The Fed: A centenarian with the license to print

Antje Passenheim

December 23, 2013

The Fed has been watching over the dollar for a 100 years. The decisions of the most powerful reserve bank in the world can inspire or shake the global economy. Amid the celebrations, there's also a chorus of boos.

It radiates power, the white and heavily guarded palace, not far from the White House and the Treasury Department. The high and dark windows do not allow a view inside - if any tourists or locals actually cared to take a look.

The people working are chauffeured straight into the underground parking. They are the guardians of the dollar.

For many people in Washington the building is a mystery. "I have no clue," said a passerby."I have no idea what that is." He's not the only one. Only a few people seem to notice the thin, elegant lettering on the marble of the building. "This is the Federal Reserve Bank," said one man. "Isn't Bernanke working here?" A woman agrees with him. "It is the Central Bank for the US. Ben Bernanke is its current boss," she said. "It regulates the monetary policy," says another.

It's been doing that for the past 100 years. But the birthday celebrations for the most powerful central bank in the world have lost some of their bluster.

The bank was born out of a cloak-and-dagger operation. In the wake of the worst financial crisis of the US, the "Panic of 1907," a group of powerful bankers on Jekyll Island in Georgia hatched the idea of a new law to create a central bank. On December 23, 1913, under President Woodrow Wilson that law was adapted, accompanied by a revolt of its opponents. The Democrat allegedly made a pact with the bankers JP Morgan and John D. Rockefeller who helped him to win the elections and he in turn helped them to the first central bank. "I unwittingly ruined my country. A great industrial nation is controlled by the system of credits… all our activities are in the hands of a few men," he later noted in his diary.

The Fed pulls the strings

The Fedral Reserve Act put the control over the dollar into the hands of private bankers. They pulled the strings of the central institutions in Washington - represented by 12 local branches throughout the country. As a last resort the Fed would help out the banking system as a lending authority - and be independent from any political interference.

"The original goal of the great experiment that was the founding of the Fed was the preservation of financial stability," said Bernanke, the outgoing Chairman of the Fed. The dollar, measured by a fixed amount of fine gold, became the global reserve currency - and still is to this day.

After the founding of the Fed several other major challenges followed, said Bernanke during a recent anniversary event in Washington. "The great depression of the 1930s, the great inflation in the 1970s and subsequent deflation, the great moderation and the great recession due to the financial crisis 2008."

But critics of the Fed say that it contributed to the crisis as a result of its wrong decisions, in particular because the bank interfered in issues which were none of its business, for example politics.

Interference in politics

The former Chairman of the Fed, Alan Greenspan, has been accused of not only ignoring the real-estate bubble but of also supporting it with his monetary policy. In 2007 this lead to the worst financial crisis since WWII. Meanwhile Greenspan's successor, Ben Bernanke, overreacted in the crisis, according to the critics."The panic of 2007 and the ensuing financial crisis have led to a massive increase in high-powered money," said James Dorn from the Cato Institute, a think tank in Washington. The Fed had long since given up on it ability to maneuver, he said. That policy was determined by the gold standard, explained Dorn. "But the traditional gold standard ended after WWI. Afterwards we had a hybrid," he said.

The Fed essentially took on a double mandate - to promote price stability but also full employment. Under the leadership of Bernanke the bank set clear goals. In the medium-term the Fed targets an inflation rate close to 2 percent.

Meanwhile it plans to continue its low interest rate policy of virtually zero percent until the unemployment rate in the US has drastically decreased. The biggest criticism, however, is over its monthly policy to buy long-term government bonds and real estate shares. Form January on these acquisitions will be reduced from $85 billion to $75 billion. But critics say that fails to address its meddling in fiscal issues that are none of its business.

The flood of money from the Feds drives the stock markets and could lead to the the next bubble, said John Allison, Director of the Cato Institute. "I think, the volatility in the economy is primarily caused by the Fed. When the Fed's radically changing the money supply and doing all the things that we just looked at, it makes economic calculation hard," said the economist who spent nearly two decades at BB&T Corporation, one of America's biggest financial institutions. "Every bubble in my career, the Fed has made them worse," he said. His radical solution: "I would get rid of the Federal Reserve."

For years politicians - especially Republicans - have demanded the same thing. They want to get rid of the Fed sooner rather than later -at the very least they want to reform the Fed. Some want its mandate to be changed. Others think the Fed should only focus on the fight against inflation and should stay out of labor-market policies. Republicans have already announced a review of the Fed in Congress in 2014. That's something the new designated Fed boss, Janet Yellen, will have to deal with. The first woman at the head of the Fed will replace Bernanke at the end of January. The celebrations will be over by then, but experts expect little to change under Yellen.