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FED SHADOW

# Trump's New Faces on the Fed

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**Donald Luskin**

## Disappointing – not enough deregulatory zeal, and too much permahawk orthodoxy.

President Donald J. Trump has picked Randal K. Quarles and Marvin Goodfriend as nominees to fill two of the three vacancies on the Federal Reserve Board of Governors – at least according to the *New York Times*, relying (as usual) on unnamed "people with direct knowledge of the decision." The White House has done nothing to contradict the story, so we will assume it's true.

- *We would be very concerned if either of these individuals were nominated for Fed chair, but in subordinate roles they are both likely to be something between harmless and mildly useful.*
- *One concern is that both, to some extent, intersect with what has become GOP permahawk orthodoxy on Fed policy, grounded in legitimate moral notions of a limited role for the state, but quite unrealistic and dangerous in the world as we know it.*
- This orthodoxy was born, as a thread in GOP political discourse, in Ron Paul's quixotic but trend-setting "end the Fed" presidential campaign in 2008. A toxic extreme was reached in the 2012 presidential campaign when Republican aspirant Rick Perry called the dovish policies of then-chair Ben Bernanke "treasonous" and threatened to "treat him pretty ugly down in Texas."
- Movement conservatives tend to automatically hew to the more respectably developed versions of the orthodoxy, such as the narrative of John Taylor that the Greenspan Fed caused the financial crisis of 2008, and that the Bernanke Fed worsened the Great Recession, both by failing to follow his eponymous policy rule. To be sure, this new GOP orthodoxy is a healthy creative reaction to the old establishment orthodoxy that now rules the Fed's groupthink. But we don't see how it would help anything to swing from one orthodoxy to another, especially one that would now impose the Taylor Rule's current recommendation of 3.9% as an ideal Fed funds rate. We applaud the ideal of an objective rule reining in the discretion of unaccountable central planners. But we caution against the naïve belief that setting the rule in the first place is itself anything but an act of central planning, and all the more so when, like the Taylor Rule, it does not contain a meta-rule governing its own potential future revision.

***Randal Quarles** is a lawyer, not an economist, and would probably not be deeply involved in monetary policy.* His role would be Vice Chair of Bank

**Update to strategic view**

**US FED:** The appointment of Quarles and Goodfriend to fill two empty seats on the Federal Reserve Board is disappointing. Quarles, to be Vice Chair of Supervision to replace Tarullo, doesn't appear to be the kind of deregulatory firebrand who could ideally champion the rollback of Dodd Frank. Goodfriend is associated with the permahawk policy faction that has enabled GOP orthodoxy since the Ron Paul "end the Fed" campaign. He'll be a useful diversifier on the Board, but would be a dangerous chairman. These nominations lower the chances that Trump will reappoint Yellen, but we aren't changing our call for that yet.

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Supervision, a position created by the Dodd-Frank Act through which the Fed acts as the nation's primary banking regulator. Quarles will replace Governor Jerome Powell, appointed by Yellen to temporarily take the role after the resignation effective in early April of Obama appointee Daniel Tarullo. *So while not setting monetary policy, Quarles will still be a very important man.*

- Quarles served in the George W. Bush administration – without either blemish or distinction, as far as we know – as the Treasury's Undersecretary for Domestic Finance in 2005 and 2006 under Secretary John Snow. He is presently chair of Cynosure Group, a private equity firm.
- He hasn't left much of a footprint by which to judge his views with respect to bank regulatory policy – that wasn't his brief at Treasury, but what little he did say there was encouraging. Even with his name having been floated for the Supervision position since mid-April, there has emerged no reason to think – that is, to hope – that he is in the strongly pro-growth deregulatory mind-set of such Trump appointees as Betsy DeVos at the Department of Education or Scott Pruitt at the Environmental Protection Agency.
- We are unsure of how to interpret Quarles association with the Center for Financial Stability thinktank, serving on its Board of Advisors. While CFS offers up unique and useful data tools, and sponsors some refreshingly unconventional takes on policy, its leading spokesmen's statements sometimes verge on the over-simplification and catastrophism that feeds the permahawk GOP orthodoxy. But we doubt that such views particularly reflect Quarles' beliefs, any more than they do other smart people on the same Board such as Henry Kaufman, Richard Posner or Myron Scholes.
- We'll learn more from Quarles' Senate confirmation hearings. But we can be sure that he will be an improvement over Tarullo, the Torquemada of banking regulation. And Quarles will come on the scene against the backdrop not only of a new deregulation-minded administration, but with the full unintended consequences of Dodd-Frank's hastily conceived web of Rube Goldberg rules, committees and arbitrary processes finally motivating some re-examination by policy weathervanes like NY Fed President William Dudley, and even, at the end, by Tarullo.
- An odd personal note: Quarles is married to C. Hope Eccles, the grand-daughter of Marriner Eccles, the Fed chair from 1934 to 1938 after whom the Fed's main Washington headquarters building is named. Eccles was a wealthy GOP banker from Utah, who came to Washington in the Great Depression and became an enthusiastic architect of New Deal economic policy. His policy errors that prolonged the Great Depression are rarely discussed, but he has been celebrated as "the father of the modern Federal reserve" at a CFS event by Quarles' wife's cousin.

