternative to open market operations. Nonetheless, due to a dramatic increase in excess reserves in the 2010s, the Fed decided to shift toward a "floor system" in which it adjusts the IOR rate, rather than the quantity of reserves, to keep the federal funds rate within its target range. Under the floor system, the Fed creates a bottom in the federal funds market: No bank will lend excess reserves to another bank for less than the amount the Fed is already paying in interest. Interest on reserves thereby influences banks looking to expand their balance sheets even when most banks have excess reserves and do not need to borrow them (either from other banks or from the Fed directly).[267] The Fed at present no longer uses traditional open market operations (or adjustments to reserve requirements) to modulate the price of reserves.[268]

3. Regulating by Promulgating Rules and Supervising

Congress also empowered the Fed to regulate the money supply by tightening (or loosening) more conventional restrictions on the size and composition of bank balance sheets. One way the Fed can do this is through ordinary regulatory rules governing bank equity capital, liquidity, and activities. Another way is via examination and safety-and-soundness supervision (an iterative, institution-specific practice of comment and response that rarely involves any final agency action). Two caveats apply. First, the Fed generally writes rules and supervises banks to reduce their likelihood of encountering financial distress, not to modulate money creation directly, even though these

266. Congress initially authorized interest on reserves in 2006 as part of the Financial Services Regulatory Relief Act, postponing the effective date to October 1, 2011. Financial Services Regulatory Relief Act of 2006, Pub. L. No. 109-351, §§ 201-203, 120 Stat. 1966, 1968-69. In October 2008, Congress made the change effective immediately. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 128, 122 Stat. 3765, 3796. Fed officials had sought this authority for decades, as they believed that the opportunity cost to banks of holding reserves ought to be zero (when reserves pay no interest, they function as a tax on banks and indirectly on bank deposits). In 2005, Fed officials also argued that paying interest on reserves would facilitate monetary policy by making it easier for the open market desk to predict demand for reserves and hence to keep the federal funds rate within its target range. Debate over whether the Fed should pay interest on reserves dates to 1913, *see, e.g.*, *Banking and Currency: Hearings on H.R. 7837 (S. 2639) Before the S. Comm. on Banking and Currency*, 63d Cong. 1971-72 (1913), when money center banks opposed such a provision to protect their correspondent business, *see* Selgin, *supra* note 147, at 17; RICHARD T. MCCULLEY, BANKS AND POLITICS DURING THE PROGRESSIVE ERA 238 (1992). Subsequent efforts to authorize interest payments were opposed by the Treasury Department, which stood to lose part of its earnings from the Fed's operating surplus. GEORGE SELGIN, FLOORED! HOW A MISGUIDED FED EXPERIMENT DEEPENED AND PROLONGED THE GREAT RECESSION 12 (2018).

267. The Board of Governors sets IOR through "good cause" rulemaking, without notice and public participation. See 12 CFR § 204.10(f) (2022). For an overview of the Fed's new operational framework, see Ricks, *Money as Infrastructure*, supra note 35, at 772-800.

268. It also uses a new facility known as the overnight reverse repurchase agreement facility (ON RRP) to pay interest to nonbanks. ON RRP is necessitated by the rise of shadow banking and various deposit substitutes, as discussed further herein. The Fed uses ON RRP to prevent the cost of overnight lending between nonbanks from falling too far below the cost of overnight lending between banks. *See infra* Section IV.B.2.

rules necessarily affect the sorts of assets banks can originate or purchase by requiring banks to maintain certain balance sheet ratios or limiting their ability to do business with certain counterparties.[269] Second, the Fed has only partial control of these tools. It shares rule-writing and supervisory powers over banks with state banking commissioners and two other federal agencies, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (a feature of our monetary architecture that has repeatedly contributed to dysfunction and breakdowns).

In practice, the Fed uses its regulatory rules to set a baseline on top of which its supervisory officials engage in firm-specific oversight. Through ongoing dialogue with banks, supervisors share their view on the safety and soundness of specific bank investments, activities, practices, and balance sheet configurations.[270] The Fed also conducts supervisory stress tests of the largest banks, the results of which it uses to determine whether bank balance sheets are too large or too risky. These powers limit the ability of banks to issue more deposits.

Although rule-writing and supervision transparently regulate the banking system (as compared with clearing interbank payments or modulating the price of reserve balances), they are also difficult to challenge in court. Ongoing supervision generally does not result in final agency action,[271] and safety-and-soundness adjudication that does result in final action is subject to a highly deferential standard of review[272] and is backed up by the Fed's near plenary powers to deny banks access to the discount window, the interbank payment system,[273] and intraday liquidity, and to withhold approvals for mergers, capital payouts, and even the purchase of office buildings.[274] The Fed's regulatory rules, meanwhile, are rarely challenged given the dependence of banks on the Fed's goodwill and because bank-specific safety-and-soundness requirements often exceed what is required of a bank under the regulatory rules (limiting the potential upside of challenging these rules in court).

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269. For an overview and critique of the most important of these rules today, the Basel capital rules, see Roberta Romano, *For Diversity in the International Regulation of Financial Institutions: Critiquing and Recalibrating the Basel Architecture*, 31 YALE J. ON REGUL. 1 (2014). For an example of how regulators have used these rules to influence credit allocation, see DANIEL K. TARULLO, BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION 55 n.16 (2008), which discusses the decision by policymakers to permit loans to owners of certain residential properties to be treated identically with owner occupied housing.

270. Menand, *supra* note 36, at 953-55.

271. *See* 5 U.S.C. § 704 (2018) (subjecting final agency actions to judicial review).

272. *See* Indep. Bankers Ass'n of Am. v. Heimann, 613 F.2d 1164, 1169 (D.C. Cir. 1979).

273. For an example of how the Fed has been able to limit bank access to certain payments infrastructure, see its dispute with a Connecticut bank, *TNB USA Inc. v. Federal Reserve Bank of New York,* No. 8-CV-7978, 2020 WL 1445806 (S.D.N.Y. Mar. 25, 2020). For an overview of the Fed's rules governing bank access to the interbank payment system, see Julie Andersen Hill, *Opening a Federal Reserve Account*, 40 YALE J. ON REGUL. (forthcoming 2023), https://ssrn.com/abstract=4048081 [https://perma.cc/R7KT-Q23J].

274. Menand, *supra* note 36, at 953 & nn.4-5, 954 & n.6; Federal Reserve Act § 24A, 12 U.S.C. § 371d (2018) (requiring approval for investments in bank premises).

Fed officials today do not generally use rules and supervision interchangeably with their power to modulate the price of reserves.[275] This division in practice has led many scholars to treat the two categories as conceptually distinct.[276] But this approach, I believe, is mistaken for two reasons.[277] First, to accomplish its statutory mandate, the Fed must regulate not merely the quantity of bank money but also its quality—deposits backed by bad assets are unstable and may disappear in the face of economic uncertainty and asset price shocks. History and theory suggest that insolvent monetary institutions are the biggest threat to the Fed's mission.[278] In crises like the one experienced in 2008, the Fed can relax the constraints on bank balance sheet expansion all it wants (pumping more reserves into the system, suspending capital requirements, etc.) but if banks have more liabilities than assets, they will be forced to shrink their deposits and hence the money supply.

Second, by regulating the quality of bank money, the Fed necessarily influences the quantity of money the banking system will create. If the Fed demands high equity levels, banks cannot originate as many loans and accordingly as many new deposits (at least not without going into the capital markets and raising more equity). In this way adding reserves and reducing equity requirements are substitutes.[279] When the Fed adds reserves in its open market operations, it lowers the hurdle rate for banks to originate new loans and add new deposits to the money supply. When the Fed lowers capital requirements, either by promulgating new capital rules or by adjusting stress tests and relaxing supervisory constraints, it produces the same monetary effect: lower

275. In the late twentieth century, the connection between interest rate policy and supervision was more widely recognized by practitioners. *To Modernize the Federal Reserve System: Hearing on H.R. 7001 Before the Subcomm. on Domestic Monetary Pol'y of the H. Comm. on Banking, Fin. & Urb. Affs.*, 96th Cong. 60 (1980) (statement of Hon. Paul A. Volcker, Chairman, Bd. of Governors of the Fed. Rsrv. Sys.) ("[T]he Board has stated on a number of occasions that it believes that the condition of the banking system and information about individual banks is an important input for monetary policy formulation which would be lost or substantially reduced if the Federal Reserve had no role in the regulation or examination function. Our experience in recent years has only served to strengthen the conviction that information which the System obtains in the course of exercising its supervisory functions provides key insights into such matters as the state of liquidity and viability of the Nation's banking institutions, indispensable elements in the formulation and implementation of monetary policy. The borderline between monetary, regulatory, and supervisory powers is sometimes indistinguishable.").

276. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 170, 175.

277. It also overlooks legislative intent. *See, e.g.*, Federal Reserve Act § 11(a), 12 U.S.C. § 248(a) (2018) (authorizing the Board to examine depository institutions and require them to file reports as "the Board may determine to be necessary or desirable to enable the Board to discharge its responsibility to monitor and control monetary and credit aggregates").

278. Paul Tucker gives the best explanation I am aware of. *See* TUCKER, *supra* note 27, at 440 (arguing that monetary stability and financial stability are intrinsically connected); *id.* at 459 (arguing that the view that central banks should focus only on price stability "amounts to mythmaking: the myth that they are not involved [in financial stability] when, in reality, they are").

279. This point is generally overlooked in corporate finance literature, which tends to treat bank deposits primarily as a source of funding rather than as a bank's core product. *See, e.g.*, ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT 110-12 (2013) (conceptualizing bank deposit "services" as a funding cost).

capital requirements free up balance sheet capacity for additional bank lending and deposit creation.[280]

Although the Fed exercises a good deal of control over lending volumes through rule writing and supervision, as well as through conventional reserve-based policy implementation, there are important limits to the Fed's powers. The Fed cannot directly control balance sheets, for example by setting the interest rates banks pay their depositors or formally directing the volume of loans that banks originate.[281] The Fed possessed the former power between 1933 and 1980, when Congress changed the law.[282] China's monetary authority, the People's Bank of China, regularly uses the latter method to control monetary conditions.[283] The Fed also has little power over individual lending decisions. Private ordering and decentralized control over monetary expansion are longstanding features of the U.S. monetary system.

4. Regulating by Lending to Nonbank Financial Firms

The Fed has one tool for administering the banking system that works around banks rather than through them. In 1932, Congress added section 13(3) to the Federal Reserve Act, authorizing the Fed to lend to any individual, partnership, or corporation.[284] (Prior to 1932, the Fed was authorized to lend and

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280. Arguably, in the 2010s, at the same time as the Fed was flooring the gas with its interest rate policy, it was slamming the breaks using its rule-writing and supervisory powers. The starkest example is a cap that the Fed placed on the balance sheet of Wells Fargo (one of the country's largest banks). The Fed kept the cap in place—citing the bank's serious governance and risk management failures—even though it worked at cross purposes with the Fed's expansionary stance during the COVID-19 recession. *See* Kevin Wack, *Fed's Conundrum: Whether to Remove Wells Fargo's Asset Cap*, AM. BANKER (Apr. 1, 2020, 4:53 PM EDT), https://www.americanbanker.com/news/feds-conundrum-whether-to-remove-wells-fargos-asset-cap [https://perma.cc/VB9F-9JZH].

281. The Fed has, in the past, employed credit controls, including three times between 1941 and 1953 (when Congress repealed the relevant authorizing legislation) and once between 1969 (when Congress reauthorized the Fed to control "any or all extensions of credit" when instructed to do so by the President) and 1982 (when Congress once again repealed the authorizing legislation). Stacey L. Schreft, *Credit Controls: 1980*, FED. RSRV. BANK RICH. ECON. REV., Nov./Dec. 1990, at 25, 25. During the most recent episode—in 1980—the Fed aimed to restrict bank annual loan growth to a range of six to nine percent. *Id.* at 35.

282. *See* Banking Act of 1933, ch. 89, sec. 11(b), 48 Stat. 162, 181-82 (1933) (authorizing the Fed to set deposit rates); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, §§ 201-210, 94 Stat. 132, 142-45 (repealing the Fed's authority to set deposit rates). For more on the Fed's use of this tool, known as Regulation Q, and its repeal, see Robert C. West, *The Depository Institutions Deregulation Act of 1980: A Historical Perspective*, FED. RSRV. BANK KAN. CITY ECON. REV., Feb. 1982, at 3, 8-10.

