The Global Curse of the Federal Reserve

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The Global Curse of the Federal Reserve

How Investors Can Survive and Profit from Monetary Chaos

Brendan Brown

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First published 2011
Paperback edition published 2013 by PALGRAVE MACMILLAN

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Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

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ISBN 978-1-137-29739-6 ISBN 978-1-137-29740-2 (eBook)
DOI 10.1057/9781137297402

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

10 9 8 7 6 5 4 3 2 1
22 21 20 19 18 17 16 15 14 13

To the memory of Irene Brown

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Foreword

Alex J. Pollock

The past four decades, from the 1970s to the 2010s, have been replete with financial and currency crises. These years have been, wrote the astute student of crises Robert Z. Aliber, 'the most tumultuous in monetary history'. Why is this?

As we know only too well, the young 21st century has featured massive bubbles in American mortgage finance and European government debt, with resulting crises. In reaction to these most recent financial crises, governments and regulators are intent on identifying and controlling 'systemically important financial institutions', or SIFIs. A SIFI is an institution influential and central enough that its mistakes can cause systemic financial instability.

No one can read this provocative book by Brendan Brown without concluding that a font of financial instability have been the mistakes of the Federal Reserve in its role as fiat currency central bank and financial manipulator to the world. In short, the Federal Reserve is the biggest SIFI of them all.

But who will control this SIFI? Who will guard these guardians? 'No one', answer the votaries of central bank independence. Since Dr. Brown observes, to the contrary, that central bank independence has become a global recipe for growing instability, his proposed answer is a new monetarist revolution.

The authors of the Federal Reserve Act of 1913 had as their principal object to create a provider of, as they called it, an 'elastic currency', which could expand in times of credit stringency or panic. In this they fully succeeded. They did not intend to create an institution which would attempt to manage the economy nor one which would print a fiat currency and, most assuredly, not one which would create a perpetual inflation. From their point of view, these are unintended results of their political achievement, results which developed over time as their creation grew dramatically in influence and power, including, as Dr. Brown insists we recognize, the power to cause financial instability.

It is often said that one of the mandates of the Federal Reserve is to preserve 'stable prices'. One prominent economic commentator even claimed that stable prices are 'a religion' of modern central banks. Nothing could be further from the truth. The Federal Reserve and all the other modern, fiat currency-issuing central banks, in fact, have a religion of constant, never-ending, intentional worldwide inflation. If the rate of inflation or the rate of depreciation of the currency is fairly steady, they call this 'price stability' – a notable example of successful Orwellian 'newspeak'.

It is worthwhile to remind ourselves of the basic math here. In targeting a continuing 2 per cent inflation, which is now called low, the central bank intends to make prices quintuple in the course of a normal lifespan.

What causes acceptance of this inflationary religion? Dr. Brown argues convincingly that the Federal Reserve and other central banks suffer from 'deflation phobia'. He points out that actual long-term price stability entails intermediate times of both rising and falling price adjustments, which offset each other on average over long periods. He further argues for the reality of 'good deflation' as well as 'bad deflation', while understanding that this has become a revolutionary idea. If all deflation is bad and can never be allowed while inflation is not only allowed but intended, the only possible outcome is perpetual inflation. Is this consistent with financial stability?

Central banks did not always have the religion of inflation; they have been converted to it since 1971, when the United States reneged on its international commitment to redeem dollars with gold. Of course, by that point the United States was unable to honour its commitment at the established parity. Since then, central banks, led by the Federal Reserve, have engendered an unprecedented four-decade-long global inflationary experiment. That this has produced the best possible monetary and financial results would certainly be a hard case to make, since these same decades are notable for their frequent financial and currency crises. Dr. Brown proposes the prosecution's case: that monetary activism has been the source of periodic bubbles and busts in different parts of the globe.

A notable irony in this context, as discussed in the book, is that Arthur Burns, the Federal Reserve chairman who presided over creating the immensely destructive Great Inflation of the 1970s, had written a book in the 1950s about the 'evils' of inflation.

Review Dr. Brown's chronicle of big, destabilizing Federal Reserve mistakes – from the 1920s, when, as the book relates, it was unintentionally stoking up a massive global credit bubble, to our own times, when it intentionally stoked the housing boom, which became the fateful housing bubble. This will bring you to the so-called Shull Paradox (propounded by Bernard Shull in his history of the rise of the Federal Reserve): How can it be that the Federal Reserve, having throughout its institutional life made such large deflationary and inflationary blunders, nonetheless grows ever more powerful and influential with each cycle, regardless of the merits of its actions? In fact, the Federal Reserve's powers in the wake of its mistakes were just added to again by the Dodd-Frank Act of 2010. Professor Shull relates the plaintive cry of a fellow economist: 'How is it that the Federal Reserve always wins?' How indeed?

To consider bringing its winning streak to an end, read on.

Alex J. Pollock is a resident fellow at the American Enterprise Institute, Washington DC, USA. He was President and CEO of the Federal Home Loan Bank of Chicago from 1991 to 2004 and is the author of *Boom and Bust* (2011).

Acknowledgements

In my writing about global credit bubbles and busts and the intimately related subjects of global capital flows and monetary disequilibrium, I have been deeply influenced by my lifelong teacher Professor Robert Z. Aliber of the University of Chicago.

As a graduate student at Chicago, I had the opportunity, provided by the great kindness and hospitality of Ethel Knight, to have dinner with Milton and Rose Friedman. For me at that time, Professor Friedman was my luminary, whose writings I had read and reread through the Keynesian darkness of my years as a student at Cambridge. I can still visualize the great humility and zest of Professor Friedman as he shared his knowledge with me. The personal insights I gained from Ethel Knight about the era when the great giants – Hayek, Knight and Friedman – taught in Chicago remain with me.

The blueprint developed here for a Second Monetarist Revolution stems in large part from an intense dialogue between myself and Robert Pringle during the spring and summer of 2010. Over many months, he both provoked my thinking on this and led me to much rethinking. Our joint work was published in the *Central Banking Journal*, of which he is the editor.

In preparing this book, Professor Steve Hanke gave me the huge opportunity of presenting ideas to the Cato Institute, in Washington, DC. He has also given me much encouragement and many useful references for further research.

I am greatly indebted to Alex Pollock for arranging a seminar around the topic of this book at the American Enterprise Institute under the title 'The Fed: Hero, Villain or Both?', where the ideas in *The Global Curse of the Federal Reserve* could be debated in full and alongside the persuasive criticism of the Fed from a monetarist standpoint by Allan Meltzer. Over the course of many years, Alex Pollock has fired my imagination and enthusiasm for a pursuing a practical, free market critique of the present US monetary and financial system.

Elizabeth V. Smith, a postgraduate economics student at University College London, and recently awarded a MSc, provided invaluable help in the toil of research and reading the manuscript at its various stages of preparation.