Why Money Isn't Neutral

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Abstract

This paper argues that redistributive politics are not accidental byproducts of monetary policy but its enduring logic. Discretionary authority transforms monetary policy from a neutral instrument of stabilization into a political process of allocation. Drawing on Cantillon's insight that new money alters relative prices and redistributes purchasing power toward early recipients, the paper shows that under central banking these effects become structural features of discretion. Linking the Fed's institutional channels to Cantillon Effects, it demonstrates how access and influence to the Fed convert monetary discretion into predictable patterns of redistribution. It utilizes three historical cases—the Fed's first purchases of agency debt in the 1970s, the Commercial Paper Crisis of 1970, and the Plaza Accord of 1985— to illustrate how special interests repeatedly leveraged these institutional pathways to steer credit in their favor. The analysis reframes the rules–discretion debate as a question of political economy. Rules constrain the scope for monetary bargaining, while discretion embeds politics within the very structure of money creation.

Keywords: central bank independence, monetary policy, political pressure, rent-seeking, redistribution

JEL Codes: E02, E42, E58, D72, D78

1 Introduction

At its core, the debate between rules and discretion in monetary policy is a debate about politics. Whether a central bank follows a rule or acts with discretion determines not only its macroeconomic performance but also the extent to which political and economic interests can shape its decisions. Rules constrain the scope for bargaining and influence, while discretion expands it. When monetary authorities operate under discretion, they become enmeshed in the political process, negotiating between organized interests and policymakers over how credit and liquidity are distributed through the economy.[1]

This paper situates monetary politics within that broader institutional choice. It argues that the redistributive consequences of monetary policy are not accidental side effects of liquidity operations, but the predictable outcomes of discretionary authority. Richard Cantillon's insight remains fundamental. Those who receive new money and credit first can spend before prices adjust, while later receivers face diminished purchasing power. (Cantillon, 2015) Under discretion, *who* receives money first is no longer a neutral outcome of market processes but a *political decision* shaped by access and institutional position. Discretion transforms Cantillon Effects from a theoretical curiosity into a persistent political reality.

From this perspective, the rules–discretion distinction acquires a distinctly *redistributive* meaning. A rules-based regime seeks to constrain the central bank's capacity to allocate money and credit in ways that favor particular interests. By contrast, a discretionary regime invites politicization as decisions over asset purchases and emergency interventions create opportunities for organized interests to secure privileged access to money creation.[2] Recent expe-

[1] For some recent papers and books on rules-discretion debate see Taylor (2012, 2017); Nikolsko-Rzhevskyy et al. (2014); Plosser (2014); Bordo and Taylor (2017); Boettke et al. (2021); Friedman (2012); King (2016); Kocherlakota (2016); Bernanke (2022).

[2] See White (1989b), White (1989a), and Wagner (1986)

rience has underscored this dynamic. Leonard (2022) shows how quantitative easing enriched financial elites while leaving wage earners more vulnerable, while Rouanet and Hazlett (2023) demonstrate how the same monetary mechanisms allowed special interests to benefit from recent crises.[3] Binder (2024) extends this argument by demonstrating that political pressures and organized interests have historically shaped monetary decisions. [4] Together, these accounts reveal that the rules–discretion distinction is not only about macroeconomic stability but also about who benefits from monetary authority.

This paper contributes to the literature by linking the Fed's institutional channels of political pressure to Cantillon Effects, showing how access and influence turn discretionary authority into enduring redistribution. It traces the channels through which special interests exploit discretionary authority to influence monetary outcomes. In doing so, it reframes redistributive effects as *structural features of discretionary governance* rather than anomalies of policy implementation. The analysis shows how institutional design mediates the interaction between politics and money creation. Discretion provides the opportunity, and access determines who benefits.[5] When discretion prevails, monetary policy becomes a form of political bargaining in which benefits concentrate among early receivers of new money while costs diffuse across the public. Redistributive politics are thus not incidental to monetary policy, they are its enduring logic.

The next section lays out the institutional channels of the utilized by special interests. It theorizes how special interests may shape the Fed's monetary policy.

[3]Luther and Cutsinger (2022) also demonstrate how the shift to a "floor system" altered seigniorage flows and heightened opportunities for politically salient redistribution. Hogan (2021) shows how paying interest on excess reserves systematically changed bank lending incentives. Burns and White (2019) show the Fed's response to the pandemic opened up doors to quasi-fiscal tools. However, Binder (2019) has noted that inflation and inequality seems to have become negatively correlated as central banks have resisted political pressure.

[4]For more work on the political economy of central banks see Woolley (1984), Toma and Toma (1986), Grier (1991), Havrilesky (1995), Binder (2021), Drechsel (2024)

[5]For a political economy framework on who accesses and benefits see Holcombe (2018)

The following section illustrates how special interests have used these channels through three cases. The paper concludes by underscoring the importance of monetary policy's redistributive effects in the rules-discretion debate.

2 Channels of Political Pressure

2.1 Monetary and Financial Policy Decisions

The Fed is responsible for both monetary policy and financial policy, with each function managed by distinct components of its governance structure. The Federal Open Market Committee (FOMC) directs monetary policy, while the Board of Governors oversees financial regulation and crisis management. This division of responsibilities creates multiple points of entry for outside influence. Understanding these institutional features is essential for analyzing how special interests seek to shape both monetary and financial policy.

The FOMC consists of the seven members of the Board of Governors, the president of the Federal Reserve Bank of New York serving a permanent seat due to that bank's role in implementing policy, and four rotating Reserve Bank presidents drawn from the remaining eleven regional banks. Meeting eight times per year, the Chair of the Board of Governors shapes the agenda as the committee reviews economic and financial conditions to set policy by majority vote. The FOMC regulates liquidity and credit conditions through open market operations, reserve requirements, or the discount window shaping distributional outcomes across the economy. The Board of Governors is a seven-member body appointed by the President and confirmed by the Senate responsible for financial policy, enforcing regulations and monitoring systemic risk. In crises, the Board coordinates with regional Reserve Banks to provide emergency liquidity and design special lending facilities. Its decisions determine which firms and

sectors gain access to credit support and under what conditions.

2.2 Reserve Bank Directors

Each Federal Reserve Bank has a nine-member Board of Directors divided into three classes, designed to balance competing constituencies within the financial system. Class A Directors represent the member banks and are elected by them. Class B Directors, also elected by banks, represent major corporations and regional industries outside finance. Class C Directors, appointed by the Board of Governors, are intended to represent the broader public. Together, these directors were meant to integrate professional expertise with civic responsibility, ensuring that the Fed's governance reflected the diversity of the economy.

Class A Directors shape the tone of district reports (like the Red Book or Beige Book) and strengthen coordination between Reserve Banks and commercial lenders by facilitating regular communication on lending conditions, liquidity pressures, and local credit risks (Woolley, 1984). This aligns Reserve Bank operations with the needs and perspectives of district banks. Class A Directors provide a conduit for the banking sector's interests to filter into the formulation of monetary policy.[6]

Class B and C Directors hold particular significance because they elect the president of each Reserve Bank, subject to approval by the Board of Governors. This authority allows them to shape the leadership and, indirectly, the policy orientation of the Fed, since Reserve Bank presidents participate in the FOMC on a rotating basis.