283. Up until 1993, the People's Bank of China (PBOC) published a Credit Plan, with aggregate credit ceilings. STEPHEN BELL, THE RISE OF THE PEOPLE'S BANK OF CHINA: THE POLITICS OF INSTITUTIONAL CHANGE 165-67 (2013). Since 2007, the PBOC has imposed credit quotas for banks. *Id.* at 167. Since 1998, it has published "window guidance" for bank credit origination. *Id.* at 169-70.

284. Federal Reserve Act § 13(3), 12 U.S.C. § 343(3) (2018) (original version added by Emergency Relief and Construction Act of 1932, ch. 520, sec. 210, 47 Stat. 709, 715). In 1933, Congress also authorized the Fed to lend to nonbanks against Treasury-security collateral for short periods of time. Federal Reserve Act § 13, para. 13, 12 U.S.C. § 347c (2018) (original version added by Act of Mar. 9, 1933, ch. 1, sec. 403, 48 Stat. 1, 7). This authority, however, has not been used since 1935 and the Fed has self-imposed by regulation most of the restrictions that Congress imposed by statute on 13(3) lending. *See* Regulation A, 12 C.F.R. pt. 201 (2022).

offer banking services only to its membership.[285]) Standing alone, such an authorization would permit the Fed to act as an ordinary bank rather than as a monetary authority: extending credit as banks do, and interacting directly with businesses, nonprofits, and governments rather than regulating the supply of bank money by interacting exclusively with banks.

But section 13(3) includes a variety of restrictions that prevent the Fed from conducting a general banking business with the public. First, unlike the Fed's other tools, the law requires the approval of the Treasury Secretary and five members of the Fed's Board to identify "unusual and exigent circumstances." Second, before lending, the Fed's FRBs must further obtain evidence that borrowers are unable to access adequate credit accommodations from banks (the "credit availability proviso").[286] Third, the Board must establish policies and procedures to ensure that (1) security is sufficient to protect taxpayers from losses, (2) borrowers are solvent, (3) loans are not designed to remove assets from the balance sheet of any single company, and (4) lending is for the purpose of providing liquidity to the financial system (the "financial system liquidity clause").[287]

Two of the above restrictions—the credit availability proviso and the financial system liquidity clause—underline the power's monetary purpose. The credit availability proviso prevents the FRBs from lending to households, nonprofits, municipalities, and businesses, as banks do, unless they can first obtain evidence that the banking system has ceased to function properly. The proviso was part of a compromise in 1932 between legislators who sought to empower a new government agency, the Reconstruction Finance Corporation, to serve as a general-purpose public lender, and President Hoover, who was opposed to public banking.[288] By adding 13(3) to the Federal Reserve Act, policymakers expected the Fed to replace lost credit in communities where banks had failed or were in such weak condition that they could not continue to lend to their existing customers.[289]

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285. Memorandum from Walter Wyatt, Gen. Couns. of the Fed. Rsrv. Bd., to Daniel Crissinger, Governor of the Fed. Rsrv. Bd., Purchase of Government Securities and Bankers Acceptances by Federal Reserve Banks Under So-Called Repurchase Agreements 10 (Aug. 18, 1923) (on file with author) ("It was never contemplated by Congress that the Federal reserve banks should make direct loans to non-member banks nor to stock, bond, and acceptance brokers or other individuals, partnerships, or corporations which ordinarily would seek such accommodations from member banks.").

286. Federal Reserve Act § 13(3)(A), 12 U.S.C. § 343(3)(A) (2018); Menand, *supra* note 19, at 332-35 (terming this the "credit availability proviso" and explaining its monetary purpose).

287. Federal Reserve Act § 13(3)(B), 12 U.S.C. 343(3)(B) (2018).

288. *See* Sastry, *supra* note 15, at 20; Herbert Hoover, Statement on Emergency Relief and Construction Legislation (July 6, 1932), https://www.presidency.ucsb.edu/documents/statement-emergency-relief-and-construction-legislation-0 [https://perma.cc/2G4J-RZLN] ("The fatal difficulty is the . . . provision that loans should also be made to individuals, private corporations, partnerships, States, and municipalities on any conceivable security and for every purpose. Such an undertaking by the United States Government makes the Reconstruction Corporation [(RFC)] the most gigantic banking and pawnbroking business in all history."). Just ten days after vetoing a bill to give general lending powers to the RFC on July 11, 1932, Sastry, *supra* note 15, at 20, President Hoover signed section 13(3) into law, *id.* at 23.

289. Menand, *supra* note 19, at 332-35. For an assessment of just how exigent circumstances were in 1932, see Bernanke, *Nonmonetary Effects*, supra note 155.

The other major restriction, the financial system liquidity clause, dates to 2010. This clause scales back the circumstances in which FRBs can bypass the banking system. By limiting the FRBs to lending for the purpose of providing liquidity to the financial system, this requirement rules out most (if not all) lending to households and businesses, even where the Fed is able to obtain evidence that borrowers are unable to access adequate credit accommodations from banks. What it permits is support for nonbank financial institutions (like Lehman Brothers and Bear Stearns) when their funding from banks dries up (as it did in 2008). Just as the Fed provides discount window lending to banks when they cannot borrow from other banks in the federal funds market, it can extend that privilege to nonbank financial firms in special circumstances.[290] The stringent conditions that are placed on this tool, however, demonstrate that it is the exception that proves the rule: the Fed was built to act through banks.

### *B. The Institutions of Monetary Administration*

In addition to illuminating the common denominator among the Fed's myriad instruments, contextualizing the Fed within the U.S. statutory framework for money and banking clarifies the Fed's unusual structure and relationship to the rest of the government. First, it sheds light on the Fed's insulation from the President and the courts. Money issue is a type of fiscal power that the framers thought should be trusted to the legislature and that policymakers have long treated differently from other regulatory tasks. Second, it helps us to appreciate why legislators devolved some decision-making power over monetary expansion to Federal Reserve Bank officials who are in part selected by investor-owned banks. This decentralization and outsourcing within the Fed preserves elements of the diffusion and delegation that policymakers embedded in the underlying banking system. (The structure of both the Board and the FRBs actually *enhanced* the power of government officials to influence monetary policy when compared to the monetary architecture that predominated prior to 1913.)

#### 1. The Independent Board of Governors

The Fed's Board of Governors is subject to little executive or judicial oversight. When viewed as a kitchen-sink agency, with a range of unrelated operational and regulatory responsibilities, this "independence" presents a bit of a puzzle. Why wouldn't Congress give the President a greater role in superintending at least some of the Fed's activities, such as its enforcement and operational functions?[291] And why wouldn't legislators want the courts to do more to police the Fed's exercise of its substantial regulatory powers? The body's positioning relative to the President and the courts becomes easier to understand and to justify when we recognize that it is a monetary

290. Menand, *supra* note 19, at 335.

291. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 170 ("There is simply no theory offered that justifies the legal insulation of the Fed from a variety of political pressures . . . for bank supervision.").

authority that uses a range of orthodox and unorthodox tools to manage the bank-issued money supply. Its freedom of action is a feature of its design, not an unintended bug.

First, Congress has intentionally circumscribed the President's role,[292] in part to ensure that Fed officials are accountable primarily to Congress. Although the Fed is engaged in what appears to be quintessential "executive"[293] activity (buying and selling financial assets, lending money, enforcing statutory rules, clearing payments, offering financial services to banks and other entities), Board governors are term tenured and can be removed by the President only "for cause."[294] Other key officials—such as the FRB presidents and directors[295]—are neither appointed by the President nor removable by the President, even for cause.[296] Although the Fed's Board is susceptible to certain forms of presidential administration, such as jawboning,[297] its Board is unusually shielded from Presidential influence. Unlike with other independent agencies, like the Securities and Exchange Commission, Congress drafted the FRA so that even

292. Congress has not fully separated the Fed from the Executive. The Fed is explicitly subordinated to the Treasury Secretary when it comes to its "fiscal agent" functions. *See* Federal Reserve Act § 15, para. 1, 12 U.S.C. § 391 (2018); *id.* § 10, para. 6, 12 U.S.C. § 246; *see also id.* § 9, para. 15, 12 U.S.C. § 332 (authorizing the use of member banks as government depositories and agents). As of 2010, Treasury Secretary approval is also required before the Fed can lend to nonbanks under section 13(3). *Id.* § 13(3)(B)(iv), 12 U.S.C. § 343(3)(B)(iv). These activities, in which executive involvement is statutorily required, are carveouts from a baseline of insulation, and they are distinct from the Fed's core mission of administering the banking system.

293. *Cf.* Seila L. LLC v. Consumer Fin. Prot. Bureau, 140 S. Ct. 2183, 2197-2200, 2211 (2020) (empowering the President to remove at pleasure the Director of the Consumer Financial Protection Bureau (CFPB) in part because the Director exercises "quintessentially executive power").

294. Initially, Congress was less jealous of the competing influence of the President and placed two officials who served (more or less) at the Chief Executive's pleasure on the Board, ex officio (the Treasury Secretary and the Comptroller of the Currency). But in 1935, Congress remade the Board on the model of the independent commissions, with every official tenured in office and removable by the President only for cause. These arrangements facilitated legislative oversight. *See* Federal Reserve Act § 10, paras. 1-2, 12 U.S.C. § 242 (2018) (amended by Banking Act of 1935, ch. 614, sec. 203(b), 49 Stat. 684, 704-05); FCC v. Fox Television Stations, Inc., 556 U.S. 502, 523 (2009) ("The independent agencies are sheltered not from politics but from the President, and it has often been observed that their freedom from presidential oversight (and protection) has simply been replaced by increased subservience to congressional direction.").

295. The President is also unable to either appoint or remove the Fed's general counsel or any of its division directors, *see* 12 U.S.C. § 248(*l*) (empowering the Fed's Board to appoint all Board personnel, exempting those appointments from the Pendleton Act and related civil service regulations, and permitting the President to grant appointed employees civil service protections), despite their substantial influence on policy, *see* CONTI-BROWN, *supra* note 30, at 84-102.

296. See Federal Reserve Act § 4, para. 4, 12 U.S.C. 341 (2018) (empowering the Class B and Class C directors of the Federal Reserve Banks, with the approval of the Board of Governors, to appoint FRB Presidents); *id.* § 11(f), 12 U.S.C. § 248(f) (empowering the Board to "suspend or remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated . . . to said bank"). The rest of the banking system, of course, is even more insulated from executive control. *See* Dan Rohde, *Central Bank Independence & Commercial Bank Independence: Are We Asking the Right Questions?*, JUST MONEY (Aug. 3, 2021), https://justmoney.org/central-bank-independence-commercial-bank-independence-are-we-asking-the-right-questions/ [https://perma.cc/33W4-CYHC].