***Marvin Goodfriend*** *will surely be very much involved in monetary policy discussions.* Goodfriend is a professor at the Tepper School of Business at Carnegie Mellon in Pittsburgh (not Paris). And he served as an economist

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at the Richmond Fed from 1993 to 2005.

- In Goodfriend' s time at the Richmond Fed, he barely intersected with the tenure of permahawk Jeffrey Lacker. But he is nevertheless connected to the latter-day monetarist stream of thinking that informs much of the GOP permahawk orthodoxy.
- Goodfriend holds the Friends of Allan Meltzer Chair at Tepper, named for the late economist who wrote a magisterial three-volume history of the Federal Reserve. Goodfriend himself was a good friend, as it were, of Meltzer – who founded the neo-monetarist Shadow Open Market Committee, of which Goodfriend is a member. A respected voice on policy and theory for many decades, Meltzer was one of many traditionalists who mistakenly voiced extremely strong warnings about the inflationary consequences of the Fed's aggressive crisis-response starting in 2008 (and who, we suspect, if he were alive, would not have learned from his error).
- Goodfriend, like Taylor, has expressed strong criticism of the Bernanke Fed's handling of the financial crisis. In one especially scathing paper – more a breezy historical critique than a rigorous theoretical assessment – he finds that Bernanke did literally everything wrong and nothing right, before, during or after. It was delivered at a 2014 Hoover Institution conference organized by Taylor, where he was joined on the program by permahawks Lacker, Meltzer, Kansas Fed President Esther George and Philadelphia Fed President Charles Plosser.
- The paper was more an historical and political polemic than a rigorously argued case from theory. And at least, unlike Taylor, Goodfriend is not pushing as an alternative a single simple rule that, once calibrated, would be blindly followed no matter what exigencies the future might bring. So in that sense Goodfriend could make a useful diversifier as an FRB governor, with an office right down the hall from the Chair, and a permanent vote on the FOMC. Salt for the stew – but not the executive chef.
- On the other hand, at Jackson Hole last year, while central bankers around the world were commiserating about the apparent limits to their powers (see "On Yellen at Jackson Hole" August 26, 2016), Goodfriend offered a paper aggressively arguing that the zero bound should not be considered a barrier to central bank interest rate targeting. He may not be a dove, but at least he thinks doves can be more powerful than doves think they can be.

*With the opportunity coming next year to replace both Chair Janet Yellen and Vice Chair Stanley Fischer, we are relieved that the Trump administration hasn't done anything really stupid here. But Quarles may be a missed opportunity to be more aggressive in rolling back the dead hand of Dodd Frank. And Goodfriend has an outlook that makes him a useful gadfly, but probably a poor crisis leader.*

- *We have been thinking it's odds-on that Trump re-appoints Yellen, if she wants the job* (see "Yellen Gives Conservatives Something to Cheer" February 17, 2017). *We're not ready to change that view yet.*

- *When he fills the third open seat on the FRB, we will get a better idea of the extent to which he may, instead, want to remake the Fed along lines that will please movement conservatives.*

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**Bottom line**

The appointment of Quarles and Goodfriend to fill two empty seats on the Federal Reserve Board is disappointing. Quarles, to be Vice Chair of Supervision to replace Tarullo, doesn't appear to be the kind of deregulatory firebrand who could ideally champion the rollback of Dodd Frank. Goodfriend is associated with the permahawk policy faction that has enabled GOP orthodoxy since the Ron Paul "end the Fed" campaign. He'll be a useful diversifier on the Board, but would be a dangerous chairman. These nominations lower the chances that Trump will reappoint Yellen, but we aren't changing our call for that yet.