The Daily Dish

Reality and Fed Policy

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Last week the House of Representatives passed The Regulations from the Executive in Need of Scrutiny (REINS) Act in a vote of 237 – 187. The bill requires the House and Senate to pass a resolution of approval which then must be signed by the President within 70 days of the passage of any major regulation. Since the REINS Act requires both houses of Congress and the President to approve a rule just one chamber is all that will be necessary to block a rule. The passage of the REINS Act comes amid the GOP's vow to make regulatory reform a priority in the new Congress.

Over the weekend, incoming White House Chief of Staff, Reince Priebus, stated that the incoming Trump Administration plans on repealing and replacing Obamacare "as quickly as possible." Priebus said that ideally they would be able to repeal and replace the law in one big move but he acknowledged that it will likely take some time and involve multiple steps. Republicans have promised to make the repeal and replacement of Obamacare a top priority.

Eakinomics: Reality and Fed Policy

The Volcker Rule has never made any sense, particularly as a regulatory response to the financial crisis. The Volcker rule is intended to preclude using taxpayer-insured deposits to finance proprietary trading by banks. The putative notion was that the risky trading that nearly brought down many banks should not be implicitly subsidized by a Federal Deposit Insurance Corporation (FDIC) guarantee.

There are lots of problems with this line of reasoning. First, there is no evidence whatsoever that proprietary trading was a key cause of the financial crisis. The mistake made by banks is one of the oldest in the books: bad mortgage loan underwriting — not high-tech risky bets — and it took more than just that error to generate a full-scale crisis. The second problem is that the FDIC is a subsidy only if the premiums charged by the FDIC are too low. Further, if they ARE too low, the right response is to raise them to eliminate the subsidy or — more radically — to simply eliminate deposit insurance and force banks to display to the market adequate risk management. None of these suggest the Volcker rule.

But a very practical problem was pointed out by Fed governor Jerome Powell recently: "'What the current law and rule do is effectively force you to look into the mind and heart of every trader on every trade to see what the intent is,' Powell said Saturday at the American Finance Association meeting in Chicago. 'Is it propriety trading or something else? If that is the test you set yourself, you are going to wind up with tremendous expense and burden."'

Exactly. The risks faced by any bank depend on its net position, whether they are customer-driven or proprietary, and no mechanical rule can trace these positions to particular funding sources. Powell's solution is to have Congress try again. It would be wiser to simply eliminate the Volcker rule entirely.

Interestingly, Powell also noted that the Fed was "close to meeting" its dual mandate for inflation (roughly 2 percent) and full employment, but that "Policy is very accommodative still." That would seem to be a plainfaced admission that the Fed is behind the curve and needs to get monetary policy normalized forthwith.

Reality may be returning to the Fed.