Central Bankers at the End of Their Rope? Monetary Policy and the Coming Depression
Jack Rasmus

Explains very well how tne major central banks work, how they have evolved, and why they are failing

This book does a better job of explaining how central banks work than any of the others I have read. Two mainstream books, Mohamed El-Erian's [[ASIN:B0165I3V4C The Only Game in Town]] and [[ASIN:0691138648 Banking on the Future: The Fall and Rise of Central Banking]] appear to be limited by the obligate blindness that bankers must have to the fact that there is no correct way to do it. The central bank's goals are too elusive, the tools are too blunt and ineffective, the process is inherently political, and there are demographic and economic variables at play which are beyond the central bankers' ability to control. [[ASIN:0300154321 Losing Control: The Emerging Threats to Western Prosperity]] is another book that covers more or less the same ground, though I think Rasmus does it better and with less bias.

Other books such as [[ASIN:091298645X The Creature from Jekyll Island: A Second Look at the Federal Reserve]] and [[ASIN:0979917654 The Secrets of the Federal Reserve]] are conspiratorial. The Jekyll Island does a great job of describing how the Federal Reserve was established, but it ascribes to conspiracy that which can be better explained by mere self-interest. The bankers look out for themselves. The second book edges close to describing a Jewish conspiracy. As Kevin McDonald writes in [[ASIN:0759672229 The Culture of Critique: An Evolutionary Analysis of Jewish Involvement in Twentieth-Century Intellectual and Political Movements]], the Jews have evolved to look out for one another, but that does not rise to the level of conspiracy. Murray Rothbard's 1962 [[ASIN:B00N59J5BS What Has Government Done to Our Money?]] was a prescient vision of things to come.

[[ASIN:B010RUSJUA The Tyranny of the Federal Reserve]], not widely read, is valuable in that it puts the operation of the central bank into a much broader perspective. It addresses an entire range of tyrannies: those of debt, usury, fractional reserve banking, gold, central banks, war, free trade, mass immigration, the media and public education. [[ASIN:0691152640 This Time Is Different: Eight Centuries of Financial Folly]] is a survey of fiat money regimes going back eight centuries. They all fail, and all for the same reason: politicians cannot control themselves when it comes to printing money. James Rickards makes the same point well in [[ASIN:1591846706 The Death of Money: The Coming Collapse of the International Monetary System]].

Rasmus' book is the most valuable of the group, effectively enumerating and describing the tools, policy objectives and targets of the central banks, and evaluating their effectiveness in light of their own targets and their ability to manage their respective economies.

Rasmus recommends a constitutional amendment to address the problem. The effect of the amendment would be to redress the abuse that he sees in the present system, whereby central banks worldwide are generating a great amount of liquidity most of which flows into financial instruments instead of the real economy, benefiting the rich and starving pensioners and savers.

He recommends democratizing the governance of the Federal Reserve, taking it out of the self-serving hands of the bankers.

This would be a good start. The book does not address larger issues, such as the coming demographic crisis as world populations age.

This is as good a book as one will find describing the problems as they exist and how they came to be. One cannot fault the book for failing to recommend a complete solution. Nobody in the world has found one. For this reason prognosticators are increasingly forecasting a global collapse, a reset that will require something new to rise from the ashes. Only between the lines does Rasmus suggest that that's where things are headed.

A five-star effort. The best single book I have read on the Federal Reserve and central banks. I am including my (somewhat unedited) reading notes as comments. See my reviews of the books cited in this review for similarly detailed analyses.

Chapter 1:

Problems & Contradictions of Central Banking

Modern central banking originated in the high period of industrial capitalism and the establishment of the capital capitalist state. It was a. Quite different from today's highly financial iced, globalized, increasingly integrated and technologically dependent capitalist economy. It's a failure can be attributed to the fact that it was not designed for today's world.

They are thus unable to perform even their most basic functions of money supply management, bank supervision, and as the lender of last resort. Central banking is increasingly employing outmoded and ineffective tools. It is not achieving its stated goals. In the past decade it has added an entirely new function – permanently subsidizing the private banking system by a chronic, massive liquidity injections.

The author's conclusion is a constitutional amendment proposal redefining central banks. Rasmus refers to Mohammed El-Erian (presumably his 2016 book the only game in town) writing that we are at a T intersection, facing collapse if we do not do things right. Rasmus says that collapse is inevitable. I note that I, neither a banker nor an economist, pointed out the flaws in El-Erian's book in my review of same. Rasmus spells them out much more clearly. The fact that he and I see what El-Erian refuses to acknowledge is probably why he is rich and we are not. He is an insider. See my review of [[adults in the room]] for a devastating quote by Larry Summers on what distinguishes insiders.

The quotes also Robert Rubin, former CEO of Goldman Sachs in former treasury secretary under Clinton, as saying that there is an enormous growth in systemic risk. "It will be nearly impossible for central banks parent or other government regulatory bodies) to successfully contain it." Rasmus says plainly it is not "nearly" but in fact impossible.

Returning to its three core functions: lender of last resort, growth and distribution of the money supply, and bank supervision – Rasmus says that these originated in the world of the gold standard and high industrialization epoch. This ended in the 1970s.

Central banks are failing because their ability to perform these primary tasks is in decline. Globalization renders the tools ineffective. There is no global central bank. The Federal Reserve and the Bank of England tried to fill that role in 2008, with a $10 trillion direct injection and another trillion dollar loan to the ECB. But neither the euros banking system nor the Japan's has been bailed out to the state. There are trillions of dollars of nonperforming loans still on the books.

The central banks do not coordinate. Rasmus writes that as of 2017, the Fed appears even more intent on going its own way.

A second problem is that technological changes generate instability. There are many new ways of creating credit outside the purview of central banks.

The third problem: loss of control of the money supply, and the consequent declining effective interest rates. Money supply is increasingly difficult to measure as new credit instruments appear. Rasmus contends that quantitative easing (QE) represents a desperate try to reassert control and influence. Interest rates are a function of supply and demand. But as money is increasingly global, the policy of no particular country can effectively dictate interest rates everywhere. Monetary velocity is increasing. The Rasmus assumes this is self-evident, my take is that increased velocity as a leveraging effect on money supply. The same dollar can be recycled more times to make more loans.

