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MONETARY POLICY GOING FORWARD: WHY A SOUND DOLLAR BOOSTS GROWTH AND EMPLOYMENT

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MONETARY POLICY GOING FORWARD: WHY A SOUND DOLLAR BOOSTS GROWTH AND EMPLOYMENT

TUESDAY, MARCH 27, 2012

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 2:28 p.m. in Room 216 of the Hart Senate Office Building, the Honorable Kevin Brady, Vice Chairman, presiding.

Senators present: DeMint and Lee.

Representatives present: Brady (presiding) and Cummings.

Staff present: Conor Carroll, Gail Cohen, Colleen Healy, Patrick Miller, Matt Salomon, Michael Connolly, Emily Jaroma, Doug Branch, and Robert O'Quinn.

OPENING STATEMENT OF HON. KEVIN BRADY, VICE CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Vice Chairman Brady. Good afternoon, everyone. Thank you for understanding the change in schedule due to House votes, and I am pleased to call this Joint Economic Committee hearing to order. I appreciate so much the presence of our distinguished witnesses today.

Today's hearing seeks to determine what role the Federal Reserve should play going forward to ensure that the United States has the world's strongest economy in the 21st century. A sound dollar, in my view, is a necessary prerequisite for maximizing economic growth and job opportunities for hard-working American taxpayers.

This proposition is both simple and profound. The sound dollar requires the Federal Reserve preserve the purchasing power of the dollar over time. Price stability reduces uncertainty and encourages entrepreneurs to make investments in new buildings, equipment and software and hire more workers, and price stability is especially important for struggling families, each time they buy groceries or fill their tanks with gasoline.

Both inflation and deflation slow growth and destroy jobs. For hard-working taxpayers, the decline in the dollar's purchasing power is the same as a cut in pay. Today's hearing will explore how the Federal Reserve should achieve a sound dollar. In 1977, Congress gave the Fed a dual mandate for maintaining price stability and maximizing output and employment. Nobel Laureate economist Robert Mundell observed "To achieve a policy outcome, you have to use the right policy lever." In January, the Fed recognized that monetary policy is the right lever to maintain the purchasing power of the dollar by declaring "the inflation rate over the longer run is primarily determined by monetary policy."

In contrast, the Fed acknowledged that monetary policy is the wrong lever to promote job creation, by declaring "the maximum level of employment is largely determined by non-monetary factors." During the 1970's, the Fed tried to use monetary policy to stimulate job creation, and the United States ended up with both higher inflation and higher unemployment.

Critics charge that eliminating the dual mandate means we don't care about jobs. They are wrong. The opposite is true. It's precisely because we care about jobs and growth that Congress should direct the Fed to preserve the purchasing power of the dollar. Monetary policy cannot stimulate employment, except for short, temporary bursts. However, monetary policy can achieve price stability, which is the foundation for creating the greatest number of jobs that last.

During the 1980's and 1990's, the Fed moved toward a rules-based policy, by ignoring the employment half of its mandate to pursue price stability. Two long booms resulted, with very low inflation, and strong job creation and rising real incomes. Then, between 2000 and 2005, the Fed deviated from the successful rules-based regime by keeping interest rates too low for too long. This contributed to the inflation of an unsustainable housing bubble, that eventually triggered a global financial crisis.

Since the height of the financial crisis, during the fall of 2008, Washington has increasingly relied on the Fed to take unusual interventionist actions, such as tripling the size of its balance sheet under QE1 and QE2. Indeed, the Fed justified these extraordinary actions by invoking, for the first time ever in late 2008, the employment half of the Federal Reserve's dual mandate.

It appears the Fed took these actions to compensate for the President's failure to pursue pro-growth budget, tax and regulatory policies. And just low borrowing costs are masking the pain of historically high federal budget deficits, the Fed's monetary experimentation allows the White House and Congress to shirk their responsibility for creating a competitive business climate.

It is time to reform the Federal Reserve for the 21st Century, with a single mandate for price stability, achieved through inflation targeting. In January, the Fed announced an inflation target of two percent, defined in terms of the price index for personal consumption expenditures. I applaud this step toward a rules-based inflation targeting regime, but I hope two percent is the upper limit of the range.

As many of us know, accurately measuring inflation isn't easy. In the last decade, we clearly saw that price indices of goods and services do not always record all of the price movements in our economy, allowing asset bubbles to inflate undetected.

To identify incipient asset bubbles before they inflate to dangerous levels, the Fed should also monitor (1), the prices of and returns on broad classes of assets including equities, corporate bonds, state and local government bonds, agricultural real estate, commercial and industrial real estate, and residential real estate; (2), the price of gold; and (3) the foreign exchange value of the U.S. dollar.

On March 8th, I introduced the Sound Dollar Act in the House. The Sound Dollar Act reforms the Fed in several important ways. It replaces the dual mandate with a single mandate for long-term price stability; it increases the Fed's accountability and openness; it expands and diversifies the voting membership of the Federal Open Market Committee; ensures credit neutrality for future Fed purchases; and institutes necessary Congressional oversight of the Consumer Financial Protection Bureau.

These reforms, I believe, are critical to ensuring America has the world's strongest economy in the 21st century. Moving to a single mandate for price stability will help to spur investment and create millions of new jobs on Main Streets across America. I look forward to the testimony of our distinguished witnesses.

Now we do have, because of votes, several members will be coming in late, and when our minority members arrive, we'll make sure they are recognized for an opening statement. At this time, I'd like to introduce our panel, starting with John B. Taylor. John Taylor is the Mary and Robert Raymond Professor of Economics at Stanford University, and the George P. Schultz Senior Fellow in Economics at the Hoover Institution.

From 2001 to 2005, Dr. Taylor served as Under Secretary of Treasury for International Affairs. Prior to that, the served as a member of the President's Council of Economic Advisers from 1989 to 1991, and as a member of the Congressional Budget Office's Panel of Economic Advisors from 1995 to 2010. His academic fields of expertise are macroeconomics, monetary economics and international economics.

Dr. Taylor is best-known for his Taylor Rule, a policy tool that prescribes the appropriate level for the target federal funds rate, based upon measures of actual inflation and output relative to potential inflation and output.

Dr. Taylor has written and contributed to numerous academic journal articles, economic textbooks, new commentaries and books, including Getting Off Track: How Government Actions and Interventions Caused, Prolonged and Worsened the Financial Crisis, as well as First Principles: Five Keys to Restoring America's Prosperity. He received a BA in Economics summa cum laude from Princeton University in 1968, and a doctorate in Economics from Stanford in 1973. Dr. Taylor, welcome.

Dr. Laurence Meyer is a Senior Managing Director at Macroeconomic Advisers, LLC. From 1996 to 2002, Dr. Meyer served as a member of the Board of Governors of the Federal Reserve System.

Before becoming a member of the Board, he was president of Laurence H. Meyer and Associates, the St. Louis-based economic consulting firm specializing in macroeconomic forecasting and policy analysis. Dr. Meyer has had numerous articles published in professional journals, has authored a textbook on macroeconomic modeling, and has testified before Congress on macroeconomic policy issues.

He received a BA magna cum laude from Yale University in 1965, a doctorate in Economics from the Massachusetts Institute of Technology in 1970. Welcome, Dr. Meyer.

Dr. William Poole is a distinguished scholar in residence at the University of Delaware and a senior fellow at the Cato Institute. Previously, Dr. Poole was the president and chief executive officer of the Federal Reserve Bank of St. Louis from 1998 to 2008. Dr. Poole was also a member of the Council of Economic Advisers in the first Reagan Administration from 1982 to 1985.

Dr. Poole has published numerous papers in professional journals, and published two books, Money and the Economy: A Monetarist's View in 1978, and Principles of Economics in 1991. He attended Swarthmore College, received an AB degree in 1959, and received MBA and doctorate degrees from the University of Chicago in 1968 and 1966, respectively. Again Dr. Poole, thank you for joining this distinguished panel.

I appreciate my counterpart on the Joint Economic Committee from the Senate, Senator DeMint, being with us today as well. Thank you. Dr. Taylor, we've reserved five minutes for opening remarks and questioning from the panel afterwards. You're recognized. Can we make sure that microphone is transmitting?

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 26.]

STATEMENT OF HON. JOHN B. TAYLOR, PH.D., MARY AND ROBERT RAYMOND PROFESSOR OF ECONOMICS, STANFORD UNIVERSITY, STANFORD, CA

Dr. Taylor. Thank you very much, and thanks for inviting me to testify on this important topic. We've now had almost 100 years of experience with the Federal Reserve Act and decision-making under the Federal Reserve. We've also had careful, documented, empirical studies of what happened during this period by people like Milton Friedman, Anna Schwartz and Allan Meltzer.

I think there's plenty of evidence that the kind of policy that works well is a rules-based, predictable, systematic policy, and the kind of policies that don't work well are the more unpredictable discretionary policies. The actions of the Federal Reserve in the Great Depression, where money growth was cut, are just one example now of many.

From the mid-60's into the 70's, we had a similar period of go-stop discretionary monetary policy. Our money growth was increased and then decreased, leading ultimately to very high unemployment, very high inflation, very high interest rates and low economic growth.

Then we had a period in the 80's and 90's, which was more rules-based, more predictable. The result was declining unemployment, lower inflation, ultimately higher economic growth and far fewer recessions. Unfortunately recently, we've moved back to these more discretionary kinds of policies. Beginning in 2003, 2004 and 2005, the Federal Reserve held interest rates too low for too long, compared to the kind of policy it would have followed in the 80's and 90's.

This discretionary policy has continued. In fact, it's hard to overstate how discretionary policy has been. As the economy begins to improve, inflation begins to pick up, and indicators are suggesting that interest rates should be on the rise, we have strong signals from the Federal Reserve that interest rates going to be near zero through 2014.

All the Fed has to do to buy trillions of dollars, billions of dollars of mortgage-backed securities or mortgages or securities backed by other items, is credit banks with deposits, electronic deposits, bank money so-called, or reserve balances so-called, and they have unlimited ability to purchase as many of these items that they want.

As a result of this, the Central Bank's balance sheet, the Central Bank's amount of reserve balance has increased from about $10 billion before the crisis, to $1,600 billion at the end of 2011. Even if one abstracts from the extraordinary interventions taken during the panic, the interventions that we're seeing now with the quantitative easings and this extensive use of the Fed's additional tool of monetary policy, are unprecedented.

I believe this causes uncertainty, helps slow the economy down. It leads to speculation of what the Fed will do next. Will there be a quantitative easing; will there not be; what will be the circumstances under which that occurs? So to me, the lesson of the history throughout this whole 100 year period is that the Federal Reserve ought to get back to more rules-based predictable policy, less interventionist policy as soon as it can.

I believe the legislation in the Sound Dollar Act, many of the provisions, will help the Fed move in this direction. I believe the idea of replacing the confusing dual mandate, first introduced during a highly interventionist period in the 70's, will improve decision-making by the Fed. It will not increase unemployment, as some worry. Indeed, I think it will reduce unemployment.

For example, if the Fed had not taken the actions in 2003, 2004 and 2005 to lower interest rates so much, which were indeed motivated to some extent by the dual mandate, I believe we would have had a good chance of avoiding the depth of this Great Recession, avoiding the higher unemployment, and ultimately would have had lower unemployment as a result.

I also think the provisions in the Sound Dollar Act to restrict the kinds of assets the Fed purchases are warranted. To the extent that the Fed buys assets backed by mortgages or potentially assets backed by automobile loans or even student loans, brings the Federal Reserve into areas of responsibility which are not in the spirit of the Constitution, and raises questions about the Fed's independence itself. I think those restrictions are important.

And finally to conclude, I believe the idea of broadening the voting responsibility to all the District bank presidents is warranted. It will enable them all to participate in the important act of designing a rules-based strategy, and it will remove any semblance that there may be favoritism because of some presidents voting more frequently than others. Thank you, Mr. Chairman.

[The prepared statement of Hon. John B. Taylor, Ph.D., appears in the Submissions for the Record on page 27.]

Vice Chairman Brady. Thank you, Dr. Taylor. Let me note that was five minutes on the button. That rarely happens. Thank you very much. Dr. Meyer.

STATEMENT OF HON. LAURENCE MEYER, SENIOR MANAGING DIRECTOR AND CO-FOUNDER, MACROECONOMIC ADVISERS, WASHINGTON, DC

Dr. Meyer. Thank you for inviting me to testify on this proposed legislation. It seems to me that one of the keys here is that several provisions are attempts to prevent the FOMC from responding to divergences from full employment, even for example, in the Great Recession, and to restrict the FOMC from carrying out stimulative policies once they've reached the near-zero funds rate, as is the case today.

But let me start with preliminaries. Can the Fed effectively carry out stabilization policy? Are estimates of the minimum sustainable unemployment rate so uncertain that policy aimed at promoting full employment might do more damage than good? Does a dual mandate undermine the ability of the Central Bank to meet its price stability mandate?

Let me answer those questions. The CBO, the IMF, the Board staff, most FOMC members, generations of CEAs and Macroeconomic Advisers all believe the FOMC can effectively promote full employment in the short run, while achieving inflation price stability in the medium or longer-term. While there is some evidence that Central Banks that have explicit inflation targets anchor long-term inflation expectations better, the difference, relative to the U.S., is very slight, the evidence is mixed, and the Fed now has an explicit price stability objective.

But the proof is in the pudding. Under Chairmen Volcker, Greenspan and Bernanke, the Fed has been successful in pushing longer inflation expectations down from an unacceptable level in the 1970's and early 1980's, right to a level consistent under their mandate, two percent. And there's been no backtracking.

The case for keeping the funds rate near zero for an extended period, and the dramatic expansion of the Fed's portfolio, do not risk soaring inflation, as long, of course, as the FOMC exits in time. The Fed has all the tools it needs to drain reserves and shrink the portfolio when appropriate. In any case, as long as it controls interest rates, it can control inflation.

This conclusion is consistent with the inflation projections of the CBO, the OMB, the IMF, FOMC participants, the Survey of Professional Forecasters and Macroeconomic Advisers. None projects inflation above two percent over the next several years, and some for a very long time.

Now let's turn to specific provisions. First, should the Congress change the FOMC's mandate from a dual to a single mandate? The answer is, it depends. If the bill is intended to move the Fed to a flexible inflation targeting regime, one practiced by virtually every other central bank around the world, this is a discussion worth having, though I still prefer the dual mandate.

