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"Audit the Fed" from an Austrian Perspective: Financial Reform Through an Unholy Coalition of Unwitting Misesians

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"AUDIT THE FED" FROM AN AUSTRIAN PERSPECTIVE: FINANCIAL REFORM THROUGH AN UNHOLY COALITION OF UNWITTING MISESIANS

INTRODUCTION

> I asked [Richard] Posner why the Fed's errors constitute a failure of capitalism. He said the central bank was part of the "capitalist structure," along with property rights and a judicial system to enforce them. To the extent that the Fed mismanaged the money supply (or interest rates) and failed to assure "a reasonable degree of economic stability," it has to be regarded as a failure of capitalism.[1]

It tends to carry credence when Judge Richard Posner, one of the most cited legal scholars in American history,[2] chalks up the 2008 financial crisis to "a failure of capitalism."[3] And, as demonstrated by the above quotation, Judge Posner seems to gloss over any particular role played by the Federal Reserve (the Fed) by labeling the central bank as merely part of a "capitalist structure."

In contrast to Posner's metatheoretical approach in analyzing America's economic woes, this Comment takes a more modest approach by focusing on the Fed not as a part of a system of capitalism, socialism, or some other economic system, but as simply a creature of legislation.[4] Indeed, the Federal Reserve Act establishes a *congressionally* chartered central bank[5] with a *presidentially* appointed board of governors[6] and a dual *mandate* of maximum

1. Caroline Baum, *Capitalism Still Has Legs That Are Long and Sexy*, BLOOMBERG (April 30, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aHEie5ri2clo&refer=home.

2. Fred R. Shapiro, *The Most-Cited Legal Scholars*, 29 J. LEGAL STUD. 409, 424 (2000).

3. RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION (2009); *See also* RICHARD A. POSNER, THE CRISIS OF CAPITALIST DEMOCRACY (2010).

4. For a comprehensive account on the political nature of the origins of the Federal Reserve, *see* MURRAY N. ROTHBARD, A HISTORY OF MONEY AND BANKING IN THE UNITED STATES: THE COLONIAL ERA TO WORLD WAR II 183–259 (2002). "The financial elites of this country, notably the Morgan, Rockefeller, and Kuhn, Loeb interests, were responsible for putting through the Federal Reserve System, as a governmentally created and sanctioned cartel device to enable the nation's banks to inflate the money supply in a coordinated fashion, without suffering quick retribution from depositors or noteholders demanding cash." *Id.* at 258.

5. Federal Reserve Act, 12 U.S.C. § 226 (2006).

6. 12 U.S.C. § 241 (2006) ("The Board of Governors of the Federal Reserve System . . . shall be composed of seven members, to be appointed by the President, by and with the advice and consent of the Senate . . . .").

employment and price stabilization.[7] Accordingly, as a modest first step towards effective financial reform, this Comment proposes amending the Federal Reserve Act to provide for a full audit. Doing so would provide accountability to both policymakers and the public at large, putting a "political check" on the Fed operations that bring about and prolong economic crises.

Part I provides some brief background information on the current "audit the Fed" movement and introduces the Federal Reserve Transparency Act legislation currently being considered in the House of Representatives. Part II looks at recent efforts by Bloomberg, L.P., through Freedom of Information Act litigation and Congress through a provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act to partially enhance Fed transparency. While limited in scope, the information gathered from these transparency measures sheds light on the type of information one might expect, at least partially, from a full audit. Part III considers some theoretical models for understanding the roles the Fed plays in both bringing about and managing economic crises. The most important of these theoretical models is Austrian Business Cycle Theory, which explains how the central bank, through credit expansion, creates "boom and bust" cycles in the economy. This section further examines other economic concepts that are relevant to understanding why certain political movements are well suited to join a coalition to demand a Fed audit. Part IV shows how Austrian Business Cycle Theory explains the 2008 financial crisis and the ensuing Great Recession. Part V looks at two prominent American political movements—Occupy Wall Street and the Tea Party. Both of these movements have platforms that would be conducive not only to demanding a Fed audit, but also providing a political check on Fed credit expansion. By pursuing economic and ideological interests that are unrelated to Austrian Business Cycle Theory, these two groups can form what may seem to be at first blush an unlikely alliance that keeps Fed-induced business cycles in check. In appealing to both the Occupy and Tea Party movements, an audit of the Fed might prove to be an easier fix than addressing what Judge Posner diagnosed as the failure of an entire economic system.

I. BACKGROUND

House Bill 459, the Federal Reserve Transparency Act of 2012, with a purpose "[t]o require a full audit of the Board of Governors of the Federal Reserve System and the Federal reserve banks by the Comptroller General of

7. 12 U.S.C. § 225a (2006) ("The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.").

the United States,"[8] passed the House of Representatives on July 25, 2012.[9] The bill, which had at least 274 co-sponsors and passed 327 to 98 with bipartisan support, was described as "a coup for its chief sponsor, Rep. Ron Paul (R-Tex.), a longtime nemesis of the Fed."[10] Indeed, Ron Paul had been introducing "audit the Fed" bills in Congress for a decade.[11]

Although House Bill 459 eventually died after passing the House, Representative Paul's influence spreading the "audit the Fed" message continued into his 2012 presidential campaign. During the campaign, Republican nominee Mitt Romney showed some support for an audit of the Federal Reserve.[12] Accordingly, "[u]nder pressure from anti-tax Tea Party activists and other small government advocates,"[13] the Republican Party included a plank in its platform calling for an annual Fed audit:

> [T]he Republican Party will work to advance substantive legislation that brings transparency and accountability to the Federal Reserve, the Federal Open Market Committee, and the Fed's dealings with foreign central banks. The first step to increasing transparency and accountability is through an annual audit of the Federal Reserve's activities. Such an audit would need to be carefully implemented so that the Federal Reserve remains insulated from political pressures and so its decisions are based on sound economic principles and sound money rather than on political pressures for easy money and loose credit.[14]

Notwithstanding this plank in the Republican platform, Mitt Romney devoted little time to this issue in his losing presidential bid.

