Audit The Fed, And Shackle It Too

By David Stockman, Contra Corner, 13 Feb 2015

The reason to be fearful about the economic and financial future is that we are in the thrall of a mainstream consensus that is downright meretricious. In attacking Rand Paul's audit legislation, for instance, one of the time-servers on the Fed Board of Governors, Jerome H. Powell, let loose the following gem:

"As recent U.S. history has shown, ***elected officials have often pushed for easier policies that serve short-term political interests….."***

A descendent of Rip Van Winkle

Perhaps Mr. Powell is a descendent of Rip Van Winkle——and missed the last 20 years of history while doing LBOs at the Carlyle Group and helping Congress improve upon its enviable record of fiscal management while at the Bipartisan Policy Center. But whatever he was doing—snoozing or otherwise distracted—- it most assuredly was not gathering evidence that "elected officials" were putting undue pressure on the Fed for "easier policies".

For crying out loud there is exactly zero evidence that "politicians" had anything to do with zero interest rates. And ZIRP defines the ultimate level of "ease" according to Bernanke himself, who famously described his policies as positioned at the "zero bound".

Indeed, given the very earliest expected date for "lift-off" in June, the Fed will have pinned the money market rate at zero for 80 months running. This unprecedented tsunami of "easy money", of course, happened with nary a Congressman or Senator darkening the door at the Eccles Building.

Defending the sacred "independence" of the Fed

Folks, this whole chorus of Fed governors——yesterday's lineup included Richard Fisher and Charles Plossner—-defending the sacred "independence" of the Federal Reserve is downright Kafkaesque. Rather than protecting the Fed from meddling politicians, it is the American public that desperately needs protection from the depredations of an unelected monetary politburo that runs the entire financial system.

Let's say you have saved a quarter million bucks over a lifetime of working and scrimping, but wish to keep it safe and liquid in your retirement years. Well thank you "independent" governors of the Fed for the privilege of owning a bank CD that generates 40 bps or the grand sum $2.75 per day. That's one visit to Starbucks each morning, but forget the cappuccino. It's just black coffee for you!

In fact, the last time there was any significant agitation on Capitol Hill about the Fed being too tight was in the early 1990s. Back then, that same quarter million dollar nest egg would have earned about $12,000 per year, not $1,000 as it present, or a whole lot of Starbucks and other living expenses, too.

The most sweeping income transfer in history

Stated differently, in their madcap pursuit of monetary "ease" our unelected financial suzerains at the Fed have implemented the most sweeping income transfer in history. By chopping upwards of 300 basis points off the historic after-tax and after-inflation return on liquid savings, the Fed annually pilfers $250 billion from the nation's $8 trillion of depositors and savers.

Needless to say, the money extracted from the hides of savers ends up in the income statements of the US banking system. There it gets booked as retained earnings and proffered as evidence that the Fed has put bank balance sheets back into the pink of health; or with increasing frequency it is allocated to dividends and buybacks, thereby fueling the Fed's so-called "wealth effects" levitation of the financial markets, and the net worth at the very top of the wealth and income ladder.

But however these extractions from the nation's savers are channeled, they amount to nothing less than a giant fiscal policy maneuver; and one so repugnant to any sense of fairness and private property rights that it would otherwise have been laughed out of any standing committee on either side of the Capitol. So there is an easy money problem all right, but it originates in the Keynesian groupthink resident in the Eccles Building, not populist legislators attempting to one-up William Jennings Bryan or Wright Patman.

Come to think of it, we have actually not had a single Federal funds rate increase in 9 years. Not even once, not even 25 basis points. In fact, during the 121 meetings the Fed has held during this century it has either cut interest rates or held them constant 100 times.

But do not attribute that chronic, massive bias toward "ease" to untoward pressures from Capitol Hill. That outcome is the product of doctrine, not politics. It flows from utterly misguided and self-serving ideology of a handful of central bankers and their amen chorus on Wall Street that claims economic growth, jobs and improving living standards can be delivered by hitting the send button on the Fed's printing press.

Back in the day, there was always a corporal's guard of populists on Capitol Hill who pilloried the Fed for being too "tight". Even the redoubtable Republican Senate Leader, Howard Baker, once braced Paul Volcker with a demand to "get your foot off the necks" of American business. But that was long ago, and by the end of the century not a peep emanated from Capitol Hill on the subject of tight money.