The feds have lost control over interest rates. Decreasing them does not stimulate investment, but increasing them acts as a strong disincentive to investment.

The fourth problem is the rise and expansion of shadow banking.

Shadow banks engage in high-risk, high return investing and are often at the center of financial crises requiring a central bank bailout. It would be impossible to even identify all of the shadow banks, much less control them, even within the United States. Doing so globally is more than impossible. Nonetheless, central banks have been bailing out shadow banks as well as traditional banks and crises occur. Shadow banks divert money from real asset investment into financial investment, reducing investment, employment, and consumption, and thus slowing domestic production and economic growth.

The fifth problem is the magnitude and frequency of financial asset bubbles. They lack both the will and the tools. Part of this is political – there's a lot of money to be made as bubbles inflate. Rasmus writes "central banks would rather try to clean up the mess from a bubble and crash and to prevent it, or even slow it down.". Bernanke said repeatedly it was not his mission to control bubbles, even in the aftermath of the 2008 crisis.

"But financial bubbles are a problem of central banks' own making, since not only do they refuse to intervene and address them, but their ongoing low interest monetary policy actually feeds them. It's not that their traditional monetary tools are insufficient to contain asset bubbles. They could very well adopt new tools, if necessary. Fundamentally, they could stop financial bubbles by various means that disrupt and slow the flow of central bank liquidity injections into financial asset markets.20

"They could prevent them but won't, and they won't because central banks are still the handmaidens of the commanding interests within the private banking system, and owe no allegiance to the general public."

The contradictions of central banking

At what point does a central bank decide that a bank or other institution is bankrupt? The question is whether the institution faces a liquidity crisis – adequate long-term assets but a shortage of short-term cash – or a solvency problem. A solvency problem occurs when debts outweigh assets.

Deciding between the two requires judgment. It requires an assessment of the value of assets and the level of debts, both of which may be hard to assess. It requires an assessment of the future ability to service debt, which is especially hard with interest rates as low as they are. A debt that can be serviced when prevailing interest rates are 2% will be unsustainable at 3%. Put another way, an institution might have a debt to income ratio of 50:1 and still be deemed able to service its debt. But when it collapses – boom! The loss that must be recognized 50 times the entity's income.

There is a contagion effect. When there are a lot of institutions in similar trouble, for one of them to declare bankruptcy calls into question the viability of the others. There is a crisis of confidence and the whole system may collapse. There is a strong incentive for the central bank to avert its eyes and not recognize insolvent institutions.

Instead, they have a tendency to inject liquidity to enable them to function short-term. This only makes the debt problem worse over the longer run. Either reviewer add that this is true not only of zombie companies such as those cluttering up the landscape in Japan and China, but of countries themselves. See Rasmus' book entitled [[the looting of Greece]].

The problem extends beyond the bailed out institutions themselves. The new liquidity seeps throughout the system, depressing interest rates so low that even companies that do not need capital go to the capital markets to borrow it. Rasmus points out Apple Computer, sitting on 200 billion in cash, still borrowing money because it is too cheap not to. Much of the borrowed money is being plowed into share buybacks, which have pushed the stock market valuations to stratospheric levels, and price-earnings ratios down to almost nothing. Rasmus notes that there will be quite a reckoning when the $5 trillion that has been borrowed since 2011 eventually has to be repaid.

Merchant banks emerged in the late Middle Ages, first in Italy and then spreading north. See Fritz Rorig [["The Medieval City"]] for a history. The oldest of central bank acknowledged as such is the Bank of England, which assumed that role about the beginning of the 19th century.

In the absence of a central bank, local banks issued their own currency. This led to frequent bank runs and financial crises. The United States had national banks in the early part of the 19th century. A legacy was not a happy one, and the United States was slow to establish a central bank. The Bank of England got a monopoly on issuing currency in 1844.

As continental central banks evolved, fractional reserve lending came into practice. Rasmus covers it briefly. The idea is that the bank loans out more money than it has deposits on the theory that not everybody will want their money back immediately. Loaned money goes into the construction of long-term assets which will enable the borrowers to pay the banks back. The long versus short problem inevitably led to liquidity crises. The banks assets might exceed its liabilities, but it would not have money on hand. Central banks handled this by limiting the amount of currency in circulation and acting as the lender of last resort.

By 1870 – 90 nearly all European states has adopted central banks. The Federal Reserve was created only in 1914, and Latin American and other central banks were founded in the early 20th century. Countries with central banks rose from 18 in 1900 up to almost 200 by the year 2000.

The three primary functions of central banks are:
- acting as a lender of last resort to bail out banks in a crisis
- regulating the supply of money in the domestic economy
- supervising the private banking system

Modern central banks perform other functions:
- raising money for governments
- issuing new paper currency
- precious metals and currency conversion
- clearinghouse services for interbank transactions
- managing government payments
- economic research

The ultimate goal of government and central banks is stable long-term growth, increasing the wealth of the society and the well-being of the citizens. To achieve that ultimate goal, central banks set targets for measurable economic statistics. Among the statistics that they target include:
- price level
- supply of money (cash, demand deposits, and other types of credit)
- currency exchange rates
- interest rates
- full employment (or conversely, an acceptable level of unemployment)

All of these targets are inter-related. Given that the tools used to achieve the objectives are also interrelated, central banks lack, and have always lacked the ability to attack any particular target in isolation.

The tools of central banking are:
- The reserve requirement: the percentage of money that must be held in the bank to back up loans made on the fractional reserve principle. The higher the reserve, the less likely the bank will suffer from a bank run, but the less profit they can make from interest on loans.
- The discount rate charged by the central bank to private banks.
- The market interest rate that banks charge one another for loans.
- Open market operations: buying and selling bonds, usually T-bills, which has the effect of injecting cash into the system or absorbing it out of the system as it is tied up in interest-bearing instruments.
- Quantitative Easing: buying bonds from private investors as well as banks and other financial institutions to provide them with liquidity. In Japan this includes buying corporate stock.
- Special Auctions: actors in the banking sector submit bids indicating the prices and amounts at which they are willing to borrow.
- Reverse Repo Agreements

All of these tools recognize that banking is a question of supply and demand: the supply of money available to be lent and the demand for borrowing. Reduce the supply of money by increasing the reserve requirement and the interest on loans goes up. Inject liquidity into the market by buying bonds, placing cash in the bank's coffers, and they find it easier to lend. The same with quantitative easing. Adjusting the discount rate directly affects demand: the more expensive it is to borrow, the lower the demand. Therefore, in the final analysis, every central bank tool manipulates the same parameters: supply and demand. The objective is to achieve a level of lending such that the money can be put to use productively, increasing human productivity and gross domestic product, and not squandered, hoarded, or stolen. The borrower should be able to put the money to use in such a way that the earnings allow the loan to be repaid with interest in the borrower to make a profit.

