

MONETARY DISORDER: MOVE OVER, MANDARINS

James Grant

You remember Jonathan Gruber. He was the brainiac from MIT who helped to design Obamacare and who credited the “stupidity” of the American electorate for its happy enactment (DelReal 2014).

I think of Professor Gruber in the context of the proliferating plans to reinvent our monetary and banking institutions. We critics have been champing at the bit for the opportunity that Donald Trump was good enough to hand us on November 8. Surely, this is the moment for new thinking. What can we contribute?

New Thinking

We don't lack for ideas. Audit the Fed. Collapse its bloated balance sheet. Abolish Humphrey-Hawkins. Repeal Dodd-Frank. Normalize interest rates. Let the stock market find its own level. Stop taxing gold as if it weren't money (it is money). Strike the Federal Reserve governors mute.

So many opportunities. So much need. Where to begin? May I suggest a preliminary consultation with the president? But, before even that essential courtesy call, an extended listening tour among the American people? Only think of the trouble that Professor Gruber might have saved himself if he had asked the customers what they wanted.

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I happen to be partial to fixed exchange rates, a convertible dollar, and the responsibility of the shareholders for the solvency of the banks in which they own a fractional interest. I believe that money should be an objective measure of value, not a magic wand, and that the price mechanism, not the FOMC, should determine bond yields, price-earnings ratios, and cap rates. I support free-range interest rates, not the cage-grown variety. In short, I favor many of the forms and institutions in place a century ago.

Not unlike Professor Gruber, I have made a study of the situation. I believe I can defend the seeming paradox of seeking progress by restoring what was “excellent, if not perfect” (to steal a line from Alexander Hamilton) (Hamilton and Rossiter 1961: 441).

There is a small problem. I can’t help but notice that America seems not to be on board just yet. In the not always edifying presidential debates, the Federal Reserve was almost a nontopic. The public debt, the astonishing growth of which the Fed’s ultra-low interest rates have facilitated, likewise got the silent treatment.

I wonder what’s come over us. In ages past, money and banking were fighting words. To its critics in the early 19th century, the Bank of England literally had blood on its hands (this was a time when offering a fake bank note was a capital crime and the Old Lady of Threadneedle Street had a voice in granting clemency to, or withholding it from, convicted counterfeiters) (Fetter 1965: 95). To Andrew Jackson, the Second Bank of the United States was a “monster” (Catterall 1903). People on both sides of the Atlantic debated recon-dite monetary points until they were blue in the face. In England, it was the Banking School versus the Currency School. In America, it was the goldbugs versus the silverites. “Coin’s Financial School,” an 1894 pamphlet extolling inflation, had an astounding sale, about one million copies (Snow 1981). Woodrow Wilson rode the “money trust” and its supposed evils to the White House in 1912 (Grant 1992: 125). The remedy for this wickedness turned out to be the Federal Reserve. The Fed came in for plenty of abuse in the great inflation of the 1970s. And when it belatedly reversed course in 1979, ultimately sending long-dated Treasuries to 15 percent, it caught more abuse.

Scrutinizing Central Banks

It will be observed that the central banks of the world are coming under new scrutiny today. But not even the crisis of the pension funds, or zero-percent savings rates, or recriminations over the errors

that so largely contributed to the coming of the Great Recession, can get the Fed much political air time. The fact is that America's central bank has paid no institutional price for its manifold failures, unless the assignment of helping to lead the Financial Stability Oversight Council, Wall Street's own Transportation Security Administration, can be accounted a form of political retribution.

Which brings me to the people and their elected representatives. I feel, as Professor Gruber must have felt, as if they have so much to learn. I wish they would attend a little more closely to the distortions wrought by ZIRP and QE and to the technical difficulties presented by the interest that the Fed pays on excess reserves. I am disappointed that my fellow citizens do not see what the world has lost by the substitution of the Ph.D. standard for the gold standard and the socialization of credit risk for the "double liability" of bank shareholders (until the 1930s, it was the shareholders, not the taxpayers, who got a capital call when a bank shut its doors) (Macey and Miller 1992). I wish that the voters and the statesmen would see as clearly as some of us do the flaws in the Fed's purchase of Treasuries and mortgages with money that didn't exist until the mandarins whistled it into existence on their computers. Has America really come to accept, as if it were the Washington Monument, an undisruptable government monopoly that is protected from operational competition by the law and from intellectual competition by the tenure system in university departments of economics?