297. *See* Paul R. Verkuil, *Jawboning Administrative Agencies: Ex Parte Contacts by the White House*, 80 COLUM. L. REV. 943 (1980).

the Fed's Chair, despite exercising significant administrative control over the agency, cannot be replaced by the President at will.[298]

Second, the Fed is rarely subject to meaningful judicial review. While adding or subtracting reserves is equivalent to promulgating new balance sheet rules, the courts treat this activity as nonjusticiable.[299] Federal courts have also recognized the informal nature of the Fed's supervisory process[300] and have repeatedly deferred to Fed determinations in cases in which they've been challenged in court.[301]

This lack of procedural safeguards for banks is not an oversight. The policymakers who built the system saw banks as public utilities performing a sovereign function.[302] The Federal Reserve Act intentionally concentrates control over the banking system in the hands of the Board, which legislators thought would enhance private liberty by constraining bank managers and

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298. *See, e.g.*, Memorandum from Ramsey Clark, Deputy Att'y Gen., to President Lyndon B. Johnson (Jul. 2, 1965) (on file with author) ("Since the [chairman's] term is prescribed by statute, it is reasonably clear that, once designated, the chairman cannot be removed from the chairmanship prior to the expiration of the four-year term."). When Congress amended the Federal Reserve Act in 1977 to fix the Fed Chair's term to begin one year into each presidential term, it legislated on the understanding that the President would have no power to remove the Chair at pleasure in the interim. *See, e.g.*, *Federal Reserve Act Amendments of 1977: Hearing on H.R. 6273 Before the Subcomm. on Domestic Monetary Pol'y of the H. Comm. on Banking, Fin. & Urb. Affs.*, 95th Cong. 6 (1977) (statement of Rep. Parren J. Mitchell, Chairman, Subcomm. on Domestic Monetary Pol'y) ("Under current law, a new President might have to wait two or three years, or even longer, before appointing the Federal Reserve Chairman."). Whether contemporary courts would vindicate the statutory design or treat the Chair's term as merely a limit on the period of time the Chair can serve without further Senate authorization (through another confirmation vote) is an open question given recent decisions (mis)interpreting term tenure provisions. *See, e.g.*, *Seila L.*, 140 S. Ct. at 2209 (assuming that severing the law's "removal provision" authorizing the President to fire the CFPB Director for inefficiency, neglect of duty, or malfeasance in office would leave the Director "removable at will by the President" as opposed to unremovable on any grounds except impeachment). For a fuller discussion of presidential removal powers and prescribed term lengths, see Jane Manners & Lev Menand, *The Three Permissions: Presidential Removal and the Statutory Limits of Agency Independence*, 121 COLUM. L. REV. 1 (2021).

299. Raichle v. Fed. Rsrv. Bank of N.Y., 34 F.2d 910, 915 (2d Cir. 1929) ("It would be an unthinkable burden upon any banking system if its open market sales and discount rates were to be subject to judicial review.").

300. United States v. Phila. Nat'l Bank, 374 U.S. 321, 330 (1963) (explaining that due to the statutory design "recommendations by the [Fed] concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings," and that "[f]ederal supervision of banking" is "one of the most successful (systems of economic regulation), if not the most successful" to which "we may owe, in part, the virtual disappearance of bank failures" (internal quotation marks omitted)); *In re* Subpoena Served Upon the Comptroller of the Currency, 967 F.2d 630, 633-34 (D.C. Cir. 1992) (explaining that the supervisory relationship "is extensive in that bank examiners concern themselves with all manner of a bank's affairs . . . . [And it] is informal in the sense that it calls for adjustment, not adjudication. In the process of comment and response, the bank may agree to change some aspect of its operation or accounting . . . [but it] is the very rare dispute . . . that culminates in any formal action").

301. *See, e.g.*, Bd. of Governors of Fed. Rsrv. Sys. v. Agnew, 329 U.S. 441, 444; *see also id.* at 449-50 (Rutledge, J., concurring in the judgment) (arguing that the Fed's removal of a banker from office is reviewable "only for abuse of discretion . . . [n]ot only because Congress has committed the [banking] system's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases").

302. H. PARKER WILLIS, THE FEDERAL RESERVE: A STUDY OF THE BANKING SYSTEM OF THE UNITED STATES 5 (1915) (explaining that banking is "everywhere regarded as a quasi-public occupation, and as demanding the general oversight and participation of the public authorities"); *see* BRANDEIS, *supra* note 205, at 63-64.

shareholders and preventing abuses. (Banks, after all, expand the money supply without facing *any* procedural constraints of the sort imposed on federal agencies by the Administrative Procedure Act.)

To temper this insulation from executive and judicial control, the Federal Reserve Act subjects Fed officials to enhanced legislative oversight.[303] Congress supervises the Fed throughout the year[304] and it is sometimes said that the Fed is a "creature" of Congress and "not an agency of the Executive."[305] Although this understanding is out of sync with contemporary judicial understandings,[306] it is consonant with a longstanding "monetary separation of powers." Rather than wielding "executive power," the Fed is best conceptualized as sharing in the legislature's exclusive fiscal authority.[307] As Alexander Hamilton put it, money is "the vital principle of the body politic . . . that which sustains its life and motion, and enables it to perform its most essential functions."[308] The power to issue money sits alongside the power to tax, spend, and borrow, as it is a means for harnessing resources and directing economic activity: the government can issue more money as an alternative to raising revenue by coercing contributions.[309] Money is also the medium in which the government collects tax revenues, measures tax obligations, and denominates expenditures. As Charles Pinckney observed during the debates on the Constitution, the "exclusive right of coining Money," including "regulating its alloy, and determining in what species of money the common Treasury shall be supplied," is "*essential* to assuring the Federal Funds."[310] In Britain, monetary policy was long used by the

303. *See* BINDER & SPINDEL, *supra* note 33, at 232-40.

304. *See supra* notes 233-235 and accompanying text.

305. *Nomination of William McChesney Martin, Jr.: Hearings Before the S. Comm. on Banking and Currency*, 84th Cong. 6 (1956) [hereinafter *Nomination Hearings*] (statement of Sen. William Douglas) (describing the Federal Reserve Board as "the creature of Congress"); Letter from William McChesney Martin, Jr., Chairman, Bd. of Governors of the Fed. Rsrv. Sys., to Hon. Joseph Cambell, Comptroller of the Currency (Apr. 20, 1955), *in Nomination Hearings*, *supra*, at 62 ("[T]he Federal Reserve System is a creature of Congress and its powers, responsibilities, and administrative procedures are determined by the Congress."). Senator Douglas told Chairman Martin that his staff had typed out "The Federal Reserve Board is an agency of the Congress," and said:

> [Senator DOUGLAS.] I will furnish you with scotch tape and ask you to place it on your mirror where you can see it as you shave each morning, so that it may remind you.
> Mr. MARTIN. I will be glad to comply.
> Senator DOUGLAS. And [the Board] is not an agency of the Executive.

*Nomination Hearings*, *supra*, at 25.

306. *See, e.g.*, Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 472 (2000); City of Arlington v. FCC, 569 U.S. 290, 304 n.4 (2013).

307. *Cf.* Kate Stith, *Congress's Power of the Purse*, 97 YALE L. J. 1343, 1344 (1988) (describing the legislature's power of the purse as part of the foundation of our constitutional order).

308. THE FEDERALIST NO. 30, at 188 (Alexander Hamilton) (Jacob E. Cooke ed., 1961).

309. *See* TUCKER, *supra* note 27, at 288 ("If the executive branch controlled the money creation power, it would at the very least be able to defer its need to go to the legislature for extra 'supply,' and at worst could inflate away the real burden of its debts to reduce the amount of taxation requiring parliamentary or congressional sanction.").

310. Charles Pinckney, *Observations on the Plan of Government Submitted to the Federal Convention in Philadelphia* (1787), *reprinted in* 3 THE RECORDS OF THE FEDERAL CONVENTION OF 1787,

Crown as a way to finance expenditures and repay debts.[311] Executive abuse of this royal prerogative fueled the Glorious Revolution in 1688. The Framers understood this and sought to deprive the President of a means of bypassing the legislature. On their view, the approval of Congress was necessary to legitimate resource gathering by the government.[312] As Hamilton explained in *Federalist No. 69* on the "real characters of the proposed executive," whereas in Britain the King "can coin money," in the United States, the President "can prescribe no rules concerning the . . . currency of the nation."[313] The Constitution reflects Hamilton's safeguard by enumerating the power to coin money and regulate its value in Article I,[314] and doctrine affirms this division of power.[315]

For many years, this was also the explicit view of most policymakers.[316] For example, Congress expressly drew on the Coinage Clause when it amended

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at 106, 117 (Max Farrand ed., 1911) (emphasis added). This thinking extended to questions of who should appoint the government's treasurer. For example, George Mason argued that if money "belong[ed] . . . to the people, the legislature representing the people ought to appoint the keepers of it." 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, *supra*, at 315 (notes of James Madison). Separately, James Wilson observed that "War, Commerce & Revenue were the great objects of the [federal] Government" and "[a]ll of them are connected with money." *Id.* at 275 ("All the principal powers of the [federal] Legislature had some relation to money." *Id.* at 233.). To many founders, monetary powers were among the most dangerous. They were placed in the legislature where they could do the least harm. Those who worried about the legislature, worried primarily about how it might use its monetary authority. For example, whereas in Britain, Gouverneur Morris explained, the "Executive has so great an interest in his prerogatives and such powerful means of defending them," in the United States, the Executive lacks these powers and it is the legislature that might threaten liberty through "[e]missions of paper money, largesses to the people—a remission of debts and similar measures." *Id.* at 76. According to Morris, the Executive veto prevents the legislature from abusing lawful powers; his example is "projects of paper money & similar expedients." *Id.* at 52. Morris and others favored delegation (and the BUS) to avoid legislative abuse of these monetary powers.

311. *See, e.g.*, DESAN, *supra* note 43, at 151-70.

312. THE FEDERALIST NO. 44, *supra* note 308, at 299-300 (James Madison) (describing the "right of coining money" as "the exclusive right of Congress"); *see also* Knox v. Lee, 79 U.S. (12 Wall.) 457, 567 (1871) (Bradley, J., concurring) (explaining that how much money to issue and in what form "is for the legislative department of the government to judge" as "[f]eeling sensibly the . . . wishes of the people, [the legislative] department cannot long (if it is proper to suppose that within its sphere it ever can) misunderstand the business interest and just rights of the community"). This monetary separation of powers is consistent with the general emphasis at the Founding on preventing the Executive from usurping legislative authority. *See* GORDON S. WOOD, THE CREATION OF THE AMERICAN REPUBLIC, 1776-1787, at 157 (1969) ("When Americans in 1776 spoke of keeping the several parts of the government separate and distinct, they were primarily thinking of insulating the judiciary and particularly the legislature from executive manipulation.").

313. THE FEDERALIST NO. 69, *supra* note 308, at 462, 470 (Alexander Hamilton).

314. U.S. CONST. art. I, § 8, cl. 1-5 ("Congress shall have [the] Power . . . To coin Money [and] regulate the Value thereof."); *see also* JOSEPH STORY, 2 COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1120, at 64 (3d ed. 1858) ("Could congress, if it did not possess the power of coining money . . . create a bank with the power to circulate bills? It would be difficult to make it out.").

315. *See* Ling Su Fan v. United States, 218 U.S. 302, 310 (1910) ("The power to 'coin money and regulate the value thereof, and of foreign coin,' is a prerogative of sovereignty and a power *exclusively* vested in the Congress of the United States.") (emphasis added); Knox v. Lee, 79 U.S. at 565-66 (1871) (noting that the power to issue money and regulate its value is "undoubtedly" a question of "legislative discretion").

316. H.R. REP. NO. 94-20, at 8 (1975) (describing the Federal Reserve as "a creature and agent of the Congress"). It is also the view of the Fed itself. *The Fed Explained*, supra note 201, at 3 fig.1.2 ("CONGRESS oversees the Federal Reserve System and its entities."); Interview by Scott Pelley, CBS News, with Jerome Powell, Chairman of the Fed. Rsrv., in Washington, D.C. (May 13, 2020),

the FRA in the 1970s to clarify the Fed's relationship to the legislature and President. House Concurrent Resolution 133, the seed of the Fed's statutory mandate, characterized the Fed as the agent of Congress and instructed it on how to exercise its statutory authority.[317] Even Fed officials who clashed repeatedly with Congress acknowledged the institution's subservience to the legislature:

> The CHAIRMAN [Proxmire]. You do acknowledge, do you not, only Congress has the constitutional authority to regulate the money supply, and the Federal Reserve is an agent of the Congress independent of the executive branch?
> Dr. BURNS. I have no quarrel with that. I know the Constitution and I am a law-abiding citizen.[318]

Traditionally, then, the division of monetary powers between Congress and the Board, between the elected legislature and a technocratic agency, was a question to be settled by legislators. The current statutory design, as we have seen, is weighted heavily toward technocracy when it comes to expansion and contraction. When it comes to other aspects of monetary policy—like credit allocation (who benefits from the creation of new money)—existing law shares control between legislators, technocrats, and investor-owned banks. The Fed's independence from executive and judicial oversight is not just a matter of insulating monetary policy from executive abuse or judicial second guessing, but also a matter of protecting legislative primacy within the government in monetary affairs. It can only be understood in light of the Fed's monetary functions and place within the monetary system.

