

BRATISLAVA INTERNATIONAL SCHOOL OF LIBERAL ARTS

**THE FEDERAL RESERVE SYSTEM AND THE AMERICAN
DEMOCRACY**

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DEMOCRACY**

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Declaration of Originality

I hereby declare that the bachelor thesis was entirely my own work, with the help of my thesis advisor and I have identified sources and citations that are used in the text properly. All the sources that are used can be founded in List of References, which is attached at the end of this work.

Bratislava, 30. April 2014

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Petra Lettrichová

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Federálny rezervný systém a Americká demokracia

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Abstrakt

Federálny rezervný systém je najmocnejšia banka v Spojených štátoch, je bankou všetkých bánk. Táto bakalárska práca je o fungovaní Federálneho rezervného systému v americkej demokracii. Fed je centrálna banka s veľkou mocou.

Federálny rezervný systém a jeho fungovanie v americkej demokracii je skúmané na troch hlavných aspektoch: po prvé, vzťah Fedu voči americkému štátu a vláde a jeho pozícia a fungovanie v rámci americkej demokracie. Po druhé, otázka vlastníctva Federálneho rezervného systému, nakoniec, Federálny rezervný systém a Európska centrálna banka.

Práca sa opiera o kvalitatívnu analýzu primárnych a sekundárnych zdrojov. Základy americkej demokracie sú skúmané v americkej Ústave a pozícia Fedu je spájaná s Ústavou a študovaná prostredníctvom svojich interných dokumentov. Sekundárne dáta pochádzajú z novín, webových stránok a kníh. Táto práca je z veľkej časti teoretická a predovšetkým používa inštitucionálny prístup než ekonomický.

Fed je nezávislá inštitúcia, ktorá nie je zakotvená v Ústave Spojených štátov amerických. Existujú závažné dôvody, ktoré naznačujú, že vytvorenie a fungovanie Federálneho rezervného systému nie je v súlade s princípmi americkej demokracie.

The Federal Reserve System and the American Democracy

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Abstract

The Federal Reserve System - the most powerful bank in the United States, the bank of banks. This thesis is about the Fed's governance within the Federal Reserve System and its place and functioning within the American democracy. The Federal Reserve System is a central bank with great power.

The Fed is examined in three aspects: first, The Federal Reserve System's relation to the American state and government and its position and function within the American democracy, second, the question of the ownership of the Fed, and last, The Federal Reserve and the European Central Bank.

This thesis relies on qualitative analysis of primary and secondary sources. The foundations of American democracy are traced to its Constitution. The position of the Fed is examined in the context to the U.S. Constitution and studied through its internal documents. Secondary data have been collected from newspapers, web pages and books. This thesis is largely theoretical and it used an institutional rather than economic approach.

The Fed is an independent institution, unconstrained by the Constitution of the United States. There are serious reasons which suggest that creation and functioning of the Federal Reserve are not consistent with American democracy.

Preface

Today's world is undergoing many serious crises, whether social, economic, crisis of democracy. Central banking is considered to be a critical point of the crises. The U.S. central bank has enormous power giving rise to the uncertainty of the system. If the economy is dysfunctional, a great part of responsibility is attributed to the central bank. Malfunctioning economy produces various problems of different kind.

Functioning of the Fed is a controversial topic. How it works within the American democratic system? Act the Fed in favor of the U.S. population, or for the benefits of private interests behind the Fed? These are real questions for which there are not clear answers.

The Federal Reserve System is the American central bank. Bachelor thesis consists of three parts focusing on the Federal Reserve System in relation to the American state and government and its position and functioning within the American democracy.

The reason for choosing this topic was that central bank's role in the recent financial crisis. Decisions which American central bank performed affected every household in the country. However, if the central bank is not accountable to the American people but to the private interests it can be a disaster for the whole economy and society. Therefore, it is important that banks are responsible for its actions and decisions.

This work used a detailed institutional analysis of the function of the Fed and institutions of American democracy. Methodology used in this thesis is a qualitative analysis and thesis is theoretical and it uses an institutional view rather than economic approach.

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Introduction

"If we [the IMF] had seen a governance structure that corresponds to our Federal Reserve System, we would have been yelling and screaming and saying that country does not deserve any assistance, this is a corrupt governing structure... It's time for us to reflect on our own structure today, and to say there are parts that can be improved."

Joseph Stiglitz, Nobel laureate and a former chief economist of the World Bank,
2010.

"Since the Fed opened for business in 1914, the currency of the United States (the U.S. dollar) has been borrowed into existence from a private bank (the Fed). The reason I say 'borrowed' into existence is because every single dollar the Fed has ever created is owed back to that bank, with interest. The Fed creates all currency, not the U.S. government, and lends it out to the U.S. government and private institutions—with interest. Now you may be asking yourself, 'If we pay back all the currency that was borrowed into existence, but we still owe the interest, where do we get the currency to pay the interest?' Answer: We have to borrow it into existence. This is one reason why the national debt keeps expanding. It can never be paid off. It is mathematically impossible" (The Wealth Cycles Staff, 2011).

"During the 2008 economic crisis, the Fed printed trillions of dollars and circulated them in the form of bailouts. From where that money comes and to where it is going is a good question" (Blinder, 1996). The quotes above illustrate some of the hot topic to paradox contained in the American democratic system - the position and role of the Federal Reserve System within it.

Many legislators and also economists criticized Ben Bernanke, the former chairman of the Federal Reserve. First reason was, that the Fed is injecting trillion dollars into the economy, which can lead potentially to triggering inflation and this inflation subsequently leads to debt. Second reason is, that "he was accused of hiding the identities of banks who received up to \$2 trillion in TAF loans. Representative Ron Paul and others have called for a Fed audit to reveal the names of these banks. For these reasons, many legislators opposed his reappointment as Federal Reserve

Chairman for a second term in January 2010. Obama easily reappointed him" (Amadeo, n.d.)

Why is the leadership of the Federal Reserve System and one of the most important persons in this institution, chairman Bernanke, so controversial? The United States are a big economy which influences not only the whole American society, but a large part of the world economy. If the Federal Reserve is an undemocratic institution, which has a problem with its internal structure, with lack of transparency and with corruption, how much of the whole American democracy is healthy? This question is no doubt legitimate, as crisis has spread from the U.S. to the world.