In a global world central bankers have less and less control over the parameters they seek to manage. Money is really a global commodity. Productivity growth is a function of technology, something certainly beyond the control of central banks. Employment levels are a function of human capital: education, experience, and ultimately personal traits such as intelligence and personality. The thesis of this book is that the traditional tools named above are in adequate to achieve the named targets, and that the name targets themselves may be badly chosen. The era of the central bank may be coming to an end.

Chapter 3:
The US Federal Reserve Bank:
Origins & Toxic Legacies / 48

Rasmus gives a short version of the fairly well-known history of the founding of the Federal Reserve. The best known account, [[the creature from Jekyll Island]], is a little bit conspiratorial. Rasmus disagrees in part. He says that the negotiations were done in the public eye, in Congress, over a period of several years culminating in 1914. It is no doubt the product of the New York banks, and it was crafted to respect their interests. Rasmus writes that it did solve real problems. The boom and bust cycle had put a damper on expansion during significant portions of the prior three decades.

The Federal Reserve is owned by the banking community itself, which in turn is dominated by the big New York banks. The bankers got most of what they wanted. To sell the plan politically, it was constructed as a decentralized group of regional Federal Reserve Banks. In fact, the New York Fed dominated from the beginning. The decentralization was only a fig leaf to get the legislation through Congress. It had bipartisan support, although the Democrats could not afford to show too much enthusiasm because they were known as the anti-banking party.

Rasmus provides a history of the first two decades of the Federal Reserve's existence. They had gotten essentially everything that they asked for from Congress, claiming that they needed the power to be able to control booms and busts and supervise banks. It did not work out in any of the central banks three primary functions.

In its supervisory role, the Federal Reserve stood idly by as the banks allowed the money supply to grow three times faster than production, creating a bubble. Much of the money went into margin loans that fueled the stock market bubble. A great many banks were still outside the Federal Reserve system, and those that were in it received very little discipline. The Federal Reserve had to balance two objectives, keeping interest rates low enough the gold didn't flow from England to the United States and throw England off the gold standard, and yet control speculation in the United States. It failed.

As a lender of last resort the Fed also failed. The discount rate was kept abnormally high, discouraging banks in trouble from borrowing. Banks failed in the brief, severe recession of 1920 – 21. There were three strong waves of bank failures in 1930 – 31, 1932, and the third and early 1933. The rate of failure was more than it had been in the decades before the Federal Reserve. To fulfill a commitment to stay the gold standard, it actually raised interest rates going into the depression. This protected wealthy investors at the expense of farmers, small businesses and workers.

The Federal Reserve was supposed to ensure a stable money and credit supply. The single currency replaced the thousands of state bank banknotes. I, the reviewer, note that since we had a single currency, the US dollar, all of the banknotes must have been denominated in dollars at the then prevailing rate of $20 per ounce of gold. Though there may have been many banknotes, they must all have purported to represent the same amount of value. Although the most conservative measures of money, currency in circulation and bank deposits, were held in check, other lending such as margin lending on stock accounts was not. The bottom line, Rasmus says is "And the Fed had totally lost control of credit creation by the end of the decade."

In its fourth role as government funding in fiscal agent, Rasmus contends that the Federal Reserve did adequately. It was able to raise the money to fund the First World War. He credits this primarily to the Department of the Treasury itself, which kept interest rates low to maximize government war borrowing.

In its fifth objective, price stability, the Fed did not do very well. Prices rose 11% to 19% during the war, after which there was a major deflation. Financial assets again surged in the bubble of the late 20s, after which all prices – goods, services, food, commodity, and financial assets – collapse together. Currency exchange rates also fluctuated wildly.

In its sixth objective, maintaining the gold standard, it absolutely failed. Although unemployment was not a stated target, it was also a disaster. By 1933, 30% of the entire workforce were unemployed, compared to 2.9% in 1929. Real output fell by 29%. Rasmus notes that in 1929, just as in 2017, the Fed's policy was not to intervene and attempt to pick a financial asset bubble, but to try to pick up the mess after his bursts. By 1927 more than 1/3 of all bank loans went into buying stock, not into improving productivity.

The Fed did not use its tools, the discount rate and open market operations, to cool the speculative bubble in 1928 and 29. It ignored the effects of the shadow banks and other players.

Rasmus concludes that although it made a number of tactical errors, the most fundamental error was that the bank operated in the interests of the banks, not the country.

Chapter 4:
Greenspan's Bank:
The 'Typhon Monster' Released / 71

The Federal Reserve was considerably chastened by the great depression. The flurry of legislation designed to control the banks left them on the sidelines. Rasmus gives Roosevelt most of the credit for the recovery – other economists would write the history differently – and says that the Federal Reserve did not regain power until March 1951 with a new record between the Fed and the treasury. Rasmus notes that the to decades without the Fed were the high point of economic and employment growth in the United States. While this is true, one must recognize that 1933 represented the absolute nadir of economic activity, and that productivity toward the end of this period was stimulated by two wars. Rasmus concludes that central-bank independence may not be the best for economic stability and growth.

The Treasury Department allowed the feds to increase reserve requirements in 1937 to offset golden flows from Europe. That slowed the economy, resulting in a short but deep double dip in the Depression.