Despite the original intent to create a balanced and politically insulated governance system, the composition of the Reserve Bank boards has consistently reflected the dominance of corporate and financial elites. In practice, most di-

[6]Another possible way Class A Directors may shape monetary policy is through recommendations to change the discount window (McKnees 1993). However, this is not found to have been a channel used in any of the cases below.

rectors have represented large corporations closely aligned with major banks. For example, a 1976 House staff report revealed a large number of Class B Directors held current or prior service to bank holding companies (U.S. Congress, House of Representatives, Committee on Banking and Currency, 1976, p. 13). Havrilesky (1986) found that Class C Directors were also rarely representative of the public as they were disproportionately made up of retired executives from large corporations. This has been a persistent feature of the Fed as a 2011 report by the Government Accountability Office found that during the Great Financial Crisis,

> Some of the institutions that borrowed from the emergency programs had senior executives and stockholders that served on Reserve Banks' board of directors... We identified at least 18 former and current Class A, B, and C directors from 9 Reserve Banks who were affiliated with institutions that used at least one emergency program. (p. 39)

In the aftermath of these revelations, the close interlocking between Reserve Bank directors and the private sector can be seen as both a shield and a constraint for the Fed. On one hand, the presence of powerful corporate and financial figures has given the institution defenders capable of protecting its autonomy from political interference by Congress or the executive branch. On the other hand, that very dependence on private allies creates its own vulnerabilities. The credibility and operational support the Fed draws from these networks come at the cost of reinforcing their sway within the institution itself (Woolley and Ziegler, 2011). The boundary between public stewardship and private interest becomes porous where policies framed as safeguarding financial stability often align with the priorities of the same corporate and banking elites that shape the informational and institutional context in which the Fed operates.

This dynamic reveals another subtle channel through which special interests can influence the direction of monetary policy.

2.3 Advisory Councils

Another channel through which special interests can influence monetary policy is through the advisory councils within the Fed. These councils are composed of representatives from specific industries who provide input on monetary policy and financial regulation. The most significant of these is the Federal Advisory Council (FAC), which consists of twelve banking executives, each representing a Federal Reserve District. Each member is appointed by their respective Reserve Bank and can be reappointed annually. The FAC meets with the Board of Governors at least quarterly, producing a report outlining the perspectives of the twelve banking executives on current monetary policy and economic conditions. These meetings offer the banking sector an opportunity to influence monetary policy in a way that aligns with its interests. A recent illustration of this dynamic came in the December 2024 meeting, where the FAC explicitly signaled support for monetary easing, noting that additional rate cuts were necessary and debating the appropriate pace at which they should occur. In doing so, the FAC effectively conveyed the banking sector's preference for a looser credit environment, providing the Fed with an organized, insider perspective on monetary conditions.

Although the FAC lacks formal decision-making authority, its significance lies in the information it transmits and the expertise it aggregates.[7] Through these advisory bodies, the Fed could draw on specialized industry knowledge to assess economic conditions and refine its policy outlook. In this sense, advisory councils function as informational conduits, translating practical market insight

[7]For examples of advisory boards providing valuable information to regulators see Abbott et al. (2017), Braun (2020), Beyers et al. (2021), Daval et al. (2023), Lavertu and Weimer (2011).

into the policymaking process.

However, these meetings offer the banking sector an opportunity to influence monetary policy in a way that aligns with its interests. The structure of the FAC is such that it lacks complete accountability, leaving room for banks to abuse their position. Its membership is composed exclusively of senior executives from member banks, typically the largest in each district, appointed and reappointed by the regional Reserve Banks whose own boards include banking representatives. This creates what (Willems, 2020) describes as an access asymmetry, where advisory positions are disproportionately occupied by industry insiders whose interests are already represented within the institution itself. The resulting network forms a closed informational circuit where privileged insiders advise without external scrutiny (Coglianese et al., 2004; Crow et al., 2017). Within such insulated structures, advisory boards can selectively frame issues to justify policies favorable to their own constituencies (Brès et al., 2019; Bundy et al., 2013). Such concentration of influence allows expert bodies to advance recommendations systematically biased toward their members' material interests (Cooper and Golec, 2019; Schenk and Johanson, 2021). In the case of the FAC, its members could frame narratives of financial fragility or credit shortages to position themselves as first receivers of new money and credit, illustrating how privileged access with little oversight can steer monetary policy toward private rather than public interests.

Despite this privileged position, scholarly accounts have often downplayed the FAC's importance, portraying it as largely ceremonial. (Board of Governors of the Federal Reserve System, 2025a,b). The Fed has shown it cares about what the FAC has to say. Woolley (1984, p. 77, fn. 29) looking through the mintues found that Arthur Burns made active use of the FAC as a soundboard for future monetary policy. This confirms Robert Holland of the Board of Governors

characterization that

> Burns was very interested in how practical decision-makers reacted to policy. He pushed harder [in the FAC] than either Martin or Eccles to ask pointed questions about banking and how they were responding.... Burns and [Governor] Mitchell particularly learned how to use this mechanism, and it was clear that the bankers often found their questioning uncomfortable. (Woolley, 1984, p. 77)

Statistical evidence also suggests the FAC influences the Fed's monetary policy. Havrilesky (1995) finds the FAC reports from 1973-1988 contained information predictive of future Fed policy actions. The coefficient on the FAC reports was -0.1452 on the Fed Funds Rate, implying a recommendation for easing corresponded to a 14.52-basis-point reduction in the Fed Funds Rate. Weise (2008) extends this analysis to include non-financial corporations, finding that they exerted greater influence over monetary policy during the 1970s but lost prominence in the 1980s. This can help explain the smaller basis-point effect of the FAC during the 1970s, as competing monetary easing signals from non-financial groups diluted the FAC's impact. Since the 1980s, the FAC gained a stronger influence with a coefficient of –0.23, showing greater Fed responsiveness to banking sector recommendations. These findings suggest that the FAC became a consistent conduit for the banking sector's perspective within the Fed's policy process, strengthening its role as a channel of financial influence rather than a purely ceremonial body.

Beyond the FAC, several other advisory councils exist to represent different constituencies. These include the Community Depository Institutions Advisory Council (formerly the Thrift Institutions Advisory Council), the Insurance Policy Advisory Committee, and the Consumer Advisory Council. These councils represent the interests of thrift institutions, insurance companies, and

consumers, respectively. Unlike the FAC, whose members are appointed by the Reserve Banks, members of these councils are appointed directly by the Board of Governors. They also meet regularly with the Board to provide industry-specific insights and to draft reports on monetary policy and financial conditions. While the degree of influence may vary across councils and over time, their existence highlights the Fed's institutionalized openness to organized groups, offering a structured channel through which special interests can attempt to steer policy in their favor.

2.4 Personal Relationships

Central banks operate within overlapping professional circles that connect policymakers, regulators, and financial executives. These networks form enduring channels of communication and trust, linking the Fed and Wall Street through "weak ties," i.e., bridges connecting separate social groups through shared professional or career paths (Granovetter, 1973, 1983). Such ties can facilitate the exchange of expertise and timely information, improving the Fed's understanding of market dynamics and operational risks.[8] Personal familiarity can also foster trust during crises, when coordination between policymakers and private institutions becomes critical.[9] Yet these same connections blur boundaries and invite regulatory capture, creating a culture of deference that discourages oversight of powerful financial actors, especially in emergencies, when officials depend most on trusted private contacts for information and support.

