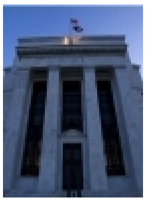
Written by **Steven Yates** on November 25, 2009

Federal Reserve Has Become a Focal Point of Public Anger



The Federal Reserve is facing its severest scrutiny since the 1930s, both from an aroused public and from members of Congress, some of whom face tough reelection fights next year and know they will have to answer to the public. Moreover, scrutiny of the Fed has moved from Internet-only “conspiracy sites” to mainstream reportage — for example, "Analysis: Fed under fire as public anger mounts" and "Fed rage boils over on Capitol Hill."

The Fed’s role in bailing out several large banks and other institutions in the wake of last year’s financial meltdown is well known, as are the six-figure bonuses elite firms paid their people while unemployment on Main Street soared to over 10 percent (close to 20 percent, if you count discouraged workers and others the official figure does not recognize as part of the labor force) — also becoming more well known daily is the sheer unconstitutionality of all of the Fed’s actions. The Fed has also faced criticism for not having reined in those tendencies that created the housing bubble.

Finally, many in Congress besides Ron Paul object to the fact that the Fed initially refused their requests to reveal which huge financial firms received billions in bailout money through the AIG bailout. (The Fed finally released this information, but billions of dollars remain unaccounted for.)

Both congressional and public irritation boiled over when it was revealed that bonuses had been paid to AIG employees responsible for the company’s collapse, salvaged with a massive bailout. Lawmakers were irked to learn that the Fed had known about the bonuses for months.

Public anger directed at Fed policy — coming from across the political spectrum — has definitely provided a boost to Dr. Paul’s H.R. 1207, the Federal Reserve Transparency Act of 2009, which has 313 cosponsors. Its Senate equivalent has 30 cosponsors. Normally Dr. Paul, author of the recent bestseller *End the Fed*, is an outsider. This is the first time a bill authored by him has gained this level of support.

It looked as though the Fed’s backers in Congress would strip H.R. 1207 of its strongest provisions, to audit the Fed’s monetary policy and its dealings with foreign central banks. But this effort was scuttled last week. After an attempt by Barney Frank (D-Mass.) to serve as an intermediary between increasingly embattled Fed chair Ben Bernanke and Congress, a House panel voted overwhelmingly to add a proposal to dig into the Fed’s books to a regulatory reform bill that is considered a "must-pass."

The Fed’s defenders call such challenges dangerous to the economy. Bernanke has said that the passage of Dr. Paul’s bill would interfere with the central bank’s ability to conduct independent monetary policy. Last week, Rep. Mel Watt (D-N.C.) offered an alternative to Dr. Paul’s proposal that was considerably weaker, but when the vote was taken, the results supported Dr. Paul’s original version.

Passage in the Senate is hardly guaranteed, though. Sen. Judd Gregg (R-N.H.) has called the audit amendment “a dangerous move … to pander to populist anger.” He added, “Make no mistake; this move to bring the Fed’s conduct of monetary policy under the control of Congress is a grave threat to our economy."

Ron Paul's long-term goal, of course, is to close down the Federal Reserve, as Andrew Jackson did the Second Bank of the United States in the 1830s after calling its minions a "den of vipers and thieves." Since the Fed was created by an act of Congress in 1913 and signed into law by President Woodrow Wilson, another act of Congress could shut it down.

Dr. Paul is far too polite to use President Jackson's language to describe today's Fed operatives. Indeed, for most of the past century the Fed's role in micromanaging the U.S. economy has been largely taken for granted — until the past year. Its key power remains the ability to create money *ex nihilo* — out of thin air, as it were. And it created plenty last fall — the electronic printing presses have been running nonstop ever since. Now it cannot account for over a trillion dollars created out of nothing and used to save those institutions deemed "too big to fail." That very phrase sticks in the craw of many on Main Street who have seen their employers fail or their jobs disappear.

