

Khurratul-ain naseer

Finance



Khurratul-Ain Naseer English 161 Dr. Parr 03/04/12 The Federal Reserve The economical flush down the toilet had the whole nation pointing fingers at each other to whose fault it was, which sooner or later ended up pointing to the Federal Reserve Bank system. The way quantitative easing (QE) was handled by the Federal Reserve planted a seed of doubt in the welfare of the economy, with the almost to be second Great Depression. Convincing articles such as Financial Innovation and the Fed, The Case for Auditing the Federal Reserve Bank Is Obvious, and Fed Under Fire have been written towards this the topic of quantitative easing by influential authors in respect to how the bank decisions should be treated by the majority of the population. Arnold Kling, a scholar for the Cato Institute, explained that the Federal Reserve has importantly changed the procedures and goals it had for a long time. Kling is pushing for an audit of the Fed to help him gain a clearer picture in understanding why QE is used the way it is. The Federal Reserve has " more than doubled its balance sheet, paid interest to banks on reserves held as deposits with the fed... invested in assets that expose taxpayers to large losses" (Kling). Now, with that much money being on stake, it seems like the best idea would be to manuscript each and every step taken by the Fed. However, there seems to be a lot of opposition towards the audit bill in Congress, so it might be a harder goal to achieve than originally planned. In Kling's article, it states the audit opponents' concern of political pressure influencing the bank, knowing that the larger question at hand is its change from the standard procedures. Government Accountability Office (GAO) is a bodily organization that undertakes investigations for the Congress, the case of auditing being one of them; it has the authority to conduct operations and functions of the Federal

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Reserve. The Congress also " recently granted the GAO new authority to conduct audits... including loan facilities... created for American International Group (AIG) and Bear Stearns...,[and also] Term Asset-Backed Securities Loan Facility (TALF) program, which uses funds from the Troubled Assets Relief Program" (Kling). At first going through this, it seems as if Congress had just handed over all auditing power to the GAO, and while above the surface it may seem true, that is not entirely the case. The power to oversee certain areas such as open market and discount window operations has not been given to GAO in order to provide an equilibrium platform to present public accountability to the Fed. Further on, a petition signed by numerous prominent economists challenges its means to keep away political pressure from the Federal Reserve in making its monetary policy decisions while having three risks being contained (Kling). Conversely, Arnold Kling's reaction to such monetary policy decisions is its banking misinformation. Kling believes that the audit process should focus on the decisions made in order to see if the Federal Reserve approached the crisis correctly, including the assessment on how the fed staff gathered the information, how this information was presented to policyholders, and what considerations drove the choices that were made. The Federal Reserve collects majority of the information it has from the banks themselves, so there is absolutely no hesitation for the banks to present twisted figures and give a false sense of profit. An audit should be pushed for in order to straighten out and let the world see for itself whether the decisions made by the Federal Reserve were for the betterment of the shareholders, or for the economy as a whole. In Fed Under Fire article in the Economist, written by an unspecified author, it clearly states that " political attacks on America's central bank are

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misguided" (Economist). When this article was written, just about a month before hand, the Federal Reserve started another round of quantitative easing, and this decision is strongly opposed by Republicans and the Chinese government. The Republicans believed the QE is causing inflation and high bubbles, and seemed to strive for only one main goal: price stability. The author feels as if the criticism towards this policy has no real logic behind for support and is mainly motivated by beliefs; for this exact reason, the policy of QE deserves a closer look. A very common mishap in this field of policy is what exactly QE does, how it is used, and when it is used. Well, for starters, QE has the same logic that a standard monetary procedure would have; although, during the usual tendency of the economical market, it's much simpler to obtain short term bonds by printing money while profiting from high interest rates. On the other hand, when the economy is going down the drain, buying long term government bonds are more suited. It is said that countries with a less forceful monetary procedure are highly likely to end up in a weak exchange rate problem; however, a powerful country such as China is yet an example of currency manipulation, accumulating "\$2. 65 trillion of reserves to stop its exchange rate rising, while trying to keep a lid on inflation" (Economist). Another worrisome doubt the QE has raised is that it might not even work at all, bringing the economy back to square one. In fact, the effect might just be the opposite of what is expected and snowball into a bigger problem to solve. The unidentified author argues that even if QE doesn't do the job it was meant to do, bringing politics into the Federal Reserve with its pressure and criticism is bound to weaken it. From a President himself, of Federal Reserve Bank in Minneapolis, Gary H. Stern, discusses two main phenomenas in Financial Innovation and the Fed. His first <https://assignbuster.com/khurratul-ain-naseer/>

concern was the "heightened competition in the domestic financial environment, as evidenced by a proliferation of institutions, instruments and new markets" (Stern). What Stern means by this observable trend is that while this growth of competition has resulted in the growth of customer service, it also took risk-taking to a whole new level. In fact, Fannie Mae had made the same mistake of risk-taking when they saw that the government had backed them up with taxpayers' money; coming to think of it, it was a much safer risk than the ones being taken now. Also, Stern feels that the growth of competition has intimidated the commercial banks in the process. As commercial banks started to feel less and less important, they started implementing the same risk-taking techniques the big corporations have in the past years, as a way to catch up with the rest of the world in the financial system. Gary Stern's second phenomenon was "the growing global integration of financial markets" (Stern). Globalization allows for a better global response to the different financial flows. His reaction towards this phenomenon was positive for the most part in trying to explain the capital flow all across the nations, but there still lies the efficiency of the Federal Reserve's monetary policy. With the instability of interest rates, debate between the long term interest rates compared to the short term rates, there is only so much that can be kept track of. Stern argues that looking back at the past few decades, the Federal Reserve bank seems to have done its' job well but as to what the future holds, there is no certainty it will continue to do so. Reading all three articles put me in a different state of mind with a different set opinion for each argument; one thing that I know I can agree with is that political pressure is bound to fail whatever it enters. However, the gray line can be drawn in this as well to show that when pressure isn't

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applied, work seems to be put on hold and crucial details can go unnoticed. I believe that in auditing the Federal Reserve, it will help put certain perspectives in place in understanding the steps and course of action the Fed took in what happened. Also, agreeing with Kling on the banking misinformation, I feel the need to specifically have the audit process look into how reliable the banking information they received was. Having an audit would mean keeping an eye on the Fed in order to avoid any type of 'shady' dealings that were happening with shareholders of major corporations, and it would be working for the interests of the economy as a whole. Works Cited " Fed Under Fire." Economist. 15 Nov. 2010. 18-21. Academic Search Premier. Web. 2 Jan. 2012. Kling, Arnold. " The Case for Auditing the Federal Reserve Bank Is Obvious. " USA Today Magazine, Jul 2010: 16. Academic Search Premier. Web. 2 Jan. 2012. Stern, Gary H. " Financial Innovation And The Fed." Region. June 2007: 2-4. Academic Search Premier. Web. 2 Jan. 2012