Hawks and Doves at the Federal Reserve

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Introduction

The FOMC is close to a turning point. It is raising the policy rate at a measured pace to normalize monetary policy. At present the U.S. economy is in excellent shape with low unemployment (3.7%) and inflation close to its 2 % target. As long as these conditions continue the FOMC will continue its gradual tightening cycle. However, if inflation increases much beyond two per cent the FOMC is likely to tighten more leading to the possibility of triggering a recession. Even if that does not happen, other shocks including fiscal tightening as the Trump tax cuts end and a U.S. tariff -induced unraveling of global supply chains and a slowdown in East Asian aggregate demand could lead to a downturn. This would be nothing new. The Fed has mistimed its exit strategy in business cycle recoveries in every episode (with the exception of four) since 1920 (Bordo and Landon Lane 2012).

How and when the Fed will react when the situation becomes tricky may be related to both the composition of the FOMC between governors and presidents and the policy preferences of its members-- whether they are hawks, doves or swingers. Normally the FOMC should have 12 voting members, 7 Governors appointed by the President and 5 Reserve bank Presidents (of whom New York is always present and the other four were on a rotating basis) who are appointed by their boards of directors. At present there are four serving governors (with three waiting to be confirmed by the U.S. Senate).

There is a general belief that the President will pick governors who have views close to his own—that Republican Presidents will pick hawks and Democratic Presidents will pick doves.[1] By contrast Reserve bank Presidents are chosen by their Boards of Directors who are less influenced by national politics and their policy preferences often reflect those associated historically with the district.[2] So for example St. Louis was always monetarist, Cleveland was

[1] However there have been episodes in history where a Republican President concerned about his election chances would pick a dove.

2 In recent years, the Board of Governors in Washington has played a greater role in the Reserve Bank selection process.

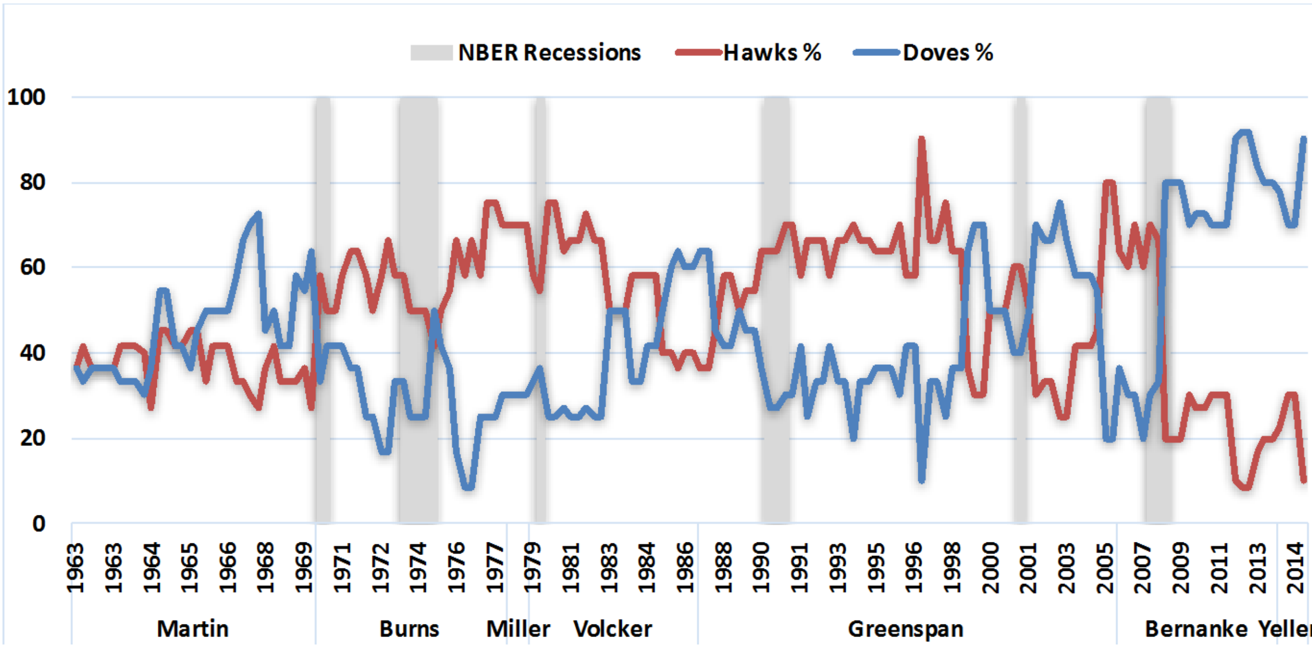
anti-inflation as was Richmond and so their Presidents have generally been classified as hawks; whereas Boston, Kansas City have often been viewed as Keynesian oriented and dovish. In addition, other important factors may be important in determining FOMC members policy preferences including when they were born (eg before or after the Great Depression and the Great Inflation) and the University where many of them received their PHDs (freshwater schools like the University of Chicago or salt water schools like Berkeley). These attributes may be crucial in affecting FOMC members' policy choices and whether we may have a hard or a soft landing.

