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Special Commentary

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Life After Ben: Choosing the Next Fed Chair

Executive Summary

The biggest question on monetary policy for the years ahead is, who will be the next Federal Reserve chairman? More importantly, who is best qualified to normalize policy without disrupting the current pace of economic growth and financial stability? The clear choice is Chairman Ben Bernanke, who nursed an ailing economy and financial market back to health by using unprecedented unconventional monetary policy. However, while it has not been explicitly stated, it is widely thought that Bernanke's second term as chairman will be his last (his term as Board member will not expire until 2020). How do we know this? Well, the chairman has done almost everything to point us in that direction besides spelling it out.

For starters, the chairman broke his typical stoic public routine and quipped in a speech to recent Princeton graduates, "I wrote recently to inquire about the status of my leave from the university (Princeton), and the letter I got back began, 'Regrettably, Princeton receives many more qualified applicants for faculty positions than we can accommodate.'"[1] If humor on a possible exit is not enough to make the case for a near-term exit, it was recently reported that President Obama is in the process of interviewing: Larry Summers, Janet Yellen and Donald Kohn.[2] The omission of Chairman Bernanke's name is noticeable and follows similar sentiment relayed in an interview on Charlie Rose, in which the president noted the chairman "has already stayed a lot longer than he wanted or he was supposed to." With the tea leaves all suggesting an exit for the current chairman, we now focus our attention on Bernanke's successor.

The best way to choose a Fed successor is to be familiar with the candidates' views on how the economy works and understand their underlying economic beliefs.

In this brief note, we revisit a framework originally laid out by Christina Romer and David Romer in a 2004 paper entitled, *"Choosing the Federal Reserve Chair: Lessons from History."*[3] The authors contend that the best way to choose a Fed successor is to be familiar with the candidates' views on how the economy works and understand their underlying economic beliefs.[4] The authors find that in periods where policy was successful, the previous views of the Fed chairmen showed that they were acutely aware of the high costs of inflation and its determinants and had realistic views about the sustainable level of unemployment.[5] Monetary policy was said to be successful under William Martin, Paul Volcker and Alan Greenspan, who shared the view that inflation was

[1] Bernanke, Ben S. (2013). "The Ten Suggestions," speech delivered at the Baccalaureate Ceremony at Princeton University, Princeton, New Jersey, June 2.
[2] Lowrey, Ann. (2013). "Obama Narrows Field for Fed Chairman to 3," New York Times, August 1.
[3] Romer, Christina D. and Romer, David (2004). "Choosing the Federal Reserve Chair: Lessons From History," Journal of Economic Perspectives, American Economic Association, vol. 18(1), pages 129-162, Winter.
[4] Romer and Romer study begins after the passage of the Banking Act of 1935 and excludes Fed Chairman Thomas McCabe (1948– 1951) due to the Fed's support of Treasury bond prices, which was not independent monetary policy.
[5] Bernanke, Ben S. (2013). "A Century of U.S. Central Banking: Goals, Frameworks, Accountability," speech delivered at the "The First 100 Years of the Federal Reserve: The Policy Record, Lessons Learned, and Prospects for the Future," a conference sponsored by the NBER, Cambridge Massachusetts July 10.

harmful and that economic slack could reduce inflation (see Table 2).[6] They also understood that under certain conditions, monetary policy could stimulate a depressed economy.

The most desirable pick would be someone who is well-rounded.

Background and experience are also important as every past chair in the Fed's history has either had fiscal policy experience and/or private-sector experience. Bernanke, Greenspan and Arthur Burns all served as chair of the Council Economic Advisors (CEA); and Marriner Eccles, Martin and G. William Miller were all businessmen (see Table 2). By far, the most desirable pick would be someone who is well-rounded with a background in the private sector, fiscal and monetary policy. To date, Paul Volcker is the only chair who came to the table with all three skill sets.

While the Romer and Romer (2004) study trails off at the Greenspan era, we augment the timeline by exploring the background and underlying economic beliefs of Bernanke, then follow the same logic to consider the top candidates being discussed by the Administration and the media. We focus on Larry Summers and Janet Yellen and explore their most recent views on inflation, employment, and financial stability.