Rasmus writes that after 1945 there was continued reliance on fiscal policy (presumably, rather than monetary policy). Here is how the Internet defines the difference:

- Fiscal policy relates to government spending and revenue collection. For example, when demand is low in the economy, the government can step in and increase its spending to stimulate demand. Or it can lower taxes to increase disposable income for people as well as corporations.
- Monetary policy relates to the supply of money, which is controlled via factors such as interest rates and reserve requirements (CRR) for banks. For example, to control high inflation, policy-makers (usually an independent central bank) can raise interest rates thereby reducing money supply.

The bankers carried the day in March 1951. Truman needed the cooperation of the private banks to buy government bonds to fund the Korean War. Moreover, it was argued that the Fed needed to raise interest rates to bring inflation under control. Marriner Eccles, a strong advocate of government control, resigned as Fed chairman and was replaced by William McChesney Martin, a banker.

For the next two decades (through the early 70s) the FOMC (Federal open market committee) handled most of the regulation through buying and selling of government bonds and setting the level of reserves for the districts of the Fed.

"In the 1960s fiscal policy primacy continued but began to ran into trouble." In other words, the government did not balance its books. It could not have guns and butter during the Vietnam War.

A number of financial innovations by the private banks circumvented Fed controls. Among them were certificates of deposit. Penn Central failed as did Franklin National Bank. This represented a failure of the Fed to supervise. Credit cards were introduced in this era – and consumer credit grew rapidly. Banks competed with savings and loans in the home mortgage business. The growth of new financial instruments left the Fed far behind.

Dollars flowed overseas first with foreign aid, US troops stationed overseas, and capital investment by US corporations. There were thus dollars in Europe to be loaned – EuroDollars – outside of the control of the federal reserve. This, combined with taking the dollar off the gold standard and the digitization of financial transactions and the related creation of new financial instruments meant that there was more money available, less subject to control by the Fed. Money velocity would've also increased, applying a multiplier effect of the monetary supply.

Continued deficit spending – as a result of fiscal policy – increase the amount of money in circulation. It cost inflation, which in turn raised the price of US exports and decreased US competitiveness. It led to an accumulation of dollars overseas and a lack of faith by our trade partners, who increasingly redeemed dollars for gold at the official rate of $35 per ounce. Under chair Arthur Burns, Nixon halted convertibility in 1971 as part of his New Economic Plan (NEP).

The end of the gold standard meant that the dollar was the reserve currency, which increased the demand for dollars as other countries would buy and sell the currency to stabilize their own currencies. Other central banks also injected liquidity, rarely taking it back.

In 1977 Congress gave the Fed the responsibility for targeting unemployment. Throughout the late 70s the Fed continued to allow liquidity to grow. It was ineffective at meeting any of its targets, which continue to change in any case: interest rates, money supply, discount rate, unemployment – they were all elusive. The Fed, under chair William Miller, tried all its tools, to no real effect. Carter replaced him with Paul Volcker in 1979.

Volcker's top priority was to curb inflation. He put a halt to the money supply growth and paid no attention to the resultant interest rates and unemployment. Inflation continued for a while, but eventually abated as the economy crashed. Volcker bailed out financial interests, including the Hunt brothers who had failed in their attempt to corner the silver market. Rasmus notes that this indicates who the Fed is designed to protect – the banks.

Rasmus reports that Volcker was no more consistent than Miller had been, expanding and then contracting the money supply rather abruptly in the first years of the Reagan administration and allowing inflation to whipsaw.

Rasmus reports that Volcker was not successful even in controlling inflation. Prices of goods and services were indeed moderated, but financial prices grew considerably. There was a stock market bubble and in Boston 1987, a junk-bond bubble, and a second housing bubble.

US corporate "offshoring" in the 1980s required the relaxation of transborder monetary transactions. This was in the interests of business, escaping high costs of production in the United States, and supported by the Reagan administration. Deregulation, both domestic and international, enhanced liquidity by making money move more easily.

Reagan saw Volcker as not sufficiently onboard with the government's objectives of improving investment and decreasing unemployment. He was replaced by Alan Greenspan, who was to serve for 20 years from 1987 until 2007. Rasmus says that Greenspan unloosed the "Typhon monster" of Greek mythology by creating excess liquidity. "Why is liquidity a monster? Because it's excess beyond available opportunities for real asset investment overflows into financial asset investment and financial market speculation." It results in bubble, which pop.

Rasmus next couple of paragraphs, although written about the 1980s, perfectly capture what is happening in 2017:

"Enabled by ever-expanding liquidity, financial asset investing becomes more profitable than real asset investing—i.e. credit expands into financial investment markets and even slows the flow of credit that might have gone into investing in real assets like structures, equipment, and other real assets that create more jobs and incomes than financial asset investment. With slowing real asset investment, productivity eventually slows as well, thus producing even fewer jobs and further reducing real earned incomes for most households. The flip side of excess liquidity is excess debt accumulation, as the expansion of that debt increasingly funds financial asset investment and financial speculation.

"The rising ratio of debt to real income has additional negative impacts on the real economy apart from diverting capital that might have financed real assets, jobs, and incomes. As real asset investment growth slows, and earned incomes grow more slowly, so does productivity slow. The growth of debt that excess liquidity creates also reduces multiplier effects from government fiscal policy that attempts to stimulate growth by means of spending increases and/or tax reductions. Debt also negatively affects monetary policy stimulus. Excess liquidity drives down interest rates. Businesses and investors then increase borrowing but divert the funds borrowed into financial asset investing as well. Financial markets expand abnormally and result in asset bubbles, with the same consequences noted above."

Rasmus concludes that Greenspan was no genius – he simply bailed the banks out every time his policies failed, seven or more times in the course of his 20 years. He did nothing about financial asset bubbles. He noted that in 1996 the stock market valuation was 120% of GDP, up from 60% in 1990. Nota bene: it is 136% as I write).

Greenspan had advocated increasing financial deregulation, such as the end of the Glass-Steagall act which had prevented banks from combining retail lending with investment banking activity. The Fed also largely abandoned its supervisory function.

The stock market crashed – NASDAQ down 86%. But the biggest bubble of all, subprime lending for housing, continued. In a quid pro quo, Greenspan kept interest rates around 1% to finance George Bush's war in Iraq, and he was reappointed. This gave new legs to and already extended, stale housing market by allowing marginal homebuyers into the market.

