“Enough is enough! it’s time to end the fed”

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Enough is enough! It's time to end the fed

Abstract

The central bank of the United States, the Federal Reserve, is not a part of the government. Its unique organizational structure combines public regulation and oversight with private banking expertise. Increasingly, it has come under the scrutiny of Congress and the public for its alleged non-transparency and failure to meet its charge of providing financial stability.

Protests against a national bank system and the attempts to centralize money and credit in a government sponsored, government-backed financial institution that operates in alleged secrecy are deeply rooted in America's history and based on the current performance of our central bank, and an opposition seems to be reaching a crescendo.

Keywords: Federal Reserve System, money supply, money creation, inflation.
JEL Classification: E42.

Introduction

"Only government can take perfectly good paper, cover it with perfectly good ink and make the combination worthless" (Milton Friedman).

The Federal Reserve System is the central bank in the United States. It provides financial services for the banking system and the central government. It is controlled by a seven-member Board of Governors appointed by the President of the United States. The Board functions as the decider and implementer in determining and carrying out monetary policy for the nation. But to be specific, the Federal Reserve System's ("the Fed") most important function is to control the size – the rate of growth – of the money supply.

The Federal Reserve System isn't a part of any of the "three branches of government". The system was set up by Congress in 1913 as an "independent agency" to monitor the nation's money. The Board isn't under anyone's direction or control. If it wants to, it can be as free and independent as the Supreme Court! Except that the Congress could pass a law to restrict, change, or even abolish it at any time.

"A modern central bank is a bureaucracy: it is an agency of the national government, directed by appointed officials, which, unlike a private business firm, does not answer to profit-seeking shareholders. Because a central bank earns revenue, it can be self-financing, and need not receive an annual budget from the legislature as a typical government bureau does. A number of economists (see: Milton Friedman; Edward Kane; W. Shugart and R. Tollison; and M. Toma) have theorized that the bureaucratic nature of the central bank, or its budgeting process, helps to explain its behavior" (White, 1999).

Lord Acton's admonishment that "Power corrupts; absolute power corrupts absolutely" underlies the criticism of the Board and its actions since inception in 1913. Since the onset of the Great Recession of 2008, the criticisms have become more numerous and more virulent.

1. A history of opposition

Protests against a national bank system and the attempts to centralize money and credit in a government-sponsored, government-backed institution that operates in complete secrecy are deeply rooted in America's history (Paul, 2009).

Thomas Jefferson was a dedicated opponent of the Fed's predecessor, the Bank of the United States and Thomas Paine, who saw paper money as the enemy of individual liberty on grounds that it always gives rise to despotism, had this to say: "As to the assumed authority of any assembly in making paper money, or paper of any kind, a legal tender, or in other language, a compulsive payment, it is a most presumptuous attempt at arbitrary power. There can be no such power in a republican government: the people have no freedom – and property or security – where the practice can be acted" (Foner, 1945).

- In 1913 when the legislation was passed creating the Federal Reserve System, Henry Cabot Lodge, Sr. held this view, "The powers vested in the Federal Reserve Board seem to me highly dangerous especially when there is political control of the Board. I should be sorry to hold stock in a bank subject to such dominations. I do not like to think that any law can be passed that will make it possible to submerge the gold standard in a flood of irredeemable paper currency" (1913).
- And during the depth of the Depression, the Chairman of the House of Representatives' Committee on Banking and Currency angrily protested: "Mr. Chairman, we have in this coun-

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try one of the most corrupt institutions the world has ever known. I refer to the Federal Reserve Board and the Federal Reserve banks. The Federal Reserve Board, a government board, has cheated the government of the United States out of enough money to pay the national debt several times over. This evil institution has impoverished and ruined the people of the United States; has bankrupted itself, and has practically bankrupted our government. It has done this through defects of the law under which it operates, through the maladministration of that law by the Federal Reserve Board and through the corrupt practices of the moneyed vultures who control it" (McFadden, 1932).

- Toward the end of the twentieth century, former U.S. Senator Barry Goldwater commented acerbitly: "Most Americans have no real understanding of the operation of the international money lenders. The accounts of the Federal System have never been audited. It operates outside the control of Congress and through its board of Governors manipulates the credit of the United States (1979).
- Nobel laureate in economics, the late Milton Friedman, perhaps America's most respected economist, brutal admonishment of the Federal Reserve System is apparent in the following diatribe: "The stock of money, prices, and output was decidedly more unstable after establishment of the (Federal) Reserve System than before. The most dramatic period of instability in output was, of course, the period between the two wars, which included the severe (monetary) contractions of 1920-21, 1929-33, and 1937-38 are directly attributable to acts of commission and omission by the Reserve authorities…
- Any system which gives so much power and so much discretion to a few men [so] that mistakes – excusable or not – can have such far reaching effects, is a bad system. It is a bad system to believers in freedom just because it gives a few men such power without any effective check by the body politic – the key political argument against an independent central bank.
- To paraphrase (Georges) Clemenceau, "Money is much too serious a matter to be left to the central bankers" (Friedman, 1994).
- And recently, none other than a former chairman of the Federal Reserve Board had this to say, "We don't know what would have happened had (federal Reserve Governor Benjamin) Strong lived; but what we do know is that the central bank of the world's most important nation in 1929 was essentially leaderless and lacking in expertise. This situation led to decisions, or non-decisions, which might well not have occurred under either better leadership or a more centralized structure. Associated with these decisions, we observe a massive collapse of money, prices, and output. Let me end my talk by abusing slightly my status as an official representative of the Federal Reserve. I would like to say to Milton (Friedman) and Anna (Schwartz): Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again" (Bernanke, 2002).