Under the dual mandate, the two mandates are conceptually on an equal footing. With flexible inflation targeting, central banks also seek to achieve full employment and price stability, but in my view operate as if they have a hierarchical ordering of the two objectives, with price stability being the principle one and full employment secondary. However, the empirical evidence is very clear.

The dual mandate and flexible inflation targeting of central banks operate in essentially the same way.

But the provisions of this proposed legislation read clearly to move the FOMC to a hard inflation targeting regime, one that's practiced by no central bank around the world today. I strongly oppose this.

Under such a regime, the Central Bank may only pursue price stability, and therefore must pay no attention to divergences from full employment, even in the case like the Great Recession. Perhaps Mervyn King summed it up best when he called supporters of such a framework "inflation nutters." Should all presidents of Reserve Banks be voting members of the FOMC?

The motivation of supporters, I expect, is that currently, there are more hawks among the presidents than among the Board members. So giving votes to all the presidents would perhaps prevent further quantitative easing.

I find it very surprising that some Members of Congress, as a general principle, would want to decrease the power of Board members, who have been nominated by a democratically elected president, confirmed by a democratically elected members of the Senate, and make Reserve Bank presidents, appointed by unelected and unrepresentative boards, a majority on the FOMC. Supporters apparently believe that there's not enough regional influence on FOMC's national policy decisions, and that bankers do not have enough influence on monetary policy.

Lastly, let me talk about the proposal, as I read it, restricting the Fed to holding only short-term government securities in its portfolio. The intention clearly is to remove the FOMC's ability to pursue quantitative easing. Now for an editorial. I regret the Fed has become so politicized. Some provisions of this bill appear to me clearly partisan. Congress should respect the following admonition: Changes in the Federal Reserve Act should only be seriously considered if there is wide bipartisan support. Thank you.

[The prepared statement of Hon. Laurence Meyer appears in the Submissions for the Record on page 31.]

Vice Chairman Brady. Thank you, Dr. Meyer. Dr. Poole.

STATEMENT OF HON. WILLIAM POOLE, PH.D., SENIOR FELLOW, CATO INSTITUTE, FORMER PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE FEDERAL RESERVE BANK OF ST. LOUIS, WASHINGTON, DC

Dr. Poole. Vice Chairman Brady, members of the Committee, I'm pleased to be here—I almost said "this morning", but this afternoon—to comment on a number of interesting and important monetary policy issues.

First, I want to applaud Congressional support for a clear assignment of responsibility to the Federal Reserve to achieve price stability, defined as a low and stable rate of inflation, and I encourage Congress to make the mandate explicit by incorporating in law the decision of the Federal Open Markets Committee to define the goal as two percent inflation.

Now, unfortunately, the clarity of the goal of price stability in the Sound Dollar Act is somewhat muddied by reference to Fed monitoring asset prices. In pursuit of the goal of price stability, the Fed monitors many different measures of economic performance, including asset prices, and it would be unfortunate if mention of asset prices in the law created undue pressure on the Fed to act in some way or another as asset prices change.

Obviously, asset price bubbles can be a serious problem. However, there is no settled understanding of how the Central Bank or anyone else can reliably identify an asset price bubble as it is occurring. I strongly support restriction of assets in the System Open Market Account to direct obligations of the United States Treasury.

Without getting into an analysis of all the non-Treasury assets the Fed has purchased, consider the mortgage-backed securities portfolio. Since World War II, the U.S. government has engaged in a variety of credit programs, for better or for worse, I might add. These include farm credits, student loans, Export-Import Bank loans, Small Business Administration loans and so forth.

Congress makes judgments about the amount of such credit to be offered, program objectives, eligibility, interest rate and other loan terms. These judgments belong with Congress and not with the Federal Reserve, because the judgments inherently have a political component to them. Understand when I say "political component" it doesn't necessarily mean a partisan component.

Now, the Federal Reserve has set its own rules for buying mortgage-backed securities, and other aspects of federal aid to the hard-hit housing sector have been matters for Congress and the President, but not the Fed's purchases of MBSs. Suppose the Fed's initial decision to purchase one and a quarter trillion of MBSs had instead been a recommendation to Congress for legislation to do the same thing, except that the Treasury would administer the program and hold the portfolio.

What would some of the questions have been as Congress debated the proposal? Well, given the federal budget situation, would it have been wise to issue one and a quarter trillion of government bonds to provide the resources to purchase a portfolio of MBSs of like size? Should the entire one and a quarter trillion have been used for MBSs, or should some have been used to expand SBA, Small Business Administration loans, for example, or help students with struggling student loans? There are many other possible ways that Congress might have preferred to use one and a quarter trillion of new federal credit, than devoting it entirely to MBSs. These issues should have been debated and decided by Congress.

Now, let me also emphasize this question. Who benefited from the Federal Reserve's program to accumulate and maintain a large portfolio of MBSs? A significant fraction of mortgages issued in recent years have been refinancing. Who can refinance? Only those with substantial equity in their properties, despite the decline in house prices and those with good credit ratings. I qualify on both counts.

But why should the Fed be helping me and others in fortunate circumstances such as I enjoy? So I suggest that the JEC request a study from the Federal Reserve, to report on the characteristics of the mortgages in the MBSs in SOMA, and understand that the required data are readily available through CoreLogic.

I believe that the benefits of Fed purchases of MBSs have gone primarily to homeowners in comfortable circumstances, and to banks and title companies that collect fees from mortgage financing. The program has done little to spur homebuilding. The monetary effects of expanding the SOMA would have occurred in equal measure if the Fed had purchased Treasury securities instead of MBSs.

I have in my statement a fairly extensive discussion of Federal Reserve emergency powers under Section 13(3) of the Federal Reserve Act, but I see that I've exhausted my time, and we can come back to that topic, if the Committee wants to talk with me about it. Thank you.

[The prepared statement of Hon. William Poole, Ph.D. appears in the Submissions for the Record on page 39.]

Vice Chairman Brady. Thank you, Dr. Poole. Thank you for the testimony today. Before we begin questioning, I'd like to turn to Mr. Cummings for the opening statement from our minority members.

OPENING STATEMENT OF HON. ELIJAH E. CUMMINGS, A U.S. REPRESENTATIVE FROM MARYLAND

Representative Cummings. Thank you very much, Mr. Chairman. I'm sorry to be late. I had a matter on the floor of the House. Chairman Casey could not be here today, and I am pleased to stand in for him this afternoon. I want to thank Vice Chairman Brady for calling this hearing, to examine our nation's monetary policy and its effect on our economy.

I also thank our esteemed witnesses for appearing before us today, and lending their expertise to this very important matter. The Federal Reserve System was created in 1913 to provide the nation with a safer, more flexible and more stable monetary and financial system. In 1977, Congress enacted legislation that spelled out in greater detail the Fed's monetary policy objectives, collectively known as the Fed's dual mandate.

These objectives are to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates. I understand that today's hearing is being called to examine legislation proposed by the Vice Chairman, that would limit the Fed's mandate to the single objective of ensuring price stability, and that would make other changes to the Central Bank's decision-making authority and structure.

While I certainly share the Vice Chairman's goal of ensuring price stability and preventing inflation, I believe that the current system is working effectively, and is also essential to enabling the Fed to adjust monetary policy quickly in times of crisis.

While it is true that in the past few years, the Fed has implemented some extraordinary monetary policies, these actions were necessitated by extraordinary circumstances, and by most measures have helped stabilize our economy and prevent a complete collapse.

Certainly, our recovery from the 2008 financial collapse has been long and painful, and at times filled with false promise. For example, while it appeared early last year that the economy was turning a corner, we stumbled again due to factors like the earthquake in Japan, the rise in energy prices, the continuing economic turmoil in Europe and the still-struggling housing market.

However, since the end of 2011, shortly after the Fed launched Operation Twist, the economy has shown signs of a sustained recovery. Last week, new claims for unemployment benefits reached a four-year low. Over the past six months, the U.S. has seen the highest consistent numbers of jobs created since 2006, and consumer confidence is at its highest level since 2004, according to a March 22nd Bloomberg report.

Moreover, the fears announced by critics of the Fed's policies have simply not been proven correct. The monetary easing actions have had such a minimal impact on inflation that Reuters recently posed the question "Where is the inflation?" The Brookings Institution economist Barry Bosworth stated recently "There's been no collapse of the American dollar. The dollar was declining up to the financial crisis and then shot up in value, and we're still not back to where we were before the financial crisis started."

Finally, I note that while some have tried to link the spike in oil prices and commodities to the Fed's monetary easing policies, the Congressional Research Service examined this issue and rejected any causal relationship. Most experts have pointed to traditional factors, such as supply and demand, as well as the increasing role of speculators in driving up prices at the pump.

The one area of our economy that continues to struggle is employment, and this is the area that the Vice Chairman's legislation would require the Feds to ignore. I could not disagree more. I commend Chairman Bernanke and the other Federal Reserve governors for continuing to pursue the objective of maximum employment, while drawing Congress' attention to the actions that it could take to support higher employment.

Unfortunately, Congress has failed to implement these actions, a failure that I find deeply troubling, given that there are millions of unemployed Americans who could benefit from the Congressional actions recommended by the Fed. Again, I thank the witnesses for joining us today, and again, Mr. Chairman, I thank you.

[The prepared statement of Representative Elijah E. Cummings appears in the Submissions for the Record on page 45.]

Vice Chairman Brady. Thank you, Mr. Cummings. Let me turn to questions. One, again thank you to the panel. The goal of introducing this legislation is to have a thoughtful, constructive discussion on what role we want the Fed to play going forward, to create the strongest foundation for economic growth and output in the United States, and to have a clear mandate from Congress, in which we hold the Fed accountable to that mandate, without confusion going forward.

As we talked to policymakers in Washington about this issue, and the public as well, there are sort of two myths that arise quickly, and because Dr. Poole and Dr. Taylor referenced it in their testimony, I'd like you to comment on it, if you would. The first is that a single mandate on price stability will then ignore unemployment issues.

We're at over eight percent unemployment. Jobs are a critical feature, a critical desire of our country. You know, how can we move to a single mandate during these times? The other myth is that somehow, a dual mandate is etched in stone, that it would be an unusual move to focus back on the purchasing power of the dollar.

But in fact, you know, of the 30 plus central banks around the world, the vast majority of them put the single mandate, price stability, as either their sole or their primary focus. In fact, the greatest period of time in U.S. history economic-wise is associated with the single mandate focused on price stability, that we've in fact won two Cold Wars, put a man on the moon and grown our economy dramatically without a dual mandate.

So I'd like Dr. Taylor and Dr. Poole to address those two myths, that this somehow would cause the Fed to ignore the business cycle and employment issues, and that a movement back to a single mandate is somehow unusual. Dr. Taylor.

Dr. Taylor. Thank you. The single mandate, single goal does not preclude the Federal Reserve from providing lender of last resort or providing liquidity in a panic. It does not preclude the Fed reducing interest rates in a recession. These are part of the ways that you implement the single mandate. I certainly made that clear in my research for many years, that the mandate is a way to get the Fed from doing more harmful things, the single mandate. You can point, as people have, to the good record on inflation.

But in the meantime, the record on other things has not been good. We have had the Great Recession. We have had a financial panic. We have had a very slow recovery, and I think you can point to actions of the Federal Reserve as significant factors in these events. I mentioned the very low interest rates in '03, '04, '05. That was in a sense an intervention, an extra intervention of the kind that they would not have done in the 80's and 90's.

More recently, the interventions and the quantitative easing causing confusion, not knowing whether they had an impact or not, when they're going to continue, when they're going to stop, and how do you reduce this gigantic balance sheet. These are all things that I think are negative with respect to economic growth and employment. The Fed, of course, has capabilities of avoiding these interventions, as it did, as you mentioned, in much of the 80's and 90's.

But the legislation such as the Sound Dollar Act would assist the Federal Reserve, would incentivize the Federal Reserve, and help encourage that kind of better economic policy.

Vice Chairman Brady. Thank you, Doctor. Dr. Poole.

Dr. Poole. Congress could certainly adopt a two percent inflation target, could support the Federal Reserve's decision, the FOMC's decision that was announced on January 25th. The Fed was clear in the memo that it sent out, the press release on that, that it could not adopt an unemployment target, a percentage, because that was not within the control of monetary policy.

I don't see anything inconsistent here. Congress could have an objective of lower unemployment, understanding that that objective would have to be pursued through fiscal policy and regulatory means, but not assigned to the Federal Reserve. So I don't understand that the legislation that we're talking about here would downgrade in any way unemployment as an objective, as a national objective.

It is certainly a national objective. It's just that the things that create unemployment are not subject to being fixed, if you will, by Federal Reserve policy. Now having said that, I want to emphasize that the Federal Reserve, with confidence in the markets about price stability, can cushion disturbances in the unemployment rate, and can act to help steer the economy in the right direction, in terms of employment and economic growth.

But that's not the same thing as saying that the Federal Reserve can achieve a numerical target or ought to be assigned a numerical target for the unemployment rate.

Vice Chairman Brady. Thank you, Dr. Poole.

Senator DeMint.

OPENING STATEMENT OF HON. JIM DEMINT, A U.S. SENATOR FROM SOUTH CAROLINA

Senator DeMint. Thank you, Chairman Brady. I appreciate you all being here, and I think I'm going to address my question mostly to Dr. Taylor, because he brought up this idea of a rules-based system, versus one that's more arbitrary, which really gets at, I think, a fundamental question about what kind of country we're going to be. Are we going to be a rule of law or rule of men? I think what you're saying is it appears now that it's very much a rule of men and opinions about what we're doing.

My concern is multi-dimensional, in the sense that when it comes to our monetary value, there's no standard, no gold standard, no standard of any kind. When it comes to monetary supply, there's criteria, there's no standard. You would think there'd be some relationship between the monetary supply and the size of our economy or the growth of our economy.

But there's nothing there, and so we've got no institutional discipline on one side, and the other side of the employment mandate, I've sat through a number of hearings with Chairman Bernanke, and it's very clear, since economies worldwide are now interwoven, that that's a clear directive, to intervene and be involved in economies all over the world.

So we have no institutional discipline that would—no rules-based system, and all the incentives are for our Federal Reserve to try to manipulate and control economies all over the world, because it affects our employment here at home. There seem to be other perverse incentives, and it seems the Federal Reserve is now playing a major role in our national debt, in the sense of underwriting it and in effect owning part of it.