Congress went silent

Nevertheless, it was actually after Congress went radio silent on the matter of monetary policy that the Fed's balance sheet exploded. Indeed, during the first 86 years of its existence, the Fed's balance sheet resembled the fabled Ohio State offense. About $5 billion and a cloud of dust—–year after year for decades running.

So by the year 2000, it had printed from thin air enough money to buy $500 billion of assets. By contrast, during the 13 weeks after the Lehman event, Bernanke printed $1.3 trillion—-and that was not owing to any Congressional mandate or gun to his head.

Indeed, it was Bernanke and his Wall Street sidekick, Hank Paulson, who went up to Capitol Hill and put a gun to their heads. It was these demagogues who scared the "politicians" witless with a phony alarm that Great Depression 2.0 was just around the corner unless the Fed opened the monetary spigots, and Congress added $700 billion of TARP on top.

In all, the Fed's balance sheet has expanded by 9X since the time at the eve of the dotcom bust when the last disciple of Wright Patman was carried out of the House chambers. So you have to think there must be something else behind all this sudden gumming from the Eccles Building about preserving the Fed's "independence".

Rand Paul is on to something

Actually, there is. What our monetary politburo is really worried about is that Rand Paul is on to something that is fundamentally threatening to their very regime. Namely, that ZIRP has crushed savers and rewarded Wall Street gamblers with free money to harvest the stupendous riches obtained from their carry trades; and that QE has been a bonanza for the fast money traders who front run the Fed but has done virtually nothing for the main street economy.

Torches and pitchforks are sure to come out

And here's their even bigger fear. When this current massive financial bubble comes crashing down for the third time this century—-and that may happen any time soon—the torches and pitchforks are sure to come out.

At length, there will be legislation, but not merely an audit. In the fullness of time it will become evident that the problem is, in fact, undue influence and "capture". That is, capture by Wall Street and the subordination of monetary policy to the palpable fear in the Eccles Building of a hissy fit in the casino.

And that goes to the heart of the matter. Congress not only needs to audit the Fed; it should shackle it entirely by abolishing the FOMC and eliminating its discretion to peg interest rates, expand its balance sheet and intervene proactively in the financial markets.

We have the free market

Stated differently, there is no need to replace the 12-member FOMC cum monetary politburo with a gaggle of 535 legislators on Capitol Hill. We have something called the free market, and that is the place where the right money market rate should be set by the interaction of users and suppliers of cash; where the yield curve should find its appropriate shape based on the interaction of savers and borrowers and the continuous flow of new information about the real world; and where honest capital markets can perform god's work of allocating debt and equity at prices which are diligently "discovered" by at-risk investors and issuers.

No need for recycled political hacks

At the end of the day, American capitalism does not need recycled political hacks like Jerome H. Powell or clueless school marms like Janet Yellen to thrive. If we need a Fed at all, it is the one designed by Carter Glass 100 years ago. That is, a "bankers bank" that was intended to provide standby liquidity at a penalty spread above the free market interest rate in consideration for good collateral originating from inventory and receivables in the real economy.

Under that arrangement, there would be no monetary central planning or pointless attempts to manage the level of GDP, the number of new jobs, the rate of housing starts, the fluctuations of the CPI or the amplitudes of the business cycle. There would also be no pegging of the money market rate, no helping hand for Wall Street gamblers, no cheap debt to enable profligate politicians to kick-the-can down the road indefinitely.

A Fed shackled to a narrow and market-driven liquidity function

In short, what the nation really needs is not an “independent” Fed, but one that is shackled to a narrow and market-driven liquidity function. The rest of its current remit is nothing more than the self-serving aggrandizement of the apparatchiks who run it; and who have now managed to turn the nation’s vital money and capital markets into dangerous, unstable casinos, and the nations savers into indentured servants of a bloated and wasteful banking system.

Yes, the monetary politburo has every reason to fear Rand Paul’s demand for a “policy audit” of the Fed. An honest one would show that its so-called “independence” has been monumentally abused in a manner which is deeply threatening to both political democracy and capitalist prosperity.

Needless to say, we can’t have that audit soon enough.