Added Uncertainty: Timing of the Announcement and Process

We will likely hear the official word from the White House in late September or October.

Before delving into the ideologies of the proposed candidates, we first consider the timing of the nomination announcement and the process. In a recent news conference, President Obama indicated the top two candidates—Janet Yellen and Larry Summers—are both highly qualified and that he will make his decision in the fall.[7] That said, we will likely hear the official word from the White House in late September or October, which is about two months before the current term expires.

With this timetable, the announcement bumps up against a number of key dates including the September FOMC meeting and press conference, when we expect the Fed to announce plans to taper the current pace of asset purchases, the continuing budget resolution, which could result in a government shutdown on October 1, and the debt ceiling, which will likely be reached in mid-October. A contentious nomination during this period could add to the already-high level of uncertainty.

Once the President makes the nomination, the nominee will appear before the Senate, more specifically the Senate Committee on Banking, Housing and Urban Affairs. The nominee then reads a prepared statement and responds to written questions from the Senators. Thereafter, the entire Senate will vote to confirm the nominee. With at least one nominee ruffling feathers, it is not out of the realm of possibility that a nominee could be rejected. With the exception of the Wilson Administration during the beginning stages of the Fed, no Fed chair nominee has ever been rejected. With such a late announcement, if the nominee fails to get confirmed, we could be well past the end of Chairman Bernanke's term of January 31, 2014 before a new chair is chosen. While Bernanke could stay on as a board member until the vacant seat is filled, the Administration will likely take the necessary steps to ensure a smooth nomination process.

Bernanke's Legacy: The Helicopter Is Landing

Time Magazine took an early stab at writing the chairman's legacy by naming him "Man of the Year" in 2009.[8] While the unwinding of the Fed's unprecedented asset purchase program will truly determine Bernanke's legacy, it cannot be refuted that that the chairman resuscitated a very sick patient (the economy) from highly critical to stable condition. That said, we tested the framework proposed by Romer and Romer (2004) and found that his views on unconventional monetary policy, the zero-lower bound, and inflation targeting were all noted in his earlier academic work.

[6] While many will question the monetary policy of Greenspan due to excessive risk taking that eventually led to the Great Recession and financial crisis, Bernanke argues that financial stability was not a tactical goal along with the dual mandate (see footnote 4).
[7] Associated Press. (2013). "Obama Calls Summers and Yellen 'Highly Qualified' to Lead the Federal Reserve," August 9.
[8] Grunwald, Michael (2009). "Person of the Year 2009: Ben Bernanke," Time Magazine, December 16.

In a 2002 speech, Bernanke addresses the role of unconventional monetary policy and its impact should the federal funds rate be pushed to the zero-lower bound. He said, "to stimulate aggregate spending when short-term interest rates have reached zero, the Fed must expand the scale of its asset purchases or, possibly, expand the menu of assets that it buys."[9] Bernanke even remarked that another approach to cap the yield on longer-dated Treasuries is "…to operate in the markets for agency debt."

Bernanke's stance on inflation was also clearly discernible prior to his chairmanship. In a piece he co-authored in 1999, *"What Happens When Greenspan Is Gone?"* Bernanke proposed inflation targeting as the most desirable policy framework going forward, stating that, "inflation targeting is a monetary-policy framework that commits the central bank to a forward-looking pursuit of low inflation.…but also promotes a more open and accountable policy-making process."[10] Regarding his view on driving the inflation rate down to zero, promulgated during the Volcker and Greenspan era, Bernanke parted with the prevailing wisdom by arguing that the "…long-run inflation rate that best promotes the dual mandate is likely to be low but not zero."[11]

In addition, the chairman pioneered a shift in communication to increased Fed transparency, which was foreshadowed in his prepared remarks at the nomination hearing. The move toward greater transparency stemmed from a belief that increased communication "reduces uncertainty in financial markets, and helps to anchor the public's expectations of long-run inflation."[12]

Fast-forward to his time as chairman, most of the discussed policies in his earlier work were implemented. Reviewing Bernanke's work prior to becoming chairman further makes the point that understanding the underlying economic beliefs prior to nomination is the best way to determine what to expect during the tenure of the named Fed chairman.

