

TRENDMACRO LIVE!

On Larry Summers' Withdrawal

Sunday, September 15, 2013

Donald Luskin

The Fed is spared assault on its credibility and independence: another systemic risk avoided.

In dozens of client conversations over the last month we bucked the consensus and predicted that Lawrence Summers would not be nominated to be the next Federal Reserve chairman. We were right. [This afternoon](#) he withdrew himself from consideration in a letter to President Obama.

- It was inevitable. [Last week](#) three Democratic senators on the Banking Committee -- Jon Tester (D-MT), Jeff Merkley (D-OR) and Sherrod Brown (D-OH) -- said they would vote against sending Summers' nomination out of committee to a full Senate vote. A fourth Democrat on the committee -- Elizabeth Warren (D-MA) is also said to have been reluctant.
- [Back in July](#) 18 Senate Democrats -- a third of the caucus -- signed a letter to President Obama opposing Summers' nomination, and endorsing instead that of current Fed vice chair Janet Yellen.
- Yes, [after that](#) Obama stood up for Summers. But that was just fending off interference with his prerogatives. [To quote Obama's *bête noire*](#), the president was simply reminding congress that *he* is "the decider."
- But the political reality right now is that Obama is in no position to push his luck on that. Already a classic lame-duck second-termer, Obama just last week narrowly avoided having to face a stinging rebuke from his own party in a congressional vote on Syria strike authority. Summers' withdrawal -- which was likely quietly requested by the White House -- means Obama won't have to go back to that brink so soon.

All that aside, would Summers have been a good Fed chair if he had been nominated and confirmed?

- Even assuming away a divisive confirmation vote, the Fed's credibility would be at risk from the get-go in a Summers chairmanship. A central bank's credibility derives in large part from its political independence. Summers would have been the most politically tainted chair in Fed history, the only chair to have previously been a Treasury secretary.
- All tangled up in the issue of central bank independence would have been Summers' larger-than-life persona. An institution that is free from politics is also free from political accountability, so it must

Update to strategic view

US FED, US MACRO: As we predicted, Summers has withdrawn as a candidate for Fed chair. This was likely at the request of the White House, to spare the president the risk of congressional defeat by his own party, which he just narrowly avoided with his Syria strike initiative. Summers has a far-ranging mind that would have set him in good stead as chair, but a difficult confirmation and his arrogant persona would have put the credibility and independence of the Fed at risk. Once again, a potential threat to systemic stability has been neatly avoided.

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be led by a man of irreproachable probity and humility. Surely that is not Larry Summers.

- The Harvard President Larry Summers we saw in the Oscar-winning film [The Social Network](#) is a man who luxuriates in his personal power, all the more so when he can use it to humiliate others (please control-click on the first video below). The FOMC won't stand for being treated like [the Winklevoss twins](#).

Larry Summers in *The Social Network*, and the aftermath

Please control-click each video to view



Source: YouTube

- Summers agrees that the cinematic portrayal of him was generally accurate (please see the second video, above). On at least two occasions he defended his conduct in the scene, once unapologetically referring to the Winklevoss twins as "a**holes" and once as "jerks" (see the third and fourth videos, above).
- We cannot imagine Mariner Eccles, William McChesney Martin, Paul Volcker, Alan Greenspan or Ben Bernanke -- or any Fed chair, or for that matter any person who wishes to be regarded with respect in a position of great trust -- publically calling anyone an "a**hole" for the purpose of defending his own conduct, or for any other purpose.
- *Summers is too arrogant and too much a loose cannon to have led the Fed successfully. He would have been a source of volatility. Facing the learning-by-doing unwind of a Fed balance sheet that is the largest in history, there's already going to be volatility enough without him.*

What about Summers' policy predispositions? *Too bad about the politics -- because Summers' monetary policy viewpoint may well be about the best we could have expected from among the crop of likely contenders.*

- To be sure, though Summers is a much-published economist, we are unaware of any original research in monetary economics.
- In some sense we see this as an plus. *Summers -- like Greenspan -- would have brought a more far-ranging mind, one that thinks like an economist, not just a monetary economist.*
- His one formal statement about monetary economics of which we are aware dates all the way back to 1991, rather bland panel remarks published in the *Journal of Money, Credit and Banking* ([licensed version](#), [bootleg version](#)).
- Janet Yellen, on the other hand, is intellectually enslaved to a lifetime of specializing in monetary economics, and many years in the Federal Reserve. But at least she knows what it's like to do original research, which in an important sense is what a Fed chair must do every day. Donald Kohn, former Fed vice chair and the

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other name [known to be](#) in contention for the nomination, literally spent his entire professional life within the Fed, and within the even more confining cell of neo-Keynesian economics to which he never made an original personal contribution.

- Yellen and Kohn, then, bring continuity and credibility to the job. But they don't bring Summers' broader experience or outlook.
- They are safe choices. That is not to say they are incapable of error. All Fed chairs are, perhaps now more than ever.

But the good news is that Summers' withdrawal spares us the prospect of systemic risk at the Fed -- the potential that the institution itself could be torn apart by a catastrophic loss of credibility and independence.

So this fits right in with the theme we've been developing all year, and which has led us last week to shift our baseline outlook toward the optimistic (see "[A Major Upgrade to our Strategic Outlook](#)" September 12, 2013) -- the removal, for the first year in seven, of constant imminent threat of systemic failure.

Bottom line

As we predicted, Summers has withdrawn as a candidate for Fed chair. This was likely at the request of the White House, to spare the president the risk of congressional defeat by his own party, which he just narrowly avoided with his Syria strike initiative. Summers has a far-ranging mind that would have set him in good stead as chair, but a difficult confirmation and his arrogant persona would have put the credibility and independence of the Fed at risk. Once again, a potential threat to systemic stability has been neatly avoided. ▶