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Subcommittee on Monetary Policy and Trade
Committee on Financial Services
United States House of Representatives

Hearing on "The Federal Reserve's Impact on Main Street, Retirees and Savings"
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The Fed Should Be Required to Provide Congress a Regular Savers' Impact Analysis

Mr. Chairman, Ranking Member Moore and Members of the Committee,

Thank you for the opportunity to be here today. I am Alex Pollock, a senior fellow at the R Street Institute, and these are my personal views. I have spent more than four decades working in and on the banking system, including studying the role of central banks in both normal times and crises. I was president and CEO of the Federal Home Loan Bank of Chicago for 12 years, then worked on financial policy issues at the American Enterprise Institute, and moved to R Street last year.

I believe this hearing is examining a critical issue: What is the Federal Reserve doing to savers, notably including retirees?

To begin with my conclusion: Congress should require a savers' impact analysis from the Federal Reserve at each discussion of the Fed's policies and plans with the committees of jurisdiction. Under the CHOICE Act, this would be quarterly. This analysis should quantify, discuss and project for the future the effects of the Fed's policies on savings and savers, so these effects can be explicitly considered along with other relevant factors.

Savings are essential to aggregate long-term economic progress and to personal and family financial well-being and responsibility. However, the American government's policies, including those of the Federal Reserve, have subsidized and overemphasized the expansion of debt and have forgotten

savings. The old theorists of savings and loans, to their credit, were clear that "savings" came first, and made possible the "loans." Our current national policy could be described, instead of "savings and loans," as "loans and loans."

There is no doubt that among the very important effects of Federal Reserve actions from 2008 to now have been the expropriation of American savers, which has been especially painful for many retirees. This has been done through the imposition of negative real interest rates on savings during the remarkably long period of nine years, from 2008 to now. Negative real interest rates would be expected from the central bank in crisis mode, but it is a long time since that was over. The financial crisis ended in spring 2009, and the accompanying recession ended in June 2009, eight years ago. House prices bottomed in 2012—five years ago—and have reinflated rapidly. As we speak, they are back up over their bubble peak. The stock market has been on a bull run since 2009 and is at all-time highs. A logical question is: what is the Fed doing, still forcing negative real interest rates on savers at this point? The Fed should be required to explain to Congress, with quantitative specifics, what it has done, what it thinks it is doing and what it plans to do, in this respect.

Consumer price inflation year-over-year in May 2017 was 1.9 percent. The Federal Reserve endlessly announces to the world its intention to create perpetual inflation of 2 percent, which is equivalent to a plan to depreciate savings at the rate of 2 percent per year.

Against that plan, what yield are savers getting? The June 2017 Federal Deposit Insurance Corp. national interest rate report shows that the average interest rate on savings accounts is 0.06 percent. The national average money market deposit account rate is 0.12 percent, according to *Bankrate*, and the average three-month jumbo certificate of deposit 0.11 percent. Savers can do better than the averages by moving their money to the higher-yielding banks and instruments, but in no case can they get their yield up to anywhere near the inflation rate or the Fed's annual inflation target. In the wholesale secondary market, for example, 90-day Treasury bills are yielding about 1 percent. And savers have to pay income taxes even on these paltry yields, making the negative real return worse.

Thrift, prudence and self-reliance, which should be encouraged, are instead being discouraged.

The CHOICE Act would require in general that the Federal Reserve be made more accountable, as it should be. No government entity, including the Fed, should be exempt from the constitutional design of checks and balances. To whom is the Fed accountable? To the Congress, of course, which created it, can abolish or redesign it and must oversee its tremendously powerful and potentially dangerous activities in the meantime. The savers' impact analysis is fully consistent with the provisions of the bill.

The CHOICE Act would also require that new regulations provide "an assessment of how the burden imposed…will be distributed among market participants." This excellent principle should also be applied to the Fed's reports to Congress of what they are doing. In particular, the Fed has been taking money away from savers in order to give it to borrowers. This benefits borrowers in general, but notably benefits highly leveraged speculators in financial markets and real estate, since it has made financing their leverage close to free. Even more importantly, it benefits the biggest borrower of all by far—the

government itself. Expropriating savers through the Federal Reserve is a way of achieving unlegislated taxation.

