

Fed Focus on Sound Dollar Would Create Strong U.S. Economy through 21st Century

By U.S. Representative Kevin Brady (R-TX), Vice Chairman of the Joint Economic Committee

Looking to our economic future, Washington should have one goal: ensuring that America has the world's strongest economy throughout the 21st century by creating the most competitive business climate on the planet.

To achieve this goal, we must thoughtfully and clearly define the role of the Federal Reserve. The Fed should protect the purchasing power of the dollar by maintaining price stability, which is the strongest foundation for economic growth. A sound dollar creates certainty that facilitates new business investment and long-term job creation.

Economists broadly agree that price stability should be the goal of monetary policy. One need only look to the Great Depression of 1930's and the Great Inflation of 1970's to understand that both inflation and deflation are destructive, reducing real output and employment.

Nevertheless, in 1977 Congress saddled the Fed with a dual mandate giving equal weight to achieving price stability and the maximum sustainable level of output and employment. While the Fed can use monetary policy to achieve price stability, the Fed cannot use monetary policy to achieve any particular level of real GDP or employment because—except in the very short term—non-monetary factors determine economic growth and job creation. Thus, it doesn't make sense for Congress to tell the Fed to control what it cannot.

During the period of the Great Moderation (1983-2000), the Fed pursued price stability through a rules-based monetary policy, effectively ignoring the employment half of its mandate. The result was two long economic booms with very low inflation, interrupted only by a short, shallow recession. The Fed later deviated from this successful policy by keeping interest rates too low for too long between 2002 and 2005, helping to inflate an unsustainable housing bubble.

Since the 2008 financial crisis, Washington has increasingly relied on the Fed to take unusual actions to spur employment—such as tripling the size of its balance sheet in large part by purchasing debt and mortgage-backed securities issued by Fannie Mae and Freddie Mac. Indeed, the Federal Open Market Committee

(FOMC) justified these extraordinary actions by invoking the employment half of the Fed's dual mandate.

Ultimately the FOMC took these actions to compensate for President Obama's failure to pursue pro-growth budget, tax and regulatory policies. Just as low borrowing costs mask the pain of historically high federal deficits, the Fed's monetary experimentation allows the White House and Congress to shirk their responsibility for creating a competitive business climate.

This monetary experimentation must end. Congress should give the Fed a single mandate for price stability, and the Fed should return to a rules-based system of inflation targeting to achieve that mandate.

To provide a foundation for long-term economic growth, I am unveiling the *Sound Dollar Act* today at a forum hosted by the American Enterprise Institute.

The *Sound Dollar Act* reforms the Fed in several key ways. The *Act* replaces the dual mandate with a single mandate for long-term price stability; increases the Fed's accountability and openness; diversifies the FOMC; ensures credit neutrality for future Fed purchases; and institutes congressional oversight of the Consumer Financial Protection Bureau (CFPB).

In January the FOMC announced a target inflation rate of 2% in terms of the price index for personal consumption expenditures. I applaud this step toward a rules-based monetary policy, but recognize that without legislation it could be reversed.

In the last decade, we learned that goods and services price indices do not always record all of the price movements in our economy, allowing asset bubbles to inflate undetected. To identify incipient bubbles, the *Sound Dollar Act* requires the FOMC to monitor the prices of assets, including gold, and the foreign exchange value of the U.S. dollar. Inflation matters. That's why the Fed must preserve the purchasing power of the dollar.

Critics often charge that focusing on a sound dollar implies that the Fed should ignore the employment needs of Americans. It's just the opposite. America can only maximize its real output with long-term price stability. Thus, a sound dollar is the foundation for lasting job growth.

To increase accountability, the *Sound Dollar Act* speeds the release of FOMC transcripts to three years; and it requires the CFPB to seek annual appropriations from Congress, just as other federal agencies do.

To broaden input into FOMC decision-making and reduce the overwhelming influence of New York and Washington, the *Sound Dollar Act* grants all 12 presidents of the regional Federal Reserve Banks a vote. This brings a broader diversity of experience and geography to FOMC deliberations. As important as New York and Washington are, there's more to the American economy.

The *Sound Dollar Act* also strengthens the Fed's independence from political interference and ensures credit neutrality. The FOMC should not allocate credit among households, firms and sectors of our economy. But that is what is happening as the Fed pushes credit to the housing sector, which invites political interference.

If credit allocation continues, the Fed's independence will be compromised. In the past, a Fed subservient to either Congress or the White House has resulted in high inflation that hurts hardworking taxpayers. That's why the *Sound Dollar Act* restricts the FOMC to dealing in Treasuries, repos and reverse repos—except in unusual and exigent circumstances.

In almost a century of existence, the Fed has never articulated its lender-of-last-resort policy. This silence contributed to the severity of the 2008 financial crisis. The *Sound Dollar Act* corrects this by requiring the Fed to publish its lender-of-last-resort policy.

Finally, the Treasury has repeatedly dipped into the Exchange Stabilization Fund for purposes that Congress never intended, such as guaranteeing money market mutual funds in 2008. Therefore, the *Sound Dollar Act* liquidates this fund and uses the proceeds to reduce the national debt.

While historians will debate the Fed's extraordinary actions for years to come, the time is now for Congress to ensure that America has the foundation to remain the world's strongest economy. Monetary policy matters. Preserving the purchasing power of the dollar creates a solid, certain foundation for strong American economic growth in a world where our competitors are quickly gaining ground.