In a recent paper with Klodiana Istrefi of the Banque de France (Bordo and Istrefi 2018) we examined the policy preferences of FOMC members who served from the early 1960s to 2015 in relation to the ideology of who appointed them. We examined both Board governors relative to the party of the US Presidents that nominated them; and the Regional Federal Reserve Bank Presidents relative to the Board of Directors of the regional Federal Reserve Bank that appointed them. We investigated three types of policy makers: inflation –fighting hawks, growth –promoting doves, and swingers (i.e those members perceived as swinging between the hawkish and dovish camps at the FOMC). The hawk and dove measure (index) was compiled by Istrefi (2017) based on narrative records in US newspapers and other sources regarding the policy leanings of FOMC members with respect to the Federal Reserve's dual mandate.[3]

As Figure 1 shows, the hawk and dove composition of the FOMC has varied considerably over time reflecting the annual rotation scheme of the FOMC, the turnover of members, and swings in preferences.

[3] The hawk-dove measure is based on all the relevant information derived from the policymaker's background (origins, education, political interests and supporters), their economic beliefs (expressed in writings, testimonies, speeches) and actions (votes and dissents). To build the hawk-dove measure, about 20,000 articles or reports from more than 30 newspapers and referencing 130 members were read to collect quotes that are informative on the policy preferences of each member. These quotes were quantified as perceptions for either a hawk or a dove. Perceptions were traced year by year, for the whole tenure of the FOMC member.

Figure 1 Hawks and Doves at the FOMC (% of the share of voting FOMC members)



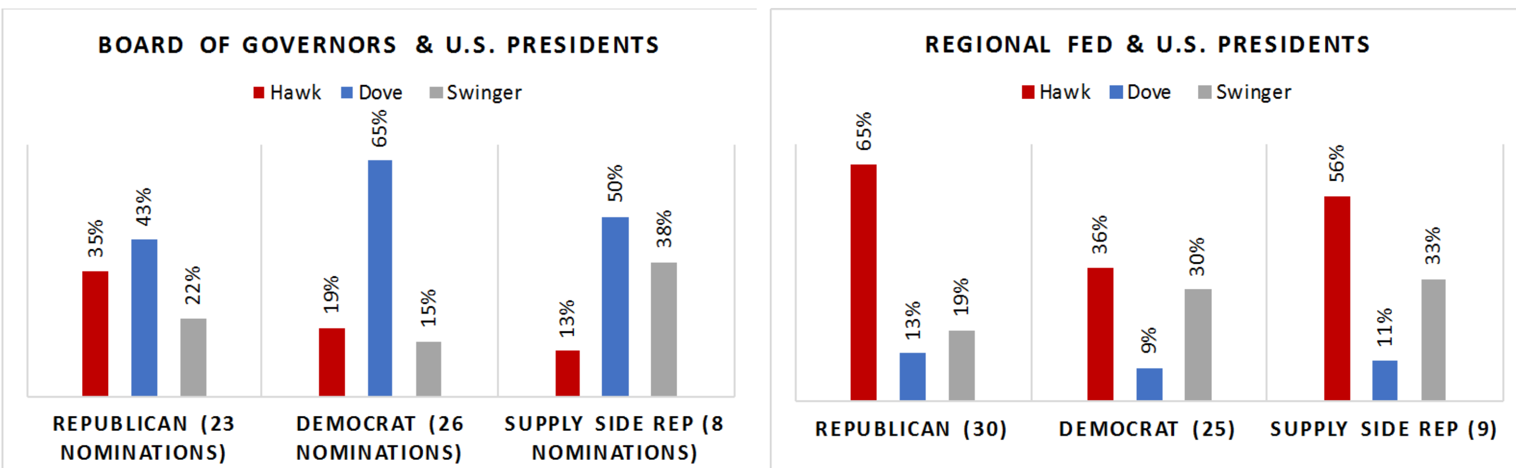
Notes: The share of perceived hawks and doves for each FOMC, from 1963 to 2015. Perceived preferences are followed in "real time", where the assigned preference of FOMC members in a meeting m, year t is based on perceptions before meeting m. In the chart, the share does not always add up to 100, as it can be that the policy preference of one or more members is not known yet.