Janet Yellen: The Playbook is Well Known

By many accounts, Janet Yellen is considered to be the frontrunner for the nomination. In fact, most suspect that to ensure a soft landing for unwinding the unprecedented expansion of the Fed's balance sheet, the similarly "dovish" vice chairwoman, who helped craft much of the current monetary policy, is best suited for the job. There is also a greater likelihood that Yellen would continue with Bernanke's well known consensus-driven approach to decision making. However, the only knock on her background is that she lacks private sector experience.

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Her views on employment and inflation are well noted. In a recent speech she states, "… I believe progress on reducing unemployment should take center stage for the FOMC, even if maintaining that progress might result in inflation slightly and temporarily exceeding two percent."[13] This view of a little more inflation for a lower unemployment rate has some investors worried that she could overweight employment at the expense of inflation.[14] On the flip side, other investors would be happy to see Yellen as chair, as there would likely be fewer surprises and greater possibility for a smooth confirmation.

Regarding financial regulation, Janet Yellen believes we have only scratched the surface with current Basel III and Dodd Frank standards. In a recent speech about the regulatory landscape, Yellen says, "Although we have made the financial system safer, important work remains" in banking regulation, problems with systematically important financing institutions and limiting

[9] Bernanke, Ben S. (2002). "Deflation: Making Sure 'It' Doesn't Happen Here," speech delivered at the National Economists Club, Washington D.C., November 21.
[10]Bernanke, Ben S., Mishkin, Frederic S., Posen, Adam S. (2000). "What Happens When Greenspan Is Gone?" Wall Street Journal, January 5.
[11] Bernanke, Ben S. (2007). "Federal Reserve Communications," speech delivered at the Cato Institute 25th Annual Monetary Conference, Washington, DC, November 14.
[12] Bernanke, Ben S. (2005). "Testimony of Ben S. Bernanke, "Nomination hearing before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, November 15.
[13] Yellen, Janet (2013). "Communication in Monetary Policy," speech delivered at Society of American Business Editors and Writers 50th Anniversary Conference, Washington, DC, April 4.
[14] Hilsenrath, Jon (2013). "Janet Yellen, a Top Contender at the Fed, Faces Test Over Easy Money," The Wall Street Journal, May 12.

risks in the shadow banking and financial markets.[15] More specifically, Yellen espouses that resurrecting efforts like Glass-Steagall are "…the most efficient ways to address the too-big-to-fail problem."[16]

Larry Summers: Contentious, but Qualified

Larry Summers' economic background is very impressive with private sector, academic and extensive public service experience. His early views on inflation and employment are well documented in his academic work. Similar to Bernanke and Yellen, Larry Summers believes that "…positive rates of inflation are almost certainly desirable"[17] and the optimal inflation rate is "…perhaps as high as 2 or 3 percent."[18] So, the idea of a little inflation to reduce the unemployment rate would likely carry through with Larry Summers as Fed chair.

Summers also believes employment should be a priority.

Summers also believes employment should be a priority. He believes economic growth and job creation "…should become the focus of our national economic conversation."[19] He also supports the view that monetary policy can help spur employment. In an earlier paper he noted, "in a high-unemployment trap, it may be well desirable to use monetary policy to jolt the economy out of that trap."[20]

Despite helping to deregulate the banking industry during the Clinton Administration, Summers' recent comments suggest that he is in favor of financial reform. While chair of the CEA, he noted that, "We have seen strong progress in both chambers, with the passage of a financial reform bill under Chairman Frank's leadership in the House and the announcement of a financial reform bill under Chairman Dodd's leadership"[21] He even goes on further to lay out what additional reform is needed.

Finally, Summers' academic work is likely where we find his true underlying economic beliefs, as he tends to restrain his own view when acting in an official capacity. In a recent speech, he notes, "It has been my observation that one can speak freely—more freely, at least-- …outside of public office than in public office."[22] This line of thinking is likely why his stance on regulation has shifted in recent years.

Conclusion

One of the most important economic decisions for the years ahead is who will be the next Fed chair. While the media has considered intangible traits, such as personality, to be important criteria, we revisit logic used in an earlier paper by Romer and Romer (2004). In the paper, the authors vet proposed candidates by understanding their views on the Fed's dual mandate and understand their underlying economic beliefs.