However, if the wind has been knocked from the sails of the "audit the Fed" movement, it may only be temporarily. According to Rasmussen, roughly

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8. Federal Reserve Transparency Act of 2012, H.R. 459, 112th Cong. (2012).

9. *Id.*

10. Ed O'Keefe, *'Audit the Fed' bill passes in the House with bipartisan support*, THE WASHINGTON POST (July 25, 2012, 3:19 PM), http://www.washingtonpost.com/blogs/2chambers/post/audit-the-fed-bill-set-for-house-vote/2012/07/24/gJQAJypU7W_blog.html. For Ron Paul's arguments against the Fed, *see* RON PAUL, END THE FED (2009).

11. Chris Moody, *Ron Paul's 'Audit the Fed' bill passes the House*, ABC NEWS (July 25, 2012), http://abcnews.go.com/Politics/OTUS/ron-pauls-audit-fed-bill-passes-house/story?id=16855319#.UO0IwW-CniU.

12. Lisa Lerer & Julie Hirschfeld Davis, *Romney Calls for Fed Audit as Party Mulls Platform Plank*, BLOOMBERG (Aug. 20, 2012, 5:57 PM), http://www.bloomberg.com/news/2012-08-20/romney-calls-for-fed-audit-as-party-mulls-platform-plank.html. ("'The Federal Reserve should be accountable,' Romney told thousands of voters at a campaign rally today in Goffstown, New Hampshire. 'We should see what they're doing.'").

13. *Id.*

14. COMMITTEE ON ARRANGEMENTS FOR THE 2012 REPUBLICAN NATIONAL CONVENTION, 2012 REPUBLICAN PLATFORM 4 (2012).

seventy-five percent of Americans favor auditing the Federal Reserve.[15] Accordingly, at the beginning of the 2013 legislative session, Representative Paul Broun (R-GA), with a stated plan "to pick up right where Congressman Paul left off," filed "audit the Fed" legislation identical to that of the retired Dr. Paul.[16] House Bill 24, the proposed Federal Reserve Transparency Act of 2013, would "require a full audit of the Board of Governors of the Federal Reserve System and the Federal reserve banks by the Comptroller General of the United States."[17] More importantly, the audit would occur within twelve months "[n]otwithstanding section 714 of title 31, United States Code, or any other provision of law."[18] Indeed, House Bill 24 would go so as far as to repeal the following exceptions on audits of the Federal Reserve under current law:[19]

> (1) transactions for or with a foreign central bank, government of a foreign country, or nonprivate international financing organization;
>
> (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations;
>
> (3) transactions made under the direction of the Federal Open Market Committee; or
>
> (4) a part of a discussion or communication among or between members of the Board and officers and employees of the Federal Reserve System related to clauses (1)-(3) of this subsection.[20]

Most notably, a Fed audit under House Bill 24 would be more thorough than any audit under current law, including monetary policy decisions, agreements with foreign central banks and governments, and Federal Open Market Committee transactions.[21] If the results of recent efforts to partially enhance Fed transparency, described in Part II, are any indication of the type of information one can expect to learn from a full audit, one can expect full ammunition for those seeking public accountability and a political check on Fed operations.

II. CURRENT FED TRANSPARENCY

To advocate for a full audit of the Federal Reserve is not to say that current law provides for *no* Fed transparency. Under 31 U.S.C. § 714, the Comptroller

15. *75% Favor Auditing The Fed*, RASMUSSEN REPORTS (July 29, 2009), http://www.rasmussenreports.com/public_content/business/general_business/july_2009/75_favor_auditing_the_fed/.

16. Ginger Gibson, *Broun wants to audit the Fed*, POLITICO (Jan. 4, 2013, 3:35 PM), http://www.politico.com/blogs/on-congress/2013/01/broun-wants-to-audit-the-fed-153390.html.

17. Federal Reserve Transparency Act of 2013, H.R. 24, 113th Cong. (2013).

18. *Id.*

19. *Id.*

20. 31 U.S.C. § 714 (2006).

21. H.R. 24.

General may audit several monetary and finance agencies, including the Federal Reserve Board and Federal Reserve banks.[22] However, 31 U.S.C. § 714(b) specifically *excludes* the following from these audits:

> (1) transactions for or with a foreign central bank, government of a foreign country, or nonprivate international financing organization;
>
> (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations;
>
> (3) transactions made under the direction of the Federal Open Market Committee; or
>
> (4) a part of a discussion or communication among or between members of the Board and officers and employees of the Federal Reserve System related to clauses (1)-(3) of this subsection.[23]

These exclusions mean that Fed audits under current law are not very thorough and, most importantly, do not include monetary policy decisions, agreements with foreign central banks and governments, and Federal Open Market Committee transactions. Important information, however, regarding Fed action during the economic crisis has been obtained in other ways: most notably, through litigation by Bloomberg, L.P., and an "audit the Fed" provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Bloomberg litigation will be discussed next, followed by the Dodd-Frank provision.