The United States is a country with the oldest democracy in the "New" world. Its central bank, however, has an undemocratic nature, an independent unchecked institution with great power.

The nature of the Fed is examined in three aspects: first, The Federal Reserve System relation to the American state and government and its position and functioning within the American democracy, second, the question of the ownership of the Fed, and last, The Federal Reserve and the European Central Bank.

"The Federal Reserve System was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system" (Board of Governors of The Federal Reserve, 2005, p. 1). The Board of Governors characterizes the creation and function of the Federal Reserve as a step forward for safer and better functioning of the financial system or whole economy of the United States. That was the original plan, the reality is different. As Fernando Leila claims "America is in the midst of an economic crisis, possibly worse than any of its previous crises. Economic contraction, high unemployment, banks bailouts, unstable interest rates, the weak dollar, inflation and intense fear loom over the oldest democracy in the world. At the root of each of these issues is the Federal Reserve of the United States of America" (Leila, 2010, p. 1).

The main focus of this thesis is on the relationship between American democracy, its institutions and the Federal Reserve System. Nothing characterizes American democracy better than the Constitution of the United States. The position of the Fed in relation to the Constitution is very controversial. "The Constitution of the

United States does not say anything with respect to the creation and function of a central bank" (Leila, 2010, p. 7). On the contrary, Constitution said that only the Congress has the power to print money. "The Congress shall have power to coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures " (Peltason, 2004).

The Government of the United States is democratically elected, accountable to the Parliament, but whom is the Fed accountable to?

This thesis attempts to answer these questions in three parts. Central for this examination is the Constitution of the United States as it frames the fundamental institutional framework of the American political system.

Literature Review

Bachelor thesis has a three main parts. First, the position of the Federal Reserve System in the American democracy. Second examines private interests behind the Fed. And third part compares the Federal Reserve System to the European Central Bank.

1. Position of the Federal Reserve in the U.S. democracy

One of the most important texts for this thesis is the work of Fernando Leila *The Missing Link of Democracy: The Federal Reserve Submission to the Democratic Government* (2010). The Federal Reserve System, as the central bank of the United States has a huge privilege to manipulate with money in the banking sector. A relation between the American state - the President of the United States, the Congress and government - and the Federal Reserve System is non-standard. The Federal Reserve System is not defined in the U.S. Constitution, which is the most important document of the American democracy. The Federal Reserve System is not a branch of the government of the United States. Relationship between the American state and the Fed is an important indicator of the quality of democracy. Fernando Leila also said that the Federal Reserve has too much power as one institution and that the strength of democracy in the USA is, as a result, questionable.

Author of the article "Central Banking in Democracy" A. S. Blinder (1996) claims that independence of the Fed seems undemocratic, but on the other hand, he examines if this independence is potentially good for protection against potential political manipulation. The United States government could have own interests with American economy. If the government had potentially greater powers in this economic area, for example, it could manipulate with interests rates, or could use the money for its own benefit.

Marc Labonte, specialist in macroeconomic policy, in his work *Federal Reserve: Oversight and Disclosure Issues* (2012), examines how the proponents and critics of the Fed argue about its functions and existence as such. Labonte claims that no one oversees the budget of the Fed and that the Congress does not control it.

2. Private interests behind the Federal Reserve

Is the Federal Reserve really independent? Who regulates function of this central bank: private owners or the state? The film by Bill Still - *Jeckyll Island* (2013), mentions three families, which own most of the American economy - Morgan, Rockefeller and Rothschild families. It is possible that these families are also behind the Federal Reserve System.

Who is behind the Fed? Examining the history of the Fed can provide information us about how this system evolved over time within the American society.

3. The Federal Reserve and European Central Bank

The Federal Reserve System is an independent American central bank. The European Central Bank is an independent central bank which operates within the European Union. Comparing both central banks is useful for better understanding of the Federal Reserve System operation within the American democracy. However the differences between the United States the European Union will have to be taken in consideration.

The three above aspects form the basis for my analysis. All of them point to the relation and operation of the Federal Reserve System within the American democracy.

Thesis Statement

The thesis examines the Federal Reserve System's relation to the American state and government and its position and function within the American democracy. The Federal Reserve System is non constitutional institution, which falls outside the system of checks and balances of the American democracy. The Fed is the central bank, which implements decisions that are more likely beneficial to private owners and corporations than to the American economy. Therefore, the nature of governance of this central bank highlights the paradox of American democracy.

Methodology

In my thesis, I used a detailed institutional analysis of the function of the Fed and institutions of American democracy. Primary sources are the Constitution of the United States, which is main document shaping the democracy of the U.S.; and the documents of the Board of Governors. Secondary sources are books and web pages which are in contradiction with the arguments in the book of the Board of Governors. Detailed reading of works and books about the issue of the Fed provides much information which will be important for complete analysis. Methodology used in this thesis is a qualitative analysis. I will examine the nature of the rule of the Fed and other factors which are connected to this issue. This work is theoretical and it uses an institutional view rather than an economic approach.

Preliminary results and discussion

1. Fed is not a government agency

"The first thing that must be understood is that the Federal Reserve Corporation is not a government agency, as most people think. It is a private corporation controlled by the Bankers, and therefore it is operated for the financial gain of the Bankers over the people, rather than for the good of the people" (Sickler, n.d.). People know who the chairman/chairwoman is, they know who is on the Board of Governors, but do we know who really owns this private bank? Why do these people not act publicly? These are questions which suggest that people know little about owners behind the Fed.

2. Fed is unconstitutional institution

The Federal Reserve System, as the central bank of the United States has a huge privilege to manipulate money and the banking sector. "Federal Reserve proposal was unconstitutional from its inception, because the Federal Reserve System was to be a bank of issue. Article 1, Sec. 8, Par. 5 of the Constitution expressly charges Congress with "the power to coin money and regulate the value thereof" (Mullins, 1983, p. 20). Nothing characterizes American democracy better than the Constitution of the United States. But where in the American Constitution is the Federal Reserve System? It is not there, but how is it possible that people overlook this fact?