Using the same framework to explore the background and underlying economic beliefs of Ben Bernanke we see that his stance on unconventional monetary policy, the zero-lower bound, and inflation targeting were all noted in his earlier academic work. We follow the same logic to consider the views of Larry Summers and Janet Yellen on inflation, employment, and financial stability.

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[15] Yellen, Janet (2013). "Regulatory Landscape: A U.S. Perspective," speech delivered at International Monetary Conference, Shanghai, China, April 4.
[16] Ibid
[17] Summers, Lawrence (August 1991). "Price Stability: How Should Long-Term Monetary Policy be Determined," Journal of Money, Credit and Banking, Volume 23, No. 3, Part 2: Price Stability, pp. 625-631.
[18] Ibid
[19] Summers, Lawrence (2013). "U.S. Must Do More Than Focus on Deficit," Financial Times, February 10
[20] Summers, Lawrence (August 1991). "Price Stability: How Should Long-Term Monetary Policy be Determined," Journal of Money, Credit and Banking, Volume 23, No. 3, Part 2: Price Stability, pp. 625-631.
[21] Summers, Lawrence (2010). "Reforming and Renewing the Financial System" Remarks at the Pew Charitable Trusts Conference in Financial Reform, March 18.
[22] Summers, Lawrence (2013). speech delivered at the London School of Economics, London, England, March 2.

We find that it is very hard to delineate between the top two candidates views on monetary policy, financial stability and the current regulatory framework. On background and experience, every past chair in the Fed’s history has either had fiscal policy experience and/or private sector experience. Janet Yellen and Larry Summers also have impressive backgrounds, but Yellen lacks experience in the private sector. Another sticking point will likely be in the decision making process. We suspect there is a greater likelihood that Yellen would continue with Bernanke’s well known consensus driven approach. Despite a difference in the decision making process, personality and private-sector experience - which are menial - we can hardly find a difference in the two candidates.

Despite menial differences, we can hardly find a difference in the two candidates.

Table 1: Background and Credentials of Fed Chairs and Candidates

Birth	Death	Chair	Education	Primary Occupation	Prior Public Service
Previous Fed Chairs[3]					
Birth	**Death**	**Chair**	**Education**	**Primary Occupation**	**Prior Public Service**
1890	1977	Marriner Eccles	Attended high school, but did not graduate	Banker; president of a Utah bank holding company	Special assistant to the secretary of the Treasury for one year
1906	1998	William McChesney Martin Jr.	B.A. in English and Latin from Yale; attended law school, but did not finish	Stockbroker; president of NY Stock Exchange; public servant	President of Export-Import Bank; assistant secretary of the Treasury for international affairs
1904	1987	Arthur Burns	A.B., A.M. and Ph.D. in economics from Columbia	Professor at Columbia; research director, and later president of NBER	CEA chairman under Eisenhower; cabinet-rank counselor under Nixon
1925	2006	G. William Miller	B.S. in marine engineering from Coast Guard Academy; J.D. from U.C. Berkeley	Businessman; CEO of Textron	Volunteer posts dealing with employment of the disadvantaged; class B director of Federal Reserve Bank of Boston
1927		Paul Volcker	A.B. in economics from Princeton; M.A. in public administration from Harvard	Banker; monetary analyst; public servant	Researcher at Federal Reserve Bank of NY; various positions, eventually under secretary for monetary affairs, at the Treasury; president of Federal Reserve Bank of NY
1926		Alan Greenspan	B.A. and M.A. in economics from NYU; began Ph.D. at Columbia; later received Ph.D. from NYU	Economic consultant and forecaster; founder of Towsend-Greenspan	Domestic policy adviser to Nixon; CEA chairman under Nixon and Ford; many task forces; chairman of National Commission on Social Security Reform
Current Fed Chair					
Birth	**Death**	**Chair**	**Education**	**Primary Occupation**	**Prior Public Service**
1953		Ben Bernanke	B.A. in economics from Harvard, Ph.D. in economics from MIT	Tenured professor at Princeton University in economics and public affairs; Associate Professor of economics at Stanford; Visiting Professor at NYU and MIT	Board of Governors of the Federal Reserve; Chairman of CEA under George W. Bush
Candidates for Next Fed Chair					
Birth	**Death**	**Chair**	**Education**	**Primary Occupation**	**Prior Public Service**
1946		Janet Yellen	B.A. in economics from Brown University, Ph.D. in economics from Yale University	Professor Emeritus at U.C. Berkeley; Assistant Professor at Harvard; Faculty of the London School of Economics and Political Science	Vice Chairwoman of the Federal Reserve; President and CEO of Federal Reserve Bank of San Francisco; Economist with Federal Reserve Board of Governors
1954		Lawrence Summers	B.S. in economics from MIT; Ph.D. in economics Harvard	President of Harvard; Chief Economist of the World Bank; hedge fund managing director	Staff of the CEA under Reagan; U.S. Department of Treasury Secretary under Clinton; National Economic Council Director under Obama