A. Bloomberg FOIA Litigation

In 2008, media corporation Bloomberg, L.P. submitted Freedom of Information Act (FOIA) requests to the Federal Reserve Board of Governors (the Board) seeking details about loans made to private banks at the Discount Window and pursuant to emergency lending programs in April and May 2008.[24] Bloomberg asked for the name of the borrowing bank, the amount of the loan, the origination and maturity dates, and the collateral given for each loan.[25] The United States District Court for the Southern District of New York rejected the Board's claims that this information was exempt from FOIA disclosure and that a request to the Board did not constitute a request for information held by the twelve regional Federal Reserve Banks.[26] The Board, joined by a group of banks, appealed to the United States Court of Appeals for

22. 31 U.S.C. § 714.
23. *Id.*
24. Bloomberg, L.P. v. Bd. of Governors of the Fed. Reserve Sys., 601 F.3d 143, 145 (2d Cir. 2010).
25. *Id.* at 145–46.
26. *Id.* at 146.

the Second Circuit, arguing for exemption under Exemption Four of the FOIA, which allows a federal agency to refuse disclosure of "trade secrets and commercial or financial information obtained from a person and privileged or confidential."[27]

In order to qualify under Exemption Four: "(1) The information for which exemption is sought must be a trade secret or commercial or financial in character; (2) it must be *obtained from a person;* and (3) it must be privileged or confidential."[28] Noting the narrow compass of FOIA exemptions and the preference for disclosure, the court held that the information at issue—the identity of the borrowing bank, the dollar amount of the loans, the loan origination and maturity dates, and the collateral securing the loan—was not "obtained from" the borrowing banks within the meaning of the exemption.[29] The court noted that while "[a] completed loan application will ordinarily contain considerable information, and when it is submitted to a lender, the lender has 'obtained' that information from the applicant," "[t]he information requested by Bloomberg was generated within a Federal Reserve Bank upon its decision to grant a loan."[30] This information did not come into existence until a Federal Reserve Bank made the decision to approve the loan request.[31]

Furthermore, even if the court were to consider the information as "obtained from" the Federal Reserve Banks themselves, as "persons," the information still was not "privileged or confidential" within the meaning of Exemption Four.[32] Information is only "confidential" for the purposes of Exemption Four when disclosure would cause substantial harm to the competitive position of the person from whom the information was obtained.[33] The court rejected the Fed's argument that the exemption applied to the Fed's program "to furnish critical infusions to distressed banks on a confidential basis."[34] Accordingly, the Second Circuit affirmed the district court's summary judgment in favor of Bloomberg.[35]

27. *Id.* at 146–47; 5 U.S.C. § 552 (2006).

28. *Bloomberg*, 601 F.3d at 147 (citing Nadler v. FDIC, 92 F.3d 93, 95 (2d Cir. 1996)).

29. *Id.*

30. *Id.* at 148.

31. *Id.*

32. *Id.* at 149–50.

33. *Bloomberg*, 601 F.3d at 150.

34. *Id.* "The Fed . . . argued that revealing borrower details would create a stigma — investors and counterparties would shun firms that used the central bank as lender of last resort — and that needy institutions would be reluctant to borrow in the next crisis." Bob Ivry, Bradley Keoun, & Phil Kuntz, *Secret Fed Loans Gave Banks $13 Billion Undisclosed to Congress*, BLOOMBERG (Nov 27, 2011, 6:01 PM), http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html.

35. *Bloomberg*, 601 F.3d at 151.

As a result of the FOIA action, Bloomberg obtained 29,000 pages of Fed documents detailing 21,000 transactions.[36] The Fed committed $7.77 trillion as of March 2009 to rescuing the financial system, including $13 billion in secret Fed loans undisclosed to Congress, providing what Bloomberg called "[a] fresh narrative of the financial crisis of 2007 to 2009."[37] According to Bloomberg, "[D]etails suggest[ed] taxpayers paid a price beyond dollars as the secret funding helped preserve a broken status quo and enabled the biggest banks to grow even bigger."[38] The data showed that the six biggest U.S. banks—JPMorgan, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley—borrowed as much as $460 billion from the Fed and accounted for sixty-three percent of the average daily debt to the Fed by all publicly traded "U.S. banks, money managers and investment-services firms."[39]

B. Dodd-Frank Audit

In June 2010, members of a House-Senate conference committee reached a compromise to allow expanded audits of the Federal Reserve[40] under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[41] Language from the Senate version of the bill granted the Government Accountability Office (GAO) authority to audit the Fed's emergency lending programs and release details about the firms that benefited from those programs.[42] The compromise broadened these audits to include the discount window and its purchases and sales of government securities, requiring the Fed to disclose details about such transactions within two years after they occur.[43] Ultimately, section 1109 of the Dodd-Frank Act included the following GAO audit of the Federal Reserve:

> Notwithstanding section 714(b) of title 31, United States Code, or any other provision of law, the Comptroller General of the United States . . . shall conduct a one-time audit of all loans and other financial assistance provided during the period beginning on December 1, 2007 and ending on the date of enactment of this Act by the Board of Governors or a Federal reserve bank under the Asset–Backed Commercial Paper Money Market Mutual Fund

36. Ivry, Keoun, & Kuntz, *supra* note 34.

37. *Id.*

38. *Id.*

39. *Id.*

40. Brady Dennis, *Lawmakers agree to expand audit of Federal Reserve*, The Washington Post (June 17, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/06/16/AR2010061605541.html.

41. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1109, 124 Stat. 1376, 2127 (2010).

42. Dennis, *supra* note 40.

43. *Id.*

> Liquidity Facility, the Term Asset–Backed Securities Loan Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Term Securities Lending Facility, the Term Auction Facility, Maiden Lane, Maiden Lane II, Maiden Lane III, the agency Mortgage–Backed Securities program, foreign currency liquidity swap lines, and any other program created as a result of section 13(3) of the Federal Reserve Act (as so designated by this title).[44]

As a result of the Dodd-Frank audit, the GAO detailed how the Fed provided $16 trillion in secret loans to bailout American and foreign banks during the financial crisis.[45] The GAO also recommended that the Fed strengthen policies that deal with conflicts of interest,[46] citing, for example:

> Our review of several recommendations for waivers granted from September 19, 2008, through March 31, 2010, indicated that FRBNY employees who requested waivers were generally allowed to continue to retain their related personal financial investments. Most of the financial interests were in institutions receiving emergency assistance, including AIG, Bank of America, Citigroup, General Electric Company (GE), and JPMC. For example, on September 19, 2008—3 days after the Federal Reserve Board authorized FRBNY to assist AIG—the then-FRBNY President granted, under authority delegated by the FRBNY Board of Directors, a waiver to a senior management official with financial interests in AIG and GE who was involved in decision making related to these two companies.[47]

Furthermore, the GAO found that the Fed lacked a comprehensive policy to manage risks related to vendor conflicts of interest.[48] This was despite the fact that the Fed awarded 103 contracts worth $659.4 million to help carry out its emergency lending activities, with a few contracts accounting for most of the spending.[49] The GAO suggested that the Fed could benefit from stronger guidance for these contracts.[50] Indeed, "the highest-value contracts were awarded noncompetitively due to exigent circumstances. The Federal Reserve Bank of New York (FRBNY) awarded almost two-thirds of its contracts noncompetitively, which accounted for seventy-nine percent of all vendor compensation."[51] Additionally, in dealing with risk-management, the Fed failed to track potential exposures in adverse economic scenarios and its procedures lacked specific guidance on how regional Federal Reserve Banks

44. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1109.
45. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-696, OPPORTUNITIES EXIST TO STRENGTHEN POLICIES AND PROCESSES FOR MANAGING EMERGENCY ASSISTANCE 131 (2011).
46. *Id.* at 65.
47. *Id.* at 70.
48. *Id.* at 73.
49. *Id.* at 52.
50. GAO-11-696, *supra* note 45, at 52.
51. *Id.* at 57.

should exercise discretion relating to high-risk borrowers.[52] Lastly, the GAO found that the Fed lacked "guidance and documentation" in its treatment of eligible relief program participants.[53]

Recent Fed transparency brought about by Bloomberg and Dodd-Frank sheds light on the Fed's conduct in the wake of the 2008 crisis. These limited steps can be complemented by political advocacy groups demanding a *full* audit, as discussed in Part V. However, mere data concerning the vast quantity of Fed bailouts is not meaningful without the economic framework provided in Part III.

III. THE FED AND ECONOMIC CRISES: THEORETICAL FRAMEWORK

The model that most clearly explains the role the Fed plays in economic crises is Austrian Business Cycle Theory, discussed in Section A below. It explains how the central bank, through credit expansion, creates "boom and bust" cycles in the economy. Section B will discuss the concept of "moral hazard," a theory which helps explain how the Fed, through its bailouts and easy money practices, can encourage risky behavior by economic actors. Two final concepts—the redistributionary effects of inflation (Section C) and inflationary government financing (Section D)—are relevant to analyzing how advocacy groups, such as Occupy Wall Street and the Tea Party, can play a role in promoting Fed accountability.

A. Austrian Business Cycle Theory

Theories of the business cycle seek to explain why, during the onset of a recession or depression, members of the business community suddenly and simultaneously experience a massive "cluster" of severe losses,[54] or what Lionel Robbins called a "cluster of errors."[55] In other words, "[w]hy should the leaders of businesses in the various industries producing producers' goods make errors of judgment at the same time and in the same direction?"[56]

In his 1912 book, *The Theory of Money and Credit*,[57] Ludwig von Mises developed what would later be called Austrian Business Cycle Theory.[58]

52. *Id.* at 82.

53. *Id.* at 117.

54. Murray N. Rothbard, *Economic Depressions: Their Cause and Cure* (1969), *in* THE AUSTRIAN THEORY OF THE TRADE CYCLE AND OTHER ESSAYS 65, 72 (Richard M. Ebeling ed., 1996).

