JOHN TAMNY

Who Needs the Fed?

WHAT TAYLOR SWIFT, UBER, AND ROBOTS TELL US ABOUT MONEY, CREDIT, AND WHY WE SHOULD ABOLISH AMERICA'S CENTRAL BANK

Understanding credit is key to understanding the economy and why the Fed is so totally backwards.

Today, the Federal Reserve is among the most disliked entities in the United States, having joined the IRS as the object of heaving electoral hatred. Americans despise the Fed, but if they are honest they are also a bit confused about why they so loathe our central bank or about what the Fed actually does—and, if they are really honest, how banking and credit work in the first place.

The truth is, credit is not a difficult concept to understand if explained clearly and simply. And understanding credit is key to understanding the economy and why the Fed and its most famous function—setting the interest rate—is so totally backwards.

With the help of Taylor Swift, Uber, Donald Trump, Michigan coach Jim Harbaugh, and robots, *Who Needs the Fed?* explains credit, how it works, and how our misunderstanding of credit and money has given the Fed power that it can't possibly use wisely.

Who Needs the Fed? is an everyman's case against the Fed that will leave readers enlightened, entertained and, above all, prepared to explain why the Fed is happily inconsequential on its best days, while perilous on its worst.

"John Tamny [is] a one-man antidote to economic obfuscation and mystification."

—GEORGE F. WILL

Who Needs the Fed?

REVEALS

Despite the Fed's efforts to render credit cheap, market actors happily ignore its confused efforts.

How robots will be the biggest credit creators in history, and will eventually make an increasingly irrelevant Fed even more irrelevant.

WHY DONALD TRUMP HAS FOR DECADES BEEN A HORRIBLE CREDIT RISK.

How Uber's "surge pricing" model for transporting its customers is infinitely better than the Fed's attempt to set the cost of credit.

Why, despite what we're told, the Fed cannot increase money supply or credit.

...AND A GREAT DEAL MORE.

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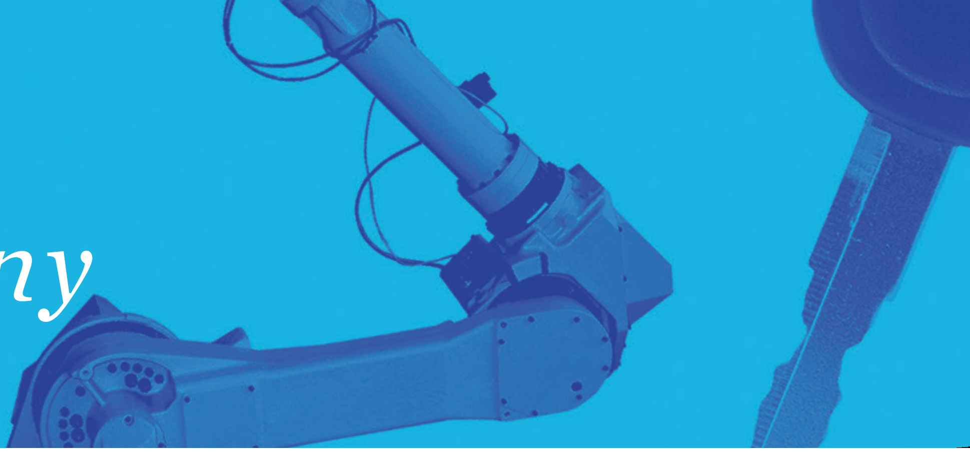
ABOUT THE AUTHOR

John Tamny



John Tamny is the Political Economy editor at Forbes, editor of RealClearMarkets, a senior economic adviser to Toreador Research & Trading, and a senior economic fellow at Reason Foundation.

He is a weekly panelist on *Forbes on Fox*, and his columns have appeared in the *Wall Street Journal*, *Investor's Business Daily*, *National Review*, the *Financial Times*, and London's *Daily Telegraph*. His first book was *Popular Economics: What the Rolling Stones, Downton Abbey, and LeBron James Can Teach You about Economics*.

PRAISE FOR JOHN TAMNY

"John Tamny [is] a one-man antidote to economic obfuscation and mystification."

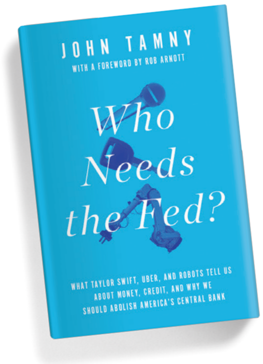
—GEORGE F. WILL

"Tamny is a brilliant and insightful writer whose provocative style will stretch your intellectual bandwidth and force you to see the world in a new way."