As I try to connect all the dots, I become very concerned that we have created a deck or really a house of cards, that we don't know which the first one is going to fall. But there's clearly not a system built on any kind of foundation that could be predictable. I know that's not exactly a question, but I'd just love to hear you talk a little bit more about where we are.

Certainly, all of us are concerned about employment, but an unpredictable monetary value and supply seems to be the biggest danger we have to long-term employment. So I'll just turn it over to you.

Dr. Taylor. Thank you very much, Senator. I think we have lots of experience that's consistent with your concern. Policy was very unpredictable in the Great Depression. Monetary policy was very unpredictable in the mid-60's and 70's. Policy was much more predictable in the 80's and 90's, and times were good then, and now policy has become unpredictable again and things are not going well. So I think there's lots of evidence, historical individual studies that are consistent with what you're saying.

I'm concerned now because, as you suggest, there seems to be no limit to the discretion that the Federal Reserve can undertake right now. If it wants to go buy another $100 billion of anything, it simply credits the banks with reserves, and goes out and uses the money. It used to be that there was some discipline with the supply and demand for money determined in the interest rate. But the Federal Reserve just sets the interest rate by paying a certain amount on deposits at the bank.

So I think we've moved into really an completely unprecedented area. I would think one way to characterize this is the Fed has replaced the interbank money market with itself. The Fed has replaced large segments of the government securities market with itself. Early in 2009–2010, the Fed replaced large segments of the mortgage-backed securities market with itself.

So this creates an enormous amount of discretion, decisions by authorities, rather than by rules, and we don't know exactly what the outcome is going to be. I wouldn't point to the fact that people are, some people are forecasting low inflation and be complacent. It could be the opposite kind of effect. It could be an effect which could be contractionary before we're all finished.

So I agree with you entirely. We have so much evidence that says a more rules-based policy works better. That's not where we are now, and I think we should get there as soon as we can, and I think legislation like this will help.

Senator DeMint. Thank you, Mr. Chairman.

Vice Chairman Brady. Thank you, Senator. Mr. Cummings.

Representative Cummings. Thank you very much. Dr. Meyer, you testified that restricting the Fed to only holding short-term government securities would eliminate the FOMC's ability to do quantitative easing; is that correct? Is your mic on?

Dr. Meyer. Yes.

Representative Cummings. Do you have any sense of how much lower GDP would be and how much higher the unemployment rate would be if the Fed did not engage in QE1 or QE2?

Dr. Meyer. There's always going to be some controversy about something that has to be determined through models. We've studied it, the Board staff has studied it, and so why don't I just share with the Committee what the Board staff, it's really three Board economists and the economists at the San Francisco Fed.

Concluded their model, state of the art, they found that QE1 and QE2 collectively saved three million jobs, lowered the unemployment rate 1½ percentage points over two years. Now I don't want to go to the wall and defend those precise numbers. Our study showed something that was a little more than half that big. But even that is meaningful.

These policies have lowered interest rates very substantially by between 75 and 100 basis points, including Operation Twist. QE1 and QE2 have stimulated aggregate demand. They've improved financial conditions.

So I think they've done what they were expected to do. But I don't want to give you the false impression. At this point, there's really very little that the Fed can do. There's an understandable reluctance to expand the balance sheet much further, rates are already zero at the short end. We're close to being in a world without policy. Fiscal policy around the world is going in the wrong direction from a stabilization standpoint, perfectly understanding in terms of long-run sustainability and growth, and monetary policy has little left.

That's why the Chairman has emphasized that the ball's in your court. You're the ones, if anybody, who's got to be thinking about full employment, dealing with how many people are out of work, and you have to decide whether you're willing to fulfill that responsibility.

Representative Cummings. Now the panel has a difference of opinion on limiting the FOMC's purchases. Dr. Taylor, you testified that the Fed's purchases of mortgage-backed securities had no impact on the mortgage interest rate. Do you agree with that, Dr. Meyer?

Dr. Meyer. Oh absolutely not, and I'm aware of many, many studies done by academics, done by the New York Fed as well as our own, that show that purchasing mortgage-backed securities have at least the same influence on interest rates as MBS, because as we say, they have taken duration out of the markets. They take that duration onto their portfolio. And, if anything, MBS should have a greater effect, because it shrinks the credit risk on mortgages, lowers mortgage rates relative to government rates.

So no. There are always, we say, two economists, three opinions. I have a lot of respect for John, a lot of respect. But we've really disagreed. There are a lot of academics, a lot of other studies that have been done, that get eerily identical impacts on interest rates. So there is a difference of opinion.

Representative Cummings. A February 1st, 2012 Bloomberg editorial titled "Federal Reserve Dual Mandate Shows Bernanke Model Working Better in Crisis," states this, and it says "The Federal Reserve Chairman Ben Bernanke's focus on full employment and price stability is being validated, as the U.S. expansion gains speed, and his counterparts in Europe emulate his approach." Dr. Meyer, do you agree with that observation?

Dr. Meyer. I think I'm going to read a quote from the Deputy Governor of the Riksbank Bank, the leading scholar, absolutely leading scholar in the world, on monetary policy strategy, Lars Svensson. "What has happened in the past is you have had a single mandate, but in practice, you have behaved as if it has been a dual mandate, and I think that has been for good reason. It's better for both inflation and the real economy if you behave as though you had a dual mandate."

So let's be very clear. There is no central bank in the world that operates as if it has a single mandate, not a single one. You can look at their mandates. They all talk about other things. You know, encouraging employment, etc. No. Is that what you want? You want the Fed to be different from every other central bank in the world. I'll give you another example. Some FOMC members say the Fed has a flexible inflation targeting regime. That's how close they are.

I've talked to many central bankers from flexible inflation targeting countries. They all say, what's the debate? We're identical to a dual mandate. So you're talking about something not like practiced around the world, not at all. You're talking about being unique, doing something that no other central bank would do, and I think you're right. I don't want to say that the monetary policy committee in the UK and the ECB just followed the U.S.

But Bernanke has been the leader. He wrote the classical paper of what to do in situations like that, and I would say that others have followed his lead, for the betterment of the U.S., their economies and the global economy.

Representative Cummings. Thank you, Mr. Chairman.

Vice Chairman Brady. Thank you.

Senator Lee.

OPENING STATEMENT OF HON. MIKE LEE, A U.S. SENATOR FROM UTAH

Senator Lee. Thank you very much. I appreciate each of you for joining us today. I think this an important issue, one that frequently doesn't get the attention that it deserves. There are some things about our current monetary policy that trouble me. One of them is what I perceive to be something of a symbiotic, almost codependent relationship between Congress on the one hand, and the Federal Reserve on the other hand.

You have Congress spending money that it doesn't have, issuing additional Treasury instruments, debt instruments to finance that spending, and it does so really to avoid the political consequences that would be associated with either budget cuts, on the one hand, or tax increases on the other hand. The Federal Reserve, for its part, keeps interest rates often artificially low, in ways that may mask the true cost associated with uncontrolled, out of control government spending.

Meanwhile in so many ways, these practices tend to impose new, additional and hidden costs on Americans, costs that create distortions on the marketplace that are not always accounted for in standard government measures. So you have Congress, the political institution that is supposed to be accountable to the people, in effect insulating itself from accountability, transferring some of that authority, and with it the responsibility and the accountability, to another institution, the Federal Reserve, which while consisting of very smart people, I will certainly give them that, is not representative.

These are not elected people. They're not accountable to anyone who is elected really, at the end of the day. They meet in secret. They may well have the best of intentions, the best of motives, and the best educational backgrounds. But they are not accountable to the people. This is troubling to me. It's part of what facilitates monetary policy that I think is unsound. The time is now to move towards a sound monetary policy, and I hope that we can see that.

Now I'd like to ask Doctors Taylor and Poole to respond to Dr. Meyer's assertion that there is, in effect, a dual mandate system in essentially every central bank throughout the world. Do you agree with that?

Dr. Taylor. Well no. In fact, there are wide differences in the instructions given to central banks at this point, and some follow them more closely than others. I think what you need to look at is what central banks actually do, and in fact during the 80's and 90's, the Federal Reserve starting with Chairman Volcker, decided that the dual mandate, which was put in place in 1977, during the height of an interventionist period, was best interpreted as a focus on price stability, focused on getting inflation down and not try to do a bunch of other things.

It was tremendously successful not only in getting inflation down, but getting unemployment down and getting economic growth up, and remarkably, making recessions less frequent and expansions longer. So it's a tremendous improvement. Unfortunately, his interpretation, as he stated at the time, is no longer the current interpretation.

Now it's completely switched, and the Federal Reserve officials now explicitly state the dual mandate as the reason for all these interventions. Because of the dual mandate, we were going to do QE1 or QE2 or Operation Twist. The Federal Reserve didn't refer to the dual mandate explicitly all those years with Volcker.

So that's why I think more than ever, we need to have some kind of legislation like this, that makes the Federal Reserve—Congress has responsibility, of course, for the Federal Reserve. You don't want to micromanage it. But you want to give it this general idea of what its responsibilities are.

Now let me just say with respect to the question on the specific impacts, I did one of the first studies on the mortgage-backed securities purchase program, and this is before the Federal Reserve actually did the studies, and found it had no significant effect, controlling for pre-payment risk and other kinds of credit risk.

There are studies, mainly at the Federal Reserve, not a surprise after all, that find it has impacts. They have a different methodology. I don't think it is appropriate. I've seen that kind of methodology fail in the past. But I think most of all, there's a great deal of uncertainty about the impacts of these programs, in terms of being positive, but there is not much uncertainty that they brought the Fed into this unprecedented degree of intervention and a gigantic balance sheet, which is uncertain how it's going to be resolved, and that's my main concern.

Senator Lee. I've got seven seconds left. Dr. Poole, can you add something? Do you want to add anything to that?

Dr. Poole. Maybe not in seven seconds. I can't talk that fast.

Senator Lee. I'll get to you next time around, then.

Vice Chairman Brady. All right. Thank you very much. I'd like to stay focused on the issue of credit allocation. I believe in an independent Fed with a dedicated source of revenue. But I just believe the Federal Reserve allocating credits to specific segments of the market helps politicize the Fed, and it also makes it—creates problems as it tries to unwind its position when inflation pressures increase.

So I would ask this of each of you. From an independence standpoint, does the Federal Reserve's credit allocation policy threaten its ability to conduct its monetary policy independently?

Dr. Taylor. Very briefly, I believe it raises questions about why an independent agency of government should be taking on responsibilities that are more appropriate for the Congress and the appropriations process. There is not a theoretical rationale for that; just politics. So I think it does raise questions, legitimate questions, and that's why I think we should try to have the Fed do much less of that credit allocation in the future.

Vice Chairman Brady. In sum, we basically limit those purchases to Treasuries going forward, those assets, except for very unusual circumstances. Dr. Meyer.

Dr. Meyer. A principle of monetary policy should be neutrality, and that means only operating in government securities. So in principle, I agree with that. Now here's the problem. The Fed now holds on its portfolio about a trillion dollars' worth of agency securities. It holds $1.6 trillion of Treasuries, and said it can't buy anymore without dysfunction in the Treasury market.

So this again is an attack on quantitative easing. What you're saying is take away that $1 trillion; you shouldn't have done it. Well, I think it had a big impact on the economy. So I think we have to—I agree with you as a point of departure. I would have said exactly what you say. You've got to hold your nose, okay, if you're going to buy MBS. It was extremely unfortunate.

But I am conflicted in this particular case, because the Fed has reached the limits, would have reached the limits of what it can do in Treasuries, and its portfolio would be almost half as large as it is today, if it didn't have the authority, which it did have, to buy MBS.

Vice Chairman Brady. Thank you. Dr. Poole.

Dr. Poole. If I accept all of Larry's judgments about the extent to which mortgage rates were reduced, I continue to insist that that reduction did nothing or practically nothing for the moribund housing market. Nor did it do anything for the people who were suffering from foreclosures and financial distress and upside down mortgages, because they couldn't refinance mortgages.

So almost all the refinancing that took place created new mortgage-backed securities, and those are the people who were assisted by this policy. Now who are the people who lost? I mean if I gained, who are the people who lost? Well, the people who lost, some of them were people living on fixed incomes, who had the rate of return on their portfolios reduced. So there's a transfer from them to me.

Some of the people who lost or will lose will be the federal government, because the Federal Reserve is taking a lower rate of return on these mortgage-backs, and may actually in time, as interest rates rise, lose capital values as well. So the program helped me, thank you, it helped me and others in like circumstances, but did very, very little for the underlying core of the problem in the housing market. It was sold for doing that, but it did not have that effect, could not.

Vice Chairman Brady. Dr. Poole, does inflation telegraph its punch? I mean is there not the belief that the Fed has to start withdrawing its accommodative policies and accommodations ahead of inflation taking root? I recall in 2007 in this room being told, being assured there were no asset bubbles. The economy was moving along great. We know what the end result was.

Can inflation also take root before the Fed begins to withdraw what is a very unprecedented and aggressive position in those mortgage-backed securities?

Dr. Poole. Well of course it can, and the issue is whether the Federal Reserve will act in a timely fashion, to prevent the inflation from taking hold. 1994 is a really good example. Alan Greenspan emphasized that the tightening of monetary policy that year was preemptive. The Fed was tightening policy so that inflation would never have a chance to take root, and he was successful and it did not have an adverse effect on the unemployment rate.

So yes, you want to withdraw the excessive expansionary force of monetary policy before inflation takes effect, and I don't think there's any disagreement here on this panel about that.

Vice Chairman Brady. I was just making a point. I'm worried the politics as that begins to happen will be driven up substantially on——

Dr. Poole. Well, the politics of that will be that as interest rates rise, as they must when the economy recovers, more than it has already, it's going to cause an explosion in the interest expense line in the federal budget, because there is an ever-growing amount of government debt outstanding, and when you start applying higher and higher interest rates to that outstanding amount of government debt, it's going to cause a very large increase in the federal budget expense component. It's going to make it that much more difficult for fiscal policy to get itself on the correct course.

Vice Chairman Brady. Thank you, Dr. Poole.

Senator DeMint.

Senator DeMint. Well, I've appreciated the discussion. We're really getting at a much bigger issue that I think our country is dealing with. As I hear you talk and the disagreement, it's really the centrally planned and managed economy that Dr. Meyer is talking about, or do we have a free market economy with a stable monetary measure of values and transactions?