3. Federal Reserve Banks have a conflicts of interests in its operation

"Stiglitz stressed that the Fed banks have clear conflicts of interest, since the banks are largely governed by a board of directors that includes officers of the very banks they are supposed to be overseeing" (WashingtonBlog, 2010).

4. The Fed is considered a secret institution

"Their secrecy privilege is protected by law" (Leila, 2010, p. 12). According to the Freedom of Information Act and also The Universal Declaration of Human Rights, Article 19: "Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and

impart information and ideas through any media and regardless of frontiers" (The United Nations, n.d.). Nevertheless many Fed documents and activities are classified and therefore information on Fed is limited.

Examining the history of the Fed can enlighten how this system evolved over time within the American society.

Implications

The Fed has a much more independent statute than it should. Consideration could be given to some limitation of the Fed independence. On one side, the Fed independence is good for protection against political manipulation, on the other side, it can lead to misuse of this institution by private owners and other corporations. While the Fed was created for the good of American economy, families, corporations, shareholders behind the Fed, have a huge impact on functioning of this institution. The American Central Bank affects interests rates, inflation and if this is used for the good of private interests and corporations, ordinary people might suffer. The Fed should be more transparent and open for Federal government and for citizens. People should know what is happening in the Central Bank in order to better understand developments of economy.

1 Position of the Federal Reserve in the U.S. democracy

This chapter has four parts, describing links between the Federal Reserve System and the U.S. democracy - the Constitution, the President and the Congress. The chapter describes the original ideas of the founders of the Fed and the present system of the Fed, its competencies, responsibilities, and function of the Federal Reserve System.

1.1 Founding Fathers

“If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around them will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered.”

Thomas Jefferson

The first ideas about the creation of the central banking originated in around the year 1791. Hamilton had an idea that first central bank will be by functioning similar to Bank of England (Johnson, 1999). "Secretary of the Treasury Alexander Hamilton advocated the creation of a central bank, a Bank of the United States, to manage the government's money and to regulate the nation's credit" (Johnson, 1999, p. 6).

At that time, there were not many policy makers that supported the establishment of central banking, On the contrary, many politicians rejected the creation of the Central Bank. One of them was the Secretary of State Thomas Jefferson. The reason of his disagreement with creation of the central bank was that the Congress of the U.S. according to the Constitution did not have power to create a central bank (Johnson, 1999, p. 6)

"Hamilton responded that Congress could create just such a bank under the constitutional clause giving it all powers "necessary and proper" to the exercise of its specifically enumerated responsibilities; since Congress had been given so many monetary and fiscal powers, Hamilton argued, it would be perfectly proper for it to

create a central bank to carry them out. Hamilton won the argument, and the First Bank of the United States was created in 1791" (Johnson, 1999, p. 6).

The main problem was, that according the Hamilton's idea the First Central Bank was supposed to be owned by the government. Reality was different. Only a small part of bank was owned by the Federal government.

"The First Bank of the United States had a capital stock of \$10 million, of which \$2 million was subscribed by the Federal government, while the remainder was subscribed by private individuals. Five of the twenty-five directors were appointed by the United States government, while the other twenty were chosen by the private investors in the bank" (Johnson, 1999, p. 7).

This first bank was owned by private investors and corporations. Private corporations had a strong presence in the early operations of the central bank; they had even twenty directors out of twenty-five. This first central bank was successful at that time, but many politicians criticized that private sector played greater role than the federal government.

After twenty years American Congress rejected re-sign the charter of the central bank and the first central bank disappeared in 1811 (Johnson, 1999).

At the beginning of the nineteenth century the United States was experiencing the war for their independence. After that, American economy was destroyed, America had high liabilities and the idea of central banking had returned back. The American government hoped that the central bank could rescue American economy and resurrect trade.

Second central bank was established in 1816 and disappeared twenty years later, in 1836 (Johnson, 1999). This bank was greater than the first bank and its purpose was regulation of money in circulation. At that time, president Andrew Jackson said, that the bank - as a one institution - had too much power (Johnson, 1999). The second bank was even more powerful than should be and represented a threat to the American democracy. It was not only Johnson who feared of powerful central bank. Many other politicians and citizens shared this view.

At the end of the nineteenth century, the U.S. economy was in trouble and its banks had problems. According to the U.S. Congress, America needed an institution which would help avoid this kind of problems. However, at the beginning of the twentieth century, American farmers, who were major borrowers at the time, and also many of

politicians were suspicious of the creation of the central bank, fearing that it would be a place with too much power concentrated in one institution (Leila, 2010).

Nevertheless the "Congress passed the Federal Reserve Act, to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes. President Woodrow Wilson signed the act into law on December 23, 1913" (Board of Governors of The Federal Reserve, 2005, p. 2). The Federal Reserve System was created to prevent financial and economic problems in the U.S. Contradictory to the expectations a few years later one of the largest financial crisis in history, the Great Depression started. The Fed was created as a mechanism to avoid problems of this kind, but many experts believed that the Fed was actually responsible for the crisis.

This was the view of one of the most renowned economists of the twentieth century, Milton Friedman. According to him, the Federal Reserve System was responsible for the Great Depression which started in 1929 and lasted for several years. Even the former Chairman of the Fed, Ben Bernanke, agrees with Milton Friedman that the Fed is responsible for causing the Great Depression (Kupelian, 2008).

In the U.S. history, many American presidents did not agree with the idea of central banking without any control by the federal government. The list includes, George Washington, Andrew Jackson, Abraham Lincoln, John Fitzgerald Kennedy.

The second central bank, set up in 1816, was a private corporation. Andrew Jackson fought against it arguing that it should serve for everyone. He meant that the central bank should not exist just for rich and powerful people, but for workers, for everyone. Jackson won his fight and he said "I killed the bank!" (Freidel, 2006).

In the 60's Kennedy signed a document - Executive order 11110 on American currency. It stipulated that the federal government had additional power to create currency for the American people. Kennedy partly rid the Fed of the power to manipulate money, as the Federal government achieved a power to print the Government money: The Federal Reserve Note. Six months later, he was assassinated. The Federal Reserve Note was considered to be the only legal currency in the United States. The federal money was removed from circulation and never got back again. Today a lot of people speculate whether the assassination of president

Kennedy had been linked to the banking cartel. He was the last president, to oppose the Federal Reserve System. (Curran, 2013).