—ANTHONY SCARAMUCCI, HOST OF "WALL STREET WEEK"

PRAISE FOR

Who Needs the Fed?



"Like a blazing sun melting away a dangerously thick fog, this delightfully written, well-argued, and insightful book clears away disastrous misconceptions about money, credit, and the operations of the Federal Reserve. It will become one of the most enormously—and positively—influential treatises of our time." –STEVE FORBES, EDITOR-IN-CHIEF, FORBES MEDIA

"John Tamny makes a strong case that the Fed never had as much influence as either its supporters hoped or its critics feared—and that what power it had in the past is today fast diminishing. In the process, he offers iconoclastic dismissals of popular macroeconomic constructs including money supply, the multiplier, the Phillips curve, the Laffer curve, banks, stimulus, and quantitative easing."

–CLIFF ASNESS, FOUNDING PRINCIPAL, AQR CAPITAL MANAGEMENT

In the best tradition of Henry Hazlitt and Robert Bartley, Tamny's book offers a provocative yet principled new look at the role of credit in today's economy. Properly equating "credit" with an economy's resources, Tamny systematically debunks the case for government or central bank efforts to increase credit."

–DAVID RESLER, FORMER CHIEF ECONOMIST, NOMURA SECURITIES

"John Tamny has written an easy-to-read and crucial-to-know overview of the Federal Reserve today, showing how the well-intentioned actions of central bankers in fact hurt our long-term economic potential. *Who Needs the Fed?* is an outstanding work of contrarian common sense—a must read."

–TOM ADAMS, FORMER CEO OF ROSETTA STONE, CEO, WORKAROUND LLC

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AN INTERVIEW WITH

John Tamny

"IN FIGHTING RECESSIONS THE FED RESTRAINS OUR ABILITY TO FIX WHAT'S HOLDING US DOWN."

What do most people get wrong about the Federal Reserve?

TAMNY: That it can increase or shrink credit with its interest rate. It can do no such thing. When we seek credit we seek access to real economic resources: think trucks, tractors, computers, desks, chairs, and most of all, labor. The Fed can't increase or shrink access to any of those. With its rate meddling it can only distort who gets access to the resources.

How is the Fed a barrier to prosperity?

TAMNY: For one, its rate meddling to some degree distorts the natural flow of credit to its most prosperous use. Central planning doesn't work. Second, the Fed has given itself the role of recession fighter. The problem there is that recessions, *when left alone*, signal the raging economic boom on the way simply because recessions are an economy's way of cleansing itself of all the misuses of labor and lousy companies holding the economy down. Without recessions, we can't have growth. I use sports a lot in the book to explain this. If not for Mike Shula's recession, Nick Saban wouldn't be head coach of Alabama. Recessions are how we fix what we're doing wrong, so in fighting recessions the Fed restrains our ability to fix what's holding us down.

What are the biggest misconceptions about credit and money?

TAMNY: That credit and money are one and the same. They aren't. If credit were money, Haiti and Honduras would have as much credit to access as the U.S. and Japan. In truth, when we borrow "money" we're not borrowing dollars as much as we're borrowing trucks, tractors, desks, chairs, computers, and labor. That's credit, and that's why if we destroyed every dollar in the world today, the U.S. would still be the richest country in the world tomorrow. If this were better understood, monetary authorities would cease tinkering with the value of the dollar and creating dollars as though doing so is the same as creating wealth.

> "If we destroyed every dollar in the world today, the U.S. would still be the richest country in the world tomorrow."

What is a simple way to understand interest rates?

TAMNY: An interest rate is simply a price. Nothing more. It is a price meant to bring together savers with borrowers. Just as McDonald's sets the price of its French fries to attract consumers of that product, interest rates are set in markets to maximize the needs of both savers and borrowers. The Fed thinks it can make credit "easy" by decreeing a low rate of interest. That's like saying Ferraris will be plentiful if we decree them to cost $10,000. There will be lots of demand, but no supply. Interest rates are simply a price signal set in markets to ensure savers are rewarded so that borrowers can borrow.

What does Taylor Swift's battle with Apple Music tell us about "easy credit"?