It's not so much a question of whether it works or not, or whether this study says we created a million jobs or whether we didn't. The question is should the Federal Reserve be attempting to manage our economy and economies all over the world through monetary policy, and in effect encouraging more national debt by helping to, in effect, mask the effect of that debt by buying our own debt.

We frankly, I don't think, know what our interest rates would be if the Federal Reserve had not intervened, and now their back's against the wall, as Dr. Meyer says, and they really can't go any further. So we're not sure what's going to happen. But I don't know that I have a question in all of this, except that it does appear to be—you've got a question, Dr. Meyer. Since I've named you in this, I'll let you ask me a question here.

Dr. Meyer. Okay. Senator DeMint, with all due respect——

Senator DeMint. Thank you.

Dr. Meyer. Do you think this hearing and the discussion about the Federal Reserve is really about a centrally planned economy versus a free market economy? Come on, come on. Give me a break.

Senator DeMint. Well, I'll answer that, because it's not just this hearing. It's the ones, a number of hearings that I've sat through, and the assurances you give us that things are working are very similar to the assurances that still haunt us today about Fannie Mae and Freddie Mac, that there's no problem with that type of subprime mortgages or whatever.

So we're not trying to be disrespectful, but hopefully intelligently cynical, because the information we've got over the last decade or so has not proved to be true, on what is a problem and what's not. But it really is, if you listen to the fact that the Federal Reserve does have a role in our economic system, in determining really how the economy works in employment, and economies all around the world, it's not just what I've heard here today.

But when Chairman Bernanke is talking, he's clearly talking about how—I almost feel like a puppeteer. He's telling me how he's pulling the strings, and while it may be for all good intentions, there is a fundamental difference in a free market economy with a standard monetary system, and what we know through history as centrally planned economies. Dr. Taylor.

Dr. Taylor. I think there's a relationship between the more discretionary monetary policy, less rules-based monetary policy we've seen now, and other kinds of policies, whether it's fiscal policy or regulatory policy. I think that's one way to characterize what you're driving at. I just finished a book where I trace that these trends to more interventionism, less interventionism, more government intrusion, less government intrusion characterize movements not just of monetary policy, but also fiscal policy.

I believe you can see that currently. There is so much, has been so much emphasis on these kind of short-term stimulus packages, whether it's the 2008 package to stimulate the economy, or the 2009 stimulus package or first-time home buyers or cash for clunkers.

There's a whole long list of actions on the fiscal side, that have the same characteristics of less predictability, more interventionism, and I believe that is a problem that we're facing, not just with respect to monetary policy, but fiscal policy and also regulatory policy. I think people should understand that, that it's a historical movement, and I believe it's harmful.

Senator DeMint. Thank you.

Dr. Poole.

Dr. Poole. In terms of the regularity, the predictability of the policies of the Federal Reserve, I believe strongly that the Fed should be confined to Treasury market, and this is part of this discussion, because if the Fed can buy any assets that it wants under conditions that it specifies, then where is that going to take us? That's what's happened. The Fed has provided credit in a variety of directions during the financial crisis, on the argument that it was necessary to deal with the financial crisis.

But as we go through time, the Fed can make this argument, it seems to me, in a variety of different circumstances. Now if you want to say that we're never going to have a financial crisis, that this is all permanently behind us, that there will never again be any occasion where the Federal Reserve might be called upon or believe that it's its responsibility to enter this market or that market, I don't think that's true.

So that's why I feel quite strongly that the Fed has gone off, has made a mistake. I understand the motivation for doing it, and I understand Larry Meyer's argument for the Fed doing it. But the Fed did not need to do it. The Fed could have asked the Treasury to buy the MBSs, and the Fed, or whatever else the Treasury wanted to buy, and then the extra government debt created that way would have been available for the Fed to buy if it wanted to do so.

So I just don't accept his argument that the only way to expand the monetary base, have the quantitative easing, was to buy the MBSs, and of course there were these other programs, the commercial paper funding facility that was not chump change. The Federal Reserve bought commercial paper amounting at one point to $350 billion, and I think you know the list of companies, or you can find out the list of companies to which the Fed lent money.

What is to limit this process? I think there is no limit on it, as we now stand.

Senator DeMint. I know we're out of time, but Dr. Taylor, your point is true. When you talk to people who create jobs, they don't know what the Federal Reserve's going to do, they don't know what the politicians are going to do, they don't know what the regulators are going to do. That's no way to operate in a rule of law country.

Vice Chairman Brady. Thank you, and I will make sure Mr. Cummings has extra time during his questioning. Mr. Cummings.

Representative Cummings. Thank you very much, Mr. Chairman. Dr. Meyer, back on March 2nd, 2011, in a Congressional Research Service report titled "The U.S. Trade Deficit and the Dollar and the Price of Oil," CRS finds that the Fed's monetary policy actions have not been the main driver of higher oil and gas prices. The report explicitly rejects any direct cause and effect relationship between changes in the value of the dollar and the price of oil.

Dr. Meyer, can you comment on the suggestion that the Federal Reserve monetary policy is a key driver of oil price fluctuations?

Dr. Meyer. Yes, happy to do so. I think it should be very clear that the price of oil increased in kind of two phases. One was the unexpectedly sharp rebound in the global economy, with global growth very high, for example, in 2010. Commodity prices are the most cyclically sensitive variable in the world. Of course commodity prices were going to rise. Then we had supply considerations, geopolitical, and it increased further.

Now I'm not going to say that there's no impact of monetary policy. No. That's not quite true. It's very secondary and it's small. But just to give you a sense here, the most direct link is that when you lower rates, you lead to a depreciation of the dollar, a great thing. But that puts upward pressure on commodity prices.

Now there's been a lot of studies of that. You've got to put it into perspective. That's a very small effect. I like to tell it like it is. So that's an effect that's there. It's logical, it's empirically-based, but it's very small.

Representative Cummings. Well, some have argued that the Federal Reserve's accommodative monetary policy has driven down the foreign exchange value of the dollar, thereby boosting oil prices.

But since their recent low in February 2009, oil prices have rebounded about a 150 percent, whereas the broad nominal index of the dollar has fallen by only 15 percent. Thus, Dr. Meyer, isn't it true that the dollar's decline can at most explain only a small part of the rise of oil prices?

Dr. Meyer. Absolutely, but let me go a little further with exchange rates, because I know that the Sound Dollar bill, it doesn't talk a lot about it, but I think it has it in mind too. You asked the Congress to report to you in that bill on the impact of monetary policy on exchange rates. So let me save the Chairman a visit, okay.

When monetary policy eases, it is inevitable that the dollar will depreciate. Rates will fall, and that will create capital outflows from the United States, and that will lead to a depreciation of the dollar. So what do you say about it? I say thank God. I mean that's how you get stimulus or monetary policy in an open economy.

You get it in part by lowering borrowing costs; you get it in part by raising asset prices; and you get maybe a third of it by stimulating net exports. Very important. That's the importance of monetary policy. The Fed has no target for the dollar. Indeed, there is no target for the dollar anywhere. There is no instrument. There is no such thing as dollar policy. It's a myth.

Representative Cummings. Further, in March 2011, Bart Tilton, Commissioner of the U.S. Commodity Futures Trading Commission, warned about the impact of speculators on oil and gas prices. His concerns were recently confirmed in a March 13, 2012, CBS news report, in which Mr. Gayle, a managing director and senior analyst covering the oil and gas sector for Oppenheimer and Company, Inc., stated that 75 percent of what Americans pay for gasoline comes from the cost of crude oil.

He went on to say that the primary Government policy that could address the price of gas would be to crack down on speculation in oil markets, which he suggests has added 30 percent to the global price of crude. To all of the panelists, do you believe that if Congress stripped the Fed of its dual mandate to promote price stability and maximum employment, it would materially impact the price of oil?

Dr. Meyer. No. But let me say, it's a terrible idea for Government to intervene and try to stop what it thinks is speculation. I don't know how they would define it. One person's speculation is another person's investment. Commodity investments have soared, for good reason. Portfolios are under-represented in real assets; I don't want to give investment advice, but it's reasonable for everybody to have a share of their portfolio in some type of real assets.

And yes, and that has driven up the price of commodities to some extent. I can't tell you sort of how much, but this is really unrelated to the Fed's mandate. It's a whole different issue.

Representative Cummings. Dr. Taylor.

Dr. Taylor. I think that there is an impact of monetary policy, whether it's too easy, which is the concern of many, or even if it's too tight, on other central banks, and therefore on commodity inflation or oil price more generally, because these are globally traded products.

We have lots of evidence that smaller central banks, the Central Bank of Norway, Central Bank of Mexico, they will hold their interest rates lower than they otherwise would, if the Fed has low interest rates. So that tends to itself induce extra inflationary pressures globally, which can affect commodity markets.

We've seen that, and it is a concern. So to the extent that that kind of policy is discouraged, because it tends to be more interventionist, by something like the Sound Dollar Act. I think it will discourage, actually discourage some of the speculative behavior you have, because central banks will therefore—other central banks will be able to find their policies more appropriate, and not be driven into these easier policies by the Federal Reserve.

Representative Cummings. Dr. Poole.

Dr. Poole. The pricing of all assets, land, gold, commodities, stocks, bonds, pricing of all such assets is heavily influenced by expectations about the future. You don't want to hold it today if you think the price is going to go down, and that is the essence of what you might call speculative activity, as a consequence of the fact that the asset is storable.

So this is a characteristic of all asset prices, and it is also true that whenever asset prices go up, when people are unhappy about that, they appeal to speculators as being the cause, and it is somehow a problem. It is somehow inconsistent with the way markets are supposed to function, and I reject that view completely.

Now what worries me about the current circumstance is that the high oil prices that we now have, attributed perhaps correctly, I don't know, to the heightened tensions in the Middle East, might in fact instead be importantly a reflection of a world economy that is stronger than we had anticipated, including a U.S. economy, that this would be a symptom of economic strength rather than a force that would tend to depress growth.

That is, when you have a strong economy, it drives up certain prices, and if we are misinterpreting the current increase in the price of oil as a negative for the economy, rather than as a sign of economic strength, then we may well have a monetary policy error coming from it.

Representative Cummings. Thank you very much, Mr. Chairman.

Vice Chairman Brady. Thank you.

Senator Lee.

Senator Lee. Thank you. Dr. Poole, as promised, I'm going to give you time to respond to what Dr. Meyer had said with regard to kind of a de facto dual mandate standard among central banks around the world. Care to respond?

Dr. Poole. No. I think that's correct. But one thing that he did say along the way, is that there is, I think he used the word "hierarchy" in the employment and price mandate or objective. That hierarchy is once we lose price stability, then we also lose employment stability, and the central bank also loses the flexibility to respond to the real economy, to the employment situation.

A very good example is what happened in the late 1970s. As the markets lost confidence in the Federal Reserve, because the Federal Reserve kept feeding money into an inflationary economy, kept saying it was going to bring inflation down; inflation kept rising.

At that point, the Federal Reserve also lost, I'll say power, to have a constructive influence on unemployment.

So when Paul Volcker came into office, he understood that the first thing he had to do was to restore Federal Reserve credibility, because that was important both for the inflation objective, but also for the employment objective.

Senator Lee. Is it your assessment that Chairman Volcker did restore that credibility? Did he succeed in doing that?

Dr. Poole. Oh absolutely.

Senator Lee. How would you compare the credibility of the Federal Reserve under the leadership of Chairman Volcker, to the credibility of the Federal Reserve today?

Dr. Poole. What I—my sense of the history here would be that it took a little while for the markets to have really a very high degree of confidence in the Federal Reserve. Volcker hung on through a difficult recession that took the unemployment rate to what, 10.6 percent? He had the support of President Reagan, and over time, with the success of that policy, the Federal Reserve position grew stronger. Market credibility improved.

That continued to strengthen through the tenure of Chairman Greenspan. I believe that the market still has a very high degree of regard, very high regard for Chairman Bernanke, but I believe it is not as solidly entrenched as it was under Greenspan. That is, it would be easier for there to be a policy mistake, and for inflation expectations to take hold.

Senator Lee. Thank you. Dr. Taylor, based on the rate at which Congress is spending, the rate at which Congress is engaging in deficit spending, and based on where you see U.S. Treasury yield rates going in the next few years, do you have any predictions, or do you have an ability to predict how long it might be between now and the time that we can expect to be paying a trillion dollars a year in interest on our national debt?

Dr. Taylor. Well, it's very hard to forecast when rates are going up, but they're going up probably more than the forecast of CBO. There's certainly a risk of that, in which the case deficit will get worse. I don't want to predict a particular date, but it's clear right now that unless policy changes, the debt is going to continue to rise as a share of GDP. Interest payments will grow rapidly as a share of the budget and of course as a share of GDP.

I don't see any change right now in that. The last time CBO made a forecast of the debt to GDP ratio long term, which was last summer, and of course it just like skyrockets to hundreds of percent. The United States of America won't be the United States of America if that happens.

So I think it's a great concern. This hearing is not on fiscal policy, but that's an extraordinarily important problem to fix. I mean the relationship to the Fed is the extent that the Fed tends to monetize that debt. It becomes more of a problem down the road, and we need to be concerned about that. Of course, they say they want to undo it and I hope they do. But in the meantime, they've set some precedents.

So I think it's most important on the fiscal side to adopt a budget which gradually reduces spending as a share of GDP. I recommend coming back to the 2007 levels as a share of GDP; that's 19½ percent, and really take this fiscal responsibility that the Congress and the President have, and deal with it now.

Senator Lee. Do you think it's plausible or reasonable to expect that Congress is likely to make significant cuts, to bring the debt to GDP ratio down, bring our deficits down, as long as interest rates remain as low as they are now?

Dr. Taylor. I think it's the right thing to do. It's really going to be the debate in this election year. You have a proposal from the House of Representatives, a budget which does that. You have a proposal from the President which doesn't do that. It's going to be part of the election, and as speaking objectively, not trying to predict the politics or predict the election, it is doable, to fix this problem in a gradual, credible way, and I'm arguing for it all the time in other fora.

So I can't predict, Senator, but I believe, I have a faith that when people see the numbers, when they see the charts, when they understand what's at stake, that the American people will respond.

Senator Lee. Thank you.

Vice Chairman Brady. I want to thank the members of the Committee for being here today for their questioning, and our witnesses as well. This is the type of discussion we want going forward, and I really think there is strong bipartisan support, when members think about it, about getting the role of the Fed right for the future, ensuring we have the strongest foundation for economic growth and low inflation, and how the Fed's role impacts that, and on ensuring the Fed is politically independent as it goes forward in time.

