Federal Reserve thumbs nose at Congress yet again on inflation

By Eric Grover

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If anyone on Capitol Hill was paying attention to last month's Federal Open Market Committee meeting, the Federal Reserve discussed alternative means of boosting inflation, yet again casually thumbing its nose at Congress.

America's central bank and most powerful financial regulator is a creature of the legislature. The Federal Reserve Reform Act mandated it to "effectively" promote "maximum employment, stable prices and moderate long-term interest rates." On its own prerogative, however, the Fed formally adopted a 2 percent inflation target in 2012.

In December, participants in the Federal Open Market Committee meeting suggested the Fed study"potential alternative frameworks for the conduct of monetary policy such as price-level targeting or nominal-GDP targeting." Whether the Fed targets an inflation rate other than zero, or a price or nominal gross domestic product level to inflict inflation on the economy, is not just bad policy, it is lawless.

In targeting 2 percent inflation, the Fed is flouting its statutory mandate to promote stable prices. Prices doubling every 35 years aren't stable. Stable means zero inflation. Nobody would say a boxer whose weight increased 2 percent every year had stable weight.

Targeting price levels or nominal GDP would simply create more latitude for Fed mischief. If the central bank misses its annual inflation target, it starts fresh the following year. If, however, it missed a price target, it'd presumably play catch-up the following year.

In 1999, dove Ben Bernanke wrote, "In the long run, the central bank can affect only inflation, not real variables such as output." Stable prices facilitate optimal decision-making to consume and save or invest, enabling

maximum sustainable wealth and job creation. Promoting inflation hinders that end.

In the extreme, hyperinflation created by central bank money printing sweeps all before it. In July 1946, Hungary's daily inflation rate peaked at 195 percent. In November 2008, Zimbabwe's daily inflation rate hit 98 percent. Consumers and businesses struggled to survive. Both economies and millions of lives were devastated.

The central bank enjoys enormous power. The temptation of our smart, well-intentioned monetary overlords to use their power to attempt to manage the economy for the putative greater good rather than simply ensuring stable prices, as required by law, which would be for the greater good, has proved irresistible.

For most of the 19th century, the United States had free banking, a gold standard, no central bank, and enjoyed gentle deflation. Modern central bankers have turned deflation into a bogeyman. But mild deflation improves standard of living and business competitiveness.

While the Fed has the tools to deliver stable prices, it has chosen not to. From 1792 to 1912, U.S. prices rose 3 percent. In stark contrast, since the creation of the Fed in 1913 to 2013, prices rose a whopping 2,380 percent. Nobel-prize winner Milton Friedman noted, "No major institution in the U.S. has so poor a record of performance over so long a period, yet so high a public reputation."

The Federal Reserve has flagrantly flouted its legal obligation to promote stable prices. Here's hoping Congress steps up and defends its constitutional prerogative this year.

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