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https://www.cbsnews.com/news/full-transcript-fed-chair-jerome-powell-60-minutes-interview-economic-recovery-from-coronavirus-pandemic/ [https://perma.cc/P9J8-KP89] ("We don't have oversight over Congress. Quite the reverse, actually. We're a creature of Congress. And they have oversight over us.").

317. H.R. Con. Res. 133, 94th Cong., 89 Stat. 1194 (1975) (including within the preamble, "Whereas article I, section 8, of the Constitution provides that Congress shall have the money power," and "Whereas Congress established the Federal Reserve Board as its agent, and delegated to its agent the day-to-day responsibility for managing the money supply").

318. *Monetary Policy Oversight Hearings*, *supra* note 180, at 54. For a similar exchange with a different Fed Chair, see also *January 1960 Economic Report of the President: Hearings Before the J. Econ. Comm.*, 79th Cong. 195:

> [Representative PATMAN.] Would you agree, Mr. Martin, that the only authority for issuing money and regulating [its] value . . . is the constitutional authority of Congress?
> Mr. MARTIN. I have never challenged the authority of Congress.
> Representative PATMAN. Would you agree that the Federal Reserve is operating on a delegation of the power of Congress to create money and regulate its value?
> Mr. MARTIN. The Federal Reserve Act is our trust indenture as I constantly describe it.

2. The Private and Regional Federal Reserve Banks

Scholars today tend to treat the Fed's regional Reserve Banks as vestigial or even unconstitutional.[319] The FRA's twelve nongovernmental federal corporations operate many of the Fed's most important monetary tools. Although their autonomy has declined over the past century,[320] the FRBs still open and maintain accounts for banks,[321] clear and settle Fedwire transactions,[322] determine whether to make discount window loans, assess the sufficiency of bank collateral, and extend emergency loans to nonbanks.[323] The FRBs also play a major role, alongside the Board, in determining the scope of open market operations and what federal funds rate to target. Relying on authority delegated by the Board, the FRBs even supervise member banks and bank holding companies.[324]

This devolution of federal regulatory power is not simply an anachronism or oversight. It reflects a sort of monetary federalism: the fact that the United States employs a diffuse network of investor-owned banks to expand the money supply. Even at the Founding, when the economy was dominated by the Bank of the United States, the First Congress permitted the states to charter banks of their own. And although Congress largely federalized the state banking system between 1863 and 1935, it also embraced diffusion so that many decisions about money and credit could be made by private bankers at a local level. The FRBs preserve this structure by retaining a role for investor-owned banks and regionally selected officials. FRB leaders are not appointed by national officials like the President.[325] They have regional backgrounds and are likely more accountable to regional interests than other federal leaders.[326]

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319. *See, e.g.*, CONTI-BROWN, *supra* note 30, at 103-26. For legal challenges, see *Melcher v. Federal Open Market Committee*, 836 F.2d 561 (D.C. Cir. 1989); *Committee for Monetary Reform v. Board of Governors of the Federal Reserve System*, 766 F.2d 538 (D.C. Cir. 1985); *Riegle v. Federal Open Market Committee*, 656 F.2d 873 (D.C. Cir. 1981); and *Reuss v. Balles*, 584 F.2d 461 (D.C. Cir. 1978).

320. The high-water mark was in the Wilson administration. *See, e.g.*, *Glass Replies to Critics*, N.Y. TIMES, Jun. 24, 1913, at 2 ("We have purposefully scattered the regional reserve banks and shall be intensely disappointed if they do not exercise a very large measure of independence." (quoting Rep. Carter Glass)).

321. Federal Reserve Act § 13, para. 1, 12 U.S.C. § 342 (2018).

322. *Id.* § 11A, 12 U.S.C. § 248a.

323. *Id.* § 10B, 12 U.S.C. § 347b (authorizing the FRBs to make advances that are secured to its satisfaction); *id.* § 13(3), 12 U.S.C. § 343(3) (authorizing the FRBs to discount notes that are secured to its satisfaction).

324. *Id.* § 11(k), 12 U.S.C. § 248(k) (authorizing the Board to delegate functions to the FRBs); 12 C.F.R. § 265.11 (2022) (delegating functions to the FRBs).

325. FRBs are overseen by nine directors: three Class A directors selected by the district member banks from amongst their number, three Class B directors selected by the member banks from amongst the region, and three Class C directors selected by the Board from amongst qualified individuals residing in the district. Federal Reserve Act § 4, paras. 9-12, 12 U.S.C. § 302 (2018). The Class B and C directors select the president. *Id.* § 4, para. 4, 12 U.S.C. § 341.

326. Studies suggest that FRB presidents, for example, act in accordance with local conditions in their districts when they vote on questions of monetary expansion and contraction. FRB boards also provide a regional face for Fed decisions—helping to justify decisions taken in Washington at a more

## IV. Understanding the Fed Unbound

Contextualizing the Federal Reserve Act and grounding it in a theory of U.S. money and banking, helps to situate the Fed within the modern administrative state—allowing us to appreciate how and why it regulates with little judicial scrutiny (through commercial transactions and nonfinal actions), the justifications for its insulation from executive oversight, and why it operates using nominally private federal corporations spread across the country. Understanding the logic of the Federal Reserve Act also explains the Fed's expanding footprint over the past fourteen years. This Part argues that the Fed's transformation, especially since 2008, is a function of the rise of money creation outside of the chartered banking system, that is, shadow banking. Section IV.A briefly recounts the emergence of shadow banking (and the Fed's role in that emergence). Section IV.B explains why shadow banking ultimately led the Fed to expand its balance sheet and pursue ad hoc lending and purchasing programs.

### *A. The Rise of Shadow Banking*

The Federal Reserve Act presumes an economy that relies primarily on monetary instruments issued by chartered banks. The Fed lacks the statutory authority to oversee or backstop nonbank money issuers, except during unusual or exigent circumstances,[327] and federal law restricts entry into the business of receiving deposits to organizations regulated as banks by either the states or federal government.[328] Even the Monetary Control Act of 1980, which permits depository institutions outside of the Fed's member system to access the Fed's balance sheet, does not contemplate Fed services for entities without a state or federal bank charter.[329]

But beginning in the 1950s, the basic structure of U.S. banking law began to fray. Broker-dealers started operating like banks without bank charters. Although these dealers were legally prohibited from maintaining deposits, they created an alternative money instrument that was formally structured as a pair of financial transactions called repurchase agreements (repos). Repos were economically equivalent in key respects to deposits that could be withdrawn daily. The Fed, deviating from the logic underlying its enabling act, supported dealer repos. In the 1950s, it developed an ersatz discount window program,

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local level. *See, e.g.*, Paul Pieper & Sang-in Hwang, *The Effect of Regional Economic Conditions on U.S. Monetary Policy*, 14 J. INT'L TRADE & COM. 93, 101 (2018) (showing that a one percent increase in the unemployment rate in a regional district relative to the national rate raises the probability of that district's FRB president dissenting from a decision to tighten monetary policy by 1.3 percentage points); Henry W. Chappell Jr., Rob R. McGregor & Todd A. Vermilyea, *Regional Economic Conditions and Monetary Policy*, 24 EUR. J. POL. ECON. 283, 292 (2008) (concluding that regional conditions affect the policy preferences of FRB presidents); John A. Gildea, *The Regional Representation of Federal Reserve Bank Presidents*, 24 J. MONEY CREDIT & BANKING 215, 220-24 (1992) (finding a local bias in FRB president voting).

327. *See* Federal Reserve Act § 13, para. 13, 12 U.S.C. § 347c (2018).

328. *See* Banking Act of 1933 § 21(a)(2), 12 U.S.C. § 378(a)(2) (2018).

329. *See supra* note 214 and accompanying text.

drawing on the repo structure to lend directly to nonbank government securities dealers.[330] This program allowed eligible dealers to function as de facto banks and to bypass banks for their short-term funding needs.[331]

In 1962, a new front opened, as the Fed lent its backing to another type of shadow bank, foreign firms issuing dollar-denominated deposits without bank charters from the U.S. government.[332] Like U.S. broker-dealers, on the asset side these institutions held U.S. bank deposits as reserves and borrowed them as needed to cover withdrawals from their dollar deposit accounts (known as "Eurodollars"). But without access to the Fed's discount window, such foreign shadow banks (the largest of which, at first, were in London and Paris[333]) were vulnerable to being cut off by U.S. banks in a downturn or following a change in risk appetite. Seeking to stabilize this emerging supply of dollar deposits overseas, the Fed entered into agreements with foreign central banks to swap dollar reserves at the FRBs for foreign currency.[334] In effect, the Fed expanded its discount window program once again: bringing foreign central banks and their banking systems into the ambit of the Federal Reserve System. In 1974, when a run materialized in the Eurodollar market—the first run in the dollar system since 1933—the Fed formalized its commitment to managing Eurodollar rates, joining

330. The practice met with strong disapproval from key members of the House Banking Committee, who accused the Fed of breaking the law. *See* Menand, *supra* note 19, at 347-48.

331. The Fed facilitated the rise of the repo market for a variety of reasons. Among the most important was William McChesney Martin's desire to support the government securities market and keep up the Fed's end of the 1951 Fed-Treasury Accord ("to assure the successful financing of the Government's requirements"). *See* FED. OPEN MKT. COMM., REPORT OF AD HOC SUBCOMMITTEE ON THE GOVERNMENT SECURITIES MARKET (1952), *in Federal Reserve System After Fifty Years: Hearings on H.R. 3783, H.R. 9631, H.R. 9685, H.R. 9686, H.R. 9687, and H.R. 9749 Before the Subcomm. on Domestic Fin. of the H. Comm. on Banking and Currency*, 88th Cong. 2005, 2021-24 (1964) (recommending the use of repo lending to nonbank dealers to improve liquidity in government securities markets); William McChesney Martin, Jr., *Replies of the Chairman of the Board of Governors of the Federal Reserve System to Questions Submitted by the Subcommittee on Economic Stabilization of the Joint Committee on the Economic Report* (Nov. 26, 1954), *in United States Monetary Policy: Recent Thinking and Experience: Hearings Before the Subcomm. on Econ. Stabilization of the J. Comm. on the Econ. Rep.*, 83d Cong. 3, 4, 14 (1954) ("When market conditions are such that approximate supply and demand estimates cannot be made . . . [dealers] tend to confine their role to that of brokers, operating mainly on a commission basis. In this role . . . [t]hey do not . . . perform the function of giving breadth and continuity to the market by their willingness to take securities into position."); Minutes, Meeting of the Federal Open Market Committee 4 (Dec. 15, 1953), https://www.federalreserve.gov/monetarypolicy/files/FOMChistmin19531215.pdf [https://perma.cc/QY6F-KB9H] (Martin requesting that members of the FOMC view the recommendation to expand repurchase facilities for nonbank dealers firms "in terms of the problem of orderly [government securities] markets").

332. *See* Robert N. McCauley & Catherine R. Schenk, *Central Bank Swaps Then and Now: Swaps and Dollar Liquidity in the 1960s*, at 9-11 (Bank for Int'l Settlements, BIS Working Paper No. 851, 2020); *see also* Benjamin Braun, Arie Krampf & Steffen Murau, *Financial Globalization as Positive Integration: Monetary Technocrats and the Eurodollar Market in the 1970s*, 28 REV. INT'L POL. ECON. 794 (2020) (describing the emergence of an agreement by the Federal Reserve and other central bank governors to serve as lenders of last resort in the Eurodollar market). For background on the origins of Eurodollar markets, see PAUL EINZIG, THE EURO-DOLLAR SYSTEM (4th ed. 1970); and GARY BURN, THE RE-EMERGENCE OF GLOBAL FINANCE (2006).

333. *See* BANKERS TRUST COMPANY, THE EURO-DOLLAR MARKET 9 (1964).

