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How Romney could end quantitative easing

To belabour the obvious, the Federal Reserve and monetary policy are critical to any president’s success; presidential elections are usually determined by the state of the economy and the Fed has a great deal to do with that, arguably never more so than today.

Many observers believe that President Obama hurt himself by taking a somewhat lackadaisical attitude toward the Fed – leaving positions on the Fed board vacant for long periods, not moving quickly to appoint replacements and failing to back away from appointees that ran into Senate confirmation difficulties.

Were he elected it is unlikely that Mitt Romney will make the same mistakes. I expect that he will move quickly to put his stamp on the Fed. So what can we expect?

Republicans in Congress have been highly critical of Fed policy, especially the episodes of “quantitative easing” that took place in 2009, 2010 and again this year. Despite the continuing lack of inflation in the price data, Republicans believe that quantitative easing is highly inflationary and should be reversed as soon as possible.

Mr Romney will have an immediate opportunity to encourage a move in that direction. Among the many responsibilities of the president is making appointments to the seven member Federal Reserve Board, which must also be confirmed by the US Senate. Members seldom complete their entire 14-year terms creating opportunities for additional appointments to fill unexpired terms. The critical position of chairman of the Fed is one to which an existing member must be separately appointed and confirmed to a 4-year term.

The term of one current member of the board, Elizabeth Duke, has already expired, meaning Mr Romney would have the opportunity to immediately nominate a new board member.

This appointment could be especially important should Mr Romney want to replace Ben Bernanke as chairman of the Fed in early 2014 when his term expires. Most observers think Mr Romney would be highly unlikely to appoint Mr Bernanke to another term, even though Mr Bernanke was appointed initially by a Republican president, George W. Bush, whom Mr Bernanke also served as chairman of the Council of Economic Advisors.

Since the new chairman must already be a member of the board, it would be desirable, from Mr. Romney's point of view, to have someone on the board ready to be named chairman when Bernanke's term as chairman expires.

Whoever Mr Romney names as Fed chairman, it is almost certain that he or she will take a more hawkish line on monetary policy. There are already a number of inflation hawks on the 12-member policy making Federal Open Market Committee, which includes, in addition to the seven members of the Federal Reserve Board, five of the 12 regional Federal Reserve presidents. (These presidents are named by local boards for each bank and are neither appointed by the president nor confirmed by the Senate.)

At a minimum, it is doubtful that the Fed will continue to maintain its present policy of being highly accommodative. A key element of this policy has been the Fed's "forward guidance" that it will continue being accommodative at least through 2015 – well past the point when Mr Romney will have had the opportunity to appoint a new Fed chairman and one or more new members of the board. (It is highly unlikely that Mr Bernanke would continue to serve on the board if he is not reappointed chairman.)

Even if Mr Obama is re-elected, major changes at the Fed cannot be ruled out. It is thought that Mr Bernanke may wish to return to academia when his term as chairman expires, regardless of the election results. He previously was a professor of economics at Princeton.

At a minimum, the ability of the Fed to credibly make promises about future policy is threatened by potential changes in party control of the White House and the wide divergence in the monetary views of the two parties. If policy is quickly reversed, it will call into question the ability of the Fed to use forward guidance as a policy tool again in the future.

In the event of a victory for Mitt Romney on November 4, who would be likely to replace Mr Bernanke?

The leading academic spokesman for the Republican point of view on monetary policy is the economist John Taylor of Stanford University. He is highly respected as a monetary theorist and served as undersecretary of the Treasury for international affairs during the Bush administration.

By all accounts, Mr Taylor was disappointed not to have been named chairman of the Fed when Mr Bernanke was named instead. Taylor's very vocal support for Mr Romney's election would appear to put him in a good position to achieve his goal should Romney win.

Possibly standing in the way of Mr Taylor's ambition is the economist Glenn Hubbard of Columbia University, who is Mr Romney's principal economic adviser. He also previously served as chairman of the Council of Economic Advisors under G W Bush. (Mr Taylor was also a member of the council in the administration of Bush senior.)

It is thought that Mr Hubbard is the one who thwarted Mr Taylor's ambition to become Fed chairman previously by having Bernanke returned to the Federal Reserve Board in 2006, even though Mr Bernanke had only completed a three-year term on the Board the previous year.

This could be important because Mr Hubbard is thought to have ambitions to be either Treasury secretary or Fed chairman. (In the interest of disclosure Mr Hubbard and I worked together at Treasury during the elder Bush's administration.) If named Treasury secretary, Mr Hubbard would have a great deal to say about who the president names to the Fed.

Following are the current members of the Fed and the dates when their terms expire:

Ben Bernanke: Jan. 31, 2020; term as chairman ends Jan. 31, 2014

Janet L. Yellen: Jan. 31, 2024; term as vice-chairman ends Oct. 4, 2014

Elizabeth A. Duke: Jan. 31, 2012 (term expired)

Jerome H. Powell: Jan. 31, 2014

Sarah Bloom Raskin: Jan. 31, 2016

Jeremy C. Stein: Jan. 31, 2018

Daniel K. Tarullo: Jan. 31, 2022

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