Chapter 5:
Bernanke's Bank:
Greenspan's 'Put' On Steroids / 106

The Fed was very data-driven, but myopic in that they were driven only by the data that they collected. The Bureau of Labor Statistics and other federal agencies gathered data on the real economy. It largely ignored what was going on in the financial economy. Rasmus contends that between the depression and 1965 the two were largely disjoint. However, from the Carter administration onward they greatly influenced one another. Not to pay attention to what was going on in the financial markets – bubbles and housing, bonds, the stock market and foreign currencies – was to be willfully blind.

Greenspan allowed himself to be blind. The "Great Moderation" was a fiction that was only sustainable by ignoring the financial sector of the economy.

Bernanke was Greenspan's protégé from the time he joined the Fed in 2002. He came from Princeton, where he had headed the economics department. He briefly left the Fed to join the Bush administration, but returned and was elevated to the chairmanship in 2006. Like Greenspan, he was a monetarist, a student of Milton Friedman, and a believer in deregulation. A monetarist believes that you manage an economy by managing the money supply; a Keynesian believes that you do it through government fiscal policy. He was also friendly with the banks.

"When the banking and financial crash finally came in 2008, he would adopt Greenspan same solutions to imploding financial bubbles and financial crises i.e. throw another wall of liquidity at it. But massive liquidity injections over decades were the fundamental originating cause of the financial instability, leading to exploding debt, inordinate leveraging, it excess demand for financial securities and financial asset bubbles. Now they would be considered the solution to the problem they had created." This reviewer notes that it is the same all over again in 2017. They learned nothing.

Long-term interest rates theoretically should to some degree track short-term interest rates. Greenspan's "conundrum" was that the two became increasingly disconnected. Although Greenspan brought short-term rates down to 1% after the 2001 "tech wreck," long-term rates fell only very slowly. Rasmus' explanation is that this worldwide flood of liquidity represents an enormous source of demand to purchase US bonds, government and corporate. It represents a constant downward pressure on bond interest rates.

There was a productivity conundrum. Goods inflation slowed at the same time as productivity decreases. Less productivity should make products more costly. But it didn't work that way. Factors Rasmus identifies are globalization, destruction of labor unions, lower minimum rage, capital replacing labor, offshoring, privatizing pensions, and the shift from manufacturing to a service economy.

Bernanke blamed a "savings glut" caused by persistent US trade deficits allowing dollars to accumulate overseas. Those dollars sought to be invested in the US, lowering long-term interest rates. But "savings" was a misnomer, the foreigners were not responsible, and it had begun long before 1996. Central banks worldwide had pumped liquidity in the system at every excuse.

Bernanke held a noninterventionist view, the idea that it was not the Fed's job to pop bubbles, up until the time he retired from the Fed. The case that Rasmus does not make is what happens when the Fed does attempt to contain asset prices. One must assume that it causes dislocations elsewhere in the economy as excess liquidity will not stand still in banks, losing value. This reviewer asks the question as to whether the Fed could contain all asset prices – stocks, bonds, real estate, precious metals and works of art – at the same time. If they did, where would the money go? Conversely, is there any federal reserve policy that would soak up the excess liquidity without causing dislocations? These are questions I hope will be answered later in the book.

Rasmus contends that the Fed abandoned its money supply and credit regulation function to carry out its lender of last resort function. The Fed's traditional tools were inadequate, leaving it to invent quantitative easing and the zero interest rate policy (QE and ZIRP).

The housing bust of 2007 also involve credit markets like asset-backed commercial paper (ABCP) and repo agreements. As the value of housing started to fall, the value of securitized loans and other financial assets collapsed quickly. Injections of 62 billion by the New York Fed and 214 billion by the European Central Bank were quickly swallowed up. The crisis originated in the shadow banks which could not borrow at the Fed's discount window. Ultimately it took tens of trillions of dollars.

Hedge funds and private equity funds began feeling. The Fed said it would buy not only T-bills but mortgage-backed securities from the big five shadow banks in New York: Goldman Sachs, Morgan Stanley, Merrill, Lehman, and Bear Stearns. Bear was crashing. Bernanke in the Fed arranged $25 billion Fed loan to J.P. Morgan to buy Bear Stearns. Chase wound up paying only 236 million. NB: Morgan and Chase are the same entity.

Bernanke played political games to get the deal through with only 4/7 Fed governors voting. The Fed's rule said they needed five.

The Fed did allow Lehman Brothers to collapse in September 2008. They did nothing to save it. This called the solvency of the other banks into question, and the New York Fed had to put another 70 billion in two quell the panic. They threw in another $85 billion to cover AIG, which was massively hemorrhaging due to credit default swaps. The Fed played favorites – money that went to AIG flowed through to Goldman Sachs.

Congress voted 700 billion for the Troubled Asset Relief Program (TARP) to be administered by the Treasury Department. Rasmus lists another six programs which together amount to another almost $2 trillion.

This money was used (I the reviewer conclude) to buy troubled assets from the troubled banks. Take the assets off of the bank books and put them onto Federal Reserve's books or some other. This was supposedly done at fair value, but of course in a financial crisis – fair value is impossible to know. Without a doubt the bankers knew it better than the government or the Fed did. The bankers were at a minimum bailed out, and in some cases given an enormous gifts. Citigroup and Bank of America became technically insolvent. They too were given loans and guarantees.

Quantitative easing was launched in March 2009 With the purchase of $600 billion worth of mortgage securities and another hundred billion dollars worth of Fannie Mae – Freddie Mac's own debt. The Fed was buying the toxic assets that had collapsed in price for private investors. QE1 total $1.75 trillion.

QE2 was launched in mid-2010. Altogether the Fed liquidity programs resulted in a federal reserve balance sheet of $4.5 trillion, still in place as of March 2017.

These actions resulted in a huge increase in money supply. The cash monetary base – currency in your currency – rose from 853 billion to $3.7 trillion at the end of 2013. Him too, the broader measure, went from $7.3 trillion to $11.2 trillion. These figures do not take in all credit growth – the total is larger, but hard to estimate.