1.2 The present System and operations of the Fed

The Federal Reserve System is the central bank of the United States of America. The Fed is the bank of banks. In 1913, President Woodrow Wilson signed the Federal Reserve Act and the Federal Reserve System was created. This part of the work is more theoretical for better understanding of function and structure of the Federal Reserve System.

The Federal Reserve System, independent American central bank is governed by the: Board of Governors consisting of seven members led by chairman/chairwoman, the current chairwoman is the first woman in this position - Janet L. Yellen. Another decision-making body is Federal Open Market Committee (FOMC). The Federal Reserve consist of twelve Federal banks (Board of Governors of The Federal Reserve, 2005). These are the most important members of the Federal Reserve and each have a responsibility to American banking system.

"Today, the Federal Reserve's duties fall into four general areas:

- conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates
- supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers
- maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
- providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system" (Board of Governors of The Federal Reserve, 2005).

Twelve Federal Reserve Banks and twenty-five branches are still under the oversight of the Board of Governors which resides in the capital city, Washington D.C.

"Each of the 12 Reserve Banks serves its region of the country, and all but one have other offices within their Districts to help provide services to depository institutions and the public. The Banks are named after the locations of their headquarters - Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco" (Federal Reserve Education, n.d).

"The Board of Governors of the Federal Reserve System is a federal government agency. The Board is composed of seven members, who are appointed by the President of the United States and confirmed by the U.S. Senate. The full term of a Board member is fourteen years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. After serving a full term, a Board member may not be reappointed" (Board of Governors of The Federal Reserve, 2005).

The Board of Governors participates in the Federal Open Market Committee (FOMC), which controls the American monetary policy. It is the most important responsibility of the members of the Board of Governors. Seven governors have a voting majority and the president of the Reserve Banks has five votes (Federal Reserve Education, n.d).

The chairman/chairwoman is head of the Federal Reserve System. For better understanding of inner working of the Fed we should consider the background from which the chairman/chairwoman came from. So far chairman/chairwoman came from different backgrounds either private sector or academia.

Currently, the first woman at this office is Janet Yellen. J. Yellen is Professor Emeritus at the University of California, Berkeley (Board of Governors of the Federal Reserve System, n.d). In her professional career she took different economic positions. Being a scientist in the position of chairwoman of the Fed she is a good example of a technocracy inside the Fed.

The former chairman of the Fed Ben Bernanke, is also Professor of the Economics at the Princeton University, New York University and also Stanford University (Axilrod, 2011, p. 149).

J. Yellen and Ben Bernanke are both the Fed technocrats operating within the American democracy. Technocracy is weakening democracy considerably. According to the Business Dictionary technocracy is "neither a democracy nor a bureaucracy because the real power has shifted from the elected representatives and bureaucrats to technocrats; engineers, managers, scientists" (BusinessDictionary, n.d.).

Alan Greenspan, another former chairman of the Fed, comes from the private sector. He worked as a corporate director in many well known corporations, as J.P. Morgan, Mobile Corporation, Morgan Guaranty Trust Company of New York, etc. J.P. (Axilrod, 2011, p. 119). We should note that J.P. Morgan was one of the financial institutions that during the 2008 crisis received financial assistance from the Federal Reserve System. While at that time A. Greenspan was not in the Fed any more it is possible that the Fed chairman might pursue the corporations' interests or interests of private owners which could be behind the Federal Reserve.

1.3 Federal Reserve and institutions of American democracy

The most important institutions of the American democracy are the President as the head of the executive power, Congress as the legislative branch. They are bound by the most important document of American democracy, The Constitution. How does the Fed - as an independent bank - operate within the American democracy?

1.3.1 The President of the United States

President of the United States represents the executive power of the state and his term is four years. The President is also Commander in Chief of the Army and Navy of the United States.

The views about relation between the President and the Fed vary. Some argue that, the President has a power to appoint members of the Fed and may also interfere in the power of the Fed. Others argue that, the President does not have the power to interfere

into the operations of the Fed; in addition to that he has limited information concerning the operation of that institution. There are many issues that are in mutual contradiction.

Firstly, the Fed is not completely independent from the American President, as one would expect. President has the power to appoint the seven members of the Board of Governors of the Fed. These seven members are later confirmed by the Senate for the period of fourteen years in the office. They cannot be reappointed. The Chairman and Vice Chairman are designated by the President and confirmed by the Senate for four years (Leila, 2010).

This President's decision regarding the Fed chairman/chairwoman can have important consequences on the American economy as each chairman/chairwoman might advocate different monetary policy. Janet Yellen's policy is to keep interest rates low, thereby increasing employment. Keeping inflation low is not her primary objective.

On the other hand, the Fed remains "a black box". The President and American citizens do not have access to necessary information regarding their Central Bank. "...the Federal Reserve has rejected a White House request that [the Federal Reserve] conduct a public review of its structure and operations" (Stiglitz, 2010).

Secondly, history shows that not just one president was interested in influencing the monetary policy and thus intervened into the powers of the Fed. It is said that, if the president wants to change the monetary policy, he can do it.

James Wilson provides an example: the Fed Chairman Arthur Burns, appointed by President Nixon was to be re-appointed as the Chairman in 1978. In an unsuccessful attempt to influence Burns' monetary decisions, President Carter expressed his doubts on the re-election of Burns. Burns disagreed, and G. William Miller was appointed to the office. However, the appointment of Burns did not help the President Carter. In 1980, the Fed continued helped to maintain high interest rates, which did not help President Carter in his quest to be re-elected (Wilson, 1995, p. 242).

Robert Auerbach, Professor of Public Affairs in his article gave another case of the Fed impact on the President's position. According to him Greenspan policy got America into recession and the economic decline undermined the Bush policy (Wilson, 1995).

List of Presidents that wished to influence the functioning of the Fed and enforced changes in monetary policy include Presidents Truman, Johnson and Nixon.

Other presidents that influenced the functioning of the Fed, include President Truman, Johnson and Nixon that enforced changes in monetary policy. If the President has any economic agenda and wants to enforce it, he needs help: first, from the institutions and bodies of the executive power, from an institution like the Fed, and from the different committees of the Congress (Wilson, 1995, p. 242).