334. *See* McCauley & Schenk, *supra* note 332, at 16-18.

a communique issued by the Bank for International Settlements, a clearing association of central banks based in Basel, Switzerland.[335]

In the 1970s, the shadow banking system grew even further when the SEC, with subsequent approval from the Justice Department,[336] authorized mutual fund managers to issue shares in portfolios of short-term debt instruments and offer daily redemption at par with cash.[337] The resulting "money market funds" grew from less than $4 billion in 1975 to over $200 billion in 1982, as the gap between the yield on these deposit substitutes and the yield on deposit account balances soared.[338] Money funds could outcompete banks on interest expense because banks were subject to regulatory restrictions on the amount they could pay their depositors. When the interest income earned by the assets owned by money funds was low, the difference in rates was minor. But when the Fed hiked overnight interest rates in the late 1970s, the difference grew to be substantial. A similar dynamic also facilitated the growth of foreign banks issuing Eurodollars.

Banks, unsurprisingly, responded to these competitive pressures by looking for higher returns and lobbying for regulatory relief. In 1991, Congress facilitated further growth of shadow banking by amending the Federal Reserve Act to permit the Fed to accept the securities that broker-dealers carry on their books as collateral for emergency loans under section 13(3).[339] Further liberalization accelerated the shift away from deposit banking and toward deposit-alternative shadow banking. By 2007, deposit substitutes, such as repos, money market fund shares, and Eurodollars, accounted for more than the total of bank deposits in circulation.[340] It was against this backdrop that the system ran aground in 2008,[341] spurring a dramatic transformation in the Fed's role in the financial system.

335. *See* Clyde H. Farnsworth, *10 Nations Plan Bank Aid to Shore Up Confidence*, N.Y. TIMES, Sept. 11, 1974, at 1.

336. Letter from Philip B. Heymann, Assistant Att'y Gen., Crim. Div., to Martin Lybecker, Assoc. Dir., Div. of Mktg. Mgmt., Sec. & Exch. Comm'n (Dec. 18, 1979), *as retyped by* Inv. Co. Inst. (Jan. 9, 1980), https://archive.org/details/DOJLetterHeymannLippeLybeckerGlassSteagallAct [https://perma.cc/VHJ2-NJSW].

337. *See* RICKS, THE MONEY PROBLEM, *supra* note 35, at 233.

338. *See* Timothy Q. Cook & Jeremy G. Duffield, Money Market Mutual Funds and Other Short-Term Investment Pools, *in Instruments of the Money Market*, FED. RSRV. BANK OF RICH. 156, 157 (1998), https://www.richmondfed.org/~/media/richmondfedorg/publications/research/special_reports/instruments_of_the_money_market/pdf/full_publication.pdf [https://perma.cc/369B-JRWR].

339. Jeffrey N. Gordon & Christopher Muller, *Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Fund*, 28 YALE J. ON REGUL. 151, 209 (2011).

340. *See* RICKS, THE MONEY PROBLEM, *supra* note 35, at 33-35, 33 fig.1.1, 35 fig.1.4.

341. For an account of how these dynamics gave rise to the crisis, including the way in which banks were squeezed on both sides of their balance sheets, see Daniel K. Tarullo, Governor, Fed. Rsrv. Bd., Speech at the Peterson Institute for International Economics: Financial Regulation in the Wake of the Crisis (June 8, 2009), https://www.federalreserve.gov/newsevents/speech/tarullo20090608a.htm [https://perma.cc/KNH7-2GAT].

*B. The Fed's Response*

Since 2008, the Fed has shifted from an agency focused primarily on administering the banking system (using its statutory tools as they were designed to be used) to an agency increasingly stretching its statutory tools to address shadow banking and the consequences of the monetary instability that shadow banking has engendered. The result has been a slew of ad hoc lending and purchasing initiatives that have seen the Fed's balance sheet grow tenfold[342] and turn from a largely passive function of cash demand in the economy to an active tool of policy.

This Section analyzes the turn and explains how it relates back to monetary problems created by shadow banking. First, it examines the changes that are a direct product of shadow banking: the Fed's ongoing and growing programs to backstop and manage shadow bank money by opening up both the left-hand and right-hand sides of its balance sheet to shadow banks. Second, it turns to two indirect consequences of shadow banking: the Fed's massive asset purchase programs known as quantitative easing (QE) and its recent emergency lending to ordinary businesses and state and local governments. The former initiative was geared toward assisting shadow banks and addressing economic stagnation triggered by shadow banking. The latter was a political byproduct of the scale and scope of shadow bank support: to legitimate the central bank's shadow-bank backstops, legislators and Fed officials sought to expand the circle of beneficiaries of Fed balance sheet expansion.

1. Backstopping Shadow Banks

The clearest and most salient examples of how the Fed has changed since 2008 are its large-scale financial sector lending programs. Each of these programs is a byproduct of the rise of shadow banking, designed to stabilize a different type of deposit alternative. They are essentially ersatz discount windows for various classes of shadow banks and various types of deposit alternatives (specifically, repos, Eurodollars, commercial paper, and money market mutual fund shares). Although the beneficiaries of this lending operate largely outside of the banking laws and are not subject to the Fed's ex ante monetary tools, they are deeply interconnected with the chartered banking system and their deposit alternatives are a critical component of the economy's money supply. As a result, barring an act of Congress, there is no way for the Fed to achieve monetary expansion consistent with its section 2A mandate without backstopping the money shadow banks issue. Were the Fed to permit the shadow banking system to collapse, a second Great Depression, or worse, would result.

342. *Assets: Total Assets: Total Assets (Less Eliminations from Consolidation): Wednesday Level*, FRED (Oct. 20, 2022), https://fred.stlouisfed.org/series/WALCL [https://perma.cc/G5WJ-QCHL].

As it turned out, the Fed's support to this system was incomplete in 2008. Lehman Brothers failed on September 15. The result was a rapid contraction in money and credit and the sharpest decline in economic activity in eighty years.[343] In the decade that followed, the Fed institutionalized the backstops it created during the global financial crisis.[344] First, in the fall of 2019, it lent hundreds of billions of dollars to align the repo rate with the effective federal funds rate.[345] Second, in March 2020, when the pandemic prompted a rapid repricing of risk assets, the Fed rolled out support facilities for money market mutual funds, commercial paper issuers, and broker-dealers, dialed up repo market lending (with nearly $500 billion outstanding to dealer firms at one point), and entered into swaps with over a dozen foreign central banks (lending nearly $500 billion at the peak).[346] Third, in 2021, the Fed announced that it would convert its emergency repo operations program into a standing repo facility, offering the primary dealers the same sort of ongoing recognition that the Federal Reserve Act bestows on banks.[347] The Fed has also left its FIMA repo facility and five of its swap lines in place—converting foreign central banks into a sort of limited-purpose network of regional reserve banks empowered to support organizations issuing dollar deposit substitutes in overseas jurisdictions.[348] In effect, the Fed has extended its statutory framework to accommodate the monetary liabilities of shadow banks across the business cycle.

2. Borrowing From Shadow Banks

The Fed has also opened up the liability side of its balance sheet to accommodate shadow banks. In 2014, it launched the overnight reverse repurchase agreement facility (ON RRP) to help control monetary expansion.[349] Through the ON RRP, the Fed borrows cash from select shadow banks

343. *See* Bernanke, *Real Effects of Disrupted Credit*, supra note 155, at 265.

344. Congress made some related changes to the FRA in Dodd-Frank, but it did not address the problem directly. Indeed, policymakers were able to take only a few steps during this period to limit shadow banking. Their most significant reform—an effort to address money market mutual funds—was only partially successful. For a critique, see Jeffrey N. Gordon & Christopher Gandia, *Money Market Funds Run Risk: Will Floating Net Asset Value Fix the Problem?*, 2014 COLUM. BUS. L. REV. 313 (2014). The SEC is currently in the process of further reforming money fund rules. *SEC Proposes Amendments to Money Market Fund Rules*, U.S. SEC. & EXCH. COMM'N (Dec. 15, 2021), https://www.sec.gov/news/press-release/2021-258 [https://perma.cc/L92R-SET3].

345. Harris, *supra* note 19; *see* Menand, *supra* note 19, at 310 & n.51.

346. Menand, *supra* note 19, at 308-14, 323 fig.8.

347. *See* Gara Afonso, Lorie Logan, Antoine Martin, William Riordan & Patricia Zobel, *The Fed's Latest Tool: A Standing Repo Facility*, FED. RSRV. BANK N.Y.: LIBERTY ST. ECON. (Jan. 13, 2022) https://libertystreeteconomics.newyorkfed.org/2022/01/the-feds-latest-tool-a-standing-repo-facility/ [https://perma.cc/X4JT-RBGT].

348. *See* Mark Choi, Linda Goldberg, Robert Lerman & Fabiola Ravazzolo, *The Fed's Central Bank Swap Lines and FIMA Repo Facility*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., June 2022, at 93; Lorie Logan, *Treasury and Federal Reserve Foreign Exchange Operations, January - March 2022*, FED. RSRV. BANK OF N.Y. 11 (May 12, 2022), https://www.newyorkfed.org/medialibrary/media/news events/news/markets/2022/fxq122.pdf [https://perma.cc/U8GJ-87SD].

349. *Overnight Reverse Repurchase Agreement Facility*, BD. GOVERNORS FED. RSRV. SYS. (Jan. 3, 2018), https://www.federalreserve.gov/monetarypolicy/overnight-reverse-repurchase-agreements.htm [https://perma.cc/WX6Q-TE48].

(predominantly money market mutual funds) by selling securities off its balance sheet.[350] Then the Fed buys its securities back for a higher price the next day (or at some pre-set date), paying the shadow bank interest and therefore controlling the rate at which the shadow bank will be willing to lend to other borrowers. These artificial transactions provide shadow banks with a way to hold central bank money just like banks. The ON RRP rate that the Fed pays to shadow banks serves as an analog to the statutory IOR rate that the Fed pays to banks. The Fed typically raises and lowers both in tandem so that it can administer both the banking and shadow banking system.[351]

As with the ersatz discount windows that the Fed has set up for shadow banks, the ON RRP is out of step with the design of the Federal Reserve Act. By allowing shadow banks to park large balances in nondefaultable form at the Fed, the facility empowers shadow banks to effectively deposit money with the Fed even though the FRA does not include these firms among the list of entities authorized to hold Fed deposits.[352] It also partly replicates the economics of a master account, paying shadow banks a rate close to IOR, even though the Federal Reserve Act authorizes the Fed to pay that rate only to depository institutions.[353] Moreover, ON RRP involves the same statutory stretch as the Fed's direct repo program for broker-dealers: neither the purchase nor the sale in ON RRP transactions are at a market price as required by section 14.[354]

As with the Fed's ersatz discount windows for domestic and foreign shadow banks, these new ersatz reserve balances[355] are evidence that the Fed has yielded to the reality that shadow banks, rather than chartered banks, are the source of elasticity in the contemporary monetary system.[356] If the Fed wants to regulate

350. In addition to state- and federally chartered banks and government sponsored enterprises, eligibility now includes SEC-registered 2a-7 funds that have net assets of no less than $5 billion or an average outstanding amount of RRP transactions of no less than $1 billion. These funds must also operate in the triparty repo market, which means they must have agreements in place with Bank of New York Mellon (which runs that market). *See Reverse Repo Counterparties*, FED. RSRV. BANK N.Y. (Sept. 30, 2022), https://www.newyorkfed.org/markets/rrp_counterparties [https://perma.cc/W6NU-B3FU].

351. *See The Fed Explained*, *supra* note 201, at 37.

352. *See* Federal Reserve Act § 13, para. 1, 12 U.S.C. § 342 (2018) (authorizing each FRB to "receive from any of its member banks, or other depository institutions . . . deposits of current funds in lawful money"); *see also id.* § 11A, 12 U.S.C. § 248a (establishing rules governing the pricing of the Fed's services "to depository institutions").

353. *Id.* § 19(b)(12)(A), 12 U.S.C. § 461(b)(12)(A) (authorizing "earnings to be paid by the Federal Reserve bank[s]" to "depository institution[s]"); *id.* § 19(b)(12)(C) (defining "depository institution" in a way that does not include money market mutual funds).

354. For a detailed treatment of the legality of the Fed's repo activities, see Menand, *supra* note 19, at 336-49.

355. Unlike master accounts, the ON RRP program does not allow authorized participants to access Fedwire and the Fed's real time settlement system.