So I want to thank the discussion today, again for our witnesses, and I look forward to future hearings on this matter. This hearing is adjourned.

[Whereupon, at 3:48 p.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

OPENING STATEMENT OF REPRESENTATIVE KEVIN BRADY, VICE CHAIRMAN, JOINT ECONOMIC COMMITTEE

Today's hearing seeks to determine what role the Federal Reserve should play going forward to ensure that the United States has the world's strongest economy in the 21st century.

A sound dollar is a necessary prerequisite for maximizing economic growth and job opportunities for hardworking American taxpayers. This proposition is both simple and profound.

A sound dollar requires that the Federal Reserve preserve the purchasing power of the dollar over time. Price stability reduces uncertainty and encourages entrepreneurs to make investments in new buildings, equipment, and software and hire more workers. And price stability is especially important for struggling families each time they buy groceries or fill their tanks with gasoline. Both inflation and deflation slow growth and destroy jobs. For hardworking taxpayers, a decline in the dollar's purchasing power is the same as a cut in pay.

Today's hearing will explore how the Federal Reserve should achieve a sound dollar. In 1977, Congress gave the Fed a dual mandate for maintaining price stability and maximizing output and employment.

Nobel Laureate economist Robert Mundell observed: To achieve a policy outcome, you must use the right policy lever. In January, the Fed recognized that monetary policy is the right lever to maintain the purchasing power of the dollar by declaring, "The inflation rate over the longer run is primarily determined by monetary policy."

In contrast, the Fed acknowledged that monetary policy is the wrong lever to promote job creation by declaring "[t]he maximum level of employment is largely determined by nonmonetary factors." During the 1970s, the Fed tried to use monetary policy to stimulate job creation, and the United States ended up with both higher inflation and higher unemployment. Critics charge that eliminating the dual mandate means we don't care about jobs. They are wrong; the opposite is true. It is precisely because we care about growth and jobs that Congress should direct the Fed to preserve the purchasing power of the dollar. Monetary policy cannot stimulate employment except for short, temporary spurts. However, monetary policy can achieve price stability, which is the foundation for creating the greatest number of jobs that last.

During the 1980s and 1990s, the Fed moved toward a rules-based policy by ignoring the employment half of its mandate to pursue price stability. Two long booms resulted, with very low inflation and strong job creation and rising real incomes.

Then, between 2002 and 2005, the Fed deviated from this successful rules-based regime by keeping interest rates too low for too long. This contributed to the inflation of an unsustainable housing bubble that eventually triggered a global financial crisis. Since the height of the financial crisis during the fall of 2008, Washington has increasingly relied on the Fed to take unusual, interventionist actions such as tripling the size of its balance sheet under QE1 and QE2. Indeed, the Fed justified these extraordinary actions by invoking—for the first time ever in late 2008—the employment half of the Federal Reserve's dual mandate.

It appears that the Fed took these actions to compensate for President Obama's failure to pursue pro-growth budget, tax and regulatory policies. Just as low borrowing costs are masking the pain of historically high federal budget deficits, the Fed's monetary experimentation allows the White House and Congress to shirk their responsibility for creating a competitive business climate. It is time to reform the Federal Reserve for the 21st century with a single mandate for price stability achieved through inflation-targeting. In January, the Fed announced an inflation target of 2% defined in terms of the price index for personal consumption expenditures. I applaud this step toward a rules-based, inflation-targeting regime, but I hope that 2% is the upper limit of the range.

Accurately measuring inflation is not easy. In the last decade, we clearly saw that price indices of goods and services do not always record all of the price movements in our economy, allowing asset bubbles to inflate undetected. To identify incipient asset bubbles before they inflate to dangerous levels, the Fed should also monitor: (1) the prices of, and returns on, broad classes of assets including: equities, corporate bonds, state and local government bonds, agricultural real estate, commercial and industrial real estate, and residential real estate; (2) the price of gold; and (3) the foreign exchange value of the U.S. dollar. On March 8th, I introduced the Sound Dollar Act in the House. The Sound Dollar Act reforms the Fed in several important ways. The Sound Dollar Act replaces the dual mandate with a single mandate for long-term price stability; increases the Fed's accountability and openness; expands and diversifies the voting membership of the Federal Open Market Committee; ensures credit neutrality for future Fed purchases; and institutes necessary congressional oversight of the Consumer Financial Protection Bureau.

These reforms are critical to ensuring that America has the world's strongest economy in the 21st century. Moving to a single mandate for price stability will help to spur investment and create millions of new jobs on Main Streets across America.

I look forward to the testimony of our distinguished witnesses.

PREPARED STATEMENT OF JOHN B. TAYLOR [1]

Chairman Casey, Vice Chairman Brady, and other members of the Committee, thank you for the opportunity to testify on "Monetary Policy Going Forward: Why a Sound Dollar Boosts Growth and Employment." As requested, in this written testimony I will focus on proposals to alter the Federal Reserve's existing dual mandate, limit the composition of Federal Reserve open purchases, and shift voting on the Federal Open Market Committee to include all District Federal Reserve Bank Presidents. I would be pleased to answer any other questions you may have.

CLEAR LESSONS FROM YEARS OF EXPERIENCE

We have now had nearly 100 years of practical experience and detailed empirical studies of monetary decision making at the Federal Reserve.[2] As a result, we have plenty of evidence that more systematic rules-based monetary policies work and more unpredictable discretionary policies do not.[3]

The past 50 years are particularly instructive in this regard. From the mid-1960s through the 1970s, monetary policy consisted of a series of unpredictable discretionary go-stop interventions with increases and decreases in money growth and interest rates that led to frequent recessions, high unemployment, low economic growth, and high inflation.

In contrast, through much of the 1980s–1990s and until recently monetary policy was conducted in a more predictable, rule-like manner with the main goal of reducing inflation and keeping it down. This was a period of generally lower unemployment, lower inflation, lower interest rates, longer expansions, and eventually stronger economic growth.

More recently we have seen a move back to discretionary policies. In 2003–2005 the Federal Reserve deviated from the policies it followed in most of the 1980s and 1990s by holding interest rates too low for too long and thereby setting off excesses in housing and other markets which helped bring on the most recent boom and bust. The Fed's continuing departure in recent years from a rules-based monetary policy—with enormous discretionary purchases of mortgage-backed and long-term treasury securities, as well as operations to twist the maturity structure of the Federal debt—have increased the size and shifted the composition of its balance sheet by unprecedented amounts creating economic uncertainty and endangering its independence.

The most fundamental lesson from this experience is that in order to increase economic growth, stability, and employment, monetary policy going forward should restore and lock-in consistent rule-like decision making and avoid unpredictable discretionary actions and interventions.

REFORM PROPOSALS

Basic economic principles and common sense provide a starting point. In any organization, a clear well-specified goal usually results in a consistent and effective strategy for achieving that goal. Too many goals blur responsibility and accountability, causing decision makers to choose one goal some times and another goal at other times in an effort to chart a middle course. In the case of monetary policy, multiple goals enable politicians to lean on the central bank to do their bidding and thereby deviate from a sound money strategy. More than one goal can also cause the Federal Reserve to exceed the normal bounds of monetary policy—moving into fiscal policy or credit allocation policy—as it seeks the additional instruments necessary to achieve multiple goals.

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[1] Parts of this testimony are based on Chapter 4, "Monetary Rules Work and Discretion Doesn't," of John B. Taylor, *First Principles: Five Key's to Restoring America's Prosperity*, New York: W.W. Norton, 2012.

[2] Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960*, Princeton, NJ: Princeton University Press, 1963. Allan H. Meltzer, *A History of the Federal Reserve*, Chicago: University of Chicago Press, Volume 1, 2003 and Volume 2, 2009.

[3] As Meltzer puts it in Volume 2 if his *History*: "Discretionary policy failed in 1929–33, in 1965–80, and now." "The lesson should be less discretion and more rule-like behavior." (p. 1255)

There is no justification for an independent agency of government to undertake interventions in these areas. In the spirit of the Constitution, they are best left to the Congress and the President to handle through the regular appropriations process. Central bank intervention is a poor substitute for sound fiscal policy, and it removes incentives for the Congress and the President to do their own jobs well: If the central bank hangs out a "We Do Fiscal Policy" shingle, or is expected to bail out fiscal policy errors, the Congress will try to avoid making tough decisions that might harm their reelection chances.

Despite these obvious pitfalls, a multiple mandate for the Fed swept in during the great interventionist wave of the 1970s, when Congress passed and President Carter signed into law the Federal Reserve Reform Act of 1977. This law explicitly gave the Federal Reserve the goals of promoting both "maximum employment" and "stable prices." This certainly was the wrong remedy for the inflationary boom-bust economy at the time, and monetary policy worsened for a while.

It was not until Paul Volcker arrived as chairman in August 1979 that things changed. Volcker knew that he had to focus on inflation like a laser beam. Of course he had to interpret the law in a way consistent with his change in policy. To achieve maximum employment, Volcker argued, he first had to reduce inflation even if that increased unemployment in the short run. While that approach eventually worked well, it also set a precedent that the dual mandate was open to interpretation by Fed officials. In recent years the dual mandate has been used by the Fed to justify massive interventions on the questionable grounds that these will reduce unemployment in the short run.

Thus, the first step toward a more consistent policy would be to remove the dual mandate and bring focus to a single goal as does H.R. 4180, The Sound Dollar Act of 2012, in which the goal is "long-run price stability." The term "long-run" makes it clear that the mandate does not mean that the Fed should overreact to minor short-run ups and downs in inflation from month to month or even quarter to quarter. The single mandate wouldn't stop the Fed from providing liquidity when money markets freeze up as they did after the 9/11 terrorist attacks, or serving as lender of last resort to banks during a panic, or reducing the interest rate in a recession.

To better understand this, consider a monetary policy strategy, or rule, of the kind I proposed in 1992 for the Federal Reserve to follow in setting interest rates.[4] In designing this rule, I assumed a particular goal for price stability—a target inflation rate of 2 percent per year. But under this rule the Fed, or any other central bank, is supposed to change its interest rate in systematic ways in response to both inflation and GDP. Specifically, the rule says that the Fed should set the interest rate equal to 1½ times the inflation rate, plus ½ times the percentage amount by which GDP differs from its long run growth path, plus 1. Thus when inflation rises the Fed is supposed to raise the interest rate. In addition, when there is a recession and GDP declines, the Fed is supposed to cut the interest rate; this helps mitigate the recession, reduce economic instability, and help generate long-term price stability. In other words, even though there is a single mandate underlying this strategy for policy, there is systematic response of the interest rate to inflation and other variables such as GDP or employment.

Some worry that a focus on the goal of price stability would lead to more unemployment. But history shows just the opposite. One reason the Fed kept its interest rate too low for too long in 2003–05 was the concern that raising the interest rate would increase unemployment, contrary to the dual mandate. If the single mandate had prevented the Fed from keeping interest rates too low for too long, then it would likely have avoided the boom and bust that was a factor in the financial crisis and which led to very high unemployment.

A quick look at recent history shows that a single mandate would help to avoid the excessive discretionary interventions. In years since 2008, the Fed has explicitly cited the dual mandate to justify its unusual interventions, including the bouts of "quantitative easing" from 2009 to 2011, when the Fed purchased massive amounts of mortgage-backed securities and longer-term Treasury securities. During the 1980s and 1990s, Fed officials rarely referred to the dual mandate, even during the period in the early 1980s when unemployment rates were as high as today. When they did so, it was to make the point that achieving price stability was the surest way for monetary policy to keep unemployment down.

Until the recent interventionist period, written policy statements and directives from the Fed did not mention the "maximum employment" part of the dual mandate in the Federal Reserve Act. There was not a single reference from 1979, when Paul

[4] "Discretion Versus Policy Rules in Practice," *Carnegie-Rochester Series on Public Policy*, North-Holland, 39, 1993, pp. 195–214. Over time the rule has come to be called the Taylor rule—a kind of benchmark for policy.

Volcker took over as Fed chair, until the end of 2008, just as the Fed was about to embark on its first bout of quantitative easing. It increased its references to maximum employment in the fall of 2010 as it embarked on its second bout of quantitative easing.

In my view a single mandate would reduce excessive discretionary interventions and encourage more rule-like policy. Nevertheless, it would be wise to consider supplementing such a reform with the Fed placing greater emphasis on the strategy or rule for setting the monetary policy instruments (the interest rate or the monetary aggregates). Until the year 2000 the Federal Reserve Act had a specific reporting requirement about the growth of the monetary aggregates. It called for the Fed to submit a report to Congress and then testify about its plans for money growth for the current and next calendar years.

The legislation only required that the Fed report its plans for money growth, not that it set them in a way specified by Congress. The Fed had authority to choose the growth rates of the aggregates. But if the Fed deviated from the plans it had to explain why. If Fed policymakers determined that their reported objectives or plans, according to the words of the act, "cannot or should not be achieved because of changing conditions" they "shall include an explanation of the reasons for any revisions to or deviations from such objectives and plans."

The reporting requirement was fully repealed in 2000, because the data on money growth had become less reliable as people found alternatives to money—such as credit cards or money market mutual funds—to make payments. The Fed therefore focused more on the interest rate when it made its decisions. While it was perfectly reasonable that money growth reporting was removed in 2000, the problem was that nothing comparable about interest rate reporting was put in its place.

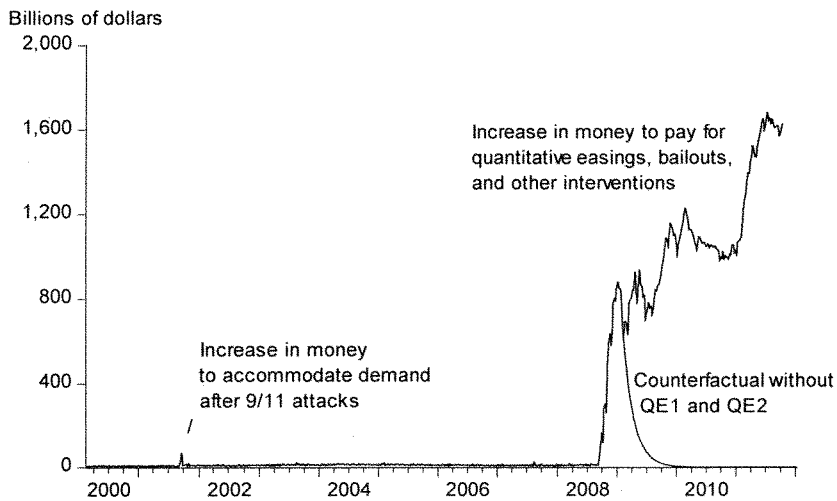
In order to further encourage more rule-like monetary policy, the Congress could reinstate the reporting and accountability requirements that were removed in 2000. But rather than focus only on money growth, it could focus directly on the systematic response of the interest rate. In doing so, it would not require that the Fed choose any particular rule for the interest rate, only that it establish some rule and report what the rule is. But if the Fed deviates from its chosen strategy, it must provide a written explanation and testify at a public congressional hearing. Such requirements would provide a degree of control by the political authorities without interfering in the day-to-day operations of monetary policy.