55. LIONEL ROBBINS, THE GREAT DEPRESSION 31 (1971).

56. *Id.*

57. LUDWIG VON MISES, A THEORY OF MONEY AND CREDIT (new ed., H.E. Batson trans., 1953).

58. Roger G. Garrison, *Introduction: The Austrian Theory in Perspective*, *in* THE AUSTRIAN THEORY OF THE TRADE CYCLE, *supra* note 54, at 7, 8. The Austrian School of economics refers not to the economics of the country of Austria, but derives its name from the nationality of some

Mises's student, F.A. Hayek, won the 1974 Nobel Prize in economics for his work expanding on the Misesian theory.[59] Under the Austrian theory, a business cycle begins when the central bank expands its liabilities through credit creation.[60] This action increases the cash reserves of commercial banks, which expand credit and, thus, increase the nation's money supply.[61] This credit expansion, in turn, lowers interest rates below what they would otherwise be in a free market.[62] This is because, in a free market, interest rates are determined by the aggregate of individual time-preferences.[63] Because a loan is an exchange of a "present good" for a "future good," and people prefer current goods to future goods, the interest rate is the premium commanded on the market on "money now" over "money in the future," varying according to the degree of people's time-preferences.[64] People's time-preferences also play another important role in Austrian Business Cycle Theory—determining to what extent people will save and invest versus how much they will consume.[65] Lower time-preferences, i.e., people are consuming less and saving and investing more, mean lower interest rates.[66] This is generally how economic growth comes about—falling time-preferences lead to increased saving and investment, as well as lower interest rates.[67]

The trouble occurs when interest rates fall not because of lower time-preferences and higher savings, but from the artificial expansion of bank credit.[68] This is because businesses react as if interest rates had fallen due to genuine savings: businesses invest more in capital and producers' goods.[69] Lengthy and time-consuming projects that, before the fall in interest rates,

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of its early and prominent practitioners, such as Carl Menger, Eugen von Böhm-Bawerk, Ludwig von Mises, Friedrich Hayek, etc. For a history of the Austrian school of economics, *see* EUGEN MARIA SCHULAK & HERBERT UNTERKÖFLER, THE AUSTRIAN SCHOOL OF ECONOMICS: A HISTORY OF ITS IDEAS, AMBASSADORS, & INSTITUTIONS (Arlene Oost-Zinner trans., 2011).

59. Murray N. Rothbard, *Hayek and the Nobel Prize*, THE LIBERTARIAN FORUM, October, 1974, at 7. *See* FRIEDRICH A. HAYEK, MONETARY THEORY AND THE TRADE CYCLE (1933); FRIEDRICH A. HAYEK, PRICES AND PRODUCTION (1931).

60. Rothbard, *supra* note 54, at 81. One could cite endless sources explaining Austrian Business Cycle Theory. Rothbard presents one of the most clear, concise expositions. *See also* MISES, A THEORY OF MONEY AND CREDIT, *supra* note 57, at 261–366; LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 535–83, 787–94 (The Scholar's Ed., 1998); MURRAY N. ROTHBARD, MAN, ECONOMY, AND STATE WITH POWER AND MARKET 989–1023 (2d ed., Scholar's Ed., 2009).

61. Rothbard, *supra* note 54, at 81.

62. *Id.*

63. *Id.* at 81–82.

64. *Id.* at 82.

65. *Id.*

66. Rothbard, *supra* note 54, at 82.

67. *Id.*

68. *Id.* at 82–83.

69. *Id.* at 83.

previously looked unprofitable, now seem profitable.[70] Eventually, this money gets paid out in higher rents to land and higher wages to workers in the capital goods industries, bidding up labor costs in a manner that, for businesses, seems sustainable under the current artificial interest rate.[71] However, the problem occurs when workers and landlords begin to spend this new money.[72] Because people's time-preferences have not actually lowered—i.e., they do not actually want to save more—workers consume most of this new income, redirecting spending back to consumer goods industries.[73] People do not save and invest enough to buy the newly-produced capital goods, leading to sudden sharp and continuing depression in the producers' goods industries.[74] At this point, it becomes evident that businesses, due to the artificially low interest rates, have misinvested the limited savings available—overinvesting in capital goods and underinvesting in consumer goods.[75] In his treatise, *Human Action*, Mises makes a famous analogy to a master-builder to demonstrate the Austrian theory of the business cycle:

> The whole entrepreneurial class is, as it were, in the position of a master builder whose task it is to erect a building out of a limited supply of building materials. If this man overestimates the quantity of the available supply, he drafts a plan for the execution of which the means at his disposal are not sufficient. He oversizes the groundwork and the foundations and only discovers later in the progress of the construction that he lacks the material needed for the completion of the structure. It is obvious that our master builder's fault was not overinvestment, but an inappropriate employment of the means at his disposal.[76]

In short, "[t]he inflationary boom thus leads to distortions of the pricing and production system."[77] Because prices in the capital goods industries had been bid up too high to be profitable once the consumers reasserted their actual time-preferences, these prices need to fall until proper market relations can be resumed.[78] Thus, according to Austrian Business Cycle Theory, a "depression" is a painful but necessary phase by which the market economy liquidates the malinvestments of the artificial boom, reestablishing consumer preferences for consumption and investment.[79] Inflationary booms can last for years until

70. *Id.*
71. Rothbard, *supra* note 54, at 83.
72. *Id.* at 83–84.
73. *Id.* at 84.
74. *Id.*
75. *Id.*
76. MISES, *supra* note 60, at 557.
77. Rothbard, *supra* note 54, at 84.
78. *Id.* at 84–85.
79. *Id.* at 85.

credit expansion finally stops—due to either bank instability or the prospect of publically intolerable price inflation—and the inevitable adjustment occurs.[80]

Hence, Austrian Business Cycle Theory explains "[t]he repeated and recurrent nature of the cycle, the massive cluster of entrepreneurial error, [and] the far greater intensity of the boom and bust in the producers' goods industries."[81] If, then, the business cycle is to be blamed on inflationary bank credit expansion by the central bank, the Austrian framework would suggest that the central bank stop expanding credit in order to minimize the adjustment that must occur.[82] This also means that, during the onset of a recession, the central bank should not try to "prop up" the current structure of business, i.e., bailouts, so as not to impede real recovery.[83] Furthermore, even if a central bank was able to "re-inflate" into another boom, they would just be setting up for a larger bust in the future.[84] Therefore, under an Austrian framework, in order to foster recovery once a recession hits, the best thing a central bank can do is "absolutely nothing."[85]

