The Fed’s Trail of Wreckage: A new book offers a critique of the Fed’s easy-money policy but no solution

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***The Lords of Easy Money: How the Federal Reserve Broke the American Economy*, by Christopher Leonard (Simon & Schuster, 384 pp., $30)**

In *The Lords of Easy Money*, journalist Christopher Leonard warns that the Federal Reserve has become “the central driver of American economic policy making.” He anchors the book around former Kansas City Fed president and FDIC vice chair Thomas Hoenig’s stubborn worry that the Fed’s reign of easy money has increased banks’ risk-taking, fueled asset bubbles, and caused an “allocative effect” that has widened the gap between the asset-owning rich and the poor. Hoenig is an institutionalist who supported the Fed’s intervention during the financial crisis but worried about the perils of Fed short-termism and about the long-term effects of sustained easy money, characterizing quantitative easing as a “deal with the devil.” Leonard admires Hoenig, comments on Fed policy through his critical lens, and notes that his predictions about quantitative easing and zero-percent interest rates came true over the following decade.

Easy money’s beneficiaries are its strongest defenders, Leonard argues persuasively. Wall Street, real-estate developers, and debtors—Uncle Sam being the biggest—love accommodative monetary policies. The costs of ultra-low interest rates are less immediately obvious; they encourage excessive risk-taking in a search for high returns, creating asset bubbles that inevitably burst. And they inflict financial repression, in the form of negative real interest rates on saving.

But Leonard wrongly asserts that, because Congress doesn't fund it, the Fed is independent. Congress created the Fed and spelled out its mandate: to promote stable prices, maximum employment, and moderate long-term interest rates. The central bank's Federal Open Market Committee—made up of seven governors of the Federal Reserve Board (appointed by the president of the United States), the New York Fed's president, and four rotating presidents from the other 11 regional Feds—implements monetary policy supporting this mandate.

Central bankers hold different views on how to implement the mandate and how strictly it should bind them. The Fed is home to a continuum of anti-inflation hawks and easy-money doves. The anti-inflation hawks are more reluctant than the doves when it comes to the central bank taking a broader role in the economy. Leonard notes that the doves get better press on the theory that they're "compassionate" and want "to help the economy and working people," while hawks are "harsh and severe" and want to "stop the Fed from helping people." But the doves' notional compassion comes at a high cost.

Many central bankers are seduced by the conceit that their money-printing will lift markets, create jobs and wealth, and save troubled financial institutions and businesses. But the Fed can't create value, and it is hubris to believe that it can manage the economy. Fed central planners, no matter how brilliant, cannot match the market's vast distributed intelligence and self-correcting power.

Wall Street is constantly looking to the Fed to bail it out of trouble. Under the four most recent Fed chairs—Alan Greenspan, Ben Bernanke, Janet Yellen, and Jerome Powell—the bank has obliged. But intervening every time markets get the jitters creates moral hazard. Fed chairmen William McChesney Martin Jr. (1951–1970) and Paul Volcker (1979–1987) understood that it wasn't the central bank's mission to keep the economy on an easy-money high. Indeed, Martin famously quipped that the Fed's job was to take away the punch bowl "just when the party was really warming up." Since Volcker, no Fed chairman has been keen to spoil the party.

Before he was appointed Fed chair, economist Alan Greenspan seemed like he would be a hard-money man; he was a libertarian and a fan of Ayn

Rand and the gold standard. He was also the first celebrity Fed chair. With Greenspan—a.k.a. “the Maestro”—at the helm, the idea that Fed mastery could deliver low inflation and unemployment, robust growth, and financial-system stability gained currency with politicians, the commentariat, and the public. Though price inflation remained modest during his reign, easy money fueled the dot-com bubble, which burst in the early 2000s. The Fed didn’t see it coming. Nor did it see the next storm. In 2007, on the brink of the financial crisis, Fed chair Bernanke said, “we do not expect significant spillover from the subprime market to the rest of the economy and to the financial system.”

Leonard recites and endorses the establishment Left’s narrative that big banks—always popular villains—caused the financial crisis, though he concedes that the Fed also “bore a great deal of responsibility.” That’s an understatement: without easy money and Washington’s weakening mortgage credit standards, there wouldn’t have been a financial crisis. Peter Wallison, a former member of the Financial Crisis Inquiry Commission, showed in his 2016 book, *Hidden in Plain Sight*, how Washington’s affordable-housing mandates forced the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac to buy and backstop ever-riskier mortgages, fueling unprecedented subprime-mortgage and housing bubbles. By June 2008, 57 percent of the mortgages in the U.S. were sketchy subprime and Alternative A-paper—and more than three-quarters of those were owned or guaranteed by the GSEs and government. Alternative A-paper loans included those with no income verification, zero or negative amortization, high loan-to-value ratios, or other indicators of high risk.

And yet the crisis, begotten by easy money, fueled demands for even more easy money. Under “Helicopter Ben” Bernanke, the Fed bought trillions of dollars of Treasuries and mortgage-backed securities. (When the Fed buys assets, it electronically creates dollars.) The central bank’s balance sheet grew from $906 billion on September 3, 2008, to $2.2 trillion on December 31, 2008. As long as prices of goods and services weren’t rising, writes Leonard, “the Fed had license to keep intervening aggressively by printing more money, which stoked asset prices yet further.”

Leonard laments the legislative gridlock ushered in by the 2010 midterm election as “an era of stasis and dysfunction.” He praises Fed activism and declares that “Tea Partiers were dedicated to halting the work of government entirely.” But this is not a fair or accurate characterization of calls for fiscal sobriety and fidelity to constitutional limits.

Leonard’ criticism of the enormous economic and societal harm caused by the Fed’s decades of easy money is spot-on. He doesn’t, however, recommend a solution. And, while acknowledging it’s “a deeply flawed tool,” like most of the financial commentariat and economic establishment, he views a powerful Fed as indispensable.

The dovish Fed policy largely continued throughout the tenure of Bernanke’s successor, economist Janet Yellen. But beginning in 2017, the Fed began ratcheting up its benchmark interest rate and reducing assets. In 2018, Jerome Powell replaced Yellen. Though no interest-rate hawk, Powell was sober-minded, thoughtful, and, given his background in private equity, intimately familiar with the allure and risks of easy money.

Then came the Covid-19 pandemic and the government-mandated lockdowns. Powell’s Fed opened a fire hydrant of liquidity, with its balance sheet reaching $7.2 trillion by June 10, 2020. And despite partisan jockeying and President Donald Trump’s toxic relationship with House Speaker Nancy Pelosi, Congress passed the $2 trillion CARES Act on March 25, 2020. Post-lockdown, the Fed has continued its gusher of easy money. By the end of March 2022, its balance sheet had swelled to $8.9 trillion, and inflation hit 8.5 percent, the highest rate since December 1981.

Yet despite this record of failure, Leonard still doesn’t trust markets to self-regulate. He casually dismisses free banking as “lunacy” and contends that “things can’t work without a central bank” because “every modern nation needs a reliable form of currency.” But central banks aren’t magical, as both history and recent events have shown. Since the Fed’s founding in 1913, the United States has suffered massive bouts of inflation and multiple economic and financial crises, many of which the Fed itself caused. “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,” Milton Friedman observed.

The lords of easy money have ushered in an era of raging price and asset inflation, malinvestment, and financial repression—an era pregnant with future crises.

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