2. Stewards of our financial system

Proponents of the Federal Reserve are quick to be specific as to the indispensable functions of the Fed: stabilize the business cycle, control inflation, maintain a solvent banking system, regulate the financial system, and more. But it is essential to realize that the *concept* behind the Federal Reserve was tried *three* times before in America. We need to know that and especially need to know why those institutions were eventually junked (Griffin, 2010).

The U.S. federal debt has not been paid off since the days of Andrew Jackson. Only the interest gets paid, while the principal portion continues to grow. The government doesn't have to pay off the principal so long as it keeps "servicing" the debt by paying the interest. Like the bankrupt consumer who stays afloat by making the minimum payment on her credit cards, the federal government has avoided bankruptcy by paying just the interest on its monster debt ($18 trillion as of 2015); but the debt is growing exponentially and even that mounting bill could soon be more than the federal government can afford to pay. So long as the debt is in U.S. dollars, the federal government can just print its way out of insolvency. But fears of inflation even in a credit crisis have driven public sentiment away from that solution (Brown, 2012).

The Fed has failed miserably at its primary task: providing a counter-cyclical influence when severe disruptions appear imminent in the economy. As an example, Fed monetary policy led to the recent U.S. credit boom and the associated house price bubble that morphed into a full-fledged financial crisis.

3. Non-transparency

By far the most secret and least accountable operation of the federal government, is not, as one might expect, the FBI, CIA, NSA, or some other super-secret intelligence agency. It is little known, however, that there is a federal agency that is super-secret: the Federal Reserve is accountable to no one; it has no budget; it has only recently been subject to an audit (see below); and no Congressional committee knows of, or can truly supervise, its operations. The Federal Reserve, virtually in total control of the nation's monetary system, is accountable to no one – and this surreal situation, if acknowledged at all, is invariably trumpeted as a virtue (Rothbard, 2015).

The first ever GAO (Government Accountability Office) audit of the Federal Reserve was completed in late summer of 2011. However, the legislation authorizing the audit had been watered-down in the U.S. Senate so that a complete audit was not carried out. The audit, such as it was, revealed that $16 trillion had been secretly given to U.S. banks and corporations and foreign banks in Scotland, Germany, Switzerland, France and even Belgium and South Korea (see Appendix 1). The Federal Reserve likes to refer to these secret bailouts as an all-inclusive loan program, but delinquencies seem to be as common as repayments and the money was loaned-out at 0% interest. This secret bailout has raised the ire of both liberals and conservatives and even socialist U.S. Senator Bernie Sanders of Vermont has exclaimed, "This is a clear case of socialism for the rich and rugged; you're on-your-own individualism for everyone else….no agency of the United States government should be allowed to bailout a foreign bank or corporation without the direct approval of Congress and the President" (Cardinale, 2011).

4. Inflation and the Fed

The historical argument against letting Congress play a role in monetary issues is that elected politicians are always inflationists, and it takes an independent body to stand up for sound money. But now, we have doubled-down with an inflationist central bank – a Fed that endlessly repeats its commitment to perpetual inflation at its "target" rate of 2% per year. But if successful in meeting the target rate of 2% per year, the compounding effect will lead to prices doubling every 36 years. And since the introduction of the Fed in 1914, 98% of the value of the dollar has been lost to inflation. With the interest rate being kept artificially low since the year 2000, Ben Franklin's admonishment of "A penny saved is a penny earned" is nothing but balderdash!

In contrast to the Fed's commitment to perpetual inflation at its "target" rate of 2% per year, Professor George Selgin argues instead for a monetary policy which would allow "prices to vary with movements in productivity" (either labor or total productivity). Rather than attempting to keep the general price level constant, a "productivity norm" policy would permit that level to change to reflect variations in unit costs of production (Selgin, 1997).