THE FEDERAL RESERVE'S BALANCE SHEET

The discretionary interventions of the Federal Reserve have been ratcheted up in such unprecedented ways in recent years that they raise fundamental questions about the future of monetary policy and deserve special consideration in monetary reform discussions. It is difficult to overstate the extraordinary nature of these interventions. To understand how these actions have already begun to change the very nature of monetary policy, put aside the unprecedented interventions leading up to and during the panic in the fall 2008 (including the bailouts of the creditors of Bear Stearns and AIG) and focus on the "Quantitative Easing: QE1 and QE2"—the large scale purchases of mortgage-backed securities and longer term treasuries—which occurred long after the emergency of the panic was over.

In order to pay for the mortgages and other large-scale securities purchases, the Fed had to credit the banks with electronic deposits—or, in other words, create "bank money," or more formally reserves balances that the banks hold at the Fed. As a result of the hundreds of billions of dollars of mortgage backed and other securities, there has been an enormous and completely unprecedented explosion of bank money, as shown in the following chart.

To provide some perspective the chart starts in the year 2000. The "reserve balances" the banks hold at the Fed—this so-called bank money—is shown on the vertical axis in billions of dollars. A tiny blip appears on the chart around the September 11, 2011 terrorist attacks. The Fed had to increase the amount of bank money at that time because the attacks on the World Trade Center damaged the payments system and banks needed money to make payments. The Fed wisely and appropriately provided the money. But that amount is completely dwarfed by the recent explosion.



Bank Money Created by the Fed

The large recent increase started in the fall of 2008 during the panic. Before the panic the amount was about $10 billion. By the end of 2008 it was $800 billion. By the end of 2011 it was $1,700 billion. In the fall of 2008 the money was used mainly for making loans to U.S. banks, securities firms, and foreign central banks. As the panic subsided the demand for those loans diminished and the bank money would have retreated back to where it was before the crisis. But instead the Fed started the large scale purchases of mortgages and Treasury bonds, first under QE1 and then under QE2, which expanded the balances by much more.

This large monetary overhang creates risks to the financial system and the economy. If it is not reduced, then the bank money will eventually pour out into the economy and cause a huge inflation. But if it is reduced too quickly, the banks may find it hard to adjust and the economy would take a hit. In order to unwind the programs in the current situation, the Fed must sell its mortgages.

Uncertainty also abounds about the impact of the large-scale asset purchases (QE1 or QE2 as defined here) on markets or the economy. For example, in my view, the empirical evidence is weak that the mortgage backed securities purchases had any significant impact on mortgage yield spreads [5] once one controls for prepayment and credit risk. Experience from the 1960s suggests that operation twists have little lasting effect on long term interests rates, over and above what would be expected from expectations of future short term yields.

Another element of unpredictability and uncertainty concerns whether or not the Federal Reserve will continue to undertake more quantitative easing if the economy does not grow strongly enough or if unemployment does not come down rapidly enough. Indeed, there is already considerable chatter and speculation in the markets about the circumstances under which the Fed would start buying mortgage backed securities again. The fact that the Fed can, if it chooses, intervene without limit into any credit market—not only mortgage backed securities but also securities backed by automobile loans, or even student loans—raises more uncertainty, and of course raises questions about why an independent agency of government should have such power.

To reduce such uncertainty and unpredictability—again with the aim of increasing economic growth and stability, some restraints on the composition and the size of the Federal Reserve's portfolio are in order. In particular, it is therefore appropriate, in my view, to limit asset purchases by the Fed to U.S. Treasury securities, as called for in *H.R. 4180, The Sound Dollar Act of 2012* with exceptions as provided in the Act.

With the Fed already holding large amounts of mortgage backed securities, it is also important for the Fed to develop a gradual and credible plan to reduce these

[5] Johannes Stroebel and John B. Taylor, "Estimated Impact of the Fed's Mortgage-Backed Securities Purchase Program," *International Journal of Central Banking*, forthcoming 2012.

holdings as part of an overall plan to reduce the monetary overhang and get its balance sheet back down toward pre-crisis levels. Had it not undertaken QE1 or QE2 it would already have removed the overhang—as shown by the counterfactual in the above chart—and there would not be considerably less uncertainty about monetary policy down the road.

THE ADVANTAGE OF REFORM LEGISLATION

Years of experience show that a clearer rules-based framework for monetary policy decisions is needed in order to increase economic growth, stability and employment. The Federal Reserve ought to begin to put forth and implement such a policy framework now, whether or not legislative reform is enacted.

But legislative reforms such as those in the *Sound Money Act of 2012* and would help lock in such a framework in the future.

A single mandate of "long-run price stability" would encourage more rule-like policy and help avoid excessive discretionary interventions. In my view it would result in more stability and thus less unemployment.

Rules to limit massive expansions of the Fed's balance sheet, including through requirements that open market operations be conducted in U.S. Treasuries, short term repurchase agreements, and reverse repurchase agreements, would clarify that the Fed's role does not include allocating credit between different sectors; it would also help reduce uncertainty and put monetary policy back on the road to a sounder more rules-based approach.

Longer run reform should also expand voting responsibility to give all Federal Reserve District Bank Presidents voting rights at every Federal Open Market Committee meeting. Such a reform, which is also part of the *Sound Money Act of 2012*, would equalize voting power across the entire economy and offset any tendency for policy decisions to favor certain sectors or groups in the economy over others. This too, in my opinion, would help instill more predictable rule-like decision-making.

Prepared Statement of Laurence H. Meyer

Chairman Casey, Vice Chairman Brady, other members of the Committee, thank you for giving me the opportunity to comment on the proposed legislation. I will assess each provision in terms of what I see as its *intent* and *consequences*.

Several provisions represent sensible efforts to increase the clarity and transparency of monetary policy. These have merit and are worthy of consideration.

Several provisions, however, appear to be attempts to prevent the FOMC from responding to divergences from full employment, as in the Great Recession, and restrict the FOMC from carrying out stimulative policy once the federal funds rate is near zero, as it is today.

Let's start with preliminaries. Should the government, broadly defined, have a goal of promoting full employment (subject to a few caveats)? Who should be responsible? There has been timely and, I believe, somewhat effective use of fiscal policy to move the economy back in the direction of full employment. Still, monetary policymakers have advantages: They can respond more quickly and are not handicapped by partisan maneuvering.

But *can* the Fed effectively carry out *stabilization* policy? Are estimates of the minimum sustainable unemployment rate so *uncertain* that monetary policy is as likely to damage economic performance as it is to improve it? Does a dual mandate *undermine* the ability of a central bank to meet its price stability mandate?

The CBO, the IMF, the Board staff, most FOMC members, generations of CEAs, and Macroeconomic Advisers all believe the FOMC *can* effectively promote full employment. While there is some evidence that central banks with an *explicit* inflation target do a better job anchoring long-term inflation expectations, the difference relative to the U.S. is very small, the evidence is mixed, and, in any case, the FOMC now has an explicit inflation objective. But the proof is in the pudding! Under Chairmen Volcker, Greenspan, and Bernanke, the FOMC effectively pushed long-run inflation expectations down from an unacceptable level in the 1970s and early 1980s to about 2%, and there has been no backtracking. In any case, the policy of keeping the funds rate near zero and the dramatic expansion of the Fed's portfolio do not risk soaring inflation. The Fed has all the tools needed to drain reserves and shrink the portfolio when appropriate. In any case, as long as it has control of interest rates, it can control inflation (not over the very short run, of course, but over the medium or longer term). This conclusion is consistent with the inflation projections of the CBO, the OMB, the IMF, FOMC participants, the Survey of Professional Forecasters, and Macroeconomic Advisers. *None* projects inflation above 2% over the next several years.

Now let's turn to specific provisions. First, should the Congress change the FOMC's mandate from a dual to a single mandate? The answer is that it depends! If the bill is intended to move the Fed to *flexible inflation targeting*, a regime practiced by virtually *every* other central bank in the world, this is a discussion worth having, though I still prefer the existing dual mandate.

Under the dual mandate, as the Chairman has emphasized and the bill notes, the two mandates are on an "equal footing." Flexible inflation targeting central banks *also* seek to achieve full employment and price stability, but, in my view, operate as if they have a *hierarchical* ordering of the two objectives: inflation is the *primary* objective, full employment *secondary*. However, the empirical evidence shows that dual mandate and flexible inflation targeting central banks operate in essentially the same way. That is, perhaps, why some FOMC members refer to the Fed's regime as flexible inflation targeting and why many central bankers who operate in flexible inflation targeting regimes say there is no difference from a dual mandate framework. I prefer the transparency and weighting of the objectives of a dual mandate regime.

But this provision reads like the goal is to move the FOMC to *hard* inflation targeting, a regime practiced by *no* central bank today. I strongly oppose this. Under such a regime, the central bank may *only* pursue price stability, and, therefore, *must* pay no attention to divergences from full employment, even in a case like the Great Recession. Perhaps Governor Mervyn King of the Bank of England sums it up best when he calls supporters of such a framework "inflation nutters!"

Should all presidents of Reserve Banks be voting members, that is, on the FOMC? The motivation of supporters, I suspect, is that currently there are more hawks among presidents than among Board members, so giving votes to all the presidents would increase the power of the hawks, perhaps prevent further quantitative easing, and dilute the power of the Chairman.

I find it very surprising that some members of Congress, as a general principle, would want to decrease the power of Board members who have been nominated by a democratically elected president and confirmed by democratically elected members of the Senate, and make Reserve Bank presidents, appointed by unelected and unrepresentative boards, a majority on the FOMC. Supporters apparently believe that there is not enough *regional* influence on the FOMC's *national* policy decisions and that bankers do not have enough influence on monetary policy.

While there is much ambiguity in the proposed legislation relating to asset purchases, any proposal restricting the Fed to holding *only* short-term government securities in its portfolio would remove the FOMC's ability to pursue quantitative easing, which is *defined* as the purchase of long-term securities to lower longer-term rates when shorter-term rates are zero. This would prevent the FOMC from providing additional stimulus when the funds rate is at a near-zero level and, indeed, promoting price stability in such circumstances. This is a restriction that, at least to my knowledge, no other central bank faces. Indeed, most central banks have greater flexibility in their asset purchases than the FOMC does today.

Now for an editorial: I regret that the Fed has become so politicized. Some of the provisions of this bill appear to me clearly partisan. Please recognize that the greatest threat to the stability of long-term inflation expectations is an assault on the independence of the Fed's monetary policy decisions.

Congress should respect the following admonition: Changes in the Federal Reserve Act should only be seriously considered if there is wide *bi-partisan* support.

Thank you. I would be pleased to take your questions.

Supplementary Materials for Testimony on
"Monetary Policy Going Forward: Why a Sound Dollar Boosts Growth and Employment"

Before the Joint Economic Committee
March 27, 2012

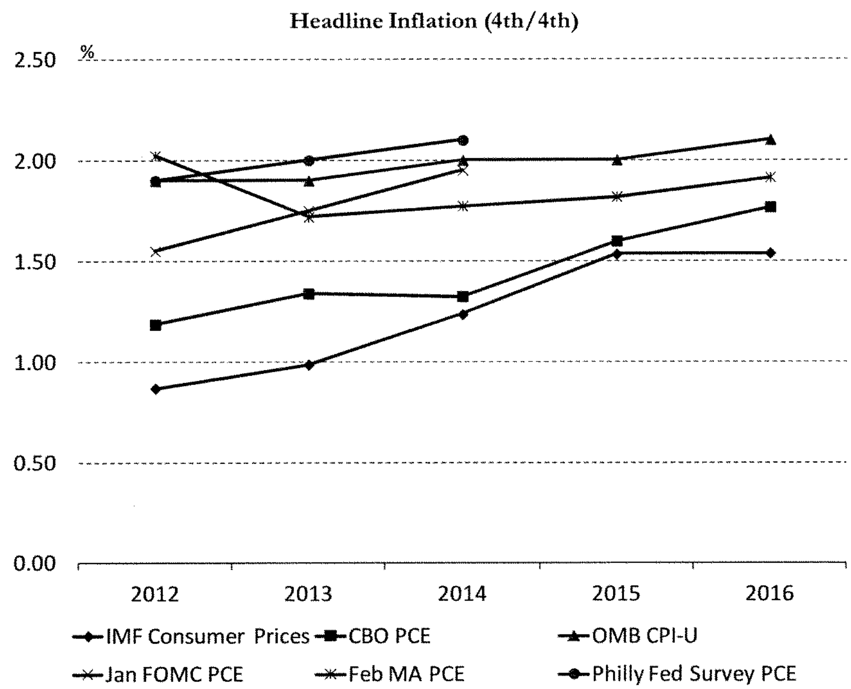
Laurence H. Meyer
Senior Managing Director and Co-Founder, Macroeconomic Advisers

Impact of LSAPs (Totaling $2.35 Trillion)