By my estimate, the Federal Reserve has taken since 2008 about $2.4 trillion from savers. The specific calculation is shown in the table at the end of this testimony. The table assumes savers could invest in six-month Treasury bills, then subtracts from the average interest rate on them the inflation rate, giving the real interest rate, which on average is -1.32 percent. This rate is then compared to the normal real interest rate, based on the 50-year average, giving us the gap the Fed has created between the actual real rates to savers and the historically normal real rates. This gap, which has averaged 2.97 percent, is multiplied by the total household savings. This gives us, by arithmetic, the total gap in dollars.

Let me repeat the answer: $2.4 trillion.

The Federal Reserve, I imagine, wishes to defend its sacrifice of the savers as a necessary evil, "collateral damage" in the course of pursuing the greater good. But there can be no doubt that taking $2.4 trillion from some people and giving it to others is a political decision and a political act. As a clearly political act, it should be openly and clearly discussed with the Congress, quantifying the effects on various sections of savers, borrowers and investors, and analyzing the economic and social implications.

The effects of the creation and manipulation of money pervade society, transfer wealth among various groups of people and can cause inflations, asset-price inflations and disastrous bubbles, which turn into busts. The money question is inherently political—it is political economics and political finance we are considering. Therefore, in developing and applying the theories and guesses with which it answers the money question, the Federal Reserve needs to be accountable to the Congress.

If you believed that the Federal Reserve had superior knowledge and insight into the economic and financial future, you could plausibly conclude that it should act as a group of philosopher-kings and enjoy independent power over the country. But no one should believe this. It is obvious that the Fed is just as bad at economic and financial forecasting as everybody else is. It is unable to predict the results of its own actions consistently. There is no evidence that it has any special insight. This is in spite of (or perhaps because of) the fact that it employs hundreds of Ph.D. economists, can have all the computers it wants (having no budget constraint) and can run models as complicated as it chooses.

Moreover, the notion of philosopher-kings is distinctly contradictory to the genius of the American constitutional design.

Seen in a broader perspective, the Federal Reserve is an ongoing attempt at price fixing and central planning by committee. Like all such efforts, naturally, it is doomed to recurring failure. It cannot know what the right interest rate is, and it cannot know how much of the losses of the bubble it is right to extract from savers.

Since the Fed cannot operate on knowledge of the future, it must rely on academic theories, in addition to flying by the seat of its pants. Its theories and accompanying rhetoric change over time and with changing personalities. Grown-up, substantive discussions with the Congress about which theories it is

applying, what the alternatives are, who the winners and losers may be and what the implications are for political economy and political finance—just as the CHOICE Act suggests—would be a big step forward in accountability. Of course, we need to add a formal savers' impact analysis.

The table calculating the cost imposed on savers by the Fed's nine years of negative real interest rates is on the next page.

Thank you again for the chance to share these views.

The Impact of The Fed on Savers

Negative versus Normal Real Interest Rates

Year	Average 6-month T-bill rates	% CPI	real 6 month T-Bill yield	Total savings**	Total lost to negative real rates	Gap from normal* real to actual real rate	Total loss to savers
2008	1.63%	3.86%	-2.23%	$ 7.84 T	$ (174.6) B	3.88%	$ (304) B
2009	0.28%	-0.36%	0.64%	$ 7.74	$ 49.2	1.02%	$ (79)
2010	0.20%	1.64%	-1.44%	$ 7.75	$ (111.7)	3.10%	$ (240)
2011	0.10%	3.16%	-3.06%	$ 8.00	$ (244.5)	4.71%	$ (377)
2012	0.13%	2.07%	-1.94%	$ 8.40	$ (163.0)	3.60%	$ (302)
2013	0.09%	1.46%	-1.37%	$ 8.68	$ (119.3)	3.03%	$ (263)
2014	0.06%	1.62%	-1.56%	$ 9.08	$ (141.9)	3.22%	$ (292)
2015	0.16%	0.12%	0.04%	$ 9.54	$ 4.0	1.62%	$ (154)
2016	0.45%	1.26%	-0.81%	$ 10.37	$ (84.0)	2.47%	$ (256)
2017 Q1	0.71%	2.54%	-1.83%	$ 10.41	$ (47.7)	3.49%	$ (91)
Total / Average	**0.35%**	**1.67%**	**-1.32%**	**$ 8.78 T**	**$ (1.033) T**	**2.97%**	**$ (2.359) T**

* Normal = 50-year average of 6-month Treasury Bill yields minus CPI inflation, 1958-2007, =1.66%

** Household savings consists of time and savings deposits, money market fund shares, and Treasury bills held by households

Source: Federal Reserve Statistical Release, Financial Accounts of the United States; R Street Analysis

Last Updated: 6/16/2017