The judgment is that the Federal Reserve succeeded at only one objective, as a lender of last resort, and did so at huge cost. The process was highly political, with government officials quite openly helping friends in high places. It absolutely failed in its supervisory capacity. It was unable to manage interest rates – the disparity between short and long term was hard to remedy.

Price stability was a failure as well. The Fed's target is called the Personal Consumption Expenditure, or PCE. It is a measure of goods and services prices. Asset prices are not part of the equation. They could not push prices up to the targeted 2% by 2016, but stock and other asset prices skyrocketed. The Fed's Inflation targets failed.

The chapter concludes with an assessment of the tools that Bernanke introduced: quantitative easing, ZIRP and the other tools to support bank liquidity, and the relaxation of mark to market and other supervisory metrics. The conclusion is that the negative effects will be felt for decades to come. They represent a massive injection of liquidity, exceeding even the specific bailout programs of 2008 – 09. Rasmus does not mention moral hazard as such, but they apparently establish a precedent that may be impossible to replicate next time.

Chapter 6:
The Bank of Japan: Harbinger of Things
That Came / 142

Japan overstimulated its economy in the 1980s, culminating with a total stock market valuation of 40% of the world's stockmarkets, and real estate valuations exceeding that of the United States. From there it was downhill.

The Bank of Japan tried all of the central bank tools, with a notable lack of success. All that worked was lender of last resort, the same as in the United States.

Japan was the first to try quantitative easing. They did it in stages, ultimately unleashing the most powerful quantitative easing of any country to date. One objective was price stability. They wanted to end deflation and achieve zero price growth. The second bout of quantitative easing did it, although a massive cost.

Japan was also among the first to introduce negative interest rates in an attempt to force banks to loan money. The money that they loaned tended to go overseas and into financial investments. It did not help at home.

As things stand, Japan's debt is 250% of GDP. The situation looks precarious.

It is interesting that Rasmus does not anywhere mention demographics. Japan's falling birth rate and huge population of elderly has to have an effect on labor demand, fiscal policy to pay pensions, income tax income and other financial parameters.

Chapter 7:
The European Central Bank under German
Hegemony / 165

The European Central Bank was not originally structured as a central bank, and does not yet have all the powers it would need. It is part of the European monetary union (EMU) which assigned price stability as it's only target. Bank supervision was expressly left to the national central banks. It negotiates money supply in concurrence with the national central banks. It is expressly enjoined from serving as a lender of last resort to sovereign governments, though it could lend to banks and central banks. Alternative organizations to bail out governments did not come into being until 2010 and 2012, at which time many of the European banks were technically insolvent.

The EMU charter required member states to avoid running budget deficits. This meant that fiscal policy could not be used as a tool of central banking. Policy would have to be implemented through monetary action. Rasmus writes that it was created by bankers in the interest of bankers. Financial interests were well taken care of and the crisis of 2009, but the real economy, employment and wages declined.

Germany dominates the ECB. The smaller NCBs are dependent on Germany for exports and capital flows, and therefore tend to support Germany. See the gripping report on this phenomenon in [[adults in the room]]. Germany likewise dominates the European commission (EC) of finance ministers. Germany's interests are served by the ECB's original week structure.

The inability to use fiscal stimulus requires austerity, tickly in the peripheral countries but increasingly even in the core, such as France. Fiscal rules have the result of preventing the successful functioning of the central bank.

From 1999 to 2008 the ECB's primary central banking function was limited to managing the money supply. It launched the euro and converted national currencies to the new one. Germany and the other northern core economies currencies were overvalued. They therefore received an excessive share of euros.

The M1 money supply grew by 104% from 1999 through 2006 as the ECB pumped excessive liquidity into the regional economy in order to jumpstart trade within the zone. This was faster than GDP growth. Exports went from the northern core to the southern and periphery countries. Banks took ECB liquidity and let it out rapidly, from the core to the periphery. The money went into real property and imports of manufactured goods from the German core.

There was a buildup of debt on the periphery, however most of it private. When the crash came, no new capital flowed in, but the debt still had to be paid. New loans were made to pay off the old. The troika imposed austerity to ensure he got repaid.

Interest rate management contributed to the 2008 crisis and the double dip recession in 2010 – 13. As elsewhere, the rate increases were too much, too late. The ECB was late to adapt experimental tools such as quantitative easing. This was inconsistent with its original charter and vision.

The ECB was late to inject liquidity, injected less as a percentage than the United States or Japan, and didn't have the mechanisms to ensure that the money would go where was needed – into investment and jobs.

According to the Bank of International settlements, the northern banks had an exposure of $1.6 trillion in periphery economy government debt by 2010. In May 2010 they launched the securities markets program (SMP) which involved indirect buying of sovereign bonds and other securities. It totaled €210 billion over the next two years, but was not enough. Thus was established the European financial stability facility (EF SF) which succeeded the ESM in 2012. Funding totaled €440 billion. There was a hitch – they required austerity.

Mario Draghi promised to do "whatever it takes." He started out right money transactions (OMT) in September 2012 to buy stocks and bonds and thus create liquidity. Estimated to have added €600 billion. However, there was not a corresponding increase in M1 money supply. It rose only from €4.53 trillion to 5.10 trillion. Rasmus writes that the signs are that the liquidity would not be loaned out and getting into the economy at large. I assume he concludes this because the €600 billion did not show any multiplier effect that could have been expected from fractional reserve banking.

ECB injections of liquidity tapered off toward the end of 2013, its balance sheet showing €2.27 trillion in assets, after which there was little new action.

After a Spanish bank went Boston others threatened to, Germany overcame its reluctance to perform bank supervision because it was even more reluctant to bail them out. The ECB established a single supervisory mechanism, SSM, to take effect in November 2014. It worked at the level of single banks, not macro policy. It only applied to the biggest banks. National Bank inspectors had to be involved. It did not involve institutions that did not have retail customers.

Nonperforming loans exceeded €1 trillion when the SSM was established and did not decline measurably for 2 1/2 years. It was only in March 2017 that the ECB issued guidelines on how to address the problem. The Italian bank problems, especially Monte dei Pasche, Are an indication of this. Though they are insolvent, the banks lumber on.

As a lender of last resort, the ECB did manage to keep private banks from going bankrupt. Governments likewise. But did they resolve anything? Were the banks able to resume lending? No.

