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Fighting the Fed, for Better or Worse

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"Don't fight the Fed" may be a time-honored tenet on Wall Street trading floors, but it's often just the oppposite on the political stage.

Several of the major Republican presidential nominees have chosen to run, in a sense, against the **Federal Reserve** [explain this], picking a fight over the powers of the institution and the policies of its chairman.

Representatives Ron Paul of Texas and Michelle Bachmann of Minnesota, as well as Texas Gov. Rick Perry have all called for mandatory audits of the central bank's balance sheet because of its aggressive and unconventional efforts to inject liquidity into the economy.

Perry, however, went further, saying any further measures by Fed Chairman Ben Bernanke during the election year would be **"almost treacherous or treasonous"** and implied he might meet physical harm if he visited the Lone Star State.

Policy and opinion aside — some would add bluster and rhetoric — there's little any of these candidates could do if one became president, other than nominate a replacement to Bernanke once his four-year term expires at the end of 2013.

The Fed answers to Congress, which alone has the power to make amendments to the **Federal Reserve Act** — the legal backing of the Fed system.

The criticism, some say, is that Bernanke and the Fed have become stand-ins for President Barack Obama and the Democratic Party. The general idea is to equate the Fed with Big Government, its tentacles reaching everywhere, accountable to no one.

Is this politicization of the Fed unprecedented?

No, says Allan Meltzer, professor of political economy at Carnegie Mellon University, and author of the two-volume "History of the Federal Reserve." He says anti-Fed talk typically coincides with problematic larger economic conditions, as is now the case.

William Poole, a senior fellow at the Cato Institute, and the former head of the Federal Reserve Bank of St. Louis, can attest to how easily the Fed's mission can become politicized.

Poole was a member of then-President Ronald Reagan's Council of Economic Advisers in 1983, when then-Fed Chairman Paul Volcker was extremely unpopular in the aftermath of a ruthless tightening of monetary policy meant to crush near hyper-inflation caused a deep, double-dip **recession** [explain this] from 1980 to 1982.

Then-Senate Majority Leader Howard Baker criticized the Fed publicly, saying it should lower interest rates, and, in general, **"get its boot off the neck of the economy."**

Poole recalls explaining to Baker that if he wanted rates lowered, he was going about it the wrong way. The Fed, he explained, had to remain apolitical and if it did what Baker wanted, right after getting publicly chastised by him, "it would look like the central bank is bowing to political pressure," something it could never do. At this point, Poole remembers, Baker saying, "'I know that, but it plays well on Main Street.'

Lost in the politics of the time was that Volcker's predecessor, G. William Miller, appointed by President Jimmy Carter, was blasted for allowing **inflation** [explain this] to run wild and resigned under pressure, making his tenure as Fed chairman among the briefest in history.

Adding credence to author Meltzer's theory is that Republicans and Democrats alike have been unhappy with the Fed's interventionist style in recent years, and considered steps to rein it in.

Rep. Paul was a leading sponsor of bipartisan legislation to revise the Fed's charter. Leading Congressional Democrats, such as then-Sen. Chris Dodd of Connecticut and Rep. Barney Frank of Massachusetts, also talked of forthcoming legislation.

Any congressional effort, however, even with a sitting Fed-busting GOP president, would first require a sizeable party majority in both houses. Under such circumstances, any legislation might reasonably resemble the Republicans' financial reform package of 2009.

Essentially, this was the party's version of what became the Dodd-Frank law, **the package of reforms that stripped the Fed of many of its regulatory and supervisory responsibilities**, so it could focus almost totally on monetary policy. The plan also called for periodic audits of the Fed's balance sheet, clear inflation targets, and greatly reduced the central bank's emergency lending authority.

Ironically enough, the **Dodd-Frank Wall Street Reform and Consumer Protection Act** added financial stability to its dual mandate of full employment and price stability, and Republicans have been trying to repeal parts, if not all, of it ever since its passage in July 2010.

If the GOP plan seems bold and fresh, its essence — antipathy toward the central bank — is almost as old as America itself.

America's first central bank, the First Bank of the United States, was chartered in 1791, and lasted just 20 years. The Second Bank of the United States was founded in 1816, and was done by 1836, after **being kneecapped by President Andrew Jackson in 1833, when he removed all federal funds from it**. Jackson blasted the central bankers as elites, "irresponsible to the people."

These failures were followed by **the National Bank Act of 1863**, which again sought to stabilize U.S. banking, and created an Office of the Comptroller of the Currency. The 1863 Act, however, failed, due to the lack of a true central banking structure.

The next major milestone came in 1913 with the Federal Reserve Act, which created the **regional Federal Reserve system,** following a series of panics, boom-and-bust cycles, and depressions that rocked the nation during the late 19th and early 20th centuries.

There were plenty of opponents and critics then, just as there are of the system today.

Going forward, the Fed could well remain in the crosshairs. If President Obama loses the presidency, and takes down his party with him — which is in the realm of possibility — the GOP would add seats in Congress. Should it gain enough to approve the 2009 Republican agenda on party lines, the central bank could become quite a bit less central. For better or worse.