Source: Istrefi (2017).

Ideology by Appointment

The 'Partisan theory' of monetary policy first formulated by Hibbs (1977) and empirically supported by Beck (1982), Stein (1985) and Alesina and Sachs (1988), among others, suggests that Democratic administrations prefer 'easy' monetary policies and choose doves, whereas Republican administrations prefer tightness and choose hawks. Indeed, our analysis shows that Democratic Board nominees have been mostly perceived to be doves in their tenure at the FOMC and very few have been perceived as hawks (See Figure 2). The share of hawks does appear higher for Republican nominees, but a slightly higher share of them are also perceived to be doves. This is not very surprising. First, if re-election motives are present, even Republicans might choose members with dovish preferences in expectation of policies to support growth and employment (eg. Richard Nixon, see Bordo, 2018a). Second, the U.S. president appoints the Board members, but each of them has to be confirmed by the Senate. Nominees have higher chances of confirmation if they are 'likable' by both besides in the Senate. Our data show that 70% of the Board of Governors in our sample were confirmed in a Democratic –majority Senate.

Figure 2 Political or institutional philosophies get checked at the door?

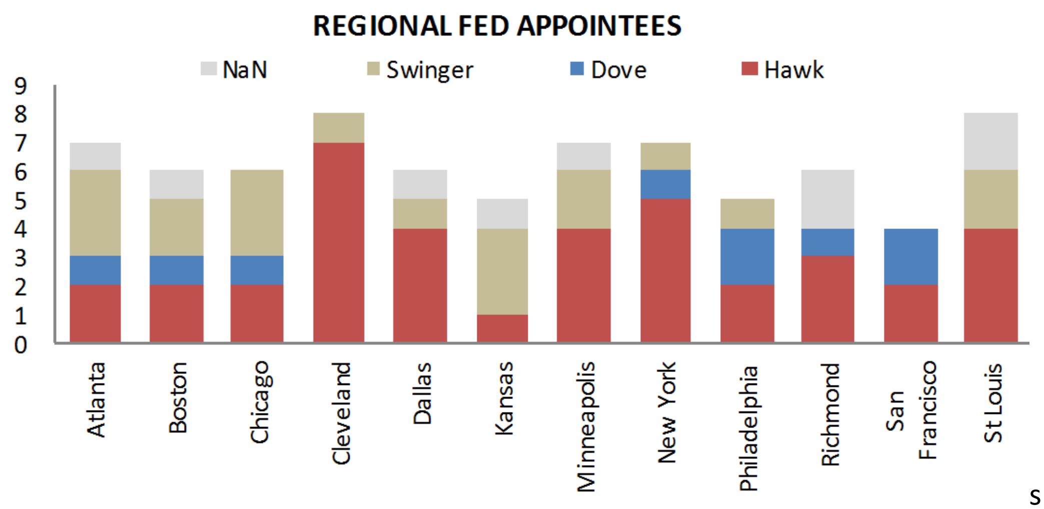


Note: The panel on the right abstracts from the regional Fed presidents for which the policy preference remained unknown.

Source: Bordo and Istrefi (2018).

By contrast, when focusing on Federal Reserve Bank Presidents who are appointed by their bank's board of directors, we observe a high share of hawks irrespective of the president's party (See Figure 2, second panel). Federal Reserve Bank presidents seem to be picked rather for having beliefs that go in line with those of the regional Federal Reserve Bank that they represent. This seems especially true for Federal Reserve banks that have a long tradition of institutional ideology (eg the Federal Reserve Bank of Cleveland's' outspoken, inflation fighting roots'). Thus several regional Feds, like the Federal Reserve Bank of Cleveland, the Federal Reserve Bank of Dallas, the Federal Reserve Bank of New York or the Federal Reserve Bank of St. Louis, have had presidents predominantly perceived as hawks (Figure 3).