TAMNY: Taylor Swift is a reminder that "easy credit" is a function of a happy buyer *and* a happy seller. Apple initially offered its music streaming service to its customers for free. Such a move was great for Apple, but what about all the musicians whose music would be given away for free? Apple forgot what the Fed always forgets; that easy credit requires the buyer and seller to both be happy. Since Apple ignored the powerful seller in Swift, there was going to be no "easy" access to her new album, *1989*.

CONTINUE READING ON REVERSE →

In fact, Apple Music customers wouldn't get to stream her music at all unless they compensated all musicians for streaming their music. It was a great lesson in credit. Swift herself is the personification of "easy credit" simply because she could give up every worldly possession she has, every dollar in every account, yet she could walk into any bank in the world right after and access millions. *Taylor Swift* is the credit, her work ethic and song writing are the credit.

The Fed presumes to decree access to something as "easy," but it quite simply can't. Credit is earned. It's reputation. It can't be legislated. We alone create access to the economy's resources.

"Taylor Swift is the credit, her work ethic and song writing are the credit."

Why does price regulation lead to scarcity?

TAMNY: Price controls are meant to please the buyer, but buyer satisfaction is solely a function of the seller being happy. For years New York City imposed rent controls to please renters, but renters ultimately lost simply because the controls on rental prices limited supply. The Fed decrees a low rate of interest in the way that NYC decreed cheap apartment rents. The correct way is the Uber way. Precisely because it fulfills the needs of sellers (its drivers) through the imposition of surge pricing, its buyers win because cars are always plentiful when we need them. Prices are the market "regulation" that ensure everyone is happy.

Can the Fed increase the money supply and therefore increase credit?

TAMNY: Imagine trying this in Baltimore. Any increase of dollars in Baltimore's banking system would vanish as quickly as it arrived. Money is a means to accessing credit, and it goes to where it's treated best. Light economic activity in Baltimore means there's very little production that merits lending. Conversely, no amount of Fed tinkering could prevent loanable funds from reaching, say, Silicon Valley. The Fed could drain the Valley's banks and VC funds tomorrow of all their dollars, but the money would return almost instantaneously. Silicon Valley is a magnet for investment and the Fed could never restrain or blunt that truth.

"Any increase of dollars in Baltimore's banking system would vanish as quickly as it arrived."

What do the supply-siders and Hillary Clinton have in common?

TAMNY: Hillary Clinton's wealth and power, along with her husband's, is to a high degree a function of their ability to influence the biggest-spending government in the world. Their swagger is not their own. Supply-siders correctly pursue tax cuts, but they literally brag that revenues to the government will soar in response to the cuts. They've ignored that government spending is a tax that neuters the genius of tax cuts, and in the process they've empowered people like Hillary Clinton. Supply-siders have missed the essential truth that government spending reductions are arguably more effective tax cuts than actual reductions in tax rates.

How is a potential Trump presidency so dangerous to the US economy?

TAMNY: Trump seeks major barriers to imports, yet imports are the source of our wealth. An economy is just a collection of individuals. As that, are we better off when the whole world wants to serve our needs? Without question.

Trade means we can do the work that most animates our talents. If we can "import" from across the world, at home we can focus on what we're good at. As a result we're more productive. Trump would seek to deaden what is the source of our vitality.

You suggest that the robot will be the biggest job creator in world history. Can you explain?

TAMNY: What is economic growth? It is the process whereby we make redundant the work that used to be necessary. Think how much more productive we are today thanks to "robots" like dishwashers, cars, computers, internet, ATMs, and other labor-saving devices. Robots ensure that even more work will be taken off our plates so that we can focus on what makes us most productive. Also, remember that credit is resources. Robots will author a resource surge that will redound to entrepreneurs and businesses. Neither can grow or create jobs without credit, and robots ensure a great deal more. The future is very bright!

AN EXCERPT FROM WHO NEEDS THE FED?

Did You Hear the One about Donald Trump Going into a Bank?

> "It's difficult to tell how easily Trump could get a loan today."

IN MANY WAYS, Donald Trump is best known today for his high-profile 2016 run for the office of president of the United States. But back in the 1980s, Trump was most famous for his skills in the area of property development. Those skills made him very rich. Trump's unapologetic advertisement of his great wealth helped fuel their misplaced disgust.

Notable about Trump, and this shouldn't be read as a pejorative, is that his accounting of his net worth was not necessarily how others perceived it. More to the point, Trump and those from whom he wanted to borrow did not share the perception of his creditworthiness.

