The Case for a Centennial Monetary Commission

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By every economic measure, our nation is presently mired in a disappointing economic recovery. In fact, ours is the weakest recovery of the past half century. Uncertainty reigns as the purchasing power of the dollar declines. What ails us goes well beyond federal fiscal policy, and it is certainly not the result of an irrational marketplace. What ails us goes much deeper to our nation's monetary policy, which is well overdue for a review.

The Growth Gap

In tracking our economy, the Congressional Joint Economic Committee, which I chair, has highlighted a disturbing and growing trend, which we refer to as "the growth gap." The growth gap can be seen as the gap between where our economy is today compared with where it would be if we had experienced an average post-1960 recovery.

How large is the growth gap? In the near term, as of January 2014, we are missing $1.21 trillion of real GDP from America's economy, and missing 4.4 million private sector jobs, just from an average recovery. If you compare the current disappointing recovery with the robust Reagan recovery, the figures are even more

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startling: $1.84 trillion in lost output and 6.95 million private sector jobs missing from our economy.

In the long term, the numbers are even more dismal. Last year, the Congressional Budget Office reduced its estimate for future growth in potential real GDP from 3.2 percent to 2.2 percent. A 1 percentage point difference may not sound like much, but it is huge. Over the long term, a 1 percent growth gap is the staggering difference between a $50 trillion economy and an $80 trillion economy that is 60 percent bigger in 2062.

These are big numbers, and it is often difficult to translate such numbers into digestible bits. So, what exactly does the growth gap mean for American families? To the average family of four today, they are missing more than $11,000 from their real disposable income that could go toward their housing, dreams, and education, or even pay for higher health care costs under the Affordable Care Act. This is a big hole, and too many families have been left behind in a major way.

Wall Street has done well in this recovery. From the end of the recession through November 2013, the S&P500 Total Return Index was up 100.8 percent. I want to see Main Street do just as well. Among our problems right now is that our current monetary policy has tilted the playing field in favor of Wall Street and away from average working families in America.

The Fed's monetary policy, in my view, has harmed American families. Keeping the federal funds rate at the zero bound for the past five years and building excess liquidity on the Federal Reserve's balance sheet from quantitative easing have kept interest rates at extremely low levels for a long time. The Fed's policies have discouraged savings, and pushed American families into riskier assets. Seniors and savers, from whom I hear frequently in my town hall meetings, attest to the harm caused by the actions of the Fed.

Yet these adverse effects of the Fed's monetary policy constitute only a partial aspect of the dangerous course that has been charted. The fact remains that the experimental policies embarked upon by the Fed have created new economic and fiscal risks:

- Open market policies have created the conditions that might lead to the next financial bubble in stocks, the bursting of which would devastate retirement accounts.
- Private sector business investment, which is the key to job creation, has likewise been hampered by the economic uncertainty from the Fed's policies.

- And the Fed's monetary policy has masked a dangerously high federal deficit by keeping interest payments at artificially low levels, therein enabling more programmatic spending than would otherwise by tolerated.

The benefits today of quantitative easing in the real marketplace are zero, in my view, and the risks continue to grow.

For most of 2013, we lived in a world that I would call "the opposite market." When the jobs numbers, or the quarterly economic data, came in each month, if the numbers were bad, the market would rally because markets perceived that the Fed stimulus would continue. That is not the sign of a healthy recovery either here in the United States or globally. Perhaps we can hope that some sanity was restored in December when the Fed announced that they would begin to taper quantitative easing and the markets responded favorably.

Inflation Risk and the Purchasing Power of the Dollar

There is another lingering risk stemming from the Fed's monetary policy: the risk of inflation. Defenders of the Fed's discretionary quantitative easing policy suggest that the policy carries little inflationary risk, and that inflation has yet to surface. However, inflation is a term that is sometimes used by ordinary people and professional economists to describe different concepts, and misunderstandings can sometimes arise. To most people, inflation refers to a general increase in the prices of goods and services as measured by such indices as the Consumer Price Index or the Personal Consumption Expenditure (PCE) Price Index. From this perspective, which the Fed currently shares, inflation is low to nonexistent. Yet, inflation can also refer to a rapid increase in asset prices, as in the case of the housing bubble in the last decade. To Austrian economists, inflation can also refer to an increase in the monetary base by a central bank.

With respect to inflation, I believe the critical issue is whether the purchasing power of the dollar is being maintained. The evidence is not heartening. In fact, since President Richard Nixon closed the "gold window" on August 15, 1971, causing the Bretton Woods gold exchange standard to collapse, the purchasing power of the dollar has declined by 83 percent.

I am concerned that the Fed's current policies of quantitative easing and maintaining extraordinary low interest rates may be providing the fuel for igniting high inflation in terms of consumer prices.

As monetary economist Mickey Levy (2013) observed in a paper for the Shadow Open Market Committee: "The Fed has kept the funds rate below inflation since 2008, the longest period in recent history. The last period of such a long sustained negative real funds rate was in 1974–1977, and it resulted in double digit inflation."