The ECB's only target was price stability, inflation of 2%, and despite the injections of l they did not achieve that. their tools did not do the job. In 2014 it looked like the euro economy was headed for another recession. At this point the ECB introduced its own version of quantitative easing, followed by the even more radical negative interest rates (NIRP).

The ECB was buying bonds at the rate of €80 billion per month. This should have vastly reduced the bonds on euro banks balance sheets. But it didn't. This indicates the bonds must've been purchased from non-bank entities and foreign banks. Credit to nonfinancial corporations continued to decline.

Chapter 8:
The Bank of England's Last Hurrah:
From QE to Brexit / 195

The financial system in Britain is more similar to that of the United States than Europe or Japan. The Bank of England is a genuine central bank, with its own currency. It was relatively late in being given the total independence that is fashionable for central banks to receive in the 1980s and 1990s. Bank supervision functions and monetary policy were theoretically supervised by the chancellor of the Exchequer, although the Bank of England was usually able to do what it wanted.

Like the other banks, the Bank of England went through waves of quantitative easing that injected large amounts of liquidity into the economy. As elsewhere, it did not achieve the desired levels of inflation in the real economy. It did, however, results in asset price inflation, real estate and stocks, just as everywhere.

The Brexit vote depressed the foreign exchange value of the pound. This in turn raised the price of imports, probably the single most significant factor in whatever consumer price inflation was realized.

The Bank of England faces the same problem as the other central banks. It has a swollen balance sheet, including lots of debt that would have otherwise not existed or gone into the private sector. Unwinding this debt will be a real problem, or would be a problem were to be attempted.

Chapter 9:
The People's Bank of China Chases Its Shadows / 215

The central bank of China has a much more compressed history than those of the Western institutions. Rasmus starts with the period of 1983 through 1998. The People's Bank of China (PBOC) started out as a part of the government. It handled fiscal matters – collections and disbursements of state owned enterprises. There are three quasi-independent government owned banks servicing different sectors of the economy: industry and commerce, agriculture, and construction.

The banks changed in character as China started to encourage private enterprise. The quarter of a million or so state owned enterprises consolidated. Some accepted outside shareholders. It became possible for entrepreneurs to start businesses. Independent banks were set up.

There were boom and bust cycles as in in the early capitalist system. China was notable only in the compressed timeframe in which it all occurred. There was little banking supervision at first. The government stepped in to sort out some of the mass, setting up government entities to purchase bad loans in order to keep the banks afloat.

The People's Bank of China took form as a central bank in the early 2000's, separating itself from the Ministry of finance. It still did not have autonomy with regard to bank supervision. Its primary target was continued growth; interest rates and inflation were secondary concerns.

In the early 2000's the money supply more than doubled. However, the money more or less had to be invested productively. The channels did not exist to send it overseas in large amounts. There simply were no financial derivatives or other speculative products to absorb it.

The PBOC, unlike other central banks, was able to get most of the nonperforming loans that it had picked up during the Asian financial crisis of the late 90s off of its balance sheet in the early 2000's. This was possible because the country experienced significant real growth.

"There are only three ways out of a debt crisis:
- expunge private debt by banks, voluntarily or by government action
- grow out of it by means of rising prices generating income with which to repay it; or
- transfer the debt to government established "bad banks" or by some other way to the government balance sheets.

Every central bank named in the book had hoped that option two would work out. China is the only one where it did.

China's residential housing bubble crested in 2007 – 08, but did not break. The financial system was too simple to have involved layers of derivatives, as it did in the United States. There were no credit default swaps, collateralized debt obligations and instruments of that sort. As a result values resumed their climb after a couple of year pause.

Central bank policy worked because China was mostly a closed society. Liquidity injected in the system did not seep out through foreign investment, shadow banks and other mechanisms.

After the world economic crisis in 2007 – eight, China injected enough liquidity into the system to almost double the money supply. This is more than the United States injected into an economy twice as large. China's objective was to shield their economy from the world economic crisis. 38% of China's liquidity was directed at infrastructure – railroads, highways, water projects, ports and the like, and another 30% into housing and commercial property.

The fact that China board money directly into sectors, whereas the United States poured money into the system and left it to the participants in the economy to route it towards investment (or hoard it), China's investment was much more effective.

China allowed the M2 money supply to grow 20% a year from 2008 through 2011, and 10 to 15% annually through 2017. This is more than was needed to accommodate real expansion. Where did the money go?

Asset prices is one thing. China discouraged housing appreciation by raising down payment requirements, forbidding ownership of more than two houses, and raising mortgage interest rates.

There was a tsunami of excess liquidity provided by all of this. Credit and debt grew to about $30 trillion. A lot of the money flowed overseas, but a lot of it also went into asset markets. Stock market, bond markets, and new securities like wealth management products. China's shadow banking system blossomed.

All of this has resulted in China's development of the same problems that afflict the West. There asset bubbles in real estate, stock, and financial assets. Real GDP growth has slowed to about 4% annually.

According to the Bank of International settlements, China's total debt as of the end of 2016 exceeded 250% of GDP, twice the ratio in 2008. Two thirds of it is corporate and business debts, with most of that concentrated in the state owned entities and local government financing vehicles. Nonperforming loans are again a problem, of a scale much larger than in 1999. With growth slower, it is an open question whether they can grow out of it this time.

Of the $30 trillion debt, bank loans account for just over half as of the end of 2016. To this should be added about $7.7 trillion in Chinese shadow banking. Determining the level of nonperforming loans is a guesstimate, but $5 trillion seems reasonable. This is 16 times the amount that they "grew out of" after 1999. That does not seem like a likely solution. China does have $4 trillion of foreign reserves in cash… depending on how well the value of foreign assets holds up in a global crisis.

As an aside from the reviewer – gold bugs estimate that China has been actively accumulating gold, now possessing 20,000 tons worth close to $1 trillion at today's valuation. If the value of gold increases significantly, as many speculate is likely in an impending global crisis, China's reserves could be significantly greater than $4 trillion.

China at one point tried to force the excess liquidity and the buying stocks. There was a stock market surge in 2015 caused by allowing margin buying, foreign participation in markets, and other such devices. They tried to dampen that, causing a stock market contraction and downward pressure on the renminbi. They tried to reverse that by throwing money at it.