A telling early example comes from the Bankers' Acceptance Market of the 1910s and 1920s, which was shaped by the personal relationship between Paul M. Warburg, chairman of the largest acceptance bank, and Benjamin Strong, the first governor of the New York Reserve Bank. Their collaboration helped

[8] See Armesto et al. (2009); Correia-Golay et al. (2013)
[9] See Haas (1992); Acemoglu et al. (2016)

establish bankers' acceptances as a key instrument of credit. While the Fed also purchased domestic trade acceptances, the policy disproportionately advanced the interests of New York institutions and foreign banks engaged in international trade finance, which had the networks to exploit the market most fully. The Warburg–Strong connection shows that revolving-door ties are not new but have long served as bridges between financial elites and central bankers.[10]

The Great Financial Crisis provides further examples where high-ranking officials from major banks frequently transitioned into key regulatory roles and vice versa. At the time of the crisis, Stephen Friedman simultaneously served as Chairman of the Board of the New York Fed and sat on Goldman Sachs's board, holding shares in the firm. When Goldman converted to a commercial bank charter, Friedman's dual role constituted a legal conflict of interest, but the Fed quietly granted him a waiver. The 2011 GAO audit concluded that the arrangement violated conflict-of-interest rules (GAO 2011), prompting subsequent reforms to tighten restrictions on Reserve Bank directors.[11]

The culture of deference these personal ties can create was captured vividly in the Segarra Tapes. Carmen Segarra, a former New York Fed examiner, secretly recorded conversations exposing the cozy relationship between Goldman Sachs and the New York Fed (Segarra 2013). The tapes revealed a regulatory culture deferential to financial institutions and hesitant to challenge major firms even when risks were apparent. This dynamic illustrates how the financial industry captures into the very culture of the institutions overseeing them. Weak ties also diffuse norms, as routine professional contact between regulators and bankers fosters a shared outlook that makes resistance costly and deference natural (Kwak, 2014; Chesterfield et al., 2025).

[10] The Fed was authorized to purchase both foreign and domestic bankers' acceptances after 1916, but in practice the largest most politically salient market remained in foreign trade finance (Chandler, 1958, p. 272)

[11] For more on the role of the revolving door in bank regulation see Lucca et al. (2014); Brezis and Cariolle (2019); Vanatta (2024); Trifiletti (2025); Brezis and Cariolle (2016))

Under discretionary regimes, these relationships become conduits for redistributive outcomes where access and influence determine who benefits first from new money and credit. Discretion amplifies these effects because it allows personal networks and informal channels to shape how policy decisions are justified, communicated, and executed. When central bankers must act without clear rules, these networks gain even greater influence over who receives support and on what terms. In this sense, the revolving door and culture of deference are not incidental to monetary policy but integral to its redistributive logic. They illustrate how discretion enables special interests to shape outcomes and preserve their privileged position within the financial order.

2.5 Congressional Committees

Congressional committees play a significant role in overseeing the Fed and influencing its policies. The Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services are composed of approximately twenty and fifty members respectively, which are dependent on the party composition of each chamber. Members are appointed by party leaders, and the chair is chosen from the majority party. The Senate's committee has the crucial power to vet nominees for the Board of Governors which can influence and direct monetary policy. Both committees are required to meet with the Board of Governors at least twice a year to discuss economic and financial conditions.

These committees provide organized interests a platform to pressure the Fed, serving as intermediaries through which special interests lobby members of Congress and influence the central bank indirectly. [12] Possessing the authority to propose legislation that alters the Fed's structure, committees can use this

[12] For evidence of bank lobbying see Blau et al. (2013); Blau (2017); Manish and O'Reilly (2019); Igan and Lambert (2019); Heyden (2025)

power to advance favored policies or threaten institutional reform if the central bank resists political or financial expectations. The biannual meetings with the Board of Governors further extend this leverage by allowing committee members to apply public pressure or promote specific policy preferences in hearings. Collectively, these interactions embed monetary policymaking within a larger political process, where congressional oversight becomes a key channel to shape monetary policy and redistribute new money to constituencies. As later sections will show, congressional committees have repeatedly used these tools to direct the Fed's discretionary authority. [13]

2.6 Executive Branch

The executive branch of the United States wields considerable influence over the Fed. One opportunity of influence is for the president privately to meet with the Fed Chair. For example, Richard Nixon frequently met with Arthur Burns, at times threatening to bring the Fed under direct executive control (Abrams and Butkiewicz, 2012) More recently, Donald Trump has persistently called the Fed for monetary easing and has threatened to fire Lisa Cook from the Board of Governors (Economic Policy Institute, 2025). However, the president's true power lies in the ability to appoint new members to the Board of Governors as seats become vacant. This ability allows the president to shape the Fed's policy direction over time. The president can also appoint the Treasury Secretary who can also put pressure on the Fed Chair.

Special interests can access the president through lobbying efforts and direct communication with key White House advisors. Corporations and financial institutions may use high-profile business summits, closed-door meetings, and advisory councils to gain influence over the administration's monetary policy

[13] Congress also exerts influence through the nomination process for the Board of Governors. This channel has been decisive in more recent episodes like the blocked nomination of Sarah Bloom Raskin in 2022 see Mayer (2022).

stance (Jacobs and King, 2016; Waterhouse, 2014; Domhoff, 2014). Additionally, they may leverage media campaigns, public relations firms, and industry think tanks to frame economic narratives that can pressure the president into advocating for monetary policies. (Petrova, 2008; Enikolopov and Petrova, 2015; Schiffrin, 2018) This can include public criticism of the Fed's decisions or calls for legislative reforms that indirectly shape policy. Through these mechanisms, the presidency becomes another channel through which organized interests attempt to shape the Fed's discretion and the broader distributional consequences of monetary policy.

3 Cases

The three cases examined in this paper were selected to illustrate distinct mechanisms through which special interests gained access to and influenced monetary policy across different institutional and historical contexts. The Federal Reserve's first purchases of agency debt (1971–1981) reveal how congressional oversight and political pressure encouraged the Fed to expand its balance sheet in ways that resembled later interventions during the Great Financial Crisis, thereby demonstrating the congressional channel of influence. The Commercial Paper Crisis of 1971, by contrast, highlights how Reserve Bank directors, the FAC, and personal relations between central bankers and private financiers shaped the Fed's response setting a precedent for discount window lending to insolvent firms throughout the 1970s and 1980s. Finally, the Plaza Accord of 1985 exemplifies how personal relations, congressional coordination, and direct meetings with the executive branch allowed globally oriented export interests to steer exchange rate policy, marking a case where non-financial political coalitions influenced international monetary outcomes. Together, these cases demonstrate how special interests access these channels and positioned themselves as the first

receivers of new money in credit.

3.1 The Federal Reserve's First Purchases of Agency Debt (1971–1981)

Political pressures channeled through congressional committees as outlined in section 2.5 reshaped the Fed's stance toward housing finance in the 1970s. Inheriting an authority it never sought, the Fed could purchase the debt of GSEs, giving Congress and the housing lobby a lever over credit policy. As hearings and legislative threats mounted, the Fed became a target for housing interests seeking privileged access to liquidity. Chairman William McChesney Martin warned in 1969 that politics was coming close to dictating monetary policy, eroding the discretion central bankers considered essential for independence. Under growing congressional influence, the Fed's balance-sheet operations increasingly accommodated housing finance, insulating GSEs from rising rates and giving them a privileged position in financial markets. Homebuilders and mortgage borrowers benefited, while non-housing firms faced comparatively tighter credit. The case thus marks a pivotal moment when discretion yielded to political pressure: special interests acting through congressional committees eroded the Fed's autonomy and steered credit policy toward housing. To trace how this transformation began, it is necessary to return to the housing market turmoil of the mid-1960s, which first brought the Fed under sustained political scrutiny.

In the mid-1960s, the housing sector entered a period of crisis that reshaped the relationship between Congress and the Fed. Thrifts as the primary providers of mortgages left them acutely exposed to rising market interest rates because they financed long-term, fixed-rate mortgages with short-term deposits. When rates began climbing in 1966, thrifts lost deposits to higher-yielding alternatives, and credit to housing dried up. Homebuilding activity collapsed to record lows,

drawing urgent attention from policymakers.

Responding to the outcry, Congress passed the Interest Adjustment Act of 1966, which amended Section 14(b) of the Federal Reserve Act to permit the Fed to purchase the obligations of government-sponsored enterprises (GSEs) such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB). The intention was to create a channel of liquidity that could support mortgage lending in periods of tight money. At the time Fed Chairman William McChesney Martin opposed this move, warning that it undermined the neutrality of monetary policy by committing the Fed to selective credit allocation, but Congress enacted the authority nonetheless. From that moment, the Fed held a tool it had not requested, while Congress and the housing lobby had secured a precedent they would soon leverage. This convergence of political pressure and new authority set the stage for the rise of powerful industry groups that would capitalize on the opportunity to shape credit policy. (U.S. House of Representatives, 1965; Haltom and Sharp, 2014, p. 2-3).

