The Lords of Easy Money- How the Federal Reserve Broke the American Economy
Christopher Leonard and Christopher Leonard

This is a useful, informative book from Christopher Leonard, an establishment writer (New York Times, Bloomberg Businessweek, Time). He takes a swipe at the Donald every time he can. On the other hand, he does not have much at all to say about Obama and Biden. He takes government statistics at face value. With regard to unemployment and inflation rates, he cites official government figures. He has not heard of John Williams' Shadow Government Statistics.

He accepts the story of Covid – that all of the reported infections were real, the deaths attributable to Covid, and that it was a natural disease. He doesn't question the people behind it. The book contains no mention whatsoever of the World Economic Forum, Bill Gates, Anthony Fauci or anything like that. His focus is the Federal Reserve, and its interaction with the executive and legislative branches. The book's concluding paragraphs reflect the book's narrow scope:

> *In many important ways, the financial crash of 2008 had never ended. It was a long crash that crippled the economy for years. The problems that caused it went almost entirely unsolved. And this financial crash was compounded by a long crash in the strength of America's democratic institutions. When America relied on the Federal Reserve to address its economic problems, it relied on a deeply flawed tool. All the Fed's money only widened the distance between America's winners and losers and laid the foundation for more instability. This fragile financial system was wrecked by the pandemic and in response the Fed created yet more new money, amplifying the earlier distortions. The long crash of 2008 had evolved into the long crash of 2020. The bills had yet to be paid.*

His historical scope covers the experience of Tom Hoenig, who started his career during Arthur Burns' chairmanship. He rose to lead the Kansas City Fed during Paul Volker's tenure, personally delivering the bad news to countless small banks that they were insolvent and had to fold. The inflation that Volker fought, and the destruction attendant to controlling it, had been brought on by the Fed's easy money policies.

The theme of short-term thinking permeates the book. Politicians don't look past the next election. The Federal Reserve is structured to facilitate long-term thinking. Hoenig became one of the few who hewed to this founding vision. One willing to make decisions that, though painful, were beneficial in the long term. He was thwarted at every turn.

Leonard does not address the fact that the world situation is in constantly change. Other countries have become more competitive, which naturally brought America down. Our commitment to equality led us to provide universal health care, which redistributed resources. It led to changes in our education system, making it more expensive and shifting the focus from the most to the least talented students. Changing intellectual currents led a substantial fraction of the population – the more intelligent fraction – to embrace non-traditional, non-reproductive outlets for their sexuality.

As a result, the whole society shortened its planning horizon. No longer multi-generational, and no longer concerned with retirement, the focus turned to current health and consumption. Leonard might have mentioned, though he didn't, that the changes he chronicles were the product of societal evolution.

Leonard delves deeply into the backgrounds of only three of his subjects. Jay Powell was born into the upper layers of the American meritocracy. Tom Hoenig was a bright son of a prosperous small businessman. John Feltner was a working man from the middle middle class. These multi-generation sons of Christian European immigrants are so typical as to be atypical. Each possessed Max Weber's Protestant work ethic and some of the Protestant sense of moral responsibility to society.

As reflected by the makeup of the Federal Reserve, such people were already becoming a minority among America's governing class during Hoenig's ascent. The government had turned its attention to assisting people whose culture was not as strong in these characteristics. Achieving equity was an increasingly difficult goal for society's leaders, both in government and the Federal Reserve. The Fed's tools – money supply and interest rates – were applied to problems they were neither designed nor adequate to solve.

The New Deal, which predates Hoenig but set the backdrop, brought major changes. Corporate and union pension plans promised support in old age, something that was previously managed by a combination of private savings, family support and shorter lifespans. Social Security evolved from an income supplement to total support. Medicare appeared early in his career. Simultaneously, college ceased being optional and, largely through the availability of student loans, vastly more expensive.

Though Leonard does not describe these societal changes, he does offer a very good discussion of the net effect. Vast pools of money accumulated. There were yield targets established for the ways in which they were invested. When T-bills yielded 4% interest, a money manager could very safely satisfy the income requirement. But – the Fed had strong incentives to reduce that yield.

Part of the Fed's charter is to maintain close to full employment. This is most easily done in an expanding economy. And, economies expand when interest rates are low – money is cheap. Politicians constantly schemed to get the Fed to expand the money supply and push interest rates down.