Figure 3 Ideology in the Federal Reserve Bank president



Source: Bordo and Istrefi (2018).

The Federal Reserve Bank of Atlanta and the Federal Reserve Bank of Kansas City had presidents predominantly perceived as swingers, whereas the Federal Reserve Bank of Philadelphia and the Federal Reserve Bank of San Francisco had presidents predominantly perceived as doves.

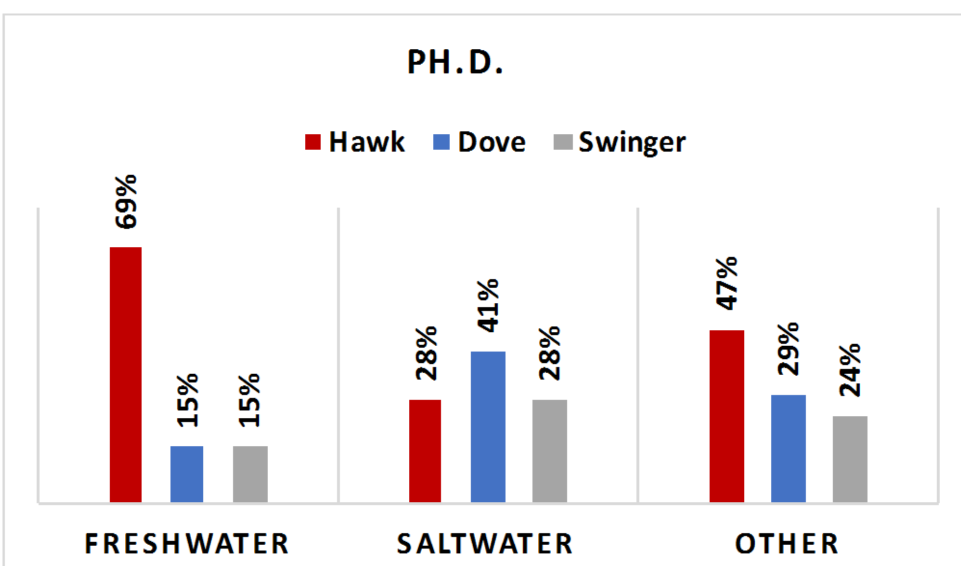
Beyond institutional memory and ideology, several other factors could explain this distribution of types, such as the ties of the Federal Reserve Banks with the Board of Governors (which is believed to have become more influential over time in choosing Federal Reserve Bank Presidents), how strong the ties of the Federal Reserve Banks with the commercial banks of the region are, or the conservative versus liberal tendencies of the region.

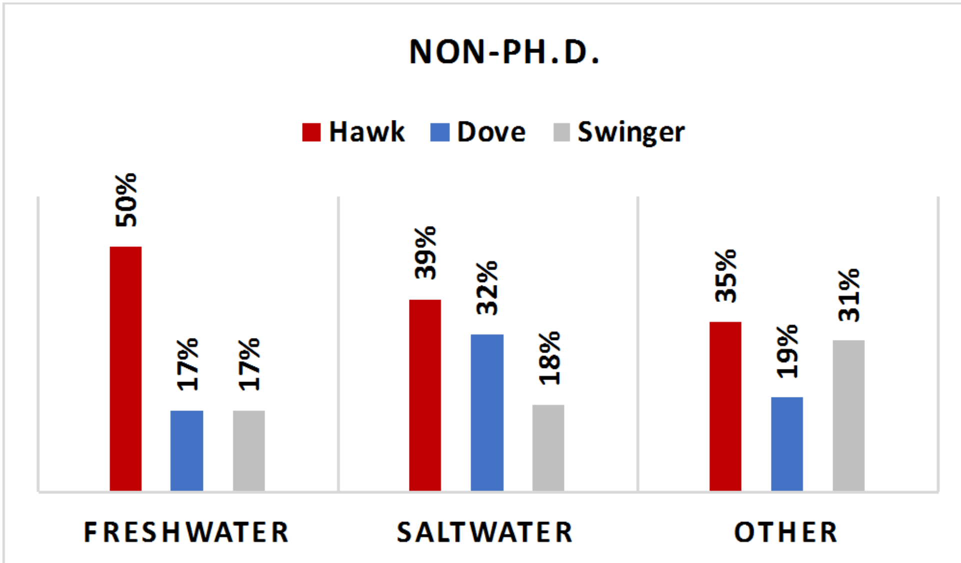
What moulds the central banker's type as a hawk or dove?

