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Don't Blame the Fed for Low Rates

Long-term rates reflect weak job creation and credit demand, both a result of President Obama's poor economic stewardship.

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The frequent claim that Federal Reserve Chair Janet Yellen and her colleagues are responsible for continuing low rates of interest may be correct in the small, but not in the large. The Fed does set the federal-funds rate—the overnight interest banks charge to lend to each other—and surely affects the timing of rate changes, but not the longer-run level. The real villain behind low interest rates is President Obama.

Long-term rates reflect weak job creation and credit demand. As the Fed correctly points out in its Statement on Longer-Run Goals and Monetary Policy Strategy: "The maximum level of employment is largely determined by non-monetary factors that affect the structure and dynamics of the labor market." The same argument applies to all real variables, such as the rate of productivity growth.

The Fed has successfully kept inflation close to its 2% target. But the real rate of interest, currently negative for short-term interest rates and only slightly positive for long rates, is a consequence of non-monetary conditions that have held the economy back.

The recovery since the recession trough in June 2009 has been the weakest since World War II. Why? Disincentives to business investment deserve special notice. Despite the lowest interest rates for a sustained period since the 1930s, business investment has exhibited weak growth. Lagging business investment has meant smaller than usual demands in credit markets, and thus low interest rates.

The Obama administration has created one disincentive after another. One is the failure to pursue tax reform and the president's insistence on higher tax rates. Another is the constraint on investment flowing from environmental activism. Cancellation of the Keystone XL pipeline is a metaphor for the entire range of environmental policies that inhibit growth. Businesses cannot expand if they cannot obtain the required permits.

The regulatory environment is a disaster, ranging from growth-killing overreach in the Affordable Care Act and Dodd-Frank to the Consumer Financial Protection Bureau, the Environmental Protection Agency and the Labor Department. The Federal Reserve is not responsible for this mess.

The Fed is responsible, however, for not defending itself by explaining to Congress and the public what is going on. The Fed is too afraid politically to mention any details of its general position that it cannot do the job on its own. Yes, there are “headwinds,” but they are largely the doing of the administration. I say largely because some of the problems have been inherited from prior administrations. The Obama administration didn’t create Fannie Mae and Freddie Mac, for instance, or the government’s affordable-housing goals—both of which fueled the 2008 financial crisis.

But the Obama administration has failed to correct the economic problems it inherited. It has simply piled on more and more disincentives to growth. These disincentives have kept long-term rates low.

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