This put the investment managers in a vice. When T-bill returns fell towards zero – they eventually got there - managers were deprived of safe investments with adequate returns. They were forced to become speculators. They financed oil wells, fracking, commercial and residential real estate, and dot com startups. Since asset prices are inversely related to cash flow, and it took only a few percentage points return to beat T-bills, asset prices zoomed. There was so much money chasing opportunity that due diligence was forgotten. Liar loans, NINJA loans (no income, no job, no assets) became widespread. When the Fed raised interest rates just a little, investors in these exotic products got skittish. At times (viz, 2008) things crashed when they all felt a need to liquidate at once.

One of the lessons Leonard emphasizes is that nothing is temporary. Every accommodation that the Fed implemented soon became permanent. The public, in particular Wall Street traders came to expect that they would be saved every time. So far they have been mostly right. Hoenig warned early in his tenure that "We will chase an open-ended commitment, I think" he said. "The Federal Reserve doesn't have a good track record of withdrawing policy accommodation in a timely manner, no matter how much we say we will." Here follows Leonard's list of such accommodations.

President Johnson in the 1960s wanted both guns and butter. Federal borrowing and deficits went up. There was inflation in both assets and commodities caused by the Fed's easy money policies. It spiraled upward throughout the 1970s. Paul Volker chose to clean it up. The turmoil, the pain was more than he or anybody else expected, but he did curb inflation. And, he was the last Fed Chair with such courage.

The Fed put more accommodative policies in place in response to the dot-com bubble bursting in 2000, and again with the subprime mortgage meltdown in 2008. These involved huge bailouts of the banks. Some money was repaid, much was not.

The Fed puts money into the economy by buying T-Bills, crediting their 24 primary dealers. They carry the T-Bills on their balance sheet. The number was less than 900 billion in 2008. After bouts of quantitative easing it is now in excess of 8 trillion.

The banks have to deploy the money they receive selling T-Bills. Flooded with money, they loan it at increasingly small rates of interest to get rid of it. They invest it in more speculative ventures. It creates asset bubbles.

Under Bernanke, post 2008, the Fed and Treasury jointly set up SPVs, Special Purpose Vehicles, authorized to purchase other classes of assets such as corporate bonds. Other central banks do likewise; the government of Japan thus owns a large share of Japanese industry. The US government owned a large share of GM after 2008.

It raises a question that Leonard does not address. How does the government vote its shares of a company? How much does it influence corporate governance? Government ownership of the means of production was a characteristic of communism and fascism. How is this different?

The $2 trillion CARES act passed at the height of Covid included stimulus checks for individuals, money intended for small business (though not much got there) and huge amounts for banks and big corporations.

The Fed is not involved in all forms of stimulus. They have nothing to do with the plan to put money into consumers' hands by forgiving parts of the $1.75 trillion of student debt held by the government. The similarity is in the fact that it reduces government income, eventually forcing the government to expand the debt and diminishing the value of the dollar.

Leonard believes the Fed is necessary. His argument against the gold standard is:

> "The gold supply was influenced by geological factors that had nothing to do with monetary policy, for instance. The discovery of a big new gold mine in Alaska could randomly increase the money supply. This helps explain why the gold-standard era was characterized by bank panics, long bouts of deflation, and periodic depressions. Also, for the gold standard to work, nations need to accept punishing bouts of deflation at times, which very few are willing to do."

He is right about deflation and depressions as corrections to heedless expansion, wrong about overall supply. The world's gold reserves are well researched. Another mother lode like Peru in the 1500s or California in 1848 is highly improbable. He does not mention Bitcoin.

This establishment book is a good counterweight to the anti-Fed [[ASIN:091298645X The Creature from Jekyll Island: A Second Look at the Federal Reserve]] and [[ASIN:0979917654 The Secrets of the Federal

Reserve]]. It should be read along with Reinhart and Rogoff's [[ASIN:0691152640 This Time Is Different: Eight Centuries of Financial Folly]] coming out of Harvard and Princeton.

Other books on the more conservative end of things are Jack Rasmus' [[ASIN:0986085391 Central Bankers at the End of Their Rope?: Monetary Policy and the Coming Depression]] and James Rickard's [[ASIN:1591846706 The Death of Money: The Coming Collapse of the International Monetary System]].

The amazing thing is that the magicians at the Fed and in the government have staved off collapse as long as they have, and gotten away with the amazingly brazen things involved in doing so. Few would have believed it possible. I fully expect that the pessimistic authors listed above will be proven right, but we all have been wrong about the timeframe.

In conclusion, this book is worth reading because it is contemporary, and for its good descriptions of how it operates and the limits on the Federal Reserve.