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Shrink the Fed Before It Shrinks the Dollar

By Jon N. Hall

At Tea Party rallies and at other get-togethers over the last two years, one could often see placards reading "End the Fed." That also happens to be the title of a worthy book by Rep. Ron Paul. If one googles those three words within quotation marks, one should get nigh on a million hits. One might conclude that there's a movement afoot in America to abolish our central bank, the Federal Reserve.

Why are folks getting so exercised about this secretive quasi-governmental agency?

One reason folks are riled at the Fed is that the Fed sets interest rates, and rates have been at historic lows for much of the last decade. This has really hurt savers. As we write, the highest rate nationwide for a one-year certificate of deposit is 1.35%. Such a rate would require a goodly chunk of change, and yet it doesn't even keep pace with the Fed's target inflation rate of 2%. The Fed's low interest rates are partly to blame for the real estate boom, which led to inflated home prices, which led to the real estate bust, which led to the financial crisis of 2008. So the Fed is at least partly responsible for the flood of foreclosures as well as the collapse of home valuations. In Las Vegas, 80 percent of homeowners are underwater on their mortgages. Thank the Fed, Nevada.

But the reason folks are truly frightened by the Fed is because the Fed has been busy "printing money." Since the 2008 financial crisis, the Fed has created $1.7 trillion of new money (that we know about). Also, the Fed has just embarked on yet another round of "quantitative easing," or QE2 -- weasel words for money-printing. So in addition to "end the Fed," we now hear "sink the QE2." QE2 is the Fed's Hail Mary pass, according to analyst Peter Schiff.

The creation of so many new dollars tends to depress the value of old dollars. But the Fed says inflation isn't a problem right now. Instead, deflation is the problem. But the gurus are talking only about "price inflation," as measured by consumer price index. The CPI is unreliable, however, as it no longer measures the most important (and volatile) consumables, food and energy, and those prices are up.

The economist Milton Friedman thought the Fed could be replaced with a computer. But the Fed already resembles a computer: HAL in the sci-fi flick *2001: A Space Odyssey*. If you'll recall, HAL was given conflicting programming and ended up killing the crew to save the mission.

Likewise, Congress gave the Fed conflicting missions. The Fed's primary duty is to preserve the value of the U.S. dollar. But in 1978 with Humphrey-Hawkins (the Full Employment and Balanced Growth Act), Congress gave the Fed an additional mission. In "Blame Congress for Inflation," which appeared in the Wall Street Journal on May 1, 2008, Rep. Paul D. Ryan writes:

> Humphrey-Hawkins changed the Fed's mandate, directing it to focus on long-term price stability and short-term economic growth. Unfortunately, in its efforts to accomplish both, the Fed could end up satisfying neither.

So Ryan introduced the Price Stability Act of 2008 to return the Fed to a single mandate. The Cato Institute endorsed it. But in Pelosi's Congress, Ryan's bill went nowhere. Now that QE2 is alarming folks, there are renewed cries for putting the Fed on a leash. Rep. Mike Pence just introduced a new bill to end the Fed's "dual mandate."

If the dollar were to collapse, there's wouldn't be "economic growth" anyway, as there wouldn't be an economy -- or at least an economy based on the dollar. So the overriding business of the Fed should be, always and everywhere, the soundness of the dollar. The dollar is too important to leave to the Fed alone. Congress needs to shrink the Fed so that it can override such things as QE2...and QE3 and QE4, and whatever else the Fed thinks up. The Fed's much-ballyhooed "independence" needs to be reexamined.

There's a tendency in America to want to lay blame for everything on a single factor. Some folks blame the unraveling of the economy on George W. Bush or on greedy Wall Street bankers or even on capitalism itself. Others now blame the Fed or Ben Bernanke. The Fed certainly deserves much of the blame. But the Fed was created by, and continues to exist at the pleasure of, Congress. The Fed's printing of fiat money makes Congress's unholy spending possible. The taxpayer certainly wouldn't underwrite Congress's spending. Without the Fed, Congress wouldn't have the money for the pork projects that get incumbents reelected.

Imagine that the Fed refused to float new bonds and/or print new money to accommodate Congress's new spending. Then we'd have a truly independent Fed. But then Congress might move to impeach Bernanke and his lieutenants.

What if the dollar were crashing and burning before our very eyes? If the dollar went to zero, foreigners wouldn't be of a mood to buy any more of our bonds. In such a scenario, printing more dollars would be futile. And it'd be too late to balance the budget. With a destroyed currency, America would have to start over.

For now, ending the Fed may be a bridge too far. And we may actually need the Fed for years to come just to undo all the harm the Fed itself has done over the last century. But first we need to spay the Fed, put it on a leash, and take it to obedience school. We can't just allow the Fed to print money like it knows what it is doing.

The Fed is playing with *our* money. It may be fiat money, but it's our money.

POINTERS: Here's a funny, clever video on the Fed for your delectation. You can also find it at this article, where Charlie Gasparino of the Fox Business Network goes to bat for Bernanke. If you're really interested in sound money, watch The Kudlow Report on CBNC. When last checked, his video gallery had 265 entries. Kudlow's articles are all over the web; archives are here and here and here and here.

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