1.3.2 The United States Congress

The United States Congress consists of the Senate and the House of Representatives. The Senate of the U.S. composes of two senators from each State elected for a six years period. According to the American Constitution, just the Congress has the power to manipulate the U.S. money (Peltason, 2004). The paradox is that until these days the Constitution does not have a single paragraph regarding the creation of the central bank. "The Federal Reserve is the black hole of our democracy - the crucial contradiction that keeps the people and their representatives from having any voice in these most important public policies" (Greider, 2009). As the Fed is responsible for regulation of the quantity of money in the economy of U.S., it has an impact on the economy of the country. If private interests groups behind the Fed regulate interest rates for their own benefit, the Federal state could run into economic problems.

Ron Paul is a member of the U.S. House of Representatives. When the former Chairman Bernanke reported to the Congress, Ron Paul made some remarkable perhaps shocking comments. He reminded that the Federal Reserve System had a total control of American money, at the same time characterizing the Fed as a secret central bank (C-Span, U.S. Economic Outlook, 2007).

The Constitution declares that it is only the U.S. Congress which has a power to issue money. However this power is performed by the Fed. In addition to it the Fed has a huge problem with transparency. The Congress does not have any power to look inside the Fed. Ron Paul said that Congress has less and less information about operations, plans, actions of the Federal Reserve; Congress does not have access to its

statistics, etc. At the hearing following the 2008-2009 financial crisis Senator Sanders asked Chairman Bernanke where the 2.2 trillion dollars were allocated by the Fed. No one from the Congress knew names of institutions which benefited from the Fed. How could this happen? Who made the decision? Chairman Bernanke went on repeating that information was provided, but no one from the Senate knew it (C-Span, U.S. Economic Outlook, 2007).

On the other side, the Federal Reserve System provides some documents for the Congress Committee and citizens. Monetary Reports and Testimony; both are reports discussing "the conduct of monetary policy and economic developments and prospects for the future" (Board of Governors of the Federal Reserve System, n.d.). They are presented every six months with the testimony of the Chair. Monetary Reports contains information on unemployment rate, inflation, GDP, interests rates, etc. Most of this information is available from the Statistical office as well. However the Congress does not have information that could be provided only by the Fed and if it gets some it cannot verify it.

1.3.3 The Constitution of the United States

The Constitution of the U.S. is consisted of the fundamental laws of the state. One of the most paradoxical phenomenons is that the Federal Reserve System, as a central bank of the U.S., is not mentioned in any article or section of the Constitution. "The Constitution of the United States doesn't say anything with respect to the creation and function of a central bank" (Leila, 2010, p. 7). Secretary of State Tomas Jefferson said essentially the same many years ago: the Senate does not have the power to create a central bank which would coin money and influence monetary policy (Johnson, 1999).

Even after the creation of the Federal Reserve, the Constitution has remained unchanged to this day. It means that existence of such an important institution as the central bank remains absent in the most important document of the American democracy. If we assume that the Constitution is the basic document of the American democracy, where is the Fed as the Central bank of the United States? In contradiction to the Constitution the Congress does not have the power to interfere with the money

operations. It is according the American Constitution that the role of the Congress in money issues is defined: "the Congress shall have the power to coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures" (Peltason, 2004).

Instead the Fed has become the one institution with this responsibility. The Fed being not a branch of the Congress at least should provide enough information about its monetary policy decisions. Neither this is the case: the information regarding decisions, regulations, operations, etc. is provided to the Congress in a very limited way.

1.4 Independence, accountability and transparency of the Fed

Today, the Fed banks are independent; this independence should ensure a fair decision of the Fed, with no intervention of any government authority. On the other hand when one institution has too much power to regulate monetary policy, the power can be abused. The Federal state does not need very detailed information on the everyday operations of the central bank. At the same time information available to the Government is insufficient and does not provide a proper evidence of the Fed functioning. In 2011, the Government Accountability Office (GAO) performed the first audit of the Fed since its creation in 1913 (Investovanie a špekulácie, 2012). It is nearly one hundred years that Government does not have precise and clear information about operations of the Federal Reserve System. "During the 2008 economic crisis, the Fed printed trillions of dollars and circulated them in the form of bailouts. From where that money comes and to where it is going is a good question" (Leila, 2010).

The audit showed that the money almost without any interest went to the accounts of huge corporations whose members were tied to the Fed. That shows that the Fed is not independent from private interests, it is controlled and often abused by private banks and corporations and the President or the Congress does not have much power or any law to change it. The corporations are likely much more powerful than the whole American government.

"In 1982, the Supreme Court of the United States held that the Federal Reserve Banks are independent, privately owned and locally controlled corporations, and there is not sufficient federal government control over 'detailed physical performance' and day to day operation of the Federal Reserve Bank for it to be considered a federal agency" (Leila, 2010).

Regarding the Fed budget no one oversees it and the Congress does not control it. The Fed is a self-financing organization, and probably prints money without restraint for private corporations which need money. One has to ask a question, how can a few people control economy of the United States? Next questions would be are the Fed's decisions for the good of the U.S. citizens or for the good of corporations?

The official Fed document states that the Fed is accountable to the American Congress and the American people. Transparency is a principle that supports the accountability of the Fed (Board of Governors of the Federal Reserve System, n.d).

Indeed, today, the Fed is much more transparent than in the past. Every citizen can look at the internet web site of the Federal Reserve and read the regular reports and testimony which Fed publishes. One of the main objectives of the Fed is to be transparent and open for the American society: "The Federal Open Market Committee seeks to explain its monetary policy decisions to the public as clearly as possible. Such clarity facilitates well-informed decision-making by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society" (Board of Governors of the Federal Reserve System, n.d).

However, the Fed objected the results of the GAO audit in 2011. Audit provided evidence that the Fed allocated trillions of dollars in the crisis to banks and corporations, and no one knew this information. The Fed still keeps a very negative attitude towards the audit.

The quality of information provided by the Fed to Congress and the public remains low. Therefore Senator Sanders named the Fed as one of the most secret institutions and proposed to impeach the transparency of the Fed (C-Span, U.S. Economic Outlook, 2009).