356. For a reflection on this tension and how the ON RRP figured in the Fed's efforts to address it, see Transcript, Meeting of the Federal Open Market Committee 118-22 (Apr. 29-30, 2014) (statement of Governor Daniel K. Tarullo), https://www.federalreserve.gov/monetarypolicy/files/FOMC20140430meeting.pdf [https://perma.cc/FDN2-5RRH]:

> [I]t does seem to me that the public policy framework had never taken account, ultimately, of the increasing integration of capital markets with conventional lending that occurred in

the amount of money in circulation—the collective balance sheet of money issuers—it has to influence their behavior. These firms are too big, and their balance sheets too complex, to regulate indirectly through banks.[357] The result is a situation in which the Fed now decides who can access these workarounds, extending privileges to actors that Congress never chose to grant ongoing access to the Fed's balance sheet—indeed, even to actors that legislators intended to exclude from such access.

3. Buying Financial Assets

Another area in which the Fed has moved beyond the Federal Reserve Act's logic—buying financial assets for reasons unrelated to adjusting the supply of reserves in the banking system—is a second order consequence of shadow banking. The Fed launched its first "quantitative easing" initiative (QE1) in December 2008. Its goal was to lower the cost of mortgage servicing and raise the value of mortgage-backed securities. QE1 was thus a product of shadow banking and the crisis it unleashed: Fed officials recognized the critical importance of correcting the damage inflicted by monetary contraction and buttressing shadow bank and bank balance sheets to improve their capital position and their ability to resume monetary expansion.[358]

In 2010, the Fed launched a second round of QE. This time officials aimed to respond to inadequate fiscal policy by turning the Fed's monetary tools to new ends. Over the next few years, the Fed purchased a substantial portfolio of U.S. Treasury securities and agency MBS.[359] These purchases were not designed to

> the roughly 30 years preceding the crisis. . . . I think we do want to consider, at least intellectually, the possibility of a shift to a monetary policy regime that takes account of that increasing integration of capital markets and traditional lending and that gives us another option in connection with financial stability.

357. *See* Ricks, *Money as Infrastructure*, supra note 35, at 790-93 (arguing that without ON RRP the Fed was not achieving sufficient passthrough from the federal funds rate to repo rates in the shadow banking system); *id.* at 795-97 (explaining that the effectiveness of the IOER tool in practice is limited when reserve balances are small relative to the overall size of short-term funding markets); *see also* Darrel Duffie & Arvind Krishnamurthy, *Passthrough Efficiency in the Fed's New Monetary Policy Setting*, *in* FED. RSRV. BANK OF KAN. CITY, DESIGNING RESILIENT MONETARY POLICY FRAMEWORKS FOR THE FUTURE: A SYMPOSIUM 21, 21-22 (2016) ("We show how the Fed's reverse repurchase (RRP) facility improves the pass-through of changes in Fed policy rates into average wholesale money market rates . . . mainly through the disintermediation of bank deposits.").

358. *See* BERNANKE, *supra* note 193, at 136-37.

359. Between 2008 and 2014, the Fed conducted three rounds of "large scale asset purchases" (LSAPs). The first round of LSAPs, popularly known as QE1, ran from December 2008 to August 2010. The Fed bought $175 billion in direct obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks; $1.25 trillion in MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae; and $300 billion of long-term Treasury securities. In November 2010, the Fed began QE2, which lasted until June 2011, and added an additional $600 billion of Treasury securities. *The Federal Reserve System: Purposes & Functions*, BD. OF GOVERNORS OF THE FED RSRV. SYS. 46-47 (Oct. 2016), https://fraser.stlouisfed.org/files/docs/historical/federal%20reserve%20history/bog_publications/bog_frs_purposes_2016.pdf [https://perma.cc/L8Y8-SHST]. Between September 2011 and December 2012, the Fed undertook a "maturity extension program" popularly known as Operation Twist: replacing $667 billion of Treasury securities with remaining maturities of 3 years or less with Treasuries with remaining

stimulate bank monetary expansion, at least not as a first-order matter; they were designed to influence behavior in credit markets and bolster aggregate demand.

They did this in three ways. First, they lowered long-term interest rates, creating a wealth effect for asset owners. With lower long-term rates, existing cash flows were worth more, raising asset prices. The resulting appreciation enriched households with financial investments, enabling them to spend more. It also increased the value of assets on business balance sheets, making it easier for businesses to borrow to finance new investments and pay off existing debt. Second, by lowering long-term interest rates, QE reduced the interest burden of debtors. Interest due on floating rate loans fell, and debtors with fixed-rate loans could refinance to lock in lower interest rates. The result was that fewer people defaulted on loans and more people had money to spend on goods and services.[360] Third, by removing large amounts of "safe assets" from the capital markets (like government debt and agency MBS), QE stimulated savers to invest in higher-risk businesses. QE may also have driven financial institutions (including banks) to change the composition of their balance sheets: making credit more cheaply available to nongovernment borrowers.[361]

The Fed's MBS purchases gave homeowners a special boost, further decreasing the cost of borrowing money to buy a home (beyond the decrease generated by the Fed's Treasury purchases) and further increasing home prices.[362] Up to a point, this resulted in fewer mortgage defaults, fewer bank losses on mortgages, and homeowners with more money to spend on goods and services.[363]

In March 2020, in response to a pandemic-induced panic on Wall Street, the Fed launched a new round of asset purchases, "distinct in both their

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maturities of six years or more. *Id.* at 48. In September 2012, the Fed launched QE3, an initially open-ended program to purchase $40 billion per month in MBS, augmented by $45 billion per month in Treasury securities in January 2013. This program slowed in December 2013 and concluded in October 2014. *Id.*

360. *See* BERNANKE, *supra* note 193, at 136-37, 143-44.

361. *See* Ben S. Bernanke, Chairman, Fed. Rsrv. Bd., Speech at the Federal Reserve Bank of Boston 56th Economic Conference: The Effects of the Great Recession on Central Bank Doctrine and Practice (Oct. 18, 2011), https://www.federalreserve.gov/newsevents/speech/bernanke20111018a.htm [https://perma.cc/HCG9-TADW] (explaining that the goal of QE was to "[put] downward pressure on longer-term Treasury and agency yields while inducing investors to shift their portfolios toward alternative assets such as corporate bonds and equities").

362. Ben S. Bernanke, Speech at the Federal Reserve Board Conference on Key Developments in Monetary Policy: The Federal Reserve's Balance Sheet: An Update (Oct. 8, 2009), https://www.federalreserve.gov/newsevents/speech/bernanke20091008a.htm [https://perma.cc/GU76-7QDC] ("As best we can tell, the programs appear to be having their intended effect. Most notably, 30-year fixed mortgage rates, which responded very little to our cuts in the target federal funds rate, have declined about 1-1/2 percentage points since we first announced MBS purchases in November, helping to support the housing market.").

363. MBS purchases also improved market functioning. The first round of MBS purchases in 2009 was explicitly directed toward this goal. *See* Ben S. Bernanke, Speech at the National Press Club Luncheon: Federal Reserve Policies to Ease Credit and Their Implications for the Fed's Balance Sheet (Feb. 18, 2009), https://www.federalreserve.gov/newsevents/speech/bernanke20090218a.htm [https://perma.cc/WL7R-XJAC] ( "The [Fed's] third set of tools for supporting the functioning of credit markets involves the purchase of longer-term securities [such as MBS] for the Fed's portfolio.").

purpose . . . and their scale and speed, which have been unparalleled."[364] The goal was to support market functioning by absorbing pressure from shadow banks and other financial firms rushing to sell their securities to raise cash. The pace was unprecedented, with more than $100 billion in assets being purchased on some days. As a result, the Fed added $1.7 trillion of Treasury securities and $800 billion of agency MBS to its balance sheet.[365] After market functioning had improved, the Fed continued the program to sustain market functioning and bolster economic activity by further reducing long-term interest rates. In total, this round of purchases added $80 billion of Treasury securities and $40 billion in MBS to the Fed's balance sheet each month. The Fed slowed this program in November 2021 and halted it in March 2022.[366]

While the Fed has the statutory authority to conduct large scale asset purchases, legislators did not expect for the Fed to use section 14(b) in this manner. As Senator Carter Glass explained in 1935:

> The sole purpose of the open-market [authority] . . . was to enable [the FRBs] to use any surplus funds they might have on hand in order to cover overhead charges, and to enable them to do as the Bank of England has always done, to enforce their rediscount rate. And that was all. It was never intended that they should go into speculative transactions and buy all sorts of securities and all that sort of thing.[367]

QE, whether meant to suppress long-term interest rates, transfer wealth from the public to homeowners, or subsidize overleveraged financial firms by reducing their transaction costs, is not designed to directly stimulate the expansion of bank balance sheets. It is not monetary policy as traditionally practiced: it does not work through the banking system, nor is it geared primarily toward increasing the supply of deposits. In many ways, it resembles fiscal policy: government investment designed to stimulate the economy. This investment is non-neutral, especially the MBS component, which assists individuals and institutions that own MBS or underlying assets.[368]

Although there were many factors that led the Fed to pursue several rounds of QE, at least three important factors relate to the rise of shadow banking. First, QE1 in 2009 and the first stage of QE Infinity in 2020 were specifically directed

364. Logan, SIFMA Remarks, *supra* note 20.

365. *Id.*

366. *See* Eric Milstein & David Wessel, *What Did the Fed Do in Response to the COVID-19 Crisis?*, BROOKINGS (Dec. 17, 2021), https://www.brookings.edu/research/fed-response-to-covid19 [https://perma.cc/358R-LSUK]; *Statement Regarding Treasury Securities and Agency Mortgage-Backed Securities Operations*, FED. RSRV. BANK N.Y. (Jan. 26, 2022), https://www.newyorkfed.org/markets/opolicy/operating_policy_220126 [https://perma.cc/9KWE-ALKD].

367. *Banking Act of 1935: Hearings on S. 1715 and H.R. 7617 Before a Subcomm. of the S. Comm. on Banking and Currency*, 74th Cong. 375 (1935) (statement of Sen. Glass); *see also* DE KOCK, *supra* note 75, at 198-99 ("[T]he theory of open-market operations, as a special form of creation or cancellation of central bank credit, is that purchases or sales of securities by the central bank tend directly and immediately to increase or decrease . . . the supply of bank cash and, therefore, . . . the credit-creating capacity of the commercial banks . . . .").

368. *See* BERNANKE, *supra* note 193, at 137.

at ensuring market functioning in the shadow banking system following a run on deposit alternatives. Second, QE2 and QE3 in the 2010s and the second stage of QE Infinity in 2020 and 2021 were efforts to correct damage inflicted by shadow banking; the Fed's conventional policy rate has been near zero due, at least in part, to a monetary contraction which slowed economic growth. Third, QE in all its incarnations relied on the Fed's balance sheet in ways that were politically possible, even imperative, as a result of the reorientation of the Fed that attended the rise of shadow banking and the crisis of 2008. Prior to the run on Bear Stearns, the Fed had largely used its balance sheet in technical ways to administer bank balance sheets: the Fed didn't aim to create money directly; it attempted to stimulate bank money creation. But once the Fed revealed that it *could* create money and bypass the banking system—using its balance sheet, for example, to rescue AIG and lend to foreign central banks—the idea that the Fed could use its money creation tools for nonregulatory purposes went from "off-the-wall" to "on-the-wall."[369]

4. Lending to Municipalities and Ordinary Enterprises

A fourth way in which the Fed has evolved beyond its enabling act is also connected, albeit indirectly, to the rise of shadow banking. In 2020, the Fed offered emergency credit to nonfinancial businesses, municipalities, and nonprofits. This assistance was expressly authorized by Congress. The CARES Act directed the Treasury Secretary to invest in Fed facilities that lend to businesses, municipalities, and nonprofits even though such lending does not otherwise square with the law.[370] The result was a suite of programs including five Main Street Lending Programs, the Municipal Liquidity Facility, and two Corporate Credit Facilities. The Fed's Main Street Lending Programs targeted businesses with up to $5 billion in annual revenues and 15,000 employees and nonprofits with endowments less than $3 billion.[371] The Fed lent $16.5 billion to 1,796 enterprises, mostly in the fourth quarter of 2020. The Fed's Municipal Liquidity Facility purchased bespoke bonds from New York's Metropolitan Transit Authority and the State of Illinois.[372] Its corporate credit facilities purchased $13.5 billion, split between high-yield and investment-grade bond ETFs and individual bonds issued by investment-grade blue-chip American corporates.[373]

These programs were in part a political byproduct of the Fed's ongoing and massive lending to the financial sector. It is highly unlikely that Congress would

369. *Cf.* Jack M. Balkin, *Constitutional Hardball and Constitutional Crises*, 26 QLR 579, 579 (2008) ("[T]he conventions that determine what makes an argument about the Constitution good or bad, what legal claims are plausible, and which are 'off the wall,' change over time in response to changing political, social, and historical conditions.").