Table 2: Previous Fed Chairs

Previous Fed Chairs[3]				
Confirmed	**Term End**	**Chair**	**Key Beliefs**	**Resulting Actions**
Nov-34	Jan-48	Marriner Eccles	Inflation and speculative excess are possible before full employment; Monetary policy cannot stimulate a depressed economy	Increase in reserve requirements in 1936 and 1937; Only very limited expansion in 1937-1938 recession
Apr-51	Jan-70	William McChesney Martin Jr.	Inflation is harmful; Inflation responds to the deviation of output from a moderate estimate of capacity; Federal Reserve can and should respond to recessions; Long-run inflation-unemployment tradeoff and low "prudent" unemployment rate; Natural rate hypothesis with a very low natural rate	Tightening in 1955 and especially in 1959 to reduce inflation; Expansion in 1953-1954 and recession in 1957-1958; Accommodative policy despite rising inflation; Mild tightening in 1969 to reduce inflation
Feb-70	Jan-78	Arthur Burns	Natural rate hypothesis with a very low natural rate; Extreme pessimism about the sensitivity of inflation to slack; Slack will reduce inflation, relatively high natural rate	Expansion in 1970-1971; Expansion in 1972-1973; Advocacy of income policies; Substantial tightening in 1974 to reduce inflation
Mar-78	Aug-79	G. William Miller	Natural rate is relatively low; Extreme pessimism about sensitivity of inflation to slack	Expansion despite high and rising inflation; Advocacy of income policies
Aug-79	Aug-87	Paul Volcker	Inflation is very harmful; Slack will reduce inflation; Relatively high natural rate	Severe tightening in 1979-1981 to reduce inflation thereafter steady low-inflation policies
Aug-87	Feb-06	Alan Greenspan	Early - Same as Volcker; Late - Low natural rate; Innovation limits inflation	Moderate tightening in 1988 to reduce inflation; Otherwise, steady, low inflation policies; Neutral policy in 1999-2000 despite low unemployment

Current Fed Chair				
Confirmed	**Term End**	**Chair**	**Key Beliefs**	**Actions**
Feb-06	Present	Ben Bernanke	Believed in the Great Moderation (fewer and less frequent recessions); Long-run price stability is essential for achieving maximum employment and overall economic stability; Transparency can help reduce uncertainty and anchor expectations of long-run inflation; Inflation targeting; Unconventional monetary policy	Reduced fed funds target rate to 0-0.25%; Large-scale asset purchases in three stages including MBS purchases and "Operation Twist"; Set a 2 percent target rate for inflation and a 6.5 percent threshold for the unemployment rate
Candidates for Next Fed Chair				
Confirmed	**Term End**	**Chair**	**Key Beliefs**	**Actions**
n/a	n/a	Janet Yellen	In favor of Dodd Frank, Basel III and even further government regulation of financial markets; Sees regulation and supervision as the most suitable tools for financial stability; Strong proponent of Fed transparency; Committed to the dual mandate but open to allowing inflation above two percent in order to reduce unemployment; Thought to be more "dovish" than Summers and Bernanke	n/a
n/a	n/a	Larry Summers	Proponent of inflation not exceeding 2-3%; Monetary policy as a tool to help spur employment; Despite helping to deregulate the banking industry during the Clinton Administration, current comments point toward support of financial reform	n/a

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