1.4.1 German Bundesbank

The case of the German Reichsbank is a good example of the fact that the independence of a central bank from the government when controlled by private interests could bear serious consequences.

Reichsbank was a German independent central bank before the Second World War. The bank was founded in 1875. On the one hand, the bank was independent from the government; on the other hand, the bank was privately owned and managed by shareholders. The bank was under the control of the Reparations Commission which was linked to the Wall Street Bankers. In years of Weimar republic the Reichsbank caused hyperinflation which caused big problems in economy and subsequently curbing hyperinflation it caused depression and extremely high unemployment. Powerful Reichsbank became the "second government" and dominated the entire economic system. The government was getting less and less powerful (Werner, 2003). "Being independent from the German government did not prevent the Reichsbank from adopting the horrific policies of the 1920s and early 1930s that ultimately proved fatal for Germany and the world, as they set the stage for the arrival of a pro-growth party, the NSDAP" (Werner, 2003).

On the contrary, the post-war Bundesbank proved to be a very successful German central bank. It was the post-war German government that passed a law which determined the policy of the Bundesbank. According the Stability and Growth Pact of these years the Bundesbank's objective was to promote the economic growth, price stability and low unemployment. German Bundesbank was not absolutely independent: It was a subject to the German law, reported to the German Parliament and was accountable to the German Federal Audit Agency. The Bundesbank success was not built on its independence, on the contrary, its success was due to its position as a part of the German democratic system (Werner, 2003).

The post-war Bundesbank case shows that a central bank is successful when it is independent from the government manipulation as well as from private interests, but depends on the elements of a democratic system.

1.4.2 The Freedom of Information Act (FOIA)

The Freedom of Information Act is a law that allows a disclosure of information controlled by the Government. "The Freedom of Information Act (FOIA), generally provides that any person has a right of access to federal agency records, unless the records are protected from disclosure by one of FOIA's nine exemptions or by one of three special law enforcement record exclusions." (Board of Governors of the Federal Reserve System, n.d).

The law includes the Federal Reserve System; it means that people have a right to know what their central bank does. The Federal Reserve System on its website publishes records which are intended for the American citizens. However, the Fed produces records which are not intended for the public as well. Referring to the FOIA one can request information that is otherwise not to be found.

However, the Board does not provide information if it is outside the Freedom of Information Act. The Fed has nine points exempted from the FOIA law: information which are in secret for the interests of national defense, internal personnel rules, statutory exception, commercial of financial information, memorandums, personnel files, information compiled for law enforcement purposes, confidential supervisory information and geological and geophysical data (Board of Governors of the Federal Reserve System, n.d).

The Freedom of Information act makes the Fed more transparent and open for the public.

2 Private interests behind the Federal Reserve

Who is behind the Fed? Who "owns" the Fed? Who uses the Fed in the financial crisis for his/her own profit? Is the Fed somehow connected to the Wall Street? Are these questions relevant and is Fed controlled by private interests including corporations?

There are many theories including conspiracy theories pointing at many families, such as Morgan, Rothschild, Rockefeller behind the Fed. Are they truth?

2.1 The global financial crisis 2008

There is some presumption that corporations that received money from the Fed in the crisis may be behind it. In 2011 an audit of the Fed took place for the first time since 1913 when Fed was created. This audit was conducted by the GAO - Government Accountability Office which investigates members of the United States Congress. Proposal on the execution of the audit of the Fed was filed by Ronald Paul, a politician in Congress. Former chairman Ben Bernanke and also former chairman Alan Greenspan were against an audit of the Fed (Investovanie a špekulácie, 2012).

From December 2007 to June 2010, the Federal Reserve secretly financially supported many of the world's banks, corporations and governments by providing them 16,000,000,000,000 dollars - that's \$ 16 trillion (Investovanie a špekulácie, 2012).

Corporations and banks which received this "financial assistance" are relatively known. In March 2008, the Fed gave JPMorgan \$ 29 billion to finance the purchase of Bear Stearns. In 2008 the New York Fed chairman Stephen Friedman approved an application of Goldman Sachs to become a bank holding company and in this way be eligible to cheap loans. As a chairman of the Fed in N.Y. S. Friedman was on the board of Goldman Sachs and owned shares of Goldman Sachs despite the fact that this clash of interests was prohibited by regulations of the Federal Reserve System. (Sanders, 2012)

"Richard Fuld, Jr. the former CEO of Lehman Brothers, served on the Fed's Board of Directors in New York from 2006 to 2008. During the financial crisis, the Fed provided \$183 billion in total financial assistance to Lehman before it collapsed" (Sanders, 2012).

This is just some the evidence of the "generosity" of the Fed during the crisis period to many corporations. Other corporations that benefited from the "financial injection" in form of cheap loans at near zero interest were: General Electric, Pupular Inc., Wilmington Trust, Webster Bank, Legacy Texas group, KeyCorp, State Street Corporation, CitiBank and many others.

Many members of the Board of Federal Reserve Banks were linked to corporations, which received "financial assistance" during the crisis. Audit of the Fed showed immense conflicts of interest inside the Federal Reserve System.

2.2 Wall Street and the Federal Reserve System

There are doubts whether the Fed is truly impartial and independent or if corporations and private shareholders use the Fed in pursuing their own interests? Eustache Mullins, author of the Secrets of the Federal Reserve wrote names and corporations which are behind the Fed. Results are shocking. This work was written in 1987, many years before the audit of the Fed. However some of the names are identical. His list included the Wall Street corporations as J.P. Morgan, the National City Bank, the Loeb Company and House of Rothschild and other individuals from the financial world such as George F. Baker, head of the First National Bank of New York, William Rockefeller, etc. (Mullins, 1983).

A conflict of interests of the Fed versus the Wall Street is evident. During the financial crisis, a large part of the Wall Street corporations received money from the Fed with zero or low interest. However the Federal Reserve System denies any connection with the Wall Street corporations or any other private interests.

Goldman Sachs is one of the largest Wall Street corporations. Goldman Sachs and the Federal Reserve are in a close connection. The current president of the Fed N.Y. William Dudley is a former chief economist of Goldman Sachs. Gerald Corrigan, the

former president of the Fed New York, is today a top executive of the Goldman Sachs. (Censky, 2012).