370. CARES Act, Pub L. No. 116-136, § 4003, 134 Stat. 281, 470-76 (2020); *see* Menand, *supra* note 19, at 324-35, 351-52 (explaining how the CARES Act amended the FRA *sub silentio*).

371. For more information, see Menand, *supra* note 19, at 321 fig.7.

372. *Id.* at 323 fig.8.

373. *Id.* at 317.

have authorized the Fed, as opposed to other government entities, to do this sort of lending in 2020 if shadow banking had not thrust the Fed into the role of lending trillions of dollars to the financial sector during recessions. It is also unlikely that the Fed would have embraced the role if it were not for the need to legitimate and sustain political support for its ongoing Wall Street lending.[374] Although the relatively small scale of these programs suggests Fed officials were reluctant to wade into private credit markets, their existence also reflects the determination of Fed officials to dispel notions that its emergency support was reserved for Wall Street.

## V. The Costs of Exceeding the Limits

The Fed's new initiatives since 2008 have had clear benefits. But unpacking the FRA helps to illuminate the costs and downsides of relying on the Fed to stabilize an unstable monetary system and tackle a host of nonmonetary problems. This Part emphasizes three. Section V.A examines the ways in which the Fed's response to shadow banking has undermined important legislative objectives embedded in the Federal Reserve Act and U.S. banking law more generally. Section V.B considers how the Fed unbound is less effective. It is poorly designed to tackle problems outside the chartered banking system, and new programs undermine its ability to carry out its core statutory functions. Section V.C explores how central bank maximalism—an approach to central banking that calls on central bankers to do whatever they can to address economic problems—impedes democracy when it is not undergirded by structures developed by legislators.

### *A. Undermining the Law's Implemental Purposes*

The Fed's expansion beyond the logic of its enabling act, even where it has been in accord with the act's ultimate ends (e.g., promoting monetary expansion), has undermined the choices that legislators made about the best means to carry out those ends, that is, the law's "implemental purposes."[375] Most significantly, the Fed's efforts to prevent shadow bank failures have facilitated the further expansion of shadow banking. By backstopping shadow banks, the Fed offers implicit and explicit recognition of the alternative forms of money that they issue. But when shadow bankers draw on this recognition to expand the money supply, they are not constrained by statutory restrictions regarding the sorts of assets they monetize or any of the other rules governing monetary expansion.

Accordingly, Fed-backed shadow banking undermines the core pillars of the American Monetary Settlement:

374. Congress rolled back these programs by statute on December 27, 2020. Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, div. N, § 1003, 134 Stat. 1182, 2146-47.

375. *See* John F. Manning, *The New Purposivism*, 2011 SUP. CT. REV. 113, 115-16 (distinguishing between a law's "ulterior" and "implemental" purposes).

*Separation:* Because shadow banks are not subject to the same activities restrictions that apply to banks, they often engage in financial and nonfinancial activities that are off limit to banks. Since the Fed now implicitly or explicitly backs most shadow bank money, shadow banks mix state-recognized money issue with private "commerce," allowing firms engaged in shadow banking to gain a competitive edge on traditional business organizations by undercutting their cost of funds.[376] The result is a financial system in which financial activity and monetary activity are increasingly tied together as firms that engage in financial activities but not monetary activities cannot survive. For example, it is difficult today to operate a broker-dealer on a partnership model. Instead, broker-dealers rely heavily on repo financing and are often part of larger financial conglomerates.

*Diffusion:* The Fed's support for shadow banks also undermines diffusion. On the surface, the rise of shadow banks appears to further diffuse monetary powers among even more separate management teams. (Shadow banks do not even have to apply for a charter before they can start issuing alternative forms of money.) But the dynamic effect of shadow banking is actually toward consolidation. Diffusion in banking was never the product of market forces. Rather, it was the result of specific policy choices and legal restrictions, which shadow banks are not subject to. By underpricing banks—issuing deposit substitutes without complying with costly banking regulations—shadow banking contributed to decisions by legislators and bank regulators to adopt more accommodative policies toward bank mergers beginning in the late 1970s.[377] The result is an increasingly concentrated banking sector.

*Supervision:* The rise of money augmentation outside of the bank regulatory perimeter undermines bank supervision. Shadow banks are not supervised. The Fed cannot restrict or control shadow bank balance sheets or activities to the same extent as banks.[378] When shadow banks expand the supply of monetary instruments in the economy they also do so without public direction. For example, the asset portfolios of shadow banks are not covered by laws like the Community Reinvestment Act or other statutes that steer the benefits of monetary elasticity (by, for example, requiring banks to extend credit in the same places they maintain deposit balances).

Shadow banking also undermines the core goals that animate the Federal Reserve Act:

*Monetary Expansion:* Shadow bank money is unstable. It does not benefit from the ex ante regulations that constrain excessive risk taking within the

376. Today, most commonly this occurs in hedge funds that finance themselves in the repo market while conducting a range of financial and nonfinancial businesses off limits to banks.

377. For a review of these policy changes, see Jeremy Kress, *Reviving Bank Antitrust*, 72 DUKE L. J. 519 (2022).

378. The Fed is able to examine and supervise the broker-dealer subsidiaries of bank holding companies, *see* 12 U.S.C. §§ 1844(c), 1818(b)(3) (2018), and set capital requirements for the consolidated entity, *id.* § 5371. Congress also authorized the Fed to regulate and supervise nonbank financial companies, including broker-dealers, designed by the Financial Stability Oversight Council as systemically important. *Id.* §§ 5361-5371.

banking system and address various market failures. Nor do shadow banks have deposit insurance or access to explicit government backstopping. An economy with a large shadow banking sector is likely to experience intermittent panics, which will threaten monetary contraction and acute recession.

*Level Playing Field:* Backstopping shadow banks and paying interest to a select group of financial firms through ON RRP undermines the fair access principle underlying section 4(8) of the FRA.[379] For example, the Fed backstops some shadow banks, such as the primary dealers, even though there is no statutory application process for this de facto monetary franchise.[380] This dynamic runs counter to the goals of Congress in 1913 to end the sort of special treatment and unpredictable backstopping that sparked public outrage following the Panic of 1907, when bank-run clearinghouses saved firms with the right connections and let others sink. Such ad hoc treatment returned in 2008 and 2020, with the Fed lending to support certain nonbank firms (such as Bear Stearns) while declining to assist others (such as Lehman Brothers).[381]

*Public Accountability and Control:* The Fed is able to provide the public with less insight into the activities of shadow banks, the assets they monetize, and even their owners. Most troublingly, Fed officials have limited visibility into the sources of vulnerability that gave rise to panic in March 2020, lacking data about the scale and scope of the repo market and the Eurodollar market. Accordingly, the Fed's effort to manage the shadow banking system over time has also reduced the Fed's ability to serve as a site of public accountability and control for the monetary system.[382]

The downstream consequences of the Fed's effort to accommodate shadow banking, such as the Fed's quantitative easing and real economy lending programs, also undercut the FRA's implemental goals and in some cases conflict with its high-level purposes. These programs expand the Fed from a monetary authority that supervises a system of publicly chartered, investor-owned banks to a government credit authority that also invests directly in households, businesses, and government securities and seeks to allocate credit either through its own balance sheet or through its power to influence the composition of bank balance sheets.[383] For example, the choice to purchase MBS—regardless of the rationale—enriches homeowners by raising the value of real estate and reducing the costs of home loans. It is a form of general economic policy that benefits

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379. Federal Reserve Act § 4, para. 8, 12 U.S.C. § 301 (2018).

380. The Fed has criteria for selecting primary dealers, but they are not derived from a legal framework. *See Primary Dealers*, FED. RSRV. BANK N.Y. (July 2022), https://www.newyorkfed.org/markets/primarydealers [https://perma.cc/Q3S2-ZH3E].

381. In 2020, the Fed purchased the debt of large corporations at market prices, while lending to medium-sized enterprises and state and local governments in more restricted ways. *See* Menand, *supra* note 19, at 316-23 (comparing the terms of the Fed's facilities).

382. Shadow banking also leads to significant rent extraction from the public. *See* PISTOR, *supra* note 35, at 77-107.

383. *See* THOMAS PIKETTY, CAPITAL AND IDEOLOGY 702 (Arthur Goldhammer trans., 2020) ("[T]he long-term real effects of these 'unconventional' monetary policies are not well understood, and . . . [might] increase the inequality of financial returns and the concentration of wealth.").

certain parties and disadvantages others. Congress did not design the Fed to play this sort of role—it is not reflected in the statutory framework, toolkit, or institutional structure.

*B. Reducing Effectiveness*

There is a practical cost to relying on the Fed to tackle tasks for which it was not designed: reduced effectiveness. Agencies pursuing multiple, unrelated tasks—true kitchen-sink agencies or "kludges"—cannot be expected to execute their tasks especially well. In an efficient agency, legal instruments and institutions are tailored to suit the agency's underlying mission. The agency's relationship to the political branches, statutory interconnections with other agencies, susceptibility to judicial review, and level of engagement with civil society are calibrated so that it can excel at a particular function in a particular political economy. For example, the optimal structure of an agency built to provide critical economic infrastructure, such as the U.S. Postal Service, is not the same as the optimal structure of an agency designed to check corporate power, such as the Federal Trade Commission, or prevent air pollution, such as the Environmental Protection Agency. It would not be a good idea, all else equal, for the Consumer Financial Protection Bureau to deliver the mail or regulate carbon emissions.

Kludging is particularly problematic for a monetary authority like the Fed given its bespoke design. As we've seen, the Fed is unusually intertwined with investor-owned business organizations, subject to minimal oversight by the executive, insulated from judicial review, and able to act with little ex ante engagement from civil society. Although the normative merits of the Fed's structure are open to debate, each of these features can be explained by reference to mission-specific challenges involved in monetary provisioning and the Fed's role as the administrator of a system of specially chartered, investor-owned business organizations. Among other things, the Fed must interact with profit-oriented banks on a daily basis, provide them with critical financial services, and rely on them to achieve its primary objectives because Congress based the U.S. monetary system on outsourcing. For these reasons, Congress also granted banks an ongoing role in the Fed's governance. Similarly, the legislators who designed the Fed sought to depoliticize decisions about the rate of expansion of the money supply and separate those decisions from ordinary government activity, so they limited the ability of the President to appoint and remove its leaders and exempted the Fed from the annual budgetary process. Congress similarly shielded the Fed from judicial review and public scrutiny, permitting it to carry out its mission without generally resorting to notice-and-comment rulemaking or other reviewable final actions.

Fed operations beyond the limits of its enabling act produce sub-optimal policy along two dimensions. First, when the Fed takes on activities outside the banking system, it is less likely to perform them well. Second, when the Fed

takes on activities outside the banking system, it is less likely to perform its core function—administering the banking system—well.

*Activities Outside the Banking System.* Because of the Fed's bespoke structure, it is not well suited to execute tasks that involve actors outside of the banking system or goals unrelated to monetary provisioning. Aspects of its design that are helpful, or at least arguably helpful, in the context of administering the banking system are counterproductive or even actively harmful in the context of programs that do not involve banks. The Fed, in other words, is not well positioned to assist shadow banks, provide liquidity to capital markets, and extend credit to businesses, nonprofits, and municipalities in ways that advance the public interest. Nor is the Fed, as designed, poised to implement industrial policy for the government, either by restricting credit to polluters, encouraging lending to green industries, or intervening in commodity markets. In the absence of a new legal framework, these functions involve picking winners and losers, exercising the sort of discretion that policymakers in the past have subjected to tighter political, judicial, and social control. Delegating these tasks to an institution that is closely tied to the banking system, operates with limited public disclosure, and has an attenuated relationship to civil society is also likely to generate policies that disproportionately benefit financial interests.

