

THE SOUND DOLLAR ACT

KEVIN BRADY'S SOUND DOLLAR ACT (H.R. ____)

Ensuring the 21st Century is Another American Century Should Be Congress's Top Priority.

Hardworking Americans deserve another American century. There is no reason for America to take a backseat to China or any nation as the world's economic superpower. Congress's role in the effort is clear—it can either lay the policy foundation for, or create hurdles against, achieving economic prosperity.

Both monetary policy and fiscal/regulatory policy contribute to the economic foundation necessary for hard working Americans to succeed. Monetary policy can achieve stable prices over the long term, but it cannot boost growth in employment except in short, temporary spurts. On the other hand, fiscal/ regulatory policy affects both short- and long-term economic growth and job creation.

As for monetary policy, the American experience from the First Bank in 1791 to the modern Fed is that the economy flourishes when the central bank, managed by competent individuals, operates independently with a rules-based approach. Yet Congress does play a role in setting the Fed's policy direction, and then it should get out of the way. For too long, Congress has abdicated its responsibility of ensuring that the Fed's mandate properly reflects the lessons of history while building toward the future. The Sound Dollar Act (SDA) would remedy this.

The Sound Dollar Act reforms the Fed. Policy changes in the bill's titles are described below.

(I) SINGLE MANDATE FOR PRICE STABILITY ACT

- SDA replaces the Fed's dual mandate with a single mandate for achieving price stability and requires the Fed to use inflation targeting to achieve stable prices.

Stable prices and predictable policy are the cornerstones for prosperity. While the Fed has operated under a dual-mandate of price stability and full employment since 1977, in practice during the Great Moderation (1983-2000) when the nation experienced two long economic booms, the Fed functioned as though it had a single mandate for achieving price stability. In fact, the Federal Open Market Committee (FOMC) had never mentioned full employment in their monetary policy statement until December 2008.

Price stability is key to growth and jobs because it encourages employers to invest and create jobs; this is more difficult with inflation or deflation. As the FOMC moved from a rules-based to a more interventionist approach, by keeping interest rates too low for too long from 2002 to 2005, the housing bubble ballooned; and more recent interventionist efforts to boost employment 'now'—such as quantitative easing—are by nature short term and may inadvertently harm long-term economic growth and job creation. Thus the country, and even employment, would be better served if the Fed adopted a single price stability mandate. Of 47 major countries, the U.S. is one of only 2 countries that do not have a single mandate for price stability or a primary mandate for price stability with other mandates clearly subordinate to price stability.

- SDA requires the Fed to monitor a broad range of assets—beyond goods and services—including gold and the foreign exchange value of the dollar, in order to avoid future asset bubbles.

Monitoring asset prices will help the Fed to identify incipient price bubbles before they inflate. How to address bubbles would depend upon circumstances and be left to the discretion of the Fed.

(II) FINANCIAL STABILITY AND MORAL HAZARD MITIGATION ACT

- SDA requires the Fed to articulate its lender-of-last-resort (LOLR) policy.

The Fed serves as LOLR to the U.S. banking system—preventing unnecessary failures of solvent but illiquid institutions; limiting the spread of financial contagion; and minimizing the impact of financial crises on the

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economy. Yet, the Fed's failure to articulate a LOLR policy in its 100-year history has created uncertainty—such as during the 2008 financial crisis when the Fed bailed out Bear Stearns, but allowed Lehman Brothers to fail. Having the Fed formally articulate its LOLR policy would increase economic certainty; decrease instances of financially-distressed firms seeking political solutions; and reduce moral hazard from firms taking excessive risks based on faulty assumptions that the Fed will bail them out.

(III) DIVERSIFYING THE FEDERAL OPEN MARKET COMMITTEE TO REFLECT A 21ST CENTURY ECONOMY ACT

- SDA would extend permanent FOMC voting membership to all regional Federal Reserve Bank Presidents.

Existing FOMC membership—7 from the Board; the President of the New York Fed; and 4 of the 11 non-New York regional bank presidents—gives too much decision-making authority to Washington and New York, limiting the influence of those from different geographic and professional backgrounds. Permanent voting membership should be extended to all 12 Federal Reserve Bank Presidents from across the country.

(IV) DEMYSTIFICATION OF MONETARY POLICY DECISIONS ACT

- SDA provides for the Fed to release its meeting transcripts within 3 years, to increase transparency.

FOMC transcripts can be released earlier without compromising the integrity of the Fed's decision making process, and this will help market participants to make better informed decisions.

(V) EXCHANGE RATE RESPONSIBILITY ACT

- SDA has the Fed report on the impact of FOMC policies on the exchange rate value of the U.S. dollar.

The Fed controls the supply of U.S. dollars, which is a major factor affecting the foreign exchange rate value of the dollar. Thus, the Fed should report to Congress on the impact of its policies.

- SDA renames the Exchange Stabilization Fund (ESF) the Special Drawing Rights (SDR) Fund, and liquidates other non-SDR assets in the ESF, with proceeds going to reduce the public debt.

The ESF has become a slush fund for the Treasury, used for purposes not envisioned by Congress. The ESF should be converted to an SDR-only fund (holding the SDR's provided by the IMF to the U.S.), with other non-SDR assets in the fund being liquidated with proceeds going to reduce the public debt.

(VI) CREDIT ALLOCATION NEUTRALITY ACT

- SDA would allow the Fed to invest only in Treasuries, repos and reverse repos, except during emergencies.

The FOMC should not be picking winners and losers through the allocation of credit among households, firms and sectors of the economy, but rather should normally invest solely in U.S. government securities, unless an emergency necessitates the Fed temporarily bringing other assets onto its books. However, following a board-certified emergency, such non-Treasury assets should be liquidated as soon as possible.

(VII) BUREAU OF CONSUMER FINANCIAL PROTECTION FUNDING ACT

- SDA requires the Consumer Financial Protection Bureau (CFPB) to be funded through regular appropriations.

The CFPB, established under Dodd-Frank, is currently funded through an unaccountable stream of funding from the Fed. This is inappropriate as the CFPB should be subject to the same Congressional oversight as other Federal agencies. Thus, SDA remedies this situation by requiring the CFPB to come before Congress as do other Federal agencies in order to receive funding.