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One Little Change for the Federal Reserve

By Jon N. Hall
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Many Americans distrust the Federal Reserve. At Tea Party rallies back in 2009, one would even see placards urging that we "End the Fed." But can Congress just summarily end the Federal Reserve? In November 2013, *Forbes* ran "100 Years Later, Was the Federal Reserve a Good Idea?" by Gerald P. O'Driscoll Jr., a former vice president and economic advisor at the Dallas Fed who is now a senior fellow at the Cato Institute. O'Driscoll contends that "the Fed has made many mistakes, but the current era of big government precludes any near-term possibility of abolishing it." He then hastened to add that the Fed "can be improved." Here's one idea that would not only "improve" the Federal Reserve, but perhaps Congress as well.

Since the Humphrey-Hawkins act of 1978, Congress has tasked the Federal Reserve with promoting full employment. That's on top of its original duty of maintaining price stability, hence the so-called "dual mandate." Inasmuch as the Fed can't do much other than "print" money (as when it buys assets in "quantitative easing") and control a couple of interest rates, this second "mandate" should be repealed. The responsibility for full employment should lie with Congress, and the Fed should have but one "mandate": preserving the value of the U.S. dollar.

Other than turning the money spigot on and off, the Fed doesn't have very many tools. Even so, Congress seems to have put all its hopes for improving employment numbers in the Federal Reserve, i.e. monetary policy. Congress has been abdicating its own responsibilities for improving the economy through fiscal policy. Indeed, Sen. Charles Schumer (D-NY) once told former Fed Chairman Bernanke: "You're the only game in town."

In "Fed's Fisher Warns of Monetary Excess" at *Newsmax* in October 2012, Robert Feinberg related that story about Schumer in a report on a speech at Cato by Richard Fisher, president of the Federal Reserve Bank of Dallas: "Fisher said that if he had been in that chair, he would have tried to bring the significance of the lack of action on fiscal policy to Schumer by responding, 'No, Senator, you're the only game in town.'"

Now, we know that Congress has farmed out many of its responsibilities to the executive branch, like the regulators in the permanent bureaucracy. (The Senate is even content to let the president "write" law.) But there are far more effective, as well as creative, ways

to straighten out our economic mess than reliance on the "easy money" policy of the Fed.

"Fiscal policy" could involve corporate income tax reform, regulatory reform, enterprise zones, and many other initiatives that only Congress, not the Fed, can launch. But dysfunction rules, and that's because the Senate, under Harry Reid, has become the place where legislation goes to die.

The Fed has had a zero interest rate policy (ZIRP) for years. And with its serial sprees in "quantitative easing" (QE1, QE2, QE Infinity), the Fed has been on the biggest buying binge in history, snapping up treasuries right and left. And when the Fed buys these assets, it "prints" money. One wonders if all this money creation and zero percent interest rates haven't just been a way to prop up the stock market.

Soon after the 2008 financial crisis, we began to hear concerns about the "exit strategy," and about how the Fed would "unwind" its extraordinary actions. The term now is "tapering," as in cutting back on the size of the Fed's monthly QE purchases. And the Fed is indeed tapering. But the Fed's "exit" must eventually involve raising interest rates.

On August 26, the wood pulp version of the Kansas City *Star* ran a guest commentary by Jim Kudlinski headlined: "The Fed is inching toward increasing interest rates -- and shouldn't waste any time." Mr. Kudlinski worked at the Fed as Director of the Division of Reserve Bank Operations, Federal Reserve Board (1971-1981):

…the Fed, and especially the hawks on the FOMC, are uneasy about maintaining rates at abnormally low levels in the pursuit of teasing out the last shred of economic growth from such a policy -- because they recognize a miscalculation on their part could be catastrophic. And they are now near or at the precipice where a wrong decision could enable inflation to gain a foothold…

I recommend Kudlinski's 741-word article for its summary of the 1970s under Fed Chairmen Burns, Miller and Volcker. It's a story about inflation. The space given to Chairman Volcker's tactics in fighting inflation and the resistance of ordinary Americans to them is well worth reading.

The market yield on "U.S. Treasury securities at 10-year constant maturity" was 1.8 percent in 2012, and was 13.92 percent in 1981. Over the last six years, the rates for these instruments have been lower than at any time since 1962, (the Excel chart only goes back to 1962). If the Treasury had to pay 1981 interest rates on our current $12.687T publicly held debt, interest on the debt would amount to over $1.766T a year; which is about half of all current federal spending.

Even if interest rates on treasuries were only half of what they were in 1981, the increased cost of borrowing would be crippling. Projections like these speak to the need for changing the role of the Fed. The Fed needs to be relieved of its "mandate" to pump up employment numbers so that it can concentrate on fighting inflation.

But to make such a change requires changing the law. And that requires a functional Congress, which we'll never have as long as Harry Reid, Democrat of Las Vegas, controls the U.S. Senate.