These are not merely abstract concerns. The Fed's response to the COVID-19 pandemic revealed how relying on the Fed to act outside the chartered banking system leads to troubling distributional consequences. First, it showed how the Fed was especially responsive to the needs of the financial firms to which it was the most connected—chartered banks, primary dealers, and certain foreign central banks. These entities received the vast majority of assistance during the period of acute contraction in March 2020. Other financial firms, including broker-dealers and foreign central banks without close relationships with Fed officials, either had to wait longer to access Fed liquidity programs, received access on less favorable terms, or were unable to access Fed assistance at all (benefiting from the Fed's support programs only indirectly).[384] This preferencing was the predictable consequence of the Fed's design: Fed officials are not required to follow any formal procedures in determining eligibility for their backstopping initiatives, their decisions are not ordinarily subject to public scrutiny or judicial review, and their leaders are less accountable to the political branches than the leaders of most government agencies.

Second, the Fed's efforts to go beyond the financial sector often skewed benefits to financial firms. For example, the Fed's Municipal Liquidity Facility was designed to extend credit to cash-strapped state and local governments. But due to its design—with relatively high interest rates—only two entities borrowed any money.[385] Among its biggest beneficiaries were financial intermediaries

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384. *See* Menand, *supra* note 19, at 307 fig.1 (showing that the initial, and largest support program was available to only 24 broker-dealers, that the initial swap lines were available to only five central banks, and that only 14 central banks in total were ultimately eligible for swap lines).

385. *See id.* at 319-20, 323 fig.8.

buying and selling municipal securities: the Fed, by setting an outside spread for these securities (i.e., a price below which it would step in to support the market), reduced the risk of trading and speculating, strengthening certain Wall Street business models. Similarly, the Fed's Corporate Credit Facility extended no direct loans to businesses but purchased billions of dollars of corporate bonds at market prices, having a similar effect on trading in secondary markets.[386] With both programs end borrowers benefited—through lower market prices for borrowing or refinancing their debt—but financial firms also benefited. With both programs the sorts of borrowers that benefited were also bigger entities—the kind whose debt trades in financial markets—leaving smaller entities, more in need of credit support during this period, without a Fed lifeline.

These outcomes can be traced back to the Fed's design. Its lack of expertise in extending credit directly to nonfinancial borrowers and servicing nonfinancial loans led Fed officials to be highly cautious and structure programs to avoid significant uptake by program participants. Its reliance on financial firms to carry out its policies meant it was incentivized to buttress their business models. And the lack of public engagement and political accountability shielded these design choices from the sort of scrutiny that might have led to more generous lending terms for ordinary enterprises.

Third, the Fed's support for nonfinancial firms was comparatively limited and poorly distributed. Whereas the Fed lent at market rates or below-market rates to financial firms and foreign central banks, it charged penalty rates to businesses, nonprofits, and municipalities. As a result, despite authorization to lend $2 trillion outside the financial system, the Fed only disbursed $40 billion, a small fraction of the balance sheet capacity it devoted to backstopping financial firms during this period.[387] And the loans that the Fed did make tended to favor larger entities with connections to large financial firms. For example, rather than improve lending terms for smaller businesses, the Fed modified its Main Street program to allow business with revenues up to $5 billion to borrow, dropped its initial prohibition to refinance existing debt, and raised the maximum loan size from $150 million to $300 million.[388] It also relaxed a limit on how indebted a company could be before taking out a loan.[389] All of these changes benefited leveraged oil and gas companies and the financial firms that held their existing debt.[390] The Fed also initially set cutoffs for its Municipal Liquidity Facility that excluded the 35 cities with the highest Black population in the country.[391] And

386. *See* Nina Boyarchenko, Caren Cox, Richard K. Crump, Andrew Danzig, Anna Kovner, Or Shachar & Patrick Steiner, *The Primary and Secondary Corporate Credit Facilities*, FED. RSRV. BANK N.Y. ECON. POL'Y REV., June 2022, at 1, 1-2.

387. *See* Menand, *supra* note 19, at 323 fig.8.

388. *See id.* at 321 fig.7, 324.

389. *See id.* at 324.

390. *See id.* at 324 n.110.

391. Aaron Klein & Camille Busette, *Improving the Equity Impact of the Fed's Municipal Lending Facility*, BROOKINGS (Apr. 14, 2020), https://www.brookings.edu/research/a-chance-to-improve-the-equity-impact-of-the-feds-municipal-lending-facility/ [https://perma.cc/2JGA-PHLE].

even after the Fed adjusted the program, many majority-Black cities were left out.[392]

Once again, these shortcomings can be tied to the Fed's design. Its massive support programs were established with minimal public engagement, by leaders insulated from ordinary forms of political accountability. They were also created by officials with little relevant experience (for example, the Fed may not have been attuned to the way in which its initial municipal lending terms excluded metropolitan areas with high minority populations) whose primary focus was interacting with the banking system. Their stringent terms reflected the technocratic and risk-averse culture that the Fed has developed to carry out its monetary functions. Fed officials were wary of incurring losses on these programs—despite legislative authorization to do so—likely because of concern about how that might interfere with its independence from political oversight. That powerful interests with ties to Wall Street were better able to have their voices heard was also likely a byproduct of the Fed's structure. The very virtues that make the Fed well suited to carry out its statutory remit regarding the banking system (e.g., technocratic insulation) are counterproductive when the Fed operates outside that system.

Fourth, the Fed's QE program functioned as a type of fiscal intervention that inherently favored the financial sector and asset owners.[393] Although the Fed's massive purchases had significant effects on the amount of money Americans must pay to buy homes and service mortgage debt, there was no opportunity for public participation in the timing and structure of this initiative. Their size and duration may well have exceeded optimal levels given the influence of financial firms on Fed policymaking and the interest these firms and their managers have in rising asset prices. Combined with the Fed's other initiatives, they are an important contributor to the financial industry's recent record profits.

*Activities Inside the Banking System.* The Fed's nonmonetary tasks also impair its ability to effectively execute on its core responsibility to administer the banking system. First, it involves Fed officials in politically polarizing decisions about credit allocation. Picking winners and losers in the financial,

392. Neil Roland, *Fed Studying Whether Municipal Liquidity Facility Leaves Out Some Majority-Black Cities*, MLEX (June 15, 2020, 16:54), https://mlexmarketinsight.com/news-hub/editors-picks/area-of-expertise/financial-services/fed-studying-whether-municipal-liquidity-facility-leaves-out-some-majority-black-cities [https://perma.cc/Q2QL-JUWF].

393. A UK Parliamentary study concluded that central bank QE programs have "had limited impact on growth and aggregate demand over the last decade." The committee further noted that while QE "is particularly effective as a tool to stabilise financial markets," "[t]o stimulate economic growth and aggregate demand, quantitative easing is reliant on a series of transmission mechanisms that operate primarily in and through financial markets" and "[t]here is limited evidence to suggest that these [mechanisms] increase bank lending or investment, or boost consumer spending by wealthy asset holders." Econ. Affs. Comm., *Quantitative Easing: A Dangerous Addiction?*, HOUSE OF LORDS 19 (July 16, 2021), https://committees.parliament.uk/publications/6725/documents/71894/default [https://perma.cc/YY57-GGZ2]. The empirical evidence as surveyed by academics paints a mixed picture. *See* Brian Fabo, Martina Jančoková, Elisabeth Kempf & Ľuboš Pástor, *Fifty Shades of QE: Comparing Findings of Central Banks and Academics*, 120 J. MONETARY ECON. 1 (2021).

business, nonprofit, and public sectors is likely to awaken actors to the importance of Fed appointments for their interests, leading to an appointments process geared toward nonmonetary considerations. This is likely to produce an organization that is oriented more around policy preferences on questions of credit allocation.

Second, by entangling the Fed with the executive branch, nonmonetary functions are likely to reduce the Fed's independence in determining the rate of monetary expansion and handling other banking-system-related matters. For example, because the law requires that the Treasury Secretary approve nonbank lending, the Treasury Secretary could influence many of the terms and conditions of the Fed's pandemic response without taking political responsibility. Moreover, if executive branch officials hold formal levers over some policy areas, they will be "sorely tempted to use them as informal bargaining chips over monetary policy. That's just how the world works."[394] These entanglements shift the Fed's allegiance from Congress to the Executive, the part of government policymakers have long sought to separate from decisions about the money supply.

### *C. Impeding the Democratic Process*

A third cost is more subtle. Relying on the Fed—an institution that can create money—to perform nonmonetary tasks presents risks to the proper functioning of our democratic institutions. The problem lies in the dynamics over time. If the Fed can print money to advance government priorities outside of monetary system stability, it can reduce the incentive for Congress to legislate. Among other things, the Fed's expenditures do not have to be financed through taxation or borrowing, nor are they included on the government's balance sheet. The Fed's asset purchases and lending programs also do not have to get through the various veto gates that slow ordinary appropriations bills. From a short-term perspective, this alternate route for government disbursement may be appealing. But when the Fed satisfies certain powerful constituencies through its programs, it alleviates pressure that would otherwise drive broader legislative action.[395] In this way, Fed expansion on the asset side of its balance sheet threatens to crowd out political action by benefiting certain groups like homeowners who would otherwise lobby elected officials for economic legislation.[396] Accordingly, the Fed's expansion may have shrunk the scope for democratic deliberation, further limiting legislators and increasing demands for additional action by the Fed.

394. TUCKER, *supra* note 27, at 450.

395. *See* PIKETTY, *supra* note 383, at 699 ("[T]he danger is that these monetary policies, by avoiding the worst, gave the impression that no broader structural change in social, fiscal, or economic policy was necessary.").

396. *See* Menand, *supra* note 19, at 354-56; TUCKER, *supra* note 27, at 436 ( "The more central banks can do, the less the elected fiscal authority will be incentivized to do, creating a tension with our deepest political values.").

## Conclusion

Congress created a complex monetary system, with the Fed at its center, to keep America's resources productively employed. This system includes officials appointed by the President to advance public purposes and executives appointed by shareholders to pursue private gain. Within the system, there are avenues for political influence and sectors shielded from it. By separating these domains and examining them piecemeal, much of the existing literature (in financial regulation, economics, political science, and administrative law) obscures their functional connectedness and political economic character.

This Article brings the pieces back together. It offers an interpretation of the Federal Reserve Act, grounded in text, structure, purpose, practice, values, and intent and sensitive to the broader institutional order and statutory framework of which it is a part. It argues that Congress created the Fed to administer a monetary system in which the power to expand and contract the money supply rests in the hands of thousands of investor-owned banks. And it shows how Congress designed the Fed to solve three problems with that system: inadequate elasticity and expansion, especially during periods of economic stringency; an uneven distribution of money and credit resources in the banking system; and inadequate public accountability and control over monetary conditions.

It then uses this understanding to draw three sets of conclusions. First, it explains the Fed's unusual regulatory methods and unique institutional design. It argues that Congress built the Fed to administer the banking system in ways sensitive to the status of banks as public instrumentalities rather than private businesses. Second, it identifies four ways in which the Fed has exceeded the limits of its enabling act: backstopping nonbank financial firms, borrowing from them, conducting large-scale asset purchases, and lending widely to enterprises outside of the financial system. It argues that the rise of shadow banking largely explains these actions. Finally, it considers three costs of the gap between the Fed's enabling act and its larger footprint: interference with the law's implemental purposes, reduced effectiveness, and less demand for elected officials to craft fiscal policy.

In the coming years, policymakers should focus on modernizing the Federal Reserve Act and amending Title 12 of the U.S. Code to address the issues raised by shadow banking and restore the structural integrity of the banking laws. Although charting a path forward is beyond the scope of this Article, the logic underlying the Federal Reserve Act and the legal framework for money and banking suggests at least one overarching principle that ought to animate legislative efforts at statutory repair and reform: define money functionally, not formally. A monetary authority with the power to regulate deposit money but not deposit substitutes (or not to the same extent) is bound to struggle to carry out its objectives, whatever they may be. Shadow banking, in other words, has not just destabilized the economy and undermined the integrity of the banking system, but it has also severed the country's monetary authority from its statutory

moorings, leaving it without a path to achieve the full range of its legislative objectives.