"...the Federal Reserve, which prints all US money, is privately owned mostly by the big Wall Street banks although the Constitution gives the US Government, not a private bank, the right to print its own money. Is it any wonder that the Fed is beholden to and controlled by Wall Street? An American central bank should be owned by the citizens of America not Wall Street" (Lawrence, 2013).

Jamie Dimon is an executive of the JP Morgan and a member of the Board of the Federal Reserve System in New York at the same time (Censky, 2012). How could member of the American central bank act independently as the CEO of the great Wall Street Corporation? This is a clear conflict of interests – not so rare in the Fed. Politician Bernard Sanders notes: "Here you have the Fed, which is supposed to regulate Wall Street. Then you have the CEO of the largest Wall Street company on the board which is supposed to be regulating" (Censky, 2012).

3 The Federal Reserve and the European Central Bank

For the better understanding of the function and position of the Federal Reserve System within the American democracy, the comparison of the Fed to the European Central Bank is made. Both central banks are independent either from the U.S. government or the EU governing body (The EU Council). Despite some other similarities different objectives and position of the European Central Bank within the European Union and the Fed position in the U.S. economy must be taken into consideration.

The European Union is a political, economic, cultural, etc. partnership which consists of twenty eight member states. As the European Union it came into existence in 1993 after the signing of the Maastricht treaty. However its origin is dated back to the early post-war period. Currently its institutional framework consists of four main institutions: The European Council, the European Court of Justice, the European Parliament, and the European Commission. This is the internal system of the EU (European Union, n.d.).

3.1 The European Central Bank

Differences and similarities between both central banks - the European Central Bank and the Federal Reserve System will be examined in four areas: independence, accountability, operation and transparency.

The European Central Bank is an independent institution of the European Union. The European Central Bank is responsible for the creation and the implementation of economic and monetary policies in the European Union and the management of the European single currency, the Euro. The European Central Bank cooperates with other twenty-eight banks in the European Union (European Union, n.d.). As a model for the creation of the ECB the now-days German Bundesbank, which is much less accountable as its predecessor the post-war Bundesbank, was used.

The Board of Governors of the European Central Bank is an example of the technocratic governance of the institution. The Board of Governors consists of

Governors of the National banks and members of the executive board. Governors of the national central banks are appointed either by governments or Presidents of the states and might be approved by national parliaments. Members of the executive board are appointed by a mutual agreement of the governments of the member States (European Union, n.d.).

The European Central Bank and the Federal Reserve System declare that they are independent, whether from the government, other institutions or private interests. However, their independence is different. As discussed above the Fed independence from the Government is limited as the chairman/chairwoman is appointed by the President and approved by the Senate. The Fed must regularly submit a report of its activities and decisions to Congress. In case of the European Central Bank Governors of the national banks as members of the ECB Governing Council are not appointed by the governing body of the European Union. The European Parliament do not have power to intervene into decisions of the ECB but seven members of the Board of Governors are appointed after consultations with the European Parliament. Even the European Central Bank does not submit regular reports to European Parliament, as the Federal Reserve System to the American Congress. One can conclude that thanks to this the European Central Bank is more independent than the Federal Reserve (Kumas, 2003).

The Fed is accountable to the U.S. Congress and therefore to the American citizens. "The Fed has long viewed transparency as a fundamental principle of central banking that supports accountability" (Board of Governors of the Federal Reserve System, n.d). The Fed regularly submits reports and documents to the Congress. Moreover the Federal Open Market Committee publishes a statement about negotiations. The Board of Government publishes the Annual Report (Board of Governors of The Federal Reserve, 2005).

On the other side the European Central Bank is less accountable and transparent than the Fed. The EU Commission has an external access to the European Central Bank; it means that the Commission can monitor its decisions. But the Governing Council of the ECB does not publish reports or documents that could allegedly lead to national interference. The European Central Bank is not supposed to receive any instructions or advices from any EU member state or institutions (Kumas, 2003).

The attitude towards auditing the ECB and the Fed is not identical. The European Central Bank declares that if an audit is required, the Bank would not oppose (Kumas, 2003). However the Fed defends its independence by opposing the conduct of the audit. Its first audit was performed only in 2011

Conclusion

The main aim of the thesis was to examine the Federal Reserve System position and function within the American democracy. Main arguments of the thesis formed the basis of chapters.

The hypothesis of the thesis was that the functioning of the American central bank is according to the ideas of founding fathers and the American Constitution. But reality is much more different. Firstly, the Fed is acting non-constitutionally as it is not defined in the U.S. Constitution, which is the most important document of the American democracy. This is the first paradox of the Fed position within the American democracy.

Secondly, the relationship between the Federal Reserve System and the institutions of the American democracy is not well defined. Fed is not completely independent from the American President, as the President has the power to appoint seven members of the Board of Governors of the Fed later confirmed by the Senate. At the same time the Fed operates completely independently from the President. The Fed remains "a black box". The President does not have access to necessary information regarding the U.S. Central Bank.

The Constitution declares that it is only the U.S. Congress which has a power to issue money. However this power is performed by the Fed. If we agree that this power is delegated to the Fed, the Congress should have the power to look inside the Fed. This is likely not the case. The Fed has an obligation to provide Congress with reports and testimonies but my research has failed to clearly demonstrate to what extent the Fed provides truthful information to the Congress. My search demonstrated that the Congress does not have access to the inside information and has to satisfy itself with the information that the Fed provides voluntarily. This is the key problem and due to it, important information is hidden from the Congress.

The adoption of the Freedom of Information Act and its implementation has assisted in making the Fed a more transparent institution. According the law more information is available for public. However, not all information is accessible as the legislations allows makes many exemptions.

The Fed falls outside the system of checks and balances. It was only in the year 2011; the Government Accountability Office (GAO) performed the first audit of the Fed since its creation in 1913. Nearly one hundred years the Government did not have precise and clear information about operations of the Federal Reserve System.

In Part 2. I have examined who is behind the Fed and who "owns" the Fed. The Fed is a private institution and the question, who used the Fed in the 2008/2009 financial crisis for his/her own profit, was a legitimate one. I have examined if the Fed is somehow connected to the Wall Street. The Fed was created with an intention to prevent potential financial problems of the USA. There is clear evidence that the Fed did not prevent either the Great Depression between the two world wars or the financial crisis in 2008/2009.