In Bordo and Istrefi (2018) we highlight two important factors in molding the policy preferences of FOMC members who have served over the past 60 years: ideology by education, and events that shaped their lives before joining the FOMC. By ideology in education we mean the graduate schools that PhD economists on the FOMC studied at. We distinguish between freshwater schools like the University of Chicago, Rochester and UCLA associated with monetarist (stable money) views and scholars like Milton Friedman, Karl Brunner, Allan Meltzer and Robert Lucas on the one hand, and salt-water schools like Harvard, MIT, Yale and Berkeley associated with scholars like Paul Samuelson, Robert Solow and James Tobin who were Keynesians and who emphasized full employment over low inflation.

Our results show that above 70% of members from freshwater schools have been hawks, while the majority of members from saltwater schools have been doves. We also found that members who did not have a PhD (eg bachelor's, master's, MBA) were less polarized; most of them were perceived as hawks irrespective of the school type.

Figure 4 Ideology by education/schools of thought



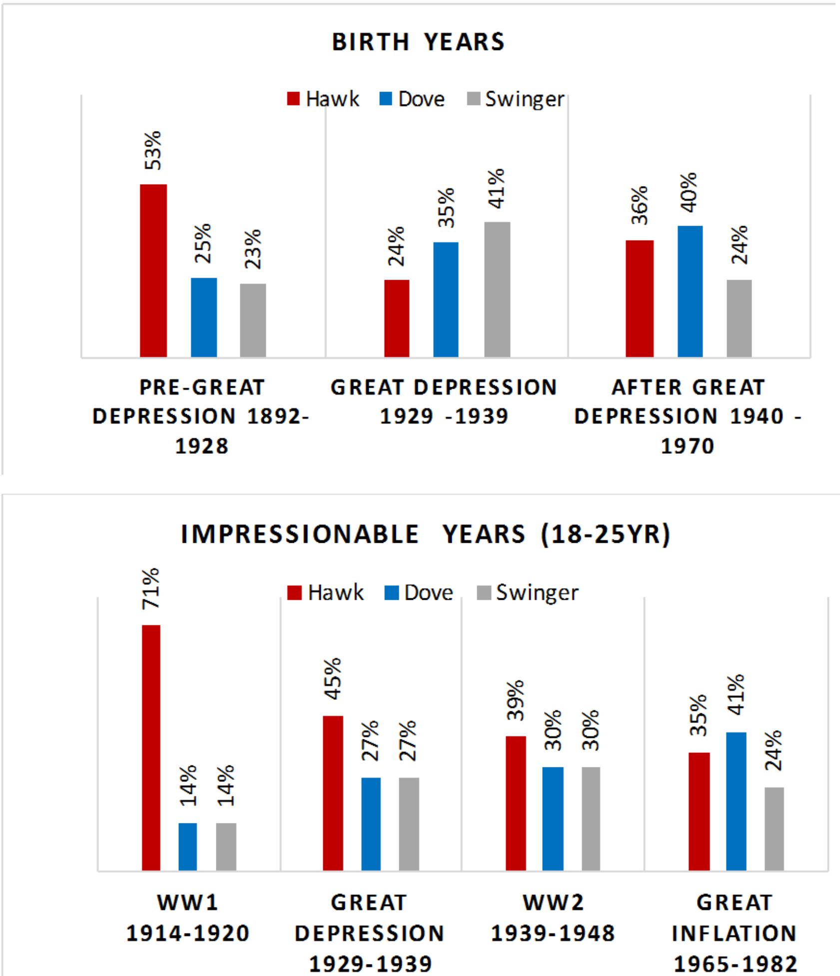


Source: Bordo and Istrefi (2018).