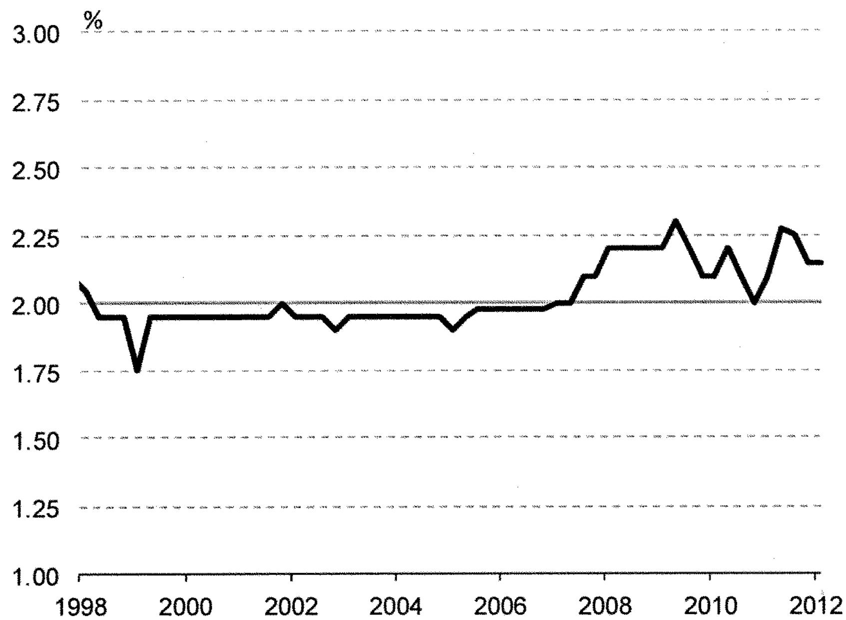
	Year 1	Year 2
Federal Reserve Study*		
GDP	2.7	2.8
Unemployment	-1.3	-1.4
Inflation	1.0	1.0
MA		
GDP	0.4	1.6
Unemployment	-0.2	-0.8
Inflation	0.2	0.4

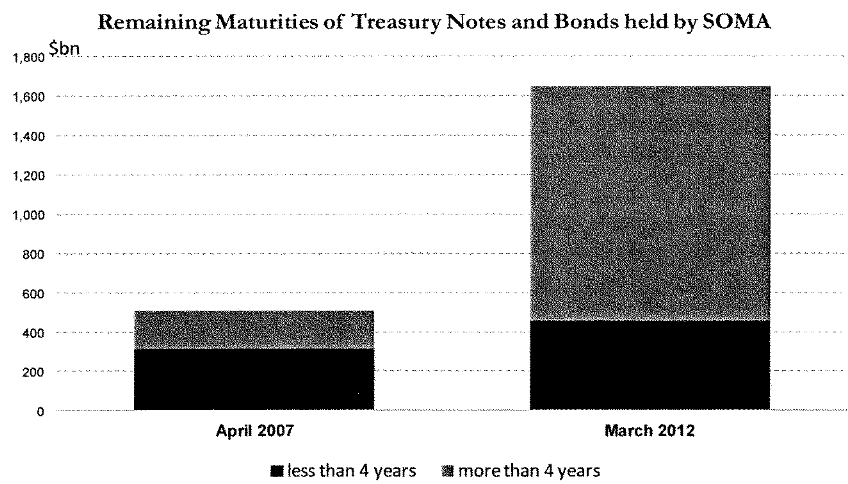
Note: Figures assume LSAPs lowered the ten-year yield by 78 bps.

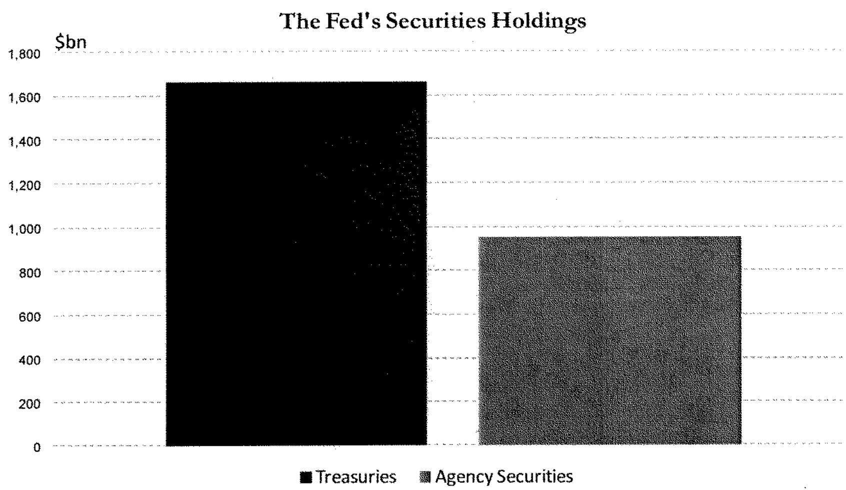
* Chung, Hess, Jean-Philippe Laforte, David Reifschneider, and John C. Williams. 2011. "Have We Underestimated the Likelihood and Severity of Zero Lower Bound Events?" FRBSF Working Paper 2011-01, January.


Headline Inflation (4th/4th)
%
2.50
2.00
1.50
1.00
0.50
0.00
2012
2013
2014
2015
2016
IMF Consumer Prices
CBO PCE
OMB CPI-U
Jan FOMC PCE
Feb MA PCE
Philly Fed Survey PCE

Survey of Professional Forecasters:
Median Expected PCE Inflation (next 10 years)




Remaining Maturities of Treasury Notes and Bonds held by SOMA
$bn
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
April 2007
March 2012
less than 4 years
more than 4 years



Composition of the Fed's Securities Holdings

Agency Securities	**$950 bn**
Agency MBS	$851 bn
Agency Debt	$99 bn
Treasuries	**$1.6 tr**
Total Securities Holdings	**$2.6 tr**

PREPARED STATEMENT OF WILLIAM POOLE

Chairman Casey, Vice Chairman Brady, members of the Committee, I am pleased to be here this morning to comment on monetary policy issues raised by the draft Sound Dollar Act. My biographical information is attached to the end of my statement. For present purposes, the most relevant part of my career is my ten years as President and CEO of the Federal Reserve Bank of St. Louis.

MANDATE FOR PRICE STABILITY

I applaud congressional support for a clear assignment of responsibility to the Federal Reserve to achieve price stability, defined as a low and stable rate of inflation. I encourage Congress to make the mandate explicit by incorporating in law the decision of the Federal Open Market Committee to define the goal as 2 percent inflation. As the FOMC emphasized in its statement on this goal, price stability does not preclude policy actions in furtherance of other goals provided that they are consistent with price stability. In fact, policy actions to mitigate undesired changes in employment can only be successful over time in an environment of price stability and market confidence in the Fed's pursuit of that goal.

Unfortunately, clarity of the goal of price stability in the Sound Dollar Act is muddied by reference to Fed "monitoring" asset prices. In pursuit of the goal of price stability, the Fed monitors many different measures of economic performance, including asset prices. It would be unfortunate if mention of asset prices in the law created undue pressure on the Fed to act in some way or other as asset prices change. Obviously, asset price bubbles can be a serious problem. However, there is no settled understanding of how the central bank or anyone else can reliably identify an asset price bubble as it is occurring.

Nor does the policy literature provide any guidance as to what the central bank should do if it wants to influence asset prices. The history of central bank and Treasury meddling in the foreign exchange market provides clear evidence of the harm that can be done by government intervention designed to influence an asset price. I urge you in the strongest possible terms not to include mention of asset prices in any legislation directing the activities of the Federal Reserve.

I do not disagree that monetary policy has important effects on the international value of the dollar. However, requiring that the Fed report on the effects of its policy on exchange rates is an invitation to mischief. Fed policy has important impacts on a wide range of variables, including exchange rates. The appropriate place for the Fed to discuss the impact of its policies is in the semi-annual monetary policy hearings. There is ample opportunity for members of Congress to question the Fed chairman on a wide range of issues, including the effects of policy on exchange rates.

ASSETS TO BE HELD BY THE FEDERAL RESERVE IN THE SYSTEM OPEN MARKET ACCOUNT (SOMA)

I strongly support restriction of assets in the SOMA to direct obligations of the U.S. Treasury. Without getting into an analysis of all of the non-Treasury assets the Fed has purchased, consider the mortgage-backed securities portfolio.

Since World War II, the U.S. Government has engaged in a variety of credit programs—for better or worse, I might add. These include farm credit, student loans, Export-Import Bank loans, Small Business Administration loans and so forth. Congress makes judgments about the amount of such credit to be offered, program objectives, eligibility, interest rate and other loan terms, disclosure and so forth. These judgments belong with Congress and not with the Federal Reserve because the judgments inherently have a political component to them. Congress authorized Fannie Mae and Freddie Mac, for example, and the process by which they have been brought into federal conservatorship under provisions of law.

The Federal Reserve has set its own rules for buying MBSs. Other aspects of federal aid to the hard-hit housing sector have been matters for Congress and the President, but not the Fed's purchases of MBSs. Suppose the Fed's initial decision to purchase $1.25 trillion of MBSs had instead been a recommendation to Congress for legislation to do the same thing, except that the Treasury would administer the program and hold the portfolio. What would some of the questions have been as Congress debated the proposal?

Given the federal budget situation, would it have been wise to issue $1.25 trillion of government bonds to provide the resources to purchase a portfolio of MBSs of like size? Should the entire $1.25 trillion have been used for MBSs, or should some expand SBA loans, or help students struggling with student loans? There were many other possible ways of using an extra $1.25 trillion of federal credit. Moreover, the program was financed not by sale of Treasury securities but by money creation. Was that wise? Shouldn't these and other issues have been debated by Congress?

Beyond that, who has benefited from the Fed program to accumulate and maintain a large portfolio of MBSs? A significant fraction of mortgages issued in recent years has been refinacings. I have refinanced my mortgage twice, for example. Who can refinance? Only those with substantial equity in their properties, despite the decline in house prices, and those with good credit ratings. I qualify on both counts. Why should the Fed be helping me and others in fortunate circumstances such as those I enjoy?

I suggest that the JEC request a study from the Federal Reserve to report on the characteristics of the mortgages in the MBSs in the SOMA. I understand that the required data are readily available through CoreLogic. I believe that the benefits of Fed purchases of MBSs have gone primarily to homeowners in comfortable circumstances and to banks and title companies that collect fees from mortgage financing. The program has done little to spur homebuilding. The monetary effects of expanding the SOMA would have occurred in equal measure if the Fed had purchased Treasury securities instead of MBSs.

The bottom line is that use of the credit resources of the U.S. Government should be decided by Congress and not by an appointed body such as the Federal Reserve. For the Fed to make these decisions embroils it unnecessarily in political decisions and has no monetary policy purpose.

EMERGENCY POWERS

Section 13(3) of the Federal Reserve Act provides that the Federal Reserve can extend credit to a wide range of participants "in unusual and exigent circumstances." I urge this Committee to study what this phrase means or ought to mean.

I looked into this issue in 2009 because I believed at the time that the Fed had abused its emergency powers during the financial crisis. At my request, a lawyer friend of mine prepared a memo on the legislative history and legal meaning of "unusual and exigent circumstances." He prefers to remain anonymous; thus, the author of the memo, which is attached at the end of my remarks, is listed as "anonymous."

The meaning in the law of "unusual and exigent circumstances" is nicely illustrated by the situation of a police officer at the door of a house who has good reason to believe that a crime is occurring in the house. Ordinarily, the officer must obtain a search warrant before entering. However, if a crime is being committed, the officer ought to enter and can do so legally without obtaining a search warrant.

In the context of a financial emergency, a crisis over a weekend does not permit time for the Federal Reserve to appeal to Congress to act. However, whenever there is time for Congress to act the Fed ought to recommend to Congress appropriate emergency action. The Fed ought not to make the judgment that Congress is unable to act because of the politics of the situation.

To an outside observer, what seemed to have happened is this. During the peak of the crisis in September 2008 and the months immediately following Treasury Secretary Henry Paulson and Fed Chairman Ben Bernanke believed that Congress would not act as required to stem the crisis and that the Fed needed to rely on an expansive interpretation of its emergency powers. I believed at the time that the Fed's responsibility was to go to Congress for credit programs beyond the weekend emergencies that led to the bailouts, wisely or not, of Bear Stearns and AIG.

In an op-ed article posted on the Cato Institute web site in July 2009, I discussed the Fed's MBS purchase program and its Commercial Paper Funding Facility (CPFF). The Fed announced the CPFF program on October 7, 2008 and made the first loans about 3 weeks later. The Fed announced the MBS program November 25, 2008. The first appearance of MBSs on the Fed's balance sheet was in mid January 2009.

The CPFF and MBS programs should have been authorized by Congress, assuming they should have been authorized at all. Neither the CPFF nor the MBS program reflected a weekend emergency. The financial crisis called for quick and decisive action, but not immediate action decided in a matter of hours. If there was an emergency at all, it was because of congressional unwillingness or inability to act and not because Congress did not have time to act. If Congress were unable to act, because of its concern about the politics of the CPFF program to provide credit to large corporations, should a federal agency make its own decision on what is necessary, committing taxpayer resources amounting to hundreds of billions of dollars? Worse yet, while legislated programs would have been financed by sale of new

Treasury securities, the Fed's programs were financed by monetary expansion—printing money.

The two programs were large. The CPFF reached a peak of $350 billion in mid January 2009; the MBS program eventually amounted to $1.25 trillion. This enormous credit expansion was financed by printing money.

The assumption that Congress could not act in a timely fashion is challenged by the relatively prompt enactment of the Troubled Asset Relief Program, proposed by Secretary Paulson in mid September 2008 and signed into law by President Bush about 2 weeks later. The American Recovery and Reinvestment Act of 2009, which President Obama signed into law less than 30 days from taking office, is another example of prompt congressional action during the financial crisis.

The Fed should better define its lender of last resort policy, but the most important part of doing so is for Congress to deny the Fed the power to hold assets other than Treasuries in the SOMA. If the expansive power remains available to the Fed, in time of crisis politicians, the Fed and market participants will assume that the Fed will use the power. Without the power to hold assets other than Treasuries in the SOMA, the Fed could not have bailed out Bear Stearns. Anyone opposed to Fed bailouts ought also to favor restriction of the SOMA to Treasuries.

FOMC VOTING MEMBERSHIP

I myself would not change this provision in the Federal Reserve Act. Current arrangements have worked satisfactorily and the clarity of ultimate political control from Washington is appropriate. It would be most unfortunate if reserve bank presidents came to be appointed by the President of the United States and confirmed by the Senate. Running appointments through Washington would damage the Fed's political independence. Although a Washington appointments process is not in the Sound Dollar Act, it would be all too easy for that to be the end result of an apparently "minor" amendment to the draft act during the legislative process.