From that moment, the Fed held a tool it had not requested, while Congress and the housing lobby had secured a precedent they would soon leverage. At the center of this effort stood the National Association of Home Builders (NAHB), which by the 1960s had become one of the most disciplined and effective special interest groups in Washington. As Lilley (1980) documents, the NAHB built durable coalitions with the U.S. Savings and Loan League, Mortgage Bankers of America, National Association of Real Estate Boards, and Association of Mutual Fund Sponsors to press legislation that favored the housing industry(CQ Almanac, 1969a,b, 1970). These coalitions delivered tangible victories: emergency subsidies for FNMA shepherded by Senator John Sparkman, regulatory concessions such as preserving interest-rate differentials under Regulation Q that benefited thrifts pushed by Representative Wright Patman, and the creation of

new subsidy programs designed to bolster housing demand (Lilley, 1980, p. 38). NAHB leaders were candid about their willingness to confront the Fed directly. Lobbyist Carl Coan observed in 1970 that Representative Wright Patman and Senator William Proxmire would "go after the Fed again and try to get some statutory priority for mortgage credit," adding the NAHB would "support any reasonable moves in that direction" (Lilley, 1980, p. 43). The Fed was thus no longer insulated from industry lobbying; it had become a target. In the halls of Congress, this newfound vulnerability quickly found expression in the actions of long-time allies of the housing lobby, who seized the opportunity to press their advantage.

These congressional allies amplified this pressure. Representative Patman, long-time chair of the House Banking and Currency Committee, was both a staunch supporter of housing interests and a vocal critic of the Fed. He repeatedly portrayed the Fed as a defender of Wall Street at the expense of ordinary Americans, and in the early 1970s he revived proposals for a development bank that would channel mortgage credit directly, as well as tax incentives to steer pension fund assets into residential lending (Lilley, 1980, p. 43). In the Senate, Sparkman and Proxmire remained among the most reliable allies of the housing lobby with the NAHB and other housing lobbies working hand-in-glove with to develop the Emergency Home Finance Act of 1970.[14] In this market, FNMA became the central buyer, purchasing mortgages from thrifts and other lenders. By doing so, it allowed them to sell loans, replenish their funds, and continue originating new mortgages rather than being locked into long-term, illiquid assets.

For the Fed, these congressional alliances translated directly into threats. As Haltom and Sharp (2014) recount, Proxmire confronted Vice Chairman J.L.

[14]Its major impact had established a secondary market for conventional mortgage loans (Lilley, 1980, p. 40).

Robertson in 1968, bluntly reminding him that the Fed was "a creature of Congress" and pressing him on whether even report language would be sufficient to change the Fed's behavior. Robertson, wary of the implication, replied that only a statutory change could compel the Fed, since its "best judgment" was not to use monetary policy in a selective way to benefit housing or any other sector (Haltom and Sharp, 2014, p. 3-4). The Board interpreted this as a veiled warning. Legislative counsel Paul Cardon reported "widespread Congressional interest" in rewriting the Federal Reserve Act to make agency purchases mandatory. Martin himself wrote to Sparkman in May 1968 to stress the dangers of subordinating monetary policy to sectoral aims (Haltom and Sharp, 2014, p. 4). Soon after, the Senate Banking and Currency Committee approved a measure that would have required the Fed to support housing markets during periods of tight money. Though the bill failed, the message was unmistakable: either the Fed acted on its own, or Congress would take away its discretion.

By 1969, even Fed officials acknowledged that symbolic purchases might be necessary to placate Congress. Robertson told the FOMC that after fending off "a determined Congressional effort to make us buy large amounts of agencies," the System might be inviting stronger retaliation by continuing to do nothing. Martin lamented that political pressures were coming close to dictating monetary policy, remarking in May 1969 that "the Federal Reserve had to try to do a more effective job of convincing Congress that there were appropriate and inappropriate objectives for a central bank." (Haltom and Sharp, 2014, p. 4) But the point was already clear that the Fed's autonomy was precarious. When Arthur Burns succeeded Martin in 1970, he inherited not just the Section 14(b) authority but the cumulative weight of these threats. By 1971, Burns openly admitted that purchasing agency debt would not provide "any great benefit to housing," but would at least "demonstrate a cooperative attitude on the part

of the System" (Haltom and Sharp, 2014, p. 5). The first outright purchase of agency securities that October was thus less an economic judgment than a political concession, undertaken under the shadow of Congress's power.

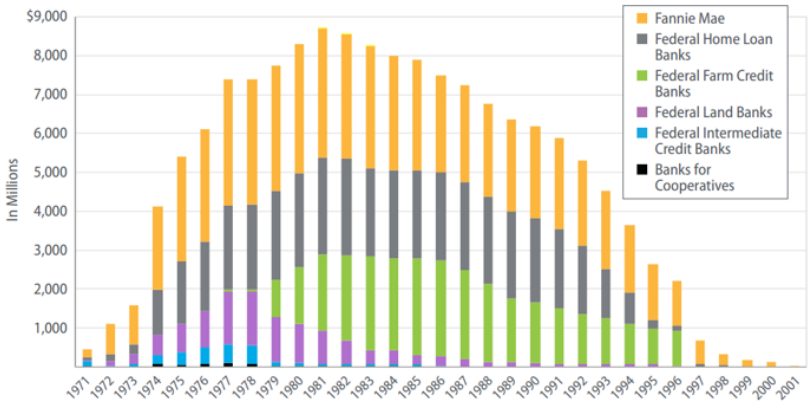

Figure 1: Fed's Holdings of Agency Debt (1971–2001).
Source: From Haltom & Sharp (2014); Annual Reports of the Federal Reserve System, Statistical Tables 3 and 4.
Note: Federally sponsored agencies are non-government agencies whose debt is guaranteed by the government. These agencies are not eligible for Federal Finance Bank Funding, and thus remained eligible for Federal Reserve System outright purchases after 1977.

The starting point for understanding the Fed's first purchases of agency debt is the composition of its holdings. As Figure 1 shows, the vast majority of purchases in the early 1970s were concentrated in FNMA (orange) and the FHLB (gray). These two institutions sat at the heart of the U.S. housing finance system: FNMA as the central buyer in the secondary mortgage market, and the FHLBs as the primary source of advances to thrifts.[15] By the mid-1970s, the Fed held roughly 10 percent of FNMA's outstanding debt, more than 40 percent of its total agency holdings, underscoring the scale of this targeted support (Haltom and Sharp, 2014, p. 5-6). This composition makes clear the policy was a targeted allocation of credit into housing sector whose political power ensured it would be shielded from broader financial tightening. The subsequent figures trace how these purchases moved through the financial system, illustrating the distributional patterns consistent with Cantillon Effects that arose when liquidity was channeled disproportionately toward the housing sector.

[15] While other agencies such as the Farm Credit and Land Banks would become more prominent later, the early years of Fed support were overwhelmingly directed toward housing finance.

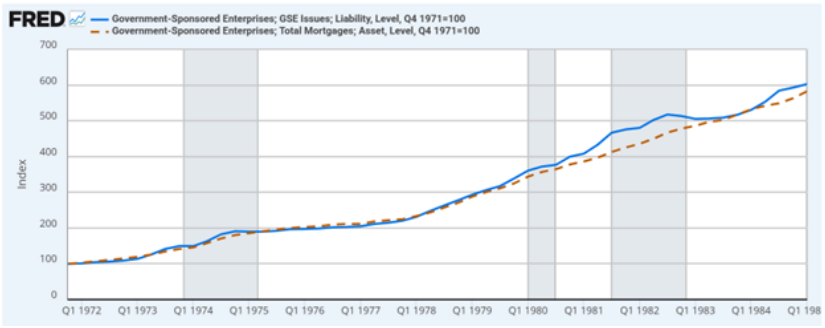

Figure 2: GSE Asset and Liability Levels Indexed to October 1971.
Source: Board of Governors of the Federal Reserve System via FRED.

