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The Case for Auditing the Fed

History is No Help to the Federal Reserve

By Alan Caruba Wednesday, April 27, 2011

Federal Reserve Chairman, Ben Bernanke, gave a press conference on Wednesday and, try as I did, I felt asleep almost immediately. For those suffering from insomnia, I would recommend you "take two Bernanke's and call me in the morning."

At the time of his appointment
Bernanke was widely known as an expert on the history of the Great Depression. It was commonly thought that he would avoid putting the nation through a similar experience, but a long, deep recession has put that in doubt.

In "New Deal or Raw Deal", historian Burton Folsom, Jr., identified three major causes of the Great Depression, beginning with a Smoot-Hawley Tariff Act on imported goods that was signed in June 1930 by Herbert Hoover. It was the highest tariff on imported goods in U.S. history. Other nations retaliated. "Our exports, therefore, dropped from $7 billion in 1929 to $2.5 billion by 1932." The result was that "By July the stock market had lost one-third of its value in ten months", a second major cause of the Depression whose beginning is generally dated to the Wall Street crash of October 1929.

The other cause was due to the fact that, in the three years leading up to the bill, "the national debt balloon(ed) from $1.3 billion to $24 billion." Our current national debt is equal to our entire Gross Domestic Product, the value of all of the nation's goods and services.

Folsom identified the third leading cause as "the poor performance of the Federal Reserve. "In practice, the Fed had raised interest rates four times, from 3.5 percent to 6 percent, during 1928 and 1929. That made it harder for businessmen to borrow money to invest, which hindered economic growth."

Under former Chairman Alan Greenspan and Bernanke, the Fed has kept the interest rates it charges banks to nearly zero. Bernanke is no doubt aware that the Fed's failure to lend money to cash-hungry banks led to the collapse of hundreds during the Great Depression.

Fast-forward to present times and we see that the Fed has literally flooded the economy with cash, essentially by simply printing money out of thin air. All of it is backed by the "full faith and credit" of the government.

On April 25, The Wall Street Journal headlined an article, "Fed Searches for Next Step" noting that it "is likely to begin closing a wide-open credit spigot this week—but faces a major decision: when to start draining the excess credit out of the economy by raising interest rates."

Whether the economy was infused with great gobs of cash or whether that liquidity is slowed, the Fed—then and now—is caught in a vice because history demonstrates that neither action had the desired purpose. If this was a game of Monopoly, the players could put the board away in its box, but neither history nor current trends point to anything other than a severe depression.

The rating service, Standard & Poors, recently issued a warning that the U.S. debt was slipping into a “negative” situation and this has been followed with a prediction by the International Monetary Fund that the U.S. economy will be overtaken by China in just five years. S&P is famous for its failure to spot bad guys like Enron, to whom it gave high ratings right up to the day it collapsed, nor should we believe the IMF propaganda which suspiciously tries to panic Americans.

The Fed was created by a small group of bankers and came into being in 1913. In good times and bad it has functioned in concert with international banks to control the volatility of the financial marketplace and sustain the viability of the individual nations they represent. The Fed functions largely in secret. The oversight that Congress is supposed to exercise is much the same of its regulatory agencies that have rarely seen trouble brewing, nor been able to do much about it except to clean up the mess with taxpayer’s funds.

The problem in the 1930s and now is the national debt, the result of insane, profligate spending. Those in the White House and the Democratic Party are opposing any rational steps to reduce it.

Instead, it enacted Obamacare, legislation that will further crash the economies of individual States. Some twenty-eight States are already on record opposing it. An effort to have it declared unconstitutional was greeted by the Supreme Court with a refusal to expedite the case just before the judges began a three month vacation.

An April 27, 2010 Cato Institute briefing paper by Arnold King presciently noted that “Recently, the Federal Reserve has significantly altered the procedures and goal that it had followed for decades. It has more than doubled its balance sheet, paid interest to banks on reserves held as deposits with the Fed, made decisions about which institutions to prop up and which should be allowed to fail, invested in assets that expose taxpayers to large losses, and raised questions about how it will avoid inflation despite an unprecedented increase in the monetary base.”

The Cato paper was titled “The Case for Auditing the Fed is Obvious.” The fate of the nation is held in the hands of the Federal Reserve. It performed poorly in the late 1920s and 30s, and confidence in its ability to extricate the nation from its enormous debt.

A combination of unsustainable entitlement programs, too much spending, and the collapse of the housing market that resulted from Fannie Mae’s and Freddie Mac’s belief that housing prices would never fall has brought us to this point in the wake of the 2008 financial crisis.

The response by the government, however, was to buy the bank’s bad debts and engage in multi-billion dollar “stimulus programs” which we were told would create employment and put the economy on track to recovery. It has not happened.

Instead, taxpayers have had the nation’s future put in jeopardy into the next and further generations, some of whom are as yet unborn.

Despite the Fed’s printing presses, the U.S. dollar is in decline at the same time that the price of gasoline, food, and everything else is rising.

The 2010 elections that put Republicans in charge of the House of Representatives, the branch of government that initiates spending bills, has resulted in partisan warfare on Capitol Hill as the GOP weighs what steps it can take. Ambivalence about raising the debt ceiling reflects GOP concerns regarding the 2012 national elections and their fear that they, not the Democrats that regained control of Congress in 2006 will be blamed for the current crisis.

Suffice to say that both political parties deserve blame for years spent initiating excessive spending and ignoring the warning signs.

Meanwhile President Obama has declared his candidacy airily demanding that taxes be raised on “the rich” at a time when raising taxes is the worst possible choice to make as the economy struggles to recover. For the passed two years, the Obama administration has engaged in every effort to undermine and destroy the economy.

John Adams, one of the Founding Fathers and the nation’s second President, warned “Remember, democracy never lasts long. It soon wastes, exhausts and murders itself. There never was a democracy that did not commit suicide.”

2012 looms as an election year in which Americans will decide whether to change course or, indeed, commit suicide.

Alan Caruba Bio

Alan Caruba Most recent columns
Alan has a daily blog called Warning Signs. His latest book is Right Answers: Separating Fact from Fantasy.

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