Price inflation is a real wealth-destroying, market-distorting phenomenon that undermines hard work, savings, and productive investment while rewarding financial speculation. Though the Federal Open Market Committee still does not see price inflation on the horizon, the question remains as to how quickly and effectively the Fed would respond if inflation were to take hold.

Leaving aside the purchasing power of the dollar, price inflation as measured by the PCE price index is being kept in check. There are three primary reasons why this is occurring: First, the fear of another financial crisis has led banks to increase excess reserves to levels substantially higher than existed before the 2008 financial crisis. Second, families and businesses have paid off a large part of their debt and continue to deleverage, thereby reducing the demand for new loans. Third, banks have been reluctant to make new loans given the uncertainty over implementation of the Dodd-Frank legislation.

Now that the fear of another crisis is receding and deleveraging has largely run its course, at some point we will see an increase in lending. The excess reserves on the Fed's balance sheet are the fuel for price inflation. As they are lent out, we could see significantly higher price inflation, which is terribly destructive to prosperity. It robs the paychecks and wallets from working families, and the real net worth of many Americans will significantly decline. It is time for a review of how we conduct our nation's monetary policy.

A Timely Review of Monetary Policy

A Centennial Monetary Commission (H.R.1176) is needed now. One hundred years into the Fed's existence, we are well overdue for a thorough review of the structure and goal of our nation's monetary policy. Originally, the Fed's mission was to provide an elastic currency to combat seasonal financial issues, but the Fed's mission has grown over the years. Today, some policymakers in Washington and New York would like to see the Fed manage nearly every aspect of the U.S. economy.

Others, like me, think the Fed should create a financial climate where the market is allowed to work; the Fed doesn't pick winners and losers, especially among the credit markets; and families can have some confidence that their hard work and their savings will be preserved through maintaining the purchasing power of the dollar over time. That, in my view, is the foundation for the strongest economic growth for this country.

The Joint Economic Committee has put forth great effort examining the basic question, which is: What must we do today to ensure that America has the strongest economy through the 21st century? How do we have another, a second American century? For starters, it is critical to have the right fiscal policy in place, but it is also absolutely critical that we have the right monetary policy in place as well.

In thinking about a national monetary commission, one must start with the question: What are the characteristics, and what is the design of a commission that produces a solid result? First, it has to be open-process, which I would call brutally bipartisan. It has to be equally balanced between parties, equally balanced between policymakers within Congress, and include bright minds and thinkers outside of Congress as well. It needs to allow a fair fight, in which the best and brightest ideas on monetary policy going forward can prevail.

The Centennial Monetary Commission, which presently has more than 30 cosponsors, would review America's economic performance since the Fed's creation in 1913, carefully examining output, employment, inflation, and financial stability. All points of view would be discussed with respect to the proper role envisioned for our central bank. The desirability of adopting monetary policy rules—including a gold standard and nominal GDP, inflation, or price level targeting—would also be considered.

After weighing the above factors, the Commission would recommend to Congress a course for U.S. monetary policy going forward—a course that would include recommendations on what is the right legislative mandate for the central bank, what is the best operational regime, and what boundaries should exist with respect to securities and purchases in the Fed's open market operations.

Fortunately, we are coming to a point of discourse about the Federal Reserve where we can have serious policy discussions about the Fed, its mandate, and the back-and-forth debate over the virtues of a rules-based versus discretionary monetary policy. The present question is not whether the Fed ought to be abolished; the question—in which both the political left and political right should have a strong interest—is how do we make sure that the Fed has the proper mandate and the best foundation to help us secure another American century.

Conclusion

As we have just marked the 100th birthday of the Federal Reserve Act, and given the financial crisis that we have been through and the extraordinary measures that have been taken by the Fed since 2008, there will never be a more appropriate time to review the Federal Reserve and our nation's monetary policy.

I am hopeful that a Centennial Monetary Commission will allow us to reengage not just the best minds and the most diverse thinking about the Fed, but also reengage Congress in our constitutional role over monetary policy.

Now is the time to act. More and more, especially since the 2008 financial crisis, normal people in average walks of life are raising their hands at my town hall meetings and asking, "Who is the Federal Reserve, and why can they do what they're doing?" Such questions are a great sign of a healthy curiosity in the interest of not only who the Fed is and what it is doing, but also of a growing understanding that the Fed is affecting all of our lives, often in a way that most families cannot imagine.

I am hopeful the Centennial Monetary Commission can help bring the role of the Fed to life for real people, living real lives and facing real problems, so that they can understand just how the Fed's decisions affect them. When we pull back that curtain and we have this healthy, constructive, thoughtful discussion, we can find a way forward for the central bank—for the Fed—that actually plays a role that helps to enhance the opportunities for families in America. Now is the time to move forward.

Reference

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