It’s Time to Rein in the Fed

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AT the Kansas City Federal Reserve’s virtual Jackson Hole economic-policy symposium, Fed chairman Jerome Powell drove a final stake into the legendary inflation fighter Paul Volcker’s Fed. The new orthodoxy promises easy money as far as the eye can see and holds that inflation is good — not Venezuelan and Zimbabwean hyperinflation of course, just a moderate dose — thus ensuring that a dollar every year is worth less. Americans should be afraid.

Powell announced the Fed’s new inflation-averaging strategy. The central bank is changing how it defines and attempts to achieve the 2 percent inflation target, which it adopted on its own authority in 2012. Henceforth, the Fed will attempt to catch up for past inflation shortfalls. Powell warned that inflation below “its desired level,” which our enlightened central bankers have decreed is 2 percent, can lead to an “unwelcome reduction” in inflation expectations, causing lower inflation. Joe and Sally Sixpack, however, would view gas, steak, and dental check-up prices not rising as welcome.

Additionally, the Fed chairman declared the central bank would not, as it has in the past, preemptively raise interest rates to stave off higher inflation when unemployment falls below its natural rate.

The new policy has an asymmetric pro-inflation bias. America’s central bankers are not contemplating deflationary policies to offset excessive past inflation. If inflation were 5 percent in period one, the Fed would try to bring it down to 2 percent in period two, not to negative 1 percent.

The Fed is a masterful political actor. Powell touted “The Fed Listens” events as “connecting with the American people.” All well and good, but it is

Congress, which represents the American people, that the Fed is supposed to heed.

The Fed isn't independent or the policymaker. It is an instrument of Congress, which by statute directs it to conduct monetary policy to achieve "stable prices," maximum employment, and moderate long-term interest rates. Stable prices mean inflation hovering around zero, not prices doubling every 35 years. If a 200-pound MMA fighter's weight increased 2 percent every year to 244 pounds after a decade, nobody would suggest his weight was stable.

Shame on the Fed for "redefining" its role under the law. But shame on Congress for not insisting the central bank hew to statute.

If Congress wants inflation, it should pass legislation changing the Fed's mandate to that effect, which President Trump or Biden would likely sign. But while many congressional cravens may want inflation, few want to go on record voting for it.

Powell allowed, "Many find it counterintuitive that the Fed would want to push up inflation." No kidding. Money is a unit of account, a means of exchange, and a store of value. Stable money is a sine qua non of stable, prosperous, free societies. There's enormous value in the dollar remaining constant for consumers and firms planning, transacting, and saving. Imagine a world where a yard continually changed.

The received wisdom is that deflation is bad. Precipitous deflation is harmful. However, gentle deflation benefits many

To bolster inflation the Fed is keeping real wholesale interest rates negative.

Interest rates are the price of present versus future investment and consumption. They are the economy's most important price, dynamically signaling where and when capital should be allocated to maximize value.

Keeping interest rates artificially low, as the Fed has done for nearly two decades, causes systemic malinvestment, incentivizes excessive risktaking, and sustains zombie firms, making society poorer, and is sowing the seeds for the next crisis. It punishes savers and creditors.

There are, however, powerful constituencies for easy money. America's biggest borrower, the federal government, loves it. Real-estate developers and brokers and much of Wall Street also vigorously support cheap debt.

With everyone focused on the COVID-19 pandemic and recession, inflation is low on people's list of concerns, but it's brewing. From December 2019 to August 24, 2020, the monetary base (M1) increased 35 percent. The Fed's real benchmark interest rate is negative. The pandemic has crimped production. As America limps out of the crisis and the velocity of money — the rate at which money turns over — recovers, it's a recipe for inflation.

Since the Fed's creation in 1913, its policies have massively debased the dollar and caused or contributed to multiple economic crises, including the Great Depression and the Great Recession, devastating job and wealth creation. While the central bank can affect price levels, easy money can't increase sustainable long-term employment and wealth. Congress should, therefore, eliminate any doubt about what the Fed can and should do by doing away with its "dual" mandate, narrowly focusing it on maintaining stable prices, something that it is equipped to deliver.

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