Stop the Fed's Dual Mandate and Boost the Dollar

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By Eric Grover

In the post-gold standard era, central banks controlling fiat money wield enormous power. When, as is the case with the Federal Reserve, their mission is more than maintaining price stability, they are potentially dangerous.

The danger now is acute.

In 1978 the Humphrey-Hawkins Full Employment and Balanced Growth Act mandated the Fed pursue monetary policies to maintain price stability and maximum employment. While price stability and a strong dollar are consistent with maximizing long-term economic growth and employment, the dual mandate has given dovish members of the Fed license to attempt to spur short-term employment gains by providing easy credit and weakening the dollar.

Fed Chairman Ben Bernanke and the Federal Open Market Committee believe U.S. inflation is too low and to stimulate the economy are effecting a second round of "quantitative easing," meaning the Fed is printing $600 billion to buy long-term Treasuries, monetizing U.S. debt, further debasing the dollar and sowing seeds of inflation.

Money is a medium of exchange, a store of value and a unit of account. As the world's reserve currency, the dollar's role in these regards is all the more important. Devaluing the dollar undermines each of them.

Under Bernanke the central bank has had a soft-dollar policy. It has kept the federal funds rate between 0 and 0.25% since 2008. The real interest rate is negative. And the Fed increased its balance sheet to $2.3 trillion, up an alarming 153% from August 2008, pumping $1.4 trillion into the banking system. Creating more dollars makes existing dollars less valuable.

Since January 2009 the St. Louis Fed's trade-weighted dollar-value index against a broad group of U.S. trading partners has declined 10%. Against gold, the dollar has declined 54%.

Interest rates express time preferences between present and future consumption. Artificially low interest rates cause malinvestment, overconsumption and capital consumption.

Bernanke is obsessed with the possibility of deflation. In a 2002 speech "Deflation: Making Sure 'It' Doesn't Happen Here" citing Milton Friedman's famous "helicopter drop" of money, he vowed to rain money on the economy in the event of a liquidity freeze.

President Obama reappointed Bernanke as Fed chairman and his first two board appointees, Janet Yellen and Sarah Raskin, were doves, favoring easy credit and a weaker dollar.

An overvalued dollar and insufficient liquidity, however, are not what ail the economy. Notwithstanding easy Fed credit and more than a trillion in unused bank reserves, the U.S. economy continues to languish in the doldrums. Printing dollars is not the answer.

The path to reviving the economy is not complicated: A strong dollar, resuscitating the private sector's animal spirits by cutting marginal taxes, eliminating capital gains and corporate taxes, championing free trade, promoting cheap and reliable energy, the rule of law, reducing stultifying regulation and encouraging free labor markets.

What can be done to rein in the Fed?

On Nov. 16 Rep. Mike Pence introduced H.R. 6406 that would strip the Fed of its dual mandate, instructing it to focus solely on maintaining price stability. Sen. Bob Corker promises a companion bill in the Senate. There's a reasonable chance Congress in 2011 will pass legislation circumscribing the Fed's mission.

St. Louis Fed President James Bullard said he would be OK with Congress eliminating the Fed's dual mandate.

In January the beleaguered hard-money camp on the FOMC will get reinforcements. Four new regional Fed presidents rotate into voting positions. Dallas Fed President Richard Fisher and Philadelphia Fed President Charles Plosser are relatively hawkish. Minneapolis Fed President Narayana Kocherlakota has expressed at least some skepticism about the Fed's low-interest policy while Chicago Fed President Charles Evans looks to be dovish.

Obama's third nomination for the Fed board, MIT economist Peter Diamond, was rejected by the Senate in August but renominated in September. The Senate should reject Diamond's nomination again and insist on a monetary hawk.

Narrowing the Fed's mission and a sound dollar are vital to America's and the world's economic health.

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