CONSUMER FINANCIAL PROTECTION BUREAU (CFPB)

It is an abomination that this entity was placed off budget by sticking it in the Federal Reserve. The Fed should have fought the arrangement. Congress often emphasizes that the power of the purse and transparency are essential to democratic governance. Quite frankly, members of Congress who voted for this arrangement should be embarrassed. I fully endorse the proposal to establish the CFPB as an agency outside the Federal Reserve.

Memorandum on "unusual and exigent circumstances"

MEMORANDUM

DATE: July 7, 2009

TO: William Poole
FROM: Anonymous
RE: Unusual and exigent circumstances

ISSUE:

What is the meaning of the phrase "unusual and exigent circumstances," found in the Federal Reserve Act, Section 13(3)?

BRIEF ANSWER:

"Unusual and exigent circumstances," as it relates to the Federal Reserve Act, refers to unforeseen financial circumstances that require immediate action or remedy, particularly when necessary to ensure the survival of a business entity. While there is no legislative history showing, what Congress intended this phrase to mean, case law demonstrates what "exigent circumstances" meant at the time in the context of financial conditions.

DISCUSSION:

I. THE LEGISLATIVE HISTORY AND APPLICATION OF THE 1932 AMENDMENT TO THE FEDERAL RESERVE ACT DO NOT PROVIDE ANY DEFINITION OF THE PHRASE "UNUSUAL AND EXIGENT CIRCUMSTANCES."

The legislative history of the Federal Reserve Act amendment does not explain the meaning of the phrase "unusual and exigent circumstances." The 1932 act that amended the Federal Reserve Act was actually a combination of two House of Representatives bills: H.R. 9642, a proposed highway-building project aimed at putting unemployed Americans to work, and H.R. 12445, which proposed broader lending powers for the Reconstruction Finance Corporation, a government agency created during the depression to support economic recovery. 75 Cong. Rec. 4,893, 12,244 (1932). The two bills were later brought together under the number of the first. *Id.* at 15,095–96. The provision amending the Federal Reserve Act was not in either original bill; its first appearance came as part of a proposed alternative bill in the Senate. *Id.* This version included the Section 13 amendment as a replacement for a provision granting broad powers to the Reconstruction Finance Corporation to loan to corporations and individuals. *Id.* Because it was proposed late in the process as part of an alternative resolution, well after the filing of the committee reports, the provision was never discussed in committee. In addition, the amendment was a small and relatively minor part of the bill, and the phrase "unusual and exigent circumstances" or anything similar was never discussed in the debates. The bill was passed without Congress providing any guidance for the construction of "unusual and exigent circumstances."

The history of the section's implementation is no more informative of the meaning of this phrase. Prior to the collapse of Bear Stearns, the Federal Reserve Board of Governors had not invoked Section 13(3) since 1936.[1] When the Board of Governors decided to extend credit to JPMorgan for the purchase of Bear Stearns, it never provided an explanation as to what constituted unusual and exigent circumstances, or why they existed, but instead merely asserted that they existed.[2] Minutes of the Board of Governors of the Federal Reserve System, Mar. 14, 2008. Also, because of the long-time dormancy of Section 13(3), there has not been any case law addressing the construction of this particular clause within the Section. Neither the history of

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[1] David Fettig, *Lender of More Than Last Resort*, The Region, Dec. 2002, at 18. In the four years after its inception, Section 13(3) was only used to make 123 small loans totaling just $1.5 million. *Id.* The later-added Section 13(b), which was enacted in 1934 and repealed in 1958, authorized loans to private corporations without an exigent circumstances requirement, and was employed to a much larger extent. *Id*. at 18, 19, 43-46. Thus, the recent use of this provision is truly unprecedented, due to both the amount of money involved and the prior dormancy of this power.

[2] This may, in fact, be all that is required under Section 13(3). *See infra* p. 5.

the statute nor the history of its usage provides any clear definition of what Congress meant by "unusual and exigent circumstances."

II. DEFINITIONS OF EXIGENCY AND EXIGENT CIRCUMSTANCES IN OTHER LEGAL AUTHORITY FROM THE PERIOD PROVIDE A USEFUL DEFINITION OF THE PHRASE IN A FINANCIAL CONTEXT AS APPLIED IN SECTION 13(3).

Black's Law Dictionary (3d ed.), published in 1933, did not have a definition of "unusual and exigent circumstances." It did, however, have a definition of exigency: "Demand, want, need, imperativeness; emergency, something arising suddenly out of the current of events; any event or occasional combination of circumstances, calling for immediate action or remedy; a a pressing necessity; a sudden and unexpected happening or an unforeseen occurrence or condition." Black's cited a District Court case which further defined exigency, equating it to emergency, and describing it as "something which arises suddenly out of the currents of events" and "any event, or occasional combination of circumstances, which calls for immediate action or remedy." *United States v. Atlantic Coast Line Co.*, 224 F. 160, 166 (E.D.N.C. 1915). In that case, a law prohibiting railroad telegraph operators from working for more than nine continuous hours, except in case of emergency, was held to permit an operator to remain at the switchboard longer than nine hours when his relief was unexpectedly and irretrievably deposed, with no way to bring in a substitute. *Id.* While these provide a useful definition of exigency at the time the 1932 amendment was enacted, it does not define the phrase in the context of the Federal Reserve Act.

However, there is case law addressing a similarly worded section of the United States Code that provides some insight. Under 41 U.S.C. §5, the Government is required to advertise for contract proposals "for a sufficient time" before contracting for goods or services, except for under certain circumstances, including "when the public exigencies require the immediate delivery of the articles or performance of the service."[3] In *Good Roads Machinery Co. of New England v. United States*, an action to recover for equipment sold under a contract with the United States, the Government argued that its own contract with the plaintiff was invalid because there was no bidding period for the contract. 19 F.Supp. 652, 653 (D.Mass. 1937). Referencing the statute, the Court defined "public exigency" as "a perplexing contingency or complication of circumstances; or a sudden or unexpected occasion for action" necessitating immediate delivery of the goods or services. *Id.* at 654. The Court held that the Great Depression, and the related need to put people to work, constituted a public exigency, as evidenced in part by the fact that the Government had at the time "recognized that a sudden and unexpected occasion for action had arisen, and were directing their best efforts to solving the complicated and perplexing problem of unemployment." *Id.* Under this section of the U.S. Code, financial conditions arising out of an economic crisis are sufficient to be considered an exigency.

Another case provides a direct example of a legal determination of exigent circumstances based on the financial health of an individual corporation. In *Carson v. Allegany Window Glass Co.*, a minority stockholder sought to have the defendant corporation placed in receivership due to self-dealing by the president-majority stockholder of the corporation. 189 F. 791 (D.Del. 1911). While there was no statute authorizing the appointment of a receiver when the corporation in question is solvent, the Court recognized that "[s]pecial and exigent circumstances[4] may, in the absence of a statute, warrant and justify a receivership of a corporation, although solvent ... " *Id.* at 796. The Court did not find that a simple shareholder dispute over how the current board or president conducted business constituted special and exigent circumstances, and stated that such a finding would require facts clearly disclosing "such fraudulent, willful or reckless mismanagement ... as to produce a conviction that further control of the corporation by the same board would result in the destruction of its business and insolvency, or cause great and unnecessary loss to its creditors or stockholders." *Id.* The fraud and misconduct, however, are not the exigent circumstance, but the cause of the exigent circumstance; what the Court stressed as being the trigger for exigency is "the probability of serious and substantial disaster or ruin to the corporate enterprise." *Id.* at 797. Therefore, in the context of determining whether to transfer control of a corporation, the Court looked to whether the conditions under those currently in control created a need for imme-

[3] The term "public exigencies" is somewhat dated—the language of this statute dates back to 1861. Act of Mar. 2, 1861, ch. 84, Sec. 20, 12 Stat. 220. However, the definition used by the Court parallels exigency and exigent circumstances in general.

[4] It is noteworthy that the language used in this 1911 case is nearly identical to the language used in the 1932 amendment.

diate action to protect the corporation. By analogy, in the context of determining whether to grant an emergency loan under Section 13(3), it follows that “unusual and exigent circumstances” would exist if extraordinary and unforeseen financial conditions left a corporation with a lack of funds that necessitated immediate action.[5]

CONCLUSION

The phrase “unusual and exigent circumstances” in Section 13(3) of the Federal Reserve Act is not clearly defined within the act. The legal definition of exigency in general is any situation or combination of circumstances that creates an immediate and pressing need for action. Drawing analogies from other cases in the financial field addressing exigent circumstances, it appears that Section 13(3) refers to situations in which loans are necessary to prevent the catastrophic failure of a corporation, and that a national economic crisis can give rise to exigent circumstances.

[5] It is worth noting that Section 11(r) of the Federal Reserve Act, added in 2002, permits the Board to come to utilize its 13(3) powers in situations where there are less than five members present. 12 U.S.C. 248(r). This provision was part of a larger bill aimed at providing insurance in the event of terrorist attacks. While the legislative history does not address the provision amending the Federal Reserve Act specifically, one can assume the reason for it was so that the Board could take immediate action in response to a financial crisis so exigent that even a delay to contact other Board members by phone “or other electronic means” would be too long (as reflected in 11(r)(1)(A)(ii)(IV)). As it was geared towards emergency situations, the requirements under which the Board may utilize its 13(3) powers with less than five members present are stringent: the present members (there must be at least two) must unanimously determine that exigent circumstances existed, that the borrower is unable to secure credit through other means, that action is necessary to prevent “serious harm to the economy or the stability” of the U.S. financial system, that they have been unable to contact the other board members by any means available, and that waiting any further to do so would be impossible.

WILLIAM POOLE BIOGRAPHICAL INFORMATION

William Poole is Senior Fellow at the Cato Institute, Distinguished Scholar in Residence at the University of Delaware, Senior Advisor to Merk Investments and a Special Advisor to Market News International.

Poole retired as President and CEO of the Federal Reserve Bank of St. Louis in March 2008. In that position, which he held from March 1998, he served on the Federal Reserve's main monetary policy body, the Federal Open Market Committee. During his ten years at the St. Louis Fed, he presented over 150 speeches on a wide variety of economic and finance topics.

Before joining the St. Louis Fed, Poole was Herbert H. Goldberger Professor of Economics at Brown University. He served on the Brown faculty from 1974 to 1998 and the faculty of The Johns Hopkins University from 1963 to 1969. Between these two university positions, he was senior economist at the Board of Governors of the Federal Reserve System in Washington. He was a member of the Council of Economic Advisers in the first Reagan administration, from 1982 to 1985.

Poole received his AB degree from Swarthmore College in 1959, and MBA and Ph.D. degrees from the University of Chicago in 1963 and 1966, respectively. Swarthmore honored him with the Doctor of Laws degree in 1989. He was inducted into The Johns Hopkins Society of Scholars in 2005 and presented with the Adam Smith Award by the National Association for Business Economics in 2006. In 2007, the Global Interdependence Center presented him its Frederick Heldring Award.

Poole has engaged in a wide range of professional activities, including publishing numerous papers in professional journals. He has published two books, *Money and the Economy: A Monetarist View*, in 1978, and *Principles of Economics*, in 1991. In 1980–81, he was a visiting economist at the Reserve Bank of Australia and in 1991, Bank Mees and Hope Visiting Professor of Economics at Erasmus University in Rotterdam. At various times, he served on advisory boards of the Federal Reserve Banks of Boston and New York, and the Congressional Budget Office.

Poole appears frequently on the speaking circuit and is well known for his commentary on current economic and financial developments.

Poole was born and raised in Wilmington, Delaware. He has four sons.

PREPARED STATEMENT OF REPRESENTATIVE ELIJAH E. CUMMINGS

Chairman Casey could not be here today and I am pleased to stand in for him this afternoon. I thank Vice-Chairman Brady for calling this hearing to examine our nation's monetary policy and its effect on our economy.

I also thank our esteemed witnesses for appearing before us today and lending their expertise to this important matter.

The Federal Reserve System was created in 1913 to "provide the nation with a safer, more flexible, and more stable monetary and financial system."

In 1977, Congress enacted legislation that spelled out in greater detail the Fed's monetary policy objectives. Collectively known as the Fed's dual mandate, these objectives are to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."

I understand that today's hearing is being called to examine legislation proposed by the Vice-Chairman that would limit the Fed's mandate to the single objective of ensuring price stability, and that would make other changes to the central bank's decision-making authority and structure.

While I certainly share the Vice-Chairman's goal of ensuring price stability and preventing inflation, I believe that the current system is working effectively, and is also essential to enabling the Fed to adjust monetary policy quickly in times of crisis.

While it is true that in the past few years, the Fed has implemented some extraordinary monetary policies, these actions were necessitated by extraordinary circumstances, and by most measures, have helped stabilize our economy and prevent a complete collapse.

Certainly, our recovery from the 2008 financial collapse has been long and painful, and at times, filled with false promise.

For example, while it appeared early last year that the economy was turning a corner, we stumbled again due to factors like the earthquake in Japan, the rise in energy prices, the continuing economic turmoil in Europe, and the still struggling housing market.

However, since the end of 2011—shortly after the Fed launched "Operation Twist"—the economy has shown signs of a sustained recovery.

Last week, new claims for unemployment benefits reached a four-year low. Over the past six months, the U.S. has seen the highest consistent numbers of jobs created since 2006, and consumer confidence is at its highest level since 2004, according to a March 22 Bloomberg report.

Moreover, the fears announced by critics of the Fed's policies have simply not been proven correct. The monetary easing actions have had such a minimal impact on inflation that Reuters recently posed the question: where is the inflation?

Brookings Institution economist, Barry Bosworth, stated recently, "There's been no collapse of the American dollar . . . the dollar was declining up to the financial crisis and then shot up in value and we're still not back to where we were before the financial crisis started."

Finally, I note that while some have tried to link the spike in oil prices and other commodities to the Fed's monetary easing policies, the Congressional Research Service examined this issue and rejected any causal relationship.

Most experts have pointed to traditional factors such as supply and demand, as well as the increasing role of speculators in driving up prices at the pump.

The one area of our economy that continues to struggle is employment, and this is the area that the Vice-Chairman's legislation would require the Fed to ignore. I could not disagree more.

I commend Chairman Bernanke and the other Federal Reserve governors for continuing to pursue the objective of maximum employment, while drawing Congress's attention to actions that it could take to support higher employment.

Unfortunately, Congress has failed to implement these actions—a failure that I find deeply troubling given that there are millions of unemployed Americans who could benefit from the Congressional actions recommended by the Fed.

Again, I thank the witnesses for joining us today, and I yield back.

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