B. Moral Hazard

Moral hazard exists in "actions of economic agents . . . to the detriment of others in situations where [the economic agents] do not bear the full consequences . . . of their actions."[86] It creates an incentive for one person to use more resources than he otherwise would, believing that someone else will pay for it.[87] In other words, moral hazard may be said to provide a "temptation to steal" or "temptation to act irresponsibly."[88] A moral hazard problem exists where one actor has the possibility to use another actor's resources against his will and acts accordingly.[89]

Government monetary intervention is moral hazard *writ large*, setting forth the following chain of situations in which moral hazard is present.[90] The

80. *Id.* at 85–86.

81. *Id.* at 86.

82. Rothbard, *supra* note 54, at 86–87. Austrian economics is a positive, not a normative science. This means that, *qua* Austrian economics, it offers no policy prescriptions to economic woes, but simply tells us the economic consequences of a given policy. Thus, it is important to emphasize that this is a policy suggestion drawn from using an Austrian framework, given the goal of a healthy economy. For explanations of Austrian epistemology and methodology, *see* MISES, *supra* note 60, at 11–142; ROTHBARD, *supra* note 60, at 1–77.

83. Rothbard, *supra* note 54, at 87.

84. *Id.*

85. *Id.*

86. Jörg Guido Hülsmann, *The Political Economy of Moral Hazard*, 1 POLITICKÁ EKONOMIE 35, 35 (2006) (citation omitted).

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 43.

intervention that provides the basis for this large-scale moral hazard is the imposition of legal tender.[91] In the United States, this means the Congressional imposition of Federal Reserve notes as legal tender. Under this system, paper money printed by government or the central bank, known as "fiat" paper money, does not compete with other monetary products.[92] This system of fiat paper money creates moral hazard for the monopolistic producer of money, i.e., the Federal Reserve, due to the "possibility to create *ex nihilo* virtually any amount of money and, thus, to buy virtually any amount of good and services for sale," with the only limit being the potential for hyperinflation.[93] But more importantly, fiat paper money creates moral hazard for the users of money, which includes citizens, governments, and, most importantly for the purposes of this Comment, banks.[94]

> [T]hey sooner or later come to realize that the masters of the printing press have the power to bail out virtually any bankrupt firm or government. *Thus they engage in more or less reckless financial planning, expecting that the monetary authorities will not allow a great mass of reckless planners to go bankrupt.* This speculation has been borne out by the last thirty years. Public and private debts are at record heights all over the world.[95]

Hence, the money producers are encouraged to continue to print, while the money users are encouraged to engage in reckless financial planning. Monetary theorists, aware of these dangers, have pointed out the necessity of avoiding impressions by the central bank that it would bail out the market participants.[96]

As outlined above, this scenario inevitably leads to financial bubbles as more or less every market participant is subject to moral hazard, basing their

91. Hülsmann, *supra* note 86, at 43.

92. *Id.*

93. *Id.* Hyperinflation occurs when the public realizes that the government or central bank will continue to inflate and, therefore, prices will continue to rise. In response, the public purchases more goods because, in the future, the value of the monetary unit will be lower and the price of goods higher. As the social demand for money decreases, prices increase more rapidly than the increase in the money supply. With rising prices comes complaints of a "scarcity of money" and greater efforts of inflation, causing even more accelerated price increases. When this happens, the public begins a "flight from money," investing in real goods in order to hold value for the future. This lowers the demand for money to practically zero, causing prices to "rise upward in astronomical proportions" as "[t]he value of the monetary unit falls practically to zero." Hyperinflation reaches a "runaway" stage when "[t]he main desideratum becomes getting hold of real goods, whatever they may be, and spending money as soon as received." At this point, "the economy in effect breaks down, the market is virtually ended, and society reverts to a state of virtual barter and complete impoverishment." ROTHBARD, MAN, ECONOMY, AND STATE, *supra* note 60, at 1019–21.

94. Hülsmann, *supra* note 86, at 44.

95. *Id.* (emphasis added).

96. *Id.*

plans on the availability of more resources than are actually available in the economy.[97] Thus, "paper money *by virtue of its mere existence* produces massive error on a large scale, until the bubble bursts in a crisis."[98]

However, besides setting forth business cycles and creating moral hazard, inflation—or "the process of issuing money beyond any increase in the stock of specie"[99]—creates further concerns that are relevant to analyzing the role political groups can play in the "audit the Fed" movement. This is because inflation has a regressive redistributionary effect, as explained in Section C, and can be used to finance government operations, discussed in Section D.