Our second salient determining factor is events that shape FOMC members' lives. We examine for each member the major economic events (high inflation and high unemployment) that occurred during their early life (when born and until 25-30 years old). This investigation is motivated by the literature in political science and social psychology which suggests that people form their core economic and political beliefs mostly during the early stages of life (age 18 to 25), which then remain fairly unaltered for the rest of their lives.

For instance, our results show that members who were born during the Great Depression tended to be doves and swingers. Those that lived their early life during periods of high inflation (like during the WW1 and the WW2) tended to be hawks (see Figure 5).

Figure 5 Great Inflation and Great Depression memories run deep



Note: WWI (1914-1924) and WWII (1939-1949), each period includes the years of the war plus post-war inflation years. Left panel: all FOMC members (n=119, excluding the unknown types); right panel: only FOMC members with impressionable years in the defined periods (n=89). The impressionable years are defined as ages of 18 to 25.

In simplest terms, we found that the odds of being a hawk are higher when a member is born during a period of high inflation or graduated from a university linked to the Chicago School ('freshwater'). A dove is most likely born during a period of high unemployment like the Great Depression and graduated from a university with strong Keynesian beliefs ('saltwater').[4, 5]

[4] Swingers share several background characteristics of doves, but not always. Being a non-economist and having

Implications for Current and Future Policy

The divide in views of the Board versus the regional Federal Reserve Bank presidents could be especially important today when the FOMC is short of three Board members, thus making the five regional Fed Presidents the voting majority (a rare situation for the governance of the Federal Reserve, see also Conti Brown, 2016). Historically the Federal Reserve Bank presidents have always been more independent and outspoken than the members of the Board, who have been more supportive of the Chairman of the Board of Governors. The last time a Board member dissented on policy was in 2005, in one of the last meetings of Chairman Alan Greenspan. Since then, the Federal Reserve Bank presidents have dissented 57 times, most of them for tighter policy. Thus, Chairman Powell might face a harder job in forming a consensus with a Federal Reserve Bank presidents –led majority. A weak Board and a weak FOMC could find it challenging to manage further rate hikes in an environment of the termination of fiscal stimulus and trade policy uncertainty. A weak FOMC means trouble ahead if conditions deteriorate and a recession looms.

In addition, it has been 35 years since the end of the Great Inflation and for some of the new FOMC members the Great Inflation is a distant memory and the seminal event in their formative years is the Great Moderation (1985 to 2003). Moreover, the macroeconomics that is taught in U.S. Graduate schools has converged around the New Keynesian model which combines elements of both freshwater and saltwater schools of thought.[6]

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graduated from universities with no immediate relation to 'freshwater'/'saltwater' schools increases the odds, albeit slightly, of being a swinger.

[5] We find a good match between the overall perceptions on the type with voting trends of the FOMC. Perceived hawks have a tendency towards tightening when they dissent (92 % of their dissents) and perceived doves have a tendency towards loosening when they dissent (94 % of their dissents). Hawks and doves have also a higher dissent rate per member, for tighter and easer policy, respectively.

[6] Although there are to be sure distinct differences between what is emphasized in each of the two schools—rules over discretion and the dominance of market solutions to the economy's ills in freshwater schools ; and managed discretion and the prevalence of market failures requiring government intervention in saltwater.

Ideological factors might also have become muted with time because the Federal Reserve , as is the case with many central banks around the world, has converged to an understanding of the importance of price stability (and the use of flexible inflation targeting). Moreover, since the Great Financial Crisis of 2007-2008 the debate has largely been over financial stability, not price stability. Financial stability has become the growing concern of central banks, and a key difference among them is on exactly what role the financial stability objective should play in their policy making. Should central banks 'lean against the wind ' of asset price booms or 'clean up the mess' after the boom busts? And if central banks lean against the wind, what tools should they use—macro-prudential regulation or their policy interest rate?[7] Although it is too soon to tell, ideology could still play a role.

Furthermore, the pendulum has been swinging away from the appointment of PhD economists as Presidents of the Regional Federal Reserve banks towards those with an MBA background with an emphasis on pragmatism and short run fixing. All of these recent forces suggest that the old hawk-dove distinction may not be quite as relevant as in the past for how the present FOMC will handle the next major inflection point in policy making.

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[7] See Bordo (2018b).

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