I can't repeat enough that for every borrower there is a saver. Furthermore, when an individual borrows "money," he is not seeking dollars so much as pursuing the economic resources (credit) that dollars can command in the marketplace. In Trump's case, he sought credit in the late 1980s in order to fund the revival of the Ambassador Hotel in Los Angeles.

A once grand hotel in the Wilshire District, a few miles from down- town Los Angeles, the Ambassador's notoriety then had to do with something extremely tragic. On June 6, 1968, Democratic presidential candidate Senator Robert F. Kennedy was assassinated in the kitchen of the Ambassador.

In the aftermath of the assassination both the hotel and the surrounding area fell into long-term decline. But an entrepreneur sees potential where others see failure. That's what makes the entrepreneur so central to positive economic evolution. Trump saw potential in a hotel and an area of Los Angeles that others had given up on, and he needed credit to animate his vision.

> "Trump and those from whom he wanted to borrow did not share the perception of his creditworthiness."

That's where Security Pacific Bank came into the picture. The Los Angeles–based bank was the fifth largest in the United States at the time, and Trump sought a meeting with its newly appointed CEO, Robert H. Smith.

Having recently been burned by charisma, reputation, and track record, Robert Smith was a different man when Trump visited him than he was…few years before. "When I first met with Trump he had already been heralded as a genius and seemed to be at the leading edge of everything," Smith wrote. "Trump had a Clintonesque aura around him, the effervescent divinity of a studied deal-maker, and a categorical ability to communicate and inspire the belief of others in his personal vision. He no doubt could have been an evangelist."

Trump sought a $50 million loan (Security Pacific's "house limit") for his Ambassador Hotel revitalization plan. Although Smith didn't explicitly reject Trump's request, he was skeptical. After the meeting he relayed

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Trump sought a $50 million loan (Security Pacific's "house limit") for his Ambassador Hotel revitalization plan. Although Smith didn't explicitly reject Trump's request, he was skeptical. After the meeting he relayed his misgivings to bank executives who were perhaps understandably bowled over by this most charismatic of businessmen. They wanted to figure out a way to finance Trump, given the prestige that would result from being his banker. Smith didn't budge.

And, while Trump presented a financial statement with many million dollars of net worth, the ability of him to bail even this one project out was limited—because it was leveraged on an illiquid base of questionable value."[8] Smith ultimately lamented his failure to clearly communicate his skepticism about Trump's creditworthiness. Remember, he didn't explicitly turn him down. Apparently eager to do business with The Donald, other executives within the bank secured $10 million for Trump as part of "an initial study on the feasibility of restoring the Ambassador Hotel." Smith "raised holy hell," and with good reason. The property market swooned during the early 1990s, and as Smith predicted, Trump wasn't able to make good on what he had borrowed. Smith went on to recall: "Two years later we wrote the whole thing off. It was a loss."

Fast-forward two decades, and Trump is claiming he's worth $10 billion.[10] That is certainly possible, but as Smith makes plain, value is subjective. It's also no major insight to point out that value is biased.

In Trump's defense, Trump understandably believes that the projects he's involved with or has a stake in are winners. If he didn't have an unshakeable belief in what he's doing, then it's probably safe to say he wouldn't have the net worth (or outsize reputation) he has today.

"Two years later we wrote the whole thing off. It was a loss."

While observable and empirical logic dictates that Trump's net worth is quite high (Forbes estimates $4.5 billion), the same logic should also cause us to question the $10 billion that Trump regularly cities. Naturally, Trump's valuation of his various ventures is not going to resemble outside estimates. Again, if he lacked a powerful belief in his projects, then they wouldn't be projects in the first place.

It is not possible to know what's on, or the value of, Trump's balance sheet. Yet, Smith's recall of Trump's subpar creditworthiness is another reminder of the obnoxious conceit that drives economists at the Fed to presume to set the price of access to the economy's resources. They can decree credit "easy," but banks and other sources of credit don't have to comply.

Trump can claim a net worth that would make loaning to him an apparent no brainer, and the Fed can flood banks with dollars. But banks, like any other business, would not remain in business for long if they lent in the way the Fed blindly presumes to set rates: as though we are all the same in terms of our ability to pay loans back. Accessing credit shouldn't be the same for everyone, nor is it. The cost of access is different for every individual and every business. It's difficult to tell how easily Trump could get a loan today. Still, Smith's memory of lending to him in the late 1980s is a reminder that even the banks, heavily regulated by the Fed, don't always march to the beat of the Fed's simplistic drum rhythms.

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