The clearest first receivers of the Fed's agency debt purchases were the Government-Sponsored Enterprises (GSEs), which acted as conduits for channeling new credit into housing finance. As Figure 2 illustrates, both GSE liabilities (blue line) and mortgage assets (orange dashed line) expanded dramatically after 1971, when the Fed began outright purchases. Between 1971 and 1975, liabilities nearly doubled, while mortgages on the asset side of the balance sheet moved in near lockstep. This tight correlation underscores how Fed absorption of GSE debt immediately freed balance sheet space, supplying the agencies with liquidity they recycled into mortgage markets. Without this intervention, GSE borrowing costs would likely have risen with market interest rates, curtailing their lending capacity. Instead, the Fed effectively insulated them, allowing the agencies to expand at precisely the moment when private credit conditions were restrictive. The broader significance is that the Fed's balance sheet now stood behind the GSEs, giving them a privileged position in financial markets and embedding them as central intermediaries of housing credit.

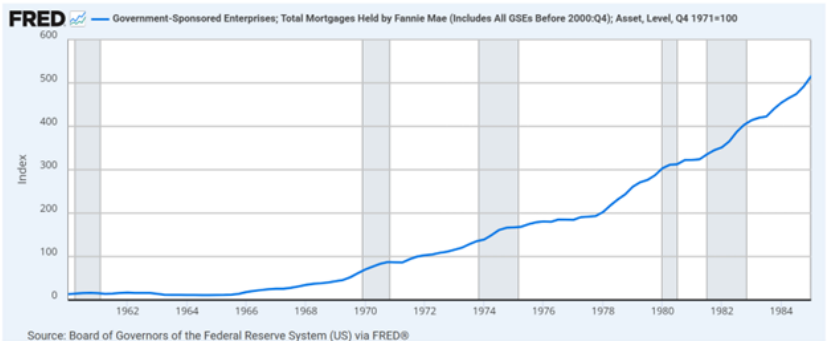

Figure 3: Total Mortgages Held by FNMA Asset Level Indexed to October 1971. *Source:* Board of Governors of the Federal Reserve System via FRED.

The expansion of FNMA's mortgage portfolio provides the clearest empirical indicator of this process. As Figure 3 shows, FNMA's holdings rose steeply through the 1970s and into the early 1980s, far outpacing the modest upward trend of the 1960s. This expansion did not represent FNMA itself as the primary beneficiary. Instead, the agency functioned as a transmission belt, stabilizing the mortgage market and allowing credit to continue flowing to politically potent housing coalition of thrifts, mortgage lenders, and homebuilders whose collective fortunes depended on continued mortgage origination. By absorbing agency debt, the Fed allowed FNMA to recycle liquidity back into mortgage markets, thereby sustaining the housing coalition even during periods of disintermediation and financial stress.

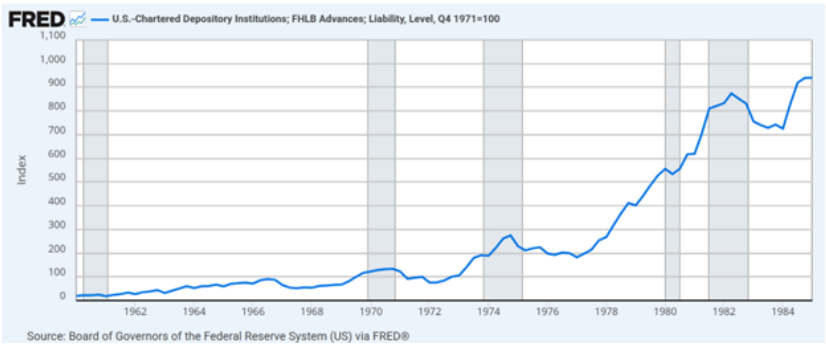

Figure 4: Advances to U.S. Depository Institutions from FHLB Liability Level Indexed to October 1971.
Source: Board of Governors of the Federal Reserve System via FRED.

The role of FHLBs reinforced this chain of transmission. Figure 4 demonstrates how advances from the FHLBs surged in the years following the Fed's intervention. This was crucial because thrifts were especially vulnerable under Regulation Q ceilings in a high-interest-rate environment. As market rates climbed above the legally capped deposit rates thrifts could pay, depositors withdrew funds in search of higher returns elsewhere. Left unchecked, this disintermediation would have starved thrifts of lendable funds. The expansion of FHLB advances cushioned the blow, providing thrifts with liquidity that allowed them to keep issuing mortgages. Crucially, this dynamic depended on the stabilization of GSE balance sheets by Fed purchases by anchoring the liabilities of the GSEs, the Fed indirectly strengthened the FHLBs' ability to advance funds to thrifts. In effect, the Fed extended protecting the balance sheets of politically sensitive mortgage lenders without formally acknowledging that it was subsidizing them.

Figure 5 compares household mortgage liabilities with nonfinancial corporate borrowing. From the mid-1970s through 1980, mortgage liabilities accelerated relative to corporate debt, indicating that the structure of credit creation favored the housing sector. While these aggregate patterns do not isolate causation,

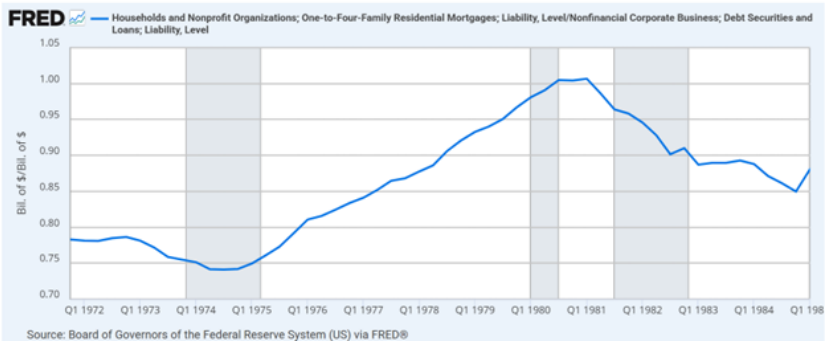

Figure 5: Ratio of Business Mortgages to Business Debt Securities and Loans Liability Levels.
Source: Board of Governors of the Federal Reserve System via FRED.

they are consistent with the distributional tendencies predicted by Cantillon Effects. The sectors nearest the channels of monetary expansion, here mortgage borrowers, experienced easier credit conditions than firms reliant on capital markets. In this sense, the political redirection of the Fed's balance sheet toward housing produced outcomes that mirrored those Cantillon described, even if the mechanism was institutional rather than purely monetary.

Taken together, these figures demonstrate how the Fed's first purchases of agency debt transmitted liquidity from the Fed to GSEs, from GSEs to thrifts and mortgage lenders, and ultimately to households and homebuilders. At each step, politically favored actors in the housing sector were supported, while corporate borrowers outside this channel found credit conditions more restrictive. The result was a politically mediated reallocation of financing that departed from the principles of neutral monetary policy. This episode illustrates how discretionary authority served both as a shield and a conduit. Yielding selectively to congressional pressure, the Fed preserved its formal independence while using its balance-sheet discretion to redirect credit toward politically favored borrowers. In this way, discretion itself became the mechanism that reconciled institutional autonomy with redistributive accommodation.