According to one recent commentator at a conference on gold, we are seeing the long-term consequences of a clash between two large-scale economic philosophies — a clash in which the wrong side ended up dominant. One side began with those British political and economic philosophers such as John Locke and Adam Smith who emphasized the importance of private property, the necessity that transactions be voluntary and not coerced, and urged noninterventionism on the part of government toward the economy. This philosophy found its way into the hands of the economists of the Austrian-school of economics, the most prolific of whom was Ludwig von Mises — author of *The Theory of Money and Credit* and *Human Action: A Treatise on Economics*. According to the Austrian view, the economy is generated by millions of individuals' free choices in the marketplace. According to the Austrians, business cycles — booms and busts — occur when too much credit, which is made available through government and central bankers, fools economic actors into overproducing.

This quickly generates a bubble, followed by a recession that must eventually occur to clear out the malinvestments. Bubbles inevitably deflate. Government should leave things alone so that a real recovery can begin. Murray Rothbard, a major American defender of the Austrian school, authored a treatise entitled *America's Great Depression* in which he argued in great detail that it was just such a policy of interference in the marketplace that caused both the Crash of '29, and — when government refused to let the market purge itself — the subsequent Great Depression. Bernanke, considered an authority on the Great Depression, even recently admitted the role of Fed policy in bringing about the Great Depression. "We did it, and we're sorry," he said.

The econmic school of thought that came to dominate and is guiding public policy as of now can be traced at least to John Law, who in the early 1700s urged the establishment of a national bank to extend credit. When his suggestions were applied in France, his recommendations led to a near economic collapse. Yet the belief in centralization and micromanagement persisted, making its way into the hands of Fabian socialists of the late 1800s and 1900s, whose members included John Maynard Keynes. The Keynesians dealt not with individuals but aggregates and abstractions, usually expressed in mathematical terms. They emphasized not individual choice but state power. According to them, business cycles are part of the warp and woof of capitalism. When recessions occur, the state must step in and stimulate demand with more easy credit through deficit spending and through money creation and credit expansion by a central bank, because the market can't be trusted.

Politicians, naturally, find this school of thought attractive. It tells them what they want to hear, and justifies what they already want to do, which is to grab for more power.

Thus the Keynesians have been in charge since the 1930s. They control the economics profession in the Western world, which is one of the reasons Fed policy is so seldom questioned, while those who agree with Dr. Paul have often found themselves dismissed as "fringe" elements. Such *ad hominem* retorts aren't making much headway these days. Not a single Keynesian, after all, foresaw the economic meltdown of 2008, while protégés of the Austrian school had seen it coming for some time, especially since the government's response to the bursting of the tech bubble did not amount to stepping aside and letting the market extinguish the malinvestments, but rather continued the same practices with the easy-credit policy that inflated the housing bubble.

Keynesian policies have continued to this day under the Obama administration, as should be clear from this past spring's "economic stimulus" package, as well as the repeated utterances that the federal government's huge expenditures of the Fed's fiat money are leading, however slowly, to an economic recovery.

The economists are already telling us that it will be a "jobless recovery," a mantra we heard back in the early years of the present decade when Fed inflation of the money supply prevented the market from clearing out the malinvestments created by the tech bubble of the late 1990s. This time, the public is more suspicious. Main Streeters understandably ask, "Just who is benefiting from the Fed's money creation machine?" The Dow may have risen back to over 10,000, and a new party may have begun on Wall Street, but Main Street is still suffering terribly!

Ben Bernanke, the Fed chairman, might soon find himself facing the sort of fight his predecessor Alan Greenspan never had to worry about. President Obama has nominated Bernanke for a second four-year term, but the confirmation hearing scheduled for December 3 might generate some fireworks — and with interest rates set at all-time lows, the fireworks will clearly indicate many people's sense of the larger picture.

With present historic-low interest rates and massive, debt-driven government spending failing to boost the economy more than a mere pittance, many Americans are waiting for the next shoe to drop and the economy to plunge further. This might happen before the 2010 elections, which would create a troublesome scenario for incumbents, especially those who don't back Ron Paul's bill.