Results of my research demonstrated that the Fed has a mixed private/technocratic character. The Fed chairman/chairwoman have come from different backgrounds either private sector or academia. The nature of governance of the Federal Reserve further highlights the paradox of the American democracy.

The thesis shows that Fed is independent from the U.S. Government but its independence from private interests is questionable. This might be a serious threat to the quality of American democracy. The Federal Reserve is considered to be a secret institution as the ownership structure of the Fed is not clear. My hypothesis that the Fed is connected to the private interests was confirmed. More, it is possible that the Fed implements decisions that are more likely beneficial to private owners and corporations than to the American economy and society. The analysis of the inner functioning of the Fed shows that the Fed is connected to private interests and corporations and there exist conflict of interests.

While views and evidence on the functioning of the U.S. Federal Reserve System within the American democracy are contradictory, I think that my thesis statement has been confirmed. The Fed is non constitutional institution implementing decisions that are often more beneficial to private interests than to the American economy. There is clear evidence that the Fed is partly in the hands of private interests and the Government gets less information than needed. The conclusion is that the Fed threatens the quality of American democracy and remains a paradox within the American democracy. To prevent the situation in which the Fed would be abused by

private interests and cause huge problems to the U.S. and world economy its position within the U.S. democracy should be much improved.

Resumé

Federálny rezervný systém je nezávislou centrálnou bankou Spojených štátov. Cieľom bakalárskej práce je poukázať na vzťah Federálneho rezervného systému voči americkému štátu a vláde a určiť jeho pozíciu a fungovanie v rámci americkej demokracie.

V prvej časti sa práca venuje pozícií Federálneho rezervného systému v rámci americkej demokracie. Práca opisuje prvé názory politikov, ale aj obyvateľov Ameriky na vytvorenie centrálnej banky, ktorá bude tlačiť peniaze a riadiť ekonomiku krajiny, a tým uchráni Americkú ekonomiku od škodlivých vplyvov. Počas histórie sa postavilo mnoho amerických prezidentov proti centrálnej banke, medzi nimi nechýbal ani prvý prezident George Washington, Andrew Jackson, Abraham Lincoln a John Fitzgerald Kennedy. Všetci sa obávali, že moc, ktorá bola sústredená v jednej centrálnej banke môže byť zneužitá.

V ďalšej podkapitole práca opisuje fungovanie Federálneho rezervného systému, povinnosti a systémy, ktorými sa riadi. Taktiež konkrétne skúma pozadie predsedov, ich predchádzajúce pôsobenie a vzdelanie. Práca týmto poukazuje na technokraciu v rámci vnútorného fungovania Federálneho rezervného systému.

Jednu z hlavných častí bakalárskej práce tvorí americký prezident, kongres a Ústava Spojených štátov amerických. Táto podkapitola definuje vzťah Federálneho rezervného systému a inštitúcií americkej demokracie. V minulosti prezidenti zasahovali svojimi rozhodnutiami do fungovania Fedu, avšak dnes je situácia diametrálne odlišná. Prezident má právo menovať predsedu Fedu, čím nepriamo môže ovplyvniť ďalšie smerovanie politiky centrálnej banky, avšak do vnútra prístup nemá. Federálny rezervný systém musí pravidelne posielat' správu kongresu o fungovaní Fedu a prognózy o stave monetárnej politiky. Avšak, aj napriek pravidelným informáciám, ktoré kongres dostáva, kongresman Ronald Paul tvrdí, že Fed neposkytuje dostatok informácií a stáva sa tajomnou inštitúciou, do ktorej nikto nemá prístup. Ústava Spojených štátov, ako základný dokument americkej demokracie do dnešných dní stanovuje, že iba kongres má právo tlačiť peniaze a regulovať monetárnu politiku, v skutočnosti toto právo od vzniku Federálneho rezervného systému stratil.

Federálny rezervný systém je centrálna banka, ktorá deklaruje, že je nezávislá, či už od vlády, alebo od záujmov súkromných korporácií. Či je centrálna banka skutočne nezávislá od súkromných záujmov je diskutabilné. Mnohé manipulácie s peniazmi, sanácia počas krízy 2008 ukazujú, že Fed je skutočne pod vplyvom záujmov korporácií. Fed vyhlasuje, že je transparentnou centrálnou bankou, na jednej strane zverejňuje informácie na webovej stránke, posiela správy kongresu, predseda podáva svedectvo o fungovaní, na strane druhej Fed počas krízy tajne podporil miliárdami dolárov súkromné korporácie, bez toho, aby o tom kongres alebo iná vládna inštitúcia vedela. Oficiálne sa Fed zodpovedá kongresu a americkému ľudu. Prípady nemeckej Reichsbank je dobrým príkladom, ako môže byť centrálna banka, ktorá je nezávislá od vlády a nezodpovedá sa jej, riadená súkromnými záujmami, čo následne môže viesť k obrovským ekonomickým ale aj sociálnym problémom. Freedom of Information Act je zákon, ktorý ustanovuje, že Fed musí poskytovať informácie pre verejnosť. Aj toto posilňuje transparentnosť americkej centrálnej banky.

V druhej časti sa práca zameriava na súkromné záujmy v pozadí Federálneho rezervného systému. Počas krízy 2008 Federálny rezervný systém tajne poskytol peniaze s takmer nulovými úrokmi rôznym korporáciám na Wall Street. Až audit, ktorý bol vykonaný vládnu inštitúciou GAO preukázal, že tieto peniaze boli poskytnuté bez akýchkoľvek informácií zo strany Fedu. Goldman Sachs, J.P. Morgan, Lehman Brothers, General Electric nechýbali v tomto zozname. Wall Street je prepojený s americkou centrálnou bankou cez rôznych zamestnancov, ktorí pracovali v centrálnej banke, ale aj v korporáciách. Stret záujmov, ktorý tu vzniká je otvorený a paradoxný.

V tretej časti bakalárskej práce je fungovanie Federálneho rezervného systému v rámci americkej demokracie porovnané s Európskou centrálnou bankou a to v troch aspektoch: nezávislosť, zodpovednosť a transparentnosť.

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