3.2 The Commercial Paper Crisis of 1970

This next case shifts from external congressional pressure to the internal workings of the Fed outlined in sections 2.2 through 2.3, showing how institutional and interpersonal networks could shape policy decisions from within. It illustrates how Reserve Bank directors, advisory councils, and personal relations shaped the Fed's behavior during the 1970 commercial paper turmoil. Under a discretionary policy regime, these channels gained added importance, as decision-making flexibility allowed institutional and interpersonal networks to steer how liquidity support was justified and delivered. Closely interconnected firms and financial institutions used these institutional and interpersonal channels to gain privileged access to the Fed and influence its actions. Even non-financial corporations, through ClassB directorships, could voice their preferences and influence policy. That the Fed intervened in what many contemporaries judged a pseudo-crisis underscores the redistributive logic at work: even without systemic necessity, institutionalized weak ties secured liquidity for exposed firms. This intervention set the stage for the events that followed, as the collapse of Penn Central soon revealed how these channels operated in practice.

In June 1970 Penn Central Railroad, the seventh largest corporation in the United States, declared bankruptcy as it faced a $63 million loss in its first quarter and exhausted its credit lines. The SEC later emphasized that Penn Central's operating losses and declining creditworthiness had been evident well before the June 1970 bankruptcy, and the firm had resorted to short-term borrowing to meet its persistent cash deficits, with outstanding commercial paper reaching $200 million prior to default (Securities and Exchange Commission, 1970).

The Fed refused to bail out the corporation, but it was worried about its $200 million in commercial paper outstanding. As a result, the Fed opened its

discount window and encouraged financial institutions to take loans as needed to ensure the financial system remained stable. The Fed conducted a couple changes to accommodate the situation. First, the collateral condition for discount window loans would allow the use of commercial paper. Banks ended up borrowing at a peak of $1.8 billion over that summer. Second, the Fed temporarily relaxed the Regulation Q interest rate ceilings on CDs to help supply liquidity by allowing banks to swap their commercial paper for the high-rate CDs. This revealed how the Fed's discretionary tools could swiftly redistribute liquidity, demonstrating that who had access to the discount window and under what terms carried significant implications for which firms and sectors weathered financial stress.

Schwartz (1987, p. 284) classifies the Penn Central episode as a pseudo–financial crisis, citing the *Economic Report of the President* which concluded that no "genuine liquidity crisis existed in mid-1970." [16] Likewise, the Council of Economic Advisors found few corporations faced a liquidity squeeze at the time. Carron and Friedman (1982, 397-398) likewise stressed that the Fed's concerns were "conditions peculiar to those firms and not to the overall financial situation," pointing to Chrysler Financial Corporation and Commercial Credit Corporation as firms unable to roll over their maturing paper. In terms of issuance, large financial institutions accounted for roughly 40 percent of the supply of commercial paper outstanding (Securities and Exchange Commission, 1970, p. 274).[17] Goldman Sachs, one of the largest dealers and the primary distributor of Penn Central's paper, epitomized the network of financial inter-

[16] Calomiris (1993), however, opposes Schwartz and argues that some larger financial institutions in the commercial paper market did face genuine difficulties. Meltzer (2010) notes that the Federal Reserve relaxed Regulation Q ceilings to allow banks to issue large-denomination (jumbo) CDs, but the volume of these CDs did not increase immediately following Penn Central's failure, suggesting that conditions remained relatively stable.

[17] These included Goldman, Sachs; A. G. Becker & Co.; Lehman Commercial Paper, Inc.; Salomon Brothers; First Boston Corp.; Merrill, Lynch Pierce, Fenner & Smith, Inc.; and Eastman Dillon, Union Securities.

mediaries whose actions and relationships shaped the Fed's eventual response. Failing to communicate adequately the deteriorating financial position of Penn Central, the firm continued to market its commercial paper until the eve of default, illustrating how the same intertwined networks that transmitted risk also amplified the pressures that drew the Fed into intervention. (Securities and Exchange Commission, 1970, p. 279).

Had the Fed not stepped in, it is clear the losers would have been those who overextended in the commercial paper market and those tied to them. During the commercial paper crisis, the FAC's role was visible in its February and May 1970 minutes, which urged "modest growth in the monetary base" and "continued restraint but with possible fractional easing" (Havrilesky, 1995, 255-287). Burns's receptiveness to this advice helps explain why the Fed's crisis response followed so closely on the FAC's guidance (Woolley, 1984, p. 84). The 1970 crisis made it visible that without formal authority, the FAC nevertheless carried bankers' concerns about liquidity strains into Fed deliberations, shaping both the pace and tone of the response.

The personnel involved in 1970 further illustrate how both institutional channels and revolving careers aligned the Fed with industry concerns. David Rockefeller of Chase Manhattan Bank, part of the $400 million Chrysler credit line, sat for the Second District on the FAC, while John A. Meyer of BostonFleet Financial, formerly head of Manufacturers Hanover Trust, another Chrysler creditor, represented the First District (Board of Governors of the Federal Reserve System, 1970; Flint, 1970c,b,a). The 1970 crisis thus illustrated the mechanisms described earlier. Without formal authority, the FAC nonetheless transmitted bankers' concerns about liquidity strains into Fed deliberations, shaping both the pace and tone of the response. This influence did not end with the FAC and extended across the broader Federal Reserve System, where personal net-

works and overlapping professional ties reinforced the same patterns of access and influence.

At the Reserve Banks, Alfred Hayes, president of the New York Fed, had previously worked at Chemical Bank, one of Chrysler's principal lenders; Monroe Kimbrel, president of the Atlanta Fed, had led the American Bankers Association, the chief lobbying group for commercial banks; and Frank E. Morris of the Boston Fed maintained close ties to "the Vault," a consortium of the city's most powerful banks and corporations (Board of Governors of the Federal Reserve System, 1970; Federal Reserve History, nda,n,n).[18] These overlapping positions exemplify what the section (2.2) identifies as the Fed's network of "weak ties" linking policymakers and financiers. Shared professional backgrounds fostered trust and blurred the line between oversight and private interest. During the Fed's response to Penn Central's default, these ties ensured that voices representing banking and corporate exposure shaped deliberations through both advisory bodies and informal networks.

The same pattern extended to the Reserve Bank directors, reflecting the mechanisms described in section (2.2). Several Chrysler creditors held Class A directorships in 1970: Manufacturers Hanover Trust Company of New York, Cleveland Trust Company, Detroit Bank and Trust Company, and Marine Midland (Board of Governors of the Federal Reserve System, 1970). Class B directors broadened representation to non-financial firms closely tied to Chrysler. Bethlehem Steel, a longstanding supplier dating back to the Chrysler Building in 1930, held a Class B directorship on the Buffalo Branch of the New York Fed; B. F. Goodrich, a major tire producer, sat as a Class C director at the Cleveland Fed; and Owens Richards Inc., a key parts supplier, also held a Class C directorship. (Board of Governors of the Federal Reserve System, 1970) Al-

[18] The rest of the banks included Manufacturers, Morgan Guaranty, Bankers and Irving in New York, Cleveland Trust, United California in Los Angeles, Detroit Bank, and the Northern and the Harris in Chicago. See (Flint 1970)

though these seats did not grant direct policymaking power, they transmitting the perspectives of Chrysler's creditors and suppliers into policy deliberations in Washington. Their input filtered into regional reports and internal consultations, ensuring that the firms most exposed to the fallout of Penn Central's default had privileged access to the Fed's decision-making process.

This case highlights two broader points. First, banks possess multiple channels for exerting rent-seeking pressure which include institutionalized seats of influence in the FAC and Reserve Bank directorates. These channels mattered precisely because they allowed sectoral perspectives to diffuse into Fed policymaking without requiring formal votes. Second, crises accentuated the role of these networks. Closely interconnected firms and financial institutions had privileged access to the Fed during the commercial paper turmoil, and even nonfinancial firms, through Class B directorships, were able to communicate their preferences. The episode thus shows how discretion amplifies the redistributive consequences of institutional access. Because no binding rules constrained emergency lending, the Fed's flexibility allowed interpersonal and advisory networks to transform informational access into preferential credit, protecting incumbents while presenting intervention as technical necessity.