Mr. Trump did not win the election by ignoring the electorate. What do the people think about money and monetary policy? I wouldn't bother polling them—you know about polls. Better consult the daily soundings conducted by Mr. Market.

The Monetary Status Quo

These results, it pains me to say, seem heavily to support the monetary status quo. At least, investors seem to like things much as they are. Karl Rove, writing in the *Wall Street Journal*, reports that two-thirds of the voters this past election day judged the economy to be "poor" or "not so good" (Rove 2016). The Trump voters are angry, all right, but this concern has so far not led them, or the fiduciaries who act in their name, to rise up against the ongoing monetary disorder.

As recently as a few months ago, some \$13 trillion of sovereign debt was priced to deliver a negative nominal yield (Wigglesworth and Platt 2016). Think about that. The owners of wealth equivalent

in size to not much less than America's GDP could have bought something besides bonds priced to deliver a certain loss. But no, they gobbled up Japanese, German, and Swiss debt at sub-zero yields. "Here," said the stewards of these trillions (addressing the central bankers), "take our money. We know that you mean to depreciate its value by 2 percent a year. So deep is our trust (or so certain are we that others, following us into this investment, will be even more trusting) that we are happy to lend on terms never before seen in 5,000 years of recorded interest-rate history" (Homer and Sylla 1991). Try to explain that one to your grandchildren.

I am not at all uncertain about what is wrong with 21st-century money. But I'm not in the least certain what the customers want.

No Monetary Utopia

There has never been a monetary utopia. The classical gold standard, "the least imperfect monetary system devised," in the words of Lewis E. Lehrman (2012: iii), cohabited with the not-quite-least-imperfect system of fractional reserve banking. There were panics and bank runs in 1825, 1837, 1847, 1857, to name but a few. Lord Overstone, the 19th-century English monetary theorist who had vested his hopes in gold convertibility (as enshrined, in Britain, in Peel's Act of 1844), came to conclude that credit was the Achilles' heel of the monetary system (O'Brien 1971: 823). It was, and it so remains. We at *Grant's* have very broadly paraphrased and summarized his thinking as follows: "The trouble with money is credit, and the trouble with credit is people" (Grant 2016).

As to the people and their elected representatives, what tradeoffs are they prepared to accept to institute a better system of money and credit? I mean a system in which money measures value but is not an adjustable instrument of national policy.

In a dynamic economy, there is constant need for adjustment. Something's got to give in response to changes in supply and demand and technology. What is that something to be? Nowadays, interest rates bear the brunt of adjustment.

In 2008 the residential real estate market was overencumbered and badly mispriced. Bad mortgage debt threatened the solvency of major financial institutions. What to do?

What the Fed did do was to press down interest rates, materialize trillions of digital dollars, infuse banks with capital, raise up equity

prices—anything to postpone the adjustments required in residential real estate itself. Eight years later, the world is on tenterhooks awaiting only the second rise in the funds rate since that long-ago upheaval. Post-2008 economic growth has been anemic—President Trump himself is living proof of that contention.

You know, cosseted college students aren't the only habitués of today's safe spaces. Wall Street occupies its own padded shelter. To protect America's asset-holding classes from aggressions, both micro and macro, the Fed stands guard. The benefits of these monetary protective services are evident enough. The costs are hypothetical yet, clearly, real enough.

Editorializing about the failure of Obamacare, the *Wall Street Journal* (November 15, 2016) pointed out that Americans bitterly resent government interference in a matter as personal and essential as health care. Money, too, is personal and oh-so essential, and—say we critics—the government is making a hash of it.

Conclusion

Obamacare failed the test of the political marketplace not because it violated the spirit of American individualism. It failed because it didn't work. I expect that one of these days, the non sequiturs and derangements of our system of governmentally imposed interest rates and governmentally administered asset prices will break down. Come that reckoning, the scales will fall from the eyes of the people who, after all, are not stupid but who are not engaged as they might be.

So I will welcome the next full-strength bear market as a public necessity. Demonstrating the failure of discretionary monetary policy by former college faculty, it will open eyes and ears to monetary alternatives. A better system—perhaps a properly time-tested one—may emerge. The mandarins have had their chance. Let's hear from the heirs to Andy Jackson.

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