

Current Events



Fed Should Go Back to Basics

WASHINGTON HAS FLOWN OUT OF CONTROL IN SO MANY areas—spending, taxes, debt, health care, financial regulations (lame), secretiveness, foreign policy (weak), etc.—that it's hard to pick the most critical problem. All should be fixed—and quickly—if the U.S. is to become safe and prosperous again.

A key area that's off track is the expanding role of the Federal Reserve, which is harmful to growth and jobs but is fixable. The Fed should go back to basics: setting the interest rate, with the goal of providing a relatively stable dollar over time and low inflation. Let the Executive Branch and Congress do the rest, using a proper system of checks and balances.

This narrower Fed mandate would reduce conflicts of interest, increase the Fed's independence, stabilize the weakening dollar and add to economic growth and employment. A focused Fed and a stable dollar would attract global investment to the U.S., a critical job creator the current Fed is not providing.

Instead, the Fed has become the fourth branch of government. It's the powerful and inbred go-to institution used when Washington wants to regulate, fund bailouts or save the global financial system, while pretending these actions are costless.

Unlike other government agencies the Fed is largely outside the normal congressional process of appropriations and performance audits. It doesn't have to get congressional approval for an increase in its balance sheet. It's not counted in the national debt, no matter how much it borrows—currently \$1.1 trillion. Because it can create money, the Fed's spending power is practically unlimited—\$1.4 trillion on bonds after the Lehman bankruptcy, with no outside approval required.

Voters have little say over the Fed's policies or personnel, a double-edged sword that gives the Fed a buffer to conduct monetary policy but with little accountability. Both its methodology and results have been deeply flawed in recent decades, with the Fed repeatedly relying on lagging inflation indicators and causing wide swings in inflation, unemployment and the value of the dollar.

Chairman Ben Bernanke has sought more transparency, but much still remains secret. Unlike Europe's central bank the Fed doesn't hold press conferences—the media sugarcoats stories to gain access. The Federal Reserve System itself screens candidates for Fed governors and regional presidents, often choosing from within. Representative Ron Paul (R-Tex.) proposed a bill in the 110th Congress to audit the sprawling Fed, but narrowing its mission to sound monetary policy would be a better step.

The Fed is trapped in too large a role, one filled with conflicts of interest: It regulates banks that are heavily dependent on low interest rates; sets credit card fees, yet has responsibility for the safety of both banks and card users; and enforces bank compliance with congressional mandates for community reinvestment (in effect, overseeing a social quota of risky loans). These are particularly complicated jobs, especially since they put the Fed at cross-purposes with its role as one of the institutions responsible for capital adequacy at banks.

Mission Creep

The Federal Reserve System has 20,000 employees and more than \$4 billion in yearly operating expenses. Its annual report states mildly that “over the years the Congress has given the Federal Reserve more authority and responsibility for achieving broad national economic and financial objectives.” Now that's a mandate!

The Fed is a major source of data for the public—on industrial production, security issuance, agricultural finance—and plays dozens of other data roles more properly conducted through the Executive Branch with appropriated funds. The net result is a massive, unfocused Fed burdened with activities that should be carried out by the private sector or other federal agencies.

News headlines in January reported that the Fed produced record net profits of \$46 billion in 2009, was fighting disclosures of bailout information, received a congressional subpoena for its records on AIG and suffered attacks for denying the obvious—that low interest rates earlier in the decade fueled the housing bubble.

Growth would likely have been just as strong in 2004–06 with a higher Fed funds rate. The dollar wouldn't have been as weak, and the economy wouldn't have depended so much on housing, leverage and foreign Treasury buyers. More growth would have come from investment and technology. The 2007–09 economic crisis would have been avoided or, at a minimum, less cataclysmic.

The Fed's most important role is to get interest rates generally right, protecting the value and purchasing power of the dollar. It hasn't been doing that. Advertisements for gold as an inflation hedge fill the airwaves, a daily vote of no-confidence in the Fed. Riding a populist wave, Congressman Paul's Federal Reserve Transparency Act of 2009 has already been passed by the House and has more than 30 Senate cosponsors. Given the Fed's breadth of endeavors, one can understand Mr. Paul's frustration with business as usual. A better approach would be for the Fed to go back to basic monetary policy, where its independence is justified. **F**



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