3.3 The Plaza Accord of 1985

Following the Commercial Paper Crisis of 1970 where personal and institutional channels enabled banks to secure liquidity despite limited systemic risk, this case shows how a different coalition of interests harnessed those same mechanisms on a global scale. It illustrates how coordinated lobbying by exporters ultimately compelled the Treasury to abandon its noninterventionist stance and negotiate the Plaza Accord. It ties together three theoretical mechanisms of personal relations (section 2.4), congressional committees (section 2.5), and the executive

branch (section 2.6). Together, these relationships demonstrate how monetary policy itself became a redistributive instrument using exchange-rate policy and monetary expansion to shift purchasing power from consumers to exporters through higher inflation and a weaker dollar.

To counteract the high inflation of the 1970s, Volcker began tightening monetary policy in late 1979 and continued throughout the early 1980s, reducing the inflation rate from 12.4 percent in 1980 to 3.8 percent in 1982. What made this period distinctive was that nominal interest rates remained elevated even as inflation collapsed, producing historically high real interest rates rather than merely reflecting expectations of inflation. Real long-term rates rose sharply after 1982, propelled by disinflation and reinforced by increased federal borrowing to finance large structural deficits (Destler and Henning, 1989, p. 18-19).

These abnormally high real rates, together with the prospect of an appreciating dollar, attracted massive inflows of foreign savings—financing nearly half of U.S. net investment by 1985 and keeping interest rates from rising by as much as five additional percentage points (Marris, 1987, p. 44-45). He further observes that capital inflows were sustained because investors expected both high nominal returns and continued dollar appreciation, confirming that this was not simply an inflation-expectations story (Marris, 1987, p. 20–22, 25–27). These forces combined to create unprecedented demand for dollar-denominated assets, appreciating the dollar even as the U.S. current account deteriorated. The trend continued as Treasury Secretary Donald Regan declared there would be no further interventions in the foreign exchange market and refused to speculate on where exchange rates should be, further bolstering expectations that the dollar would remain strong.

The appreciating dollar adversely affected exporters and those competing with importers as imports became much cheaper. Exporters and import com-

petitors responded by mounting a coordinated lobbying campaign directed at Congress, the Treasury, and ultimately the White House. Caterpillar, Inc., highly dependent on foreign sales, raised the issue as early as December 1981, when Board Chairman Lee L. Morgan testified before the House Ways and Means Subcommittee on Trade that "high interest rates and unstable exchange rates are complicating the financial management of multinational corporations and depressing international trade and investment" (Funabashi, 1989, p. 70). By late 1982 Morgan, as chair of the Business Roundtable Task Force on International Trade and Investment, was calling the yen-dollar rate "the single most important trade issue facing the U.S." (Destler and Henning, 1989, p. 33).

Morgan then brought his case directly to Congress. In April 1983 he told the Senate Foreign Relations Committee that "the problem facing American business today as a result of misalignment in the exchange rate between the dollar and the yen is the single most important trade issue facing the U.S. today" and in October 1983 testified before the House Banking Committee that the "exchange rate advantage... alone is sufficient to impair the competitiveness of U.S. firms and workers". He pressed for a joint U.S.-Japan initiative to stabilize the yen and dollar, including foreign exchange intervention and lower U.S. interest rates (Funabashi, 1989, 70-71).

By mid-1983 the Business Roundtable had thrown its full support behind Morgan's campaign, and in February 1984 the Board of Directors of the National Association of Manufacturers also went on record against the strong dollar (Destler & Henning 1989, pp. 35–36). Labor joined in as well: in 1984 the AFL-CIO Executive Council declared that the dollar's "overvaluation greatly contributed" to the trade deficit, with its chief economist Rudolph Oswald urging that "currency values [be] readjust[ed] to more realistic levels" (Destler and Henning, 1989, p. 123).

When initial appeals to the Treasury met resistance—"Treasury people, especially Beryl Sprinkel, were 100 percent free market believers. They just kept saying, 'Markets determine values of currency'" (Funabashi, 1989, p. 71)—Morgan shifted to the White House. House Minority Leader Robert Michel and Senator Charles Percy arranged three meetings between Morgan and other executives (from Ford, U.S. Steel, Borg-Warner, Hewlett-Packard, and Honeywell) and President Reagan in 1983–84. Reagan, supported by Treasury Secretary Donald Regan, refused to commit, though other Cabinet members, notably Secretary of State George Shultz, expressed sympathy (Funabashi, 1989, p. 71-72).

By 1985, pressure had intensified. Major business associations like the U.S. Chamber of Commerce, the National Association of Manufacturers, and the U.S. Council for International Business sent letters to Cabinet officials warning that "the administration was not giving the matter sufficient attention" (Destler and Henning, 1989, p. 36-37). At the same time, executives like Lee Iacocca of Chrysler, Roger B. Smith of General Motors, and Colby H. Chandler of Eastman Kodak publicly denounced the strong dollar and pressed Treasury Secretary James Baker for action (Destler and Henning, 1989, pp. 124–125); (Funabashi, 1989, p. 73).

This convergence of lobbying ultimately helped compel the Treasury to abandon its hands-off stance and pursue coordinated exchange-rate intervention at the Plaza Accord in September 1985 (Destler and Henning, 1989, p. 40-42); (Funabashi, 1989, p. 74-75). The pressures eventually emerged in the form of a few bills in Congress. In the Senate Bill Bradley, Daniel Patrick Moynihan, and Max S. Baucus proposed a bill making foreign exchange intervention mandatory if the United States ran large current account deficits while in the House Stan Lundine and John J. LaFalce proposed a similar bill. (Destler and Hen-

ning, 1989, p. 38-40) In addition, Congress proposed protectionist policies as a more direct response to these pressures. In 1985 Senator John C. Danforth won unanimous passage of import surcharge legislation against Japan while Senator Lloyd Benston, Representative Dan Rostenkowski, and Representative Richard A. Gephardt introduced a bill that would impose 25% duties on imports from countries running large trade surpluses with the United States.

With Reagan's reelection came a few changes in the administration. Donald Regan traded positions with James Baker III. Baker's aides Richard Darman became Deputy Secretary of Treasury and David Mulford became the Assistant Secretary for International Affairs. The change in the administration also came with a shift in exchange rate policy. Already in the January G-5 meeting Baker stated, "in light of recent developments in foreign exchange markets," the G-5 "reaffirmed their commitment made at the Williamsburg Summit to undertake coordinated intervention in the markets as necessary." (Frankel, 2015) One of the reasons for this shift was concern over the mounting pressures from Congress for protectionist policies. On the series of bills proposed in Congress, Baker stated, "There is a prairie fire burning out there. It's going to take considerable energy on our part to fight this." (Business Week 7 October 1985) Mulford went far as to include Section 11 of the London G-5D meeting citing "protectionist pressures, if not resisted could lead to mutually destructive retaliation with serious damage to the world economy." (Funabashi, 1989, p. 15-16).

At the Fed, Volcker agreed with Baker there was a need to ease monetary policy but he was more hesitant to depreciate the dollar in fear of putting it into free fall and raising inflation. Volcker stated to the House Banking Committee, "a sharp depreciation in the external value of a currency carries pervasive inflationary threats... we have to recognize that depreciation of our currency does not in itself provide a fundamental solution, and is in fact a two-

edged sword." (Funabashi, 1989, p. 48). Volcker was unwilling to take any risks with unilateral rate cuts but was overruled by Reagan appointees at the Board of Governors in March 1986. [19] The slower growth during the summer also pressured Volcker to conduct two more rate cuts that year (Destler and Henning, 1989, p. 52-53); (Funabashi, 1989, p. 51).