China faces the same dilemma as the West. "In 2008, every dollar of credit and debt produced a dollar of real growth; in 2017 it takes four dollars to produce one dollar of growth. The rest diverts into financial markets producing price bubbles and requiring still more debt to rollover and refinance the rising levels of old debt."

Chapter 10:
Yellen's Bank:
From Taper Tantrums to Trump Trade / 257

Yellen has pretty much followed Bernanke's policies. Although quantitative easing may have ended at some point, the Fed continues to use other tools to inject liquidity into the economy.

Rasmus says very directly that this is a conscious gift to the wealthy financial interests at the cost of everybody else, especially savers and pensioners. The money flows to corporations which pay generous dividends and conduct stock buybacks that favor the financial classes. Interest rates are so low that pension funds cannot make a decent return by buying bonds and by keeping money in banks. They too must reach for yield by buying overpriced stocks. It is unsustainable. The inequalities in wealth have grown insupportable.

Rasmus concludes with Yellen's five challenges:
"1) how to raise interest rates, should the economy expand in 2017-18, without provoking undue opposition by investors and corporations now addicted to low rates; 2) how to begin selling off its $4.5 trillion balance sheet without spiking rates, slowing the US economy, and sending EMEs into a tailspin; 3) how to conduct bank supervision as Congress dismantles the 2010 Dodd-Frank Banking Regulation Act; 4) how to ensure a 'monetary policy first' regime continues despite a re-emergence of fiscal policy in the form of infrastructure spending; and 5) how to develop new tools for lender of last resort purposes in anticipation of the next financial crisis."

There are not, obviously, clear answers to any of these. The Fed has painted itself into a corner with no apparent exit.

Chapter 11:
Why Central Banks Fail / 287

"But the new function of ensuring financial stability is something of a misnomer. The fundamental means by which central banks today attempt to stabilize the banking system is by permanently subsidizing it."

Rasmus has earlier said that the quantity theory of money, the idea that increasing the money supply will lead to inflation, has been repeatedly disproven. Others such as Kenneth Rogoff and Carmen Reinhart would say that it is only being held in abeyance and will come back with a vengeance when excessive injection of liquidity finally topples the institutions.

Rasmus writes that" Therefore, if discussions on central banking in the 21st century are to address new functions, this one should be more accurately termed the subsidization of the banking system by virtually free money enabled by central banks' chronic and massive liquidity provisioning." Rasmus says that this subsidization function started in the 1970s.

The most important development, per Rasmus, is the capture first by Citibank and then by Goldman Sachs of all of the key appointed positions in the Bush, Obama, and Trump administrations. How else, Rasmus asked, can one explain the fact that the Federal Reserve has continued massive liquidity injections for seven years after this last crisis was wound up in 2010? Only for the benefit of the banks.

Rasmus provides two lists of reasons central banks fail: excuses, and real reasons.

The excuses include

- too much discretion; no monetary rule.
- Fiscal policy and the gates monetary policy. I, the reviewer, add the there is no discussion of the immense government deficits anywhere in this work. That would be a function of fiscal policy.
- Banks become bottlenecks to lending. The monetarist theory is that if you increase the money supply you will get lending. Wrong. The banks may simply sit on the money.
- Wrong targets: 2% growth in what?
- dual mandate: which is it? Prices, inflation, or employment?
- Global savings glut – those damned foreigners
- the need for new tools
- government influence with central-bank independence

Rasmus list of real reasons central banks fail is as follows. Enlisting them, Rasmus is offering the conclusion that the central banks have failed. As he has so elaborately described, they have failed in their assigned missions. But they, and the countries they represent, are still in place. As institutions they have survived. This is therefore our list of reasons why they haven't been effective in their assigned role.

- Mismanaging money supply and serving as a reactionary lender of last resort
- fragmented and feeling banking supervision
- the inability to achieve 2% price stability. The problem is persistent deflation.
- The failure to address financial asset price inflation
- declining influence of interest rates on real investment
- central-bank policies and the redirection of investment to financial assets
- monetary tools: declining effects and rising contradictions
- victims of their own ideology: Taylor rules, Phillips curves, and NIRP's. It doesn't work like the book says. Rasmus: "central bankers may be victims of their own false ideological notions, just as politicians and government bureaucrats may be. The Taylor rule maintains that central banks should not pursue policies that attempt to adapt or respond to economic business cycles."

Rasmus concludes that central banking has been failing to perform even its own presumed functions, targets and tools. They have not adapted or changed keep up with global developments. Monetary policy is a path to yet more financial and economic stability.

Conclusion:
Revolutionizing Central Banking in the Public Interest:
Embedding Change Via Constitutional Amendment / 323

This final chapter is in the form of a constitutional amendment to democratize the function of the federal reserve. It would give the general public the power to select the leadership. It would require that the Federal Reserve, and its lender of last resort function, ensure that liquidity flowed to the real economy rather than financial assets. It provides for consistent banking supervision by parties not connected to the banks themselves.

The amendment does not address related problems. It makes no mention of fiscal policy, chronic government debts. The federal reserve has the power both to redistribute money within the economy, which Rasmus rightly says that it does, favoring the financial interests. It also has the power to create money that the government needs to offset budget deficits, currently running between $500 million and $1 billion.

The national debt, standing at $20 trillion, requires $400 billion per year just to service. The government debt is about equal to GDP in the United States; unsupportable, but better than Europe, England, China or Japan. None of these would be able to withstand a significant increase in interest rates.

The book does not address the question of demographics. The demographics in the United States are terrible, with the rising generations barely keeping up in numbers with those who are retiring. This is not to even to mention its composition. There is a question of whether the current rising generation, 50% made up of disadvantaged minorities, will have the same productivity as the retirees it replaces.

The demographics in China, Japan, England and Europe are worse. They all have inverted population pyramids. Supporting the promised pension and healthcare benefits will require more tax income from fewer taxpayers. Printing money will not do the trick; at some time the printed money has to be recognized as being increasingly less valuable. Inflation has to kick in and the real economy, just as Rasmus documents that it has in the financial economy.