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Five Ways Trump Can Use Fed to Aid American Workers

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On the campaign trail Donald Trump lashed out at Washington insiders for favoring policies that were "good for Wall Street … but unfair to American workers" and of diverting money "into the pockets of a handful of large corporations." Riffing on Franklin D. Roosevelt's famous "Forgotten Man" radio talk, he promised to make Washington answerable to America's "forgotten men and women."

If Trump really means it, he should take aim at one government agency that has steered boatloads of money into the pockets of large Wall Street firms: the Federal Reserve.

To make a Fed more accountable to the people than to Wall Street, President-elect Trump and his team might start with these five reforms:

Shut the Revolving Door

The Fed recently announced an expansion of a one-year ban on departing employees working at a financial institution that had been under their purview at the central bank. But this policy should go much further.

As policymakers focus on the need for diversity at the regulatory agencies, the most dangerous bias in Fed appointments is one that favors former Wall Street executives. For example, ties between the industry and the central bank are illustrated in how many presidents of the Fed regional banks used to work at a huge financial services company, with several of them having worked at one firm: Goldman Sachs. Four of the presidents — William Dudley of the New York Fed, Patrick Harker of the Philadelphia Fed, Robert Kaplan of the Dallas Fed and Neel Kashkari of the Minneapolis Fed — each at one time worked for Goldman.

To let Fed appointees help craft policies affecting their former firms is just asking for trouble.

The fix is relatively easy: In addition to the one-year ban on senior and mid-level Fed employees working at a financial firm, how about a similar if not longer "cooling off" period before the Fed board or regional banks can hire a senior executive from a major firm?

End Fed Bailouts for Good

Thanks to power under the Federal Reserve Act, the Fed lent billions of dollars to cherry-picked banks in the financial crisis. But this policy was disastrous. After the Fed made a loan to help rescue Bear Stearns, other big investment banks — including Lehman Brothers — thought that they could count on the Fed to get them out of hot water. Everyone knows what happened next.

The Dodd-Frank Act tried to constrain the Fed's powers — known as its "13(3)" authority — by limiting emergency lending to instances that were broad-based rather than institution-specific. But this provision is so vague to be toothless. As long as any authority like this remains, the chaos of the financial crisis could happen again. It's better to repeal section 13(3) altogether. After all, the Fed already has a way for supplying emergency funds broadly, by auctioning them to the highest bidder.

Level Playing Field for Accessing Fed Funds

The Fed's auctions, known as "open market operations," have traditionally been open only to a score or so of Wall Street financial firms known as "primary dealers," forcing other firms to seek needed liquidity through private-sector channels. That arrangement usually works; but when the primary dealers themselves get into trouble it can break down. Fear of such a breakdown is what caused the Fed to turn its 13(3) spigot wide open in 2008.

The primary-dealer system is a throwback to horse-and-buggy times, when auction participants had to actually show up at the New York Fed. Today, the internet makes that unnecessary. The European Central Bank routinely allows hundreds of European banks to participate in its auctions. The Fed ought to follow its example. To make 13(3) lending unnecessary, it can also let "systematically important" (i.e., too-big-to-fail) nonbanks take part. Finally, it can offer to trade cash for a broader set of securities, as it did temporarily using its "Term Auction Facility," and as the Bank of England now does routinely.

Stop Paying Banks to Hoard Cash

As a way to set a floor on falling interest rates, the Fed has been rewarding banks for holding on to cash since October 2008 by paying them "interest on excess reserves." But that policy never made sense. Credit was already rapidly drying up, but IOER made it dry up even faster. Paying such interest has worked like a brake on bank lending and the economic recovery ever since.

The policy also adds to the federal deficit by reducing the Fed's net earnings, which are government income. The Fed also pays interest to foreign banks. In fact, U.S. subsidiaries of foreign holding companies hold a disproportionate share of excess reserves at the Fed. If Trump doesn't want Americans to foot foreign nations' defense bills, why have them prop up foreign banks?

Subject the Fed to GAO Audits

Most of the Fed's monetary operations are exempt from ordinary audits by the Government Accountability Office. Fed officials claim that allowing such audits would undermine the Fed's independence. But allowing unrestricted GAO audits of the Fed doesn't alter Congress' constitutional Fed oversight powers at all. Instead, by supplying needed information on the Fed's programs, the GAO could allow Congress to exercise those powers more responsibly. If this means making Fed officials answer tougher questions, that's a benefit instead of a defect.

Other monetary reforms could also help ordinary citizens. But this list is at least a start. Let's hope the Trump administration really cares about America's forgotten men and women, and that it puts its monetary policy reform agenda where its mouth is.

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