Figure 6: Trade Weighted U.S. Dollar Index 1978-1990
Source: Board of Governors of the Federal Reserve System via FRED.

After the January 1986 G-5 meeting, the Treasury conducted its first currency intervention. Between the Plaza Accord in September and the end of October the United States sold $3.2 billion, while Japan, West Germany, France, and Great Britain sold $5 billion, and the remaining G-10 countries sold $2 billion into the foreign exchange market. The dollar depreciated by about 13% against the yen and 10.5% against the mark. The countries continued the multilateral dollar sales but to a lesser extent as the other G-10 countries began worrying about the appreciation of their own currencies. The Fed ended up selling $695 million to the foreign exchange market and the Japan ended up selling $200 million. In 1986 the Fed performed unilateral sales of dollars by expanding the money supply by $6 billion and cutting rates from 8% to 5.5%.

[19] Vice Chair Preston Martin, Governors Manuel Johnson, Wayne D. Agnell, and Robert Heller

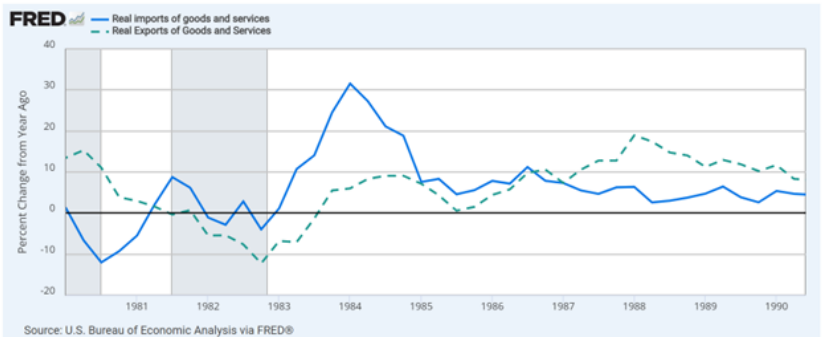

Figure 7: Real Imports and Real Exports 1980-1990
Source: U.S. Burea of Economic Analysis via FRED.

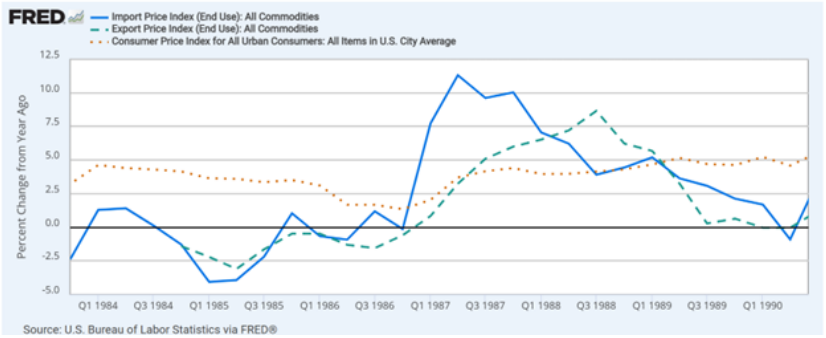

Figure 8: Import, Export, and Consumer Price Indices 1980-1990
Source: Board of Governors of the Federal Reserve System via FRED.

The immediate channels of the monetary expansion operated through financial institutions active in foreign-exchange markets, which purchased dollars as the Fed intervened. [20] Other early beneficiaries included exporters, who received payment for U.S. goods in newly created dollars as foreign demand responded to the depreciating exchange rate. Figures 7 and 8 depict patterns consistent with this distributional dynamic: real exports rose steadily after 1985, while import prices and overall inflation edged upward. Together, these outcomes suggest that the Plaza Accord's policy mix favored exporters and producers of tradable goods, while the associated depreciation and price increases imposed dispersed costs on dollar holders and consumers. In this sense, the Plaza Accord redistributed purchasing power through relative price changes that advantaged early receivers of new money and burdened later ones.

This case provides a few insights into how special interests might shape monetary policy. First, it highlights how monetary policy can be another form of redistribution. Rather than taxing imports or subsidizing exports which are powers assigned to fiscal policy, Baker and Volcker decided to utilize monetary policy to redistribute the purchasing power from consumers to exporters in the form of higher inflation and a temporarily lower real exchange value for the dollar. Second, the pressures were not directly towards the Fed. Unlike the previous cases where special interests like financial institutions could directly pressure the Fed through channels like the FAC, these pressures were indirect from Congress and the Treasury. Third, it shows how discretion functioned as the hinge between policy autonomy and redistribution. By responding to political pressure through monetary easing and exchange-rate intervention rather than legislation,

[20] One might object that since the Fed sold dollars at the prevailing market price, early receivers did not gain any transfer. However, Selgin (2012) argues that Cantillon Effects still arise in such cases: even when the Fed sells rather than gives away new money, those with privileged access (e.g., primary dealers or financial institutions active in the foreign exchange market) benefit from spending before the general price level adjusts. Because voluntary exchange is not zero-sum, initial recipients enjoy emergent profits (*lucrum emergens*) relative to later receivers who bear the costs of higher input and consumer prices.

the Fed and Treasury preserved their institutional freedom while channeling the benefits of monetary expansion toward export interests. The very flexibility meant to insulate policy from politics thus became the vehicle through which political demands were met.

4 Conclusion

The historical evidence presented in this paper reframes the enduring debate between rules and discretion as a question of political economy rather than technical management. By combining Cantillon's insight with a systematic account of the channels of influence, it shows how special interests repeatedly gain privileged access to monetary expansion. The three cases, spanning the 1970s through the 1980s, demonstrate that these dynamics are neither anomalies nor temporary responses to crisis. They are recurring features of the Fed across different institutional environments. To understand the Fed is to see it not simply as a manager of financial stability but as a political institution whose discretionary authority inherently generates redistributive effects.

The three cases analyzed demonstrate how discretion transforms policy flexibility into a vehicle for redistribution through established channels of influence. In the 1970s, the Fed's purchases of agency debt redirected liquidity toward the housing sector, channeling credit into an already overheated market and reinforcing the Great Inflation. In the 1970 commercial paper crisis, large financial firms secured preferential access to the discount window, establishing expectations of future accommodation. In 1985, exporters and their allies in Congress successfully pressed for the Plaza Accord, using monetary expansion and exchange-rate intervention to secure sectoral gains at the expense of consumers and importers. Despite differences in context and instruments, each case demonstrates how discretion allows organized interests to become the first

receivers of new money and credit. To see Cantillon Effects as structural rather than incidental is to recognize that monetary policy has always been a vehicle for redistribution shaped by political economy. This persistence underscores that Cantillon Effects are an enduring feature of discretionary central banking.

These cases illustrate the broader theoretical contribution of this paper. Previous work made clear that the Fed does not operate in a vacuum. Yet these accounts often treated "pressure" as an external variable without fully theorizing how it translates into redistribution. By reinterpreting these dynamics through Cantillon Effects, this paper shows that special interests shape the distributional pattern of monetary expansion itself. The framework of Cantillon Effects, when combined with an account of the institutional and political channels of pressure on the Fed, uncovers the hidden redistributive logic of discretionary monetary policy.

The diagnosis is clear. Discretionary monetary policy creates space for special interests to influence the direction of credit and the structure of economic opportunity. The benefits of Fed interventions are highly concentrated while the costs are diffused across consumers and less-favored sectors. The distributive consequences are rarely recognized in real time because they unfold gradually and indirectly, but over the long run they contribute to inflationary pressures and distorted investment patterns. These costs are no less real for being hidden, and their invisibility is precisely what makes Cantillon Effects so politically powerful.

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