C. Redistributionary Effects of Inflation

When the central bank issues new money, or credit, it has a diffusion effect—"the first receivers of the new money gain the most, the next gain slightly less, etc., until the midpoint is reached, and then each receiver loses more and more as he waits for the new money."[100] This is because, for those who first receive the money, prices remain the same while, for later receivers, prices have been *bid up* by the newly created money.[101] Thus, credit expansion has the redistributionary effect of raising prices as the money supply increases, with the inflators, and those selling to them, benefitting at the expense of those who later receive the money.[102] Writes Rothbard:

> This is the charm of inflation—for the beneficiaries—and the reason why it has become so popular, particularly since modern banking processes have camouflaged its significance for those losers who are far removed from the banking operations. The gains of the inflators are visible and dramatic; the losses to the others hidden and unseen, but just as effective for all that.[103]

The above process describes the "short-run," or "one-shot," gains and losses from inflation.[104]

Inflation also creates permanent gains and losses.[105] Each individual will react and alter spending patterns differently in response to his gains and losses.[106] Furthermore, new money forms "a high ratio to the existing cash balances of some and a low ratio to that of others," resulting in "a variety of changes in spending patterns."[107] Thus, prices do not increase uniformly, and

97. *Id.*
98. *Id.*
99. ROTHBARD, *supra* note 60, at 990.
100. *Id.*
101. *Id.*
102. *Id.* at 991.
103. *Id.*
104. ROTHBARD, *supra* note 60, at 992.
105. *Id.*
106. *Id.*
107. *Id.*

the purchasing power of money falls disproportionally.[108] Because some prices rise more than others, some people permanently gain, while some permanently lose.[109] Rothbard describes some of the notable "losers" in the inflation process:

> Particularly hard hit by an inflation, of course, are the relatively "fixed" income groups, who end their losses only after a long period or not at all. Pensioners and annuitants who have contracted for a fixed money income are examples of permanent as well as short-run losers. Life insurance benefits are permanently slashed. Conservative anti-inflationists' complaints about "the widows and orphans" have often been ridiculed, but they are no laughing matter nevertheless. For it is precisely the widows and orphans who bear a main part of the brunt of inflation. Also suffering losses are creditors who have already extended their loans and find it too late to charge a purchasing-power premium on their interest rates.[110]

With the redistributionary effect of inflation in mind, it becomes significant that, according to the Consumer Price Index, the purchasing power of the U.S. dollar has decreased by over ninety-five percent since the inception of the Federal Reserve in 1913.[111] It is in this way that the inflationary policies of a central bank can be viewed as levying a regressive "inflation tax" for the government, discussed in Section D below.

D, Inflationary Government Financing

Mises differentiates "simple" inflation from credit expansion, which, as described above, sets forth the business cycle.[112] In the former instance, "political and institutional convenience" causes a government to borrow from the central bank, which provides funds by issuing bank notes or crediting the government's deposit account.[113] This transaction amounts to fiat money creation, or inflation, as the new money filters into the market through government spending.[114] For example, the United States used this method to fund its involvement in World War II, borrowing money from commercial banks.[115] Thus, this method of borrowing allows the government to finance operations through inflation, rather than taxation. In light of the

108. *Id.*
109. ROTHBARD, *supra* note 60, at 992.
110. *Id.* at 992–93.
111. *Consumer Price Index for All Urban Consumers: Purchasing Power of the Consumer Dollar*, FEDERAL RESERVE BANK OF ST. LOUIS, (June 9, 2013, 1:33 PM), http://research.stlouisfed.org/fred2/series/CUUR0000SA0R.
112. MISES, *supra* note 60, at 568.
113. *Id.*
114. *Id.*
115. *Id.*

redistributionary effects of inflation, discussed in Section C above, this method of government financing amounts to a regressive "inflation tax."

IV. THE FED AND THE 2008 CRISIS

A. The Housing Bubble

The events surrounding the recent "Great Recession" have sparked a renewal of interest in Austrian Business Cycle Theory.[116] Several high profile investment advisers and financial commentators, inspired by the failure of mainstream macroeconomists to foresee or explain the subprime mortgage crisis and corresponding financial meltdown, have employed the theory in their interpretation and analysis.[117] Indeed, interest in the theory has been reinforced by a number of economists, journalists, and politicians associated with the Austrian school who warned of the emerging housing bubble.[118] Austrian economist, Joseph Salerno, demonstrates how the Great Recession serves as a textbook example of Austrian Business Cycle Theory.[119]

Reacting to the bursting of the dot-com bubble in 2000 and corresponding recession in early 2001, the Federal Reserve immediately and aggressively lowered the target Federal Funds rate and reversed a decline in monetary growth.[120] This expansionary monetary policy was further spurred by the terrorist attacks on September 11, 2001.[121] From 2001 to the end of 2005, the

116. Joseph T. Salerno, *A Reformulation of Austrian Business Cycle Theory in Light of the Financial Crisis*, 15 Q. J. AUSTRIAN ECON. 3, 4 (2012), *available at* http://mises.org/journals/qjae/pdf/qjae15_1_1.pdf.

117. *Id.*

118. *Id.* For popular examples of prominent Austrian predictions, *see, e.g.*, *Treasury's Policy on Housing GSE's: Hearing Before the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 107th Cong. 47–48 (2002) (statement of Rep. Ron Paul, Member, H. Comm. on Financial Services). "[D]espite the long-term damage to the economy inflicted by the government's interference in the housing market, the government's policy of diverting capital to other uses creates a short-term boom in housing. Like all artificially created bubbles, the boom in housing prices cannot last forever. When housing prices fall, homeowners will experience difficulty as their equity is wiped out. Furthermore, the holders of the mortgage debt will also have a loss. These losses will be greater than they would have otherwise been had government policy not actively encouraged over-investment in housing." *Id.* at 48; Jdouche, *Peter Schiff Was Right 2006–2007 (2nd Edition)*, YOUTUBE (Nov. 2, 2008), http://www.youtube.com/watch?v=2I0QN-FYkpw. (a compilation of financial analyst Peter Schiff warning of the housing bubble on cable news outlets, at some points being mocked by pundits). For a comprehensive list of Austrian predictions (with links), *see* Walter Block, *Austrian Thymologists Who Predicted the Housing Bubble*, LEWROCKWELL.COM (Dec. 22, 2010), http://www.lewrockwell.com/block/block168.html.