5. "Too big to fail"

The Fed's action in "bailing-out" failing financial institutions has reduced the incentive to be careful and will encourage financial institutions to make even *riskier* gambles in the future. Any financial crisis leaves its mark in the form of a stream of losses among the institutions, and these losses must ultimately be borne by someone. When such an event occurs in the private sector, the resolution process begins with identifying management responsible for the problems, replacing them, and the losses identified and dealt with. Not until these actions are taken can market confidence return. It's not a question of avoiding such losses for they will occur in a dynamic economy. The important point is how quickly the firm takes the losses and pushes forward with the process of recovery. But for the U.S. government and the Fed, many of its policies seem to revolve around the idea some financial institutions and corporations are "too big to fail." Such policy has led to the U.S. economy being very slow to recover from The Great Recession of 2008 and the ultimate cost to taxpayers has been larger than it needs to be.

6. Soft-budget constraint

In the former Soviet Union and now in China, the state-run enterprises (SRO) are shielded. If a firm gets in trouble, the banking system gives the firm more money. This leads to inefficient operations and a high opportunity cost. The Fed loaning money to General Motors, Chrysler, and other corporations is no different.

Since the onset of the Great Recession of 2008 and continuing into what is now almost seven years of a languishing economic recovery and expansion, the Fed has greatly expanded its balance sheet and changed the composition of its assets. The average maturity of its portfolio has been lengthened, which means it has taken on much greater interest-rate risk, and its portfolio is concentrated in housing assets. This is a form of credit allocation that takes the central bank into the realm of fiscal policy, which deals with the size and composition of government spending. *By lending to particular sectors at subsidized interest rates, the Fed is shifting resources toward favorite sectors.* Since the year 2000, the Fed has kept interest rates artificially low. In fact, the Fed has created a completely artificial market.

7. No limit on money creation

The Fed has a unique power that is limited to it alone; it can create money out of thin air. The trillions of money the Fed has created since the start of the first stimulus package in 2009 and through three "quantitative easing" experiments (Q1, Q2, and Q3) have driven the monetary base to unprecedented heights. Has this "printing press money" been seamlessly absorbed into the U.S. economy? Hardly. For the most part, the "new" money sits as reserves in bank vaults and corporate accounts awaiting a different environment than currently exists. Should such an environment arrive where both consumers and businesses felt confident that the nation's leadership was equal to the domestic and international challenges and was safe again for lending and borrowing, we could see a level of price increases none of us have experienced in our lifetime.

There is an important difference between the economic administration of money and that of other resources. An improperly managed money supply leads to much greater economic discoordination than an incorrect supply of any other good or service. "Excess demand or excess supply of money affects spending in numerous other markets, and hence affects the entire system of market price and profit signals". One can think of the market being like a wheel, with money as the hub, prices as the spokes, and other goods as the rims. A change in the relation of one good to the rest is like a tightening or loosening of a single spoke: it has a great effect on one small part of the wheel, but much less effect on the rest of the wheel. A change in the relation of money to other goods is like moving the hub: it has a great effect on all parts of the wheel, because it moves all the spokes at once. Adjust a spoke a particular price – improperly, and you make one small part of the wheel wobble; adjust the hub – money – improperly, and you bend the whole wheel out of shape (Selgin, 1988).

An increase in the money supply also changes the distribution of income and wealth. The ripple effect also alters the structure of relative prices, and therefore, of the kinds and quantity of goods that will be produced (Rothbard, 2015).

The far-reaching consequences of monetary disequilibrium are a matter of grave concern precisely because market prices have a coordinating role to perform. Incorrect adjustments in the money supply promote *general* calculation chaos (Selgin, 1988).

Conclusion

The Fed should get out of the business of setting interest rates. Interest rates are the price of money and we shouldn't have price controls. Price controls don't work for gasoline, soap, wages, or food and we shouldn't have price controls on the rate of interest. Interest is the most universal signal that goes throughout the market place. It gives people feedback on whether they should expand or contract their business. When you don't have true market interest rates what you end up having is a distortion of the market place where people over-invest resulting in the development of a bubble or false boom and then comes a correction.

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Appendix A

List of Institutions that received the most money from the Fed (Dec. 2007 – June 2010)

Citigroup: **$2.5 trillion**, Morgan Stanley: **$2.04 trillion**, Merrill Lynch: **$1.949 trillion**, Bank of America: **$1.344 trillion**, Barclays PLC (United Kingdom): **$868 billion**, Bear Sterns: **$853 billion**, Goldman Sachs: **$814 billion**, Royal Bank of Scotland (United Kingdom): **$541 billion**, JP Morgan Chase: **$391 billion**, Deutsche Bank (Germany) **$354 billion**, UBS (Switzerland): **$287 billion**, Credit Suisse (Switzerland): **$262 billion**, Lehman Brothers: **$183 billion**, Bank of Scotland (United Kingdom): **$181 billion**, BNP Paribas (France): **$175 billion.**

Source: US Government Accountability Office (GAO).