119. Salerno, *supra* note 116, at 7.

120. *Id.* at 24.

121. *Id.*

Fed's MZM[122] monetary aggregate increased by about $1 billon per week and the M2[123] aggregate by about $750 million per week, while the monetary base increased by about $200 billion, a cumulative increase of 33.3%.[124]

> The Federal Funds rate was driven down below 2 percent and held there for almost three years, pegged at 1 percent for a year . . . . The result was that the real interest rate, as measured by the difference between the Federal Funds rate and headline CPI, was negative from roughly 2003 to 2005. Rates on 30-year conventional mortgages fell sharply from over 7 percent in 2002 to a low of 5.25 percent in 2003 and, aside from brief upticks in 2003 and again in 2004, fluctuated between 5.5 percent and 6.0 percent until late 2005 . . . . Perhaps, more significantly, 1-year ARM rates plummeted from a high of 7.17 percent in 2000 to a low of 3.74 percent in 2003, rising to 4.1 percent in 2004 and to slightly over 5 percent in 2005.[125]

Simultaneous with this expansionary monetary policy, credit standards were loosened while unconventional (subprime) mortgages became increasingly popular.[126] The result was a rapid expansion of mortgage lending, with the subprime share of home mortgages outstanding rising from 8.62% in 2000 to 13.51% in 2005.[127] Housing prices accelerated to double-digit annual increases.[128] Writes Salerno: "The housing boom soon turned into a bubble as expectations lost contact with fundamentals and propelled housing prices upward at accelerating rates."[129]

By 2003, the credit-induced bubble hit corporate profits, and stock prices began a steep ascent into 2007.[130] This, combined with the aforementioned increase in real estate prices, led to a $23 trillion increase in household net worth from 2003 to 2006, driving the ratio of household net worth to annual GDP to over 450% (an increase of 100 percentage points in a matter of three years).[131] Salerno describes the effect of the housing bubble on the individual household:

122. Money with zero maturity.

123. *See* Board of Governors of the Federal Reserve System, *Current FAQs: What is the money supply? Is it important?*, *available at* http://www.federalreserve.gov/faqs/money_12845.htm ("*M2* is defined as M1 plus savings deposits, small-denomination time deposits . . . and retail money market mutual fund shares," where "*M1* is defined as the sum of currency held by the public and transaction deposits at depository institutions.").

124. Salerno, *supra* note 116, at 24.

125. *Id.* at 25–26.

126. *Id.* at 26. These unconventional mortgages included interest-only, negative equity, and no-down-payment mortgages. *Id.*

127. *Id.*

128. *Id.*

129. Salerno, *supra* note 116, at 26.

130. *Id.* at 28.

131. *Id.* at 29.

> This enormous increase in net worth was based almost solely on paper profits and phantom capital gains on households' real estate and financial assets. Misled by their inflation-bloated balance sheets, households were induced to "cash out" some of their home equity and increase expenditures on consumer goods and services. In the expression of the day, people began "using their homes as ATM machines." Households financed their increased spending on boats, luxury autos, upscale restaurant meals, pricey vacations etc., through fixed-dollar debt. The increase in value of home equity and 401(k) plans also reduced saving out of current income, and the personal saving rate plunged from over 4 percent immediately after the recession of 2001 to less than 1 percent during 2005 . . . .[132]

Thus, from 2003 to 2007, household assets rose by $21,743.3 trillion while liabilities, consisting mostly of home mortgages and consumer credit, increased by $4,500.8 trillion. As a result, the year-over-year rate of growth of household debt nearly doubled, reaching eleven percent for three consecutive years.[133]

Alas, all artificial credit-induced booms inevitably lead to a bust: in 2007, housing prices, corporate profits, and the stock market plunged as "[t]he capital gains accumulated since the mid-1990s were revealed to be an illusion."[134] During 2008, household net worth declined by $13 trillion, or twenty percent—a sum that exceeded the annual GDP of Germany, Japan, and the U.K. combined.[135] "This," writes Salerno, "brought the overconsumption frenzy, which had spanned two inflationary booms, to a screeching halt."[136]

> Real retail sales and food services, which had plateaued at an annual rate of $180 billion during 2006 and 2007, declined precipitously to $160 billion in less than a year and remained stagnant for a year. Concurrently, firms in the retail sector shed over 1 million workers from their payrolls with employment dropping from a high of 15.56 million in December 2007 to a low of 14.36 million in December of 2009. On a year-over-year basis, retail employment shrank by 5 percent for more than half of 2009. The S&P Retail Stock Index (RLX) lost over half of its value between February 2007 and November 2009, falling from 533 to 223. Indeed, the fall in the RLX was as sharp and deep as the fall of the S&P 500.[137]

The Wilshire 5000 Total Market Index, which tracks the total dollar value of all U.S. headquartered equity securities, is a good proxy for capital accumulation in the United States.[138] From 2007 to 2009, the index collapsed

132. *Id.* at 30.
133. *Id.* at 31.
134. Salerno, *supra* note 116, at 32.
135. *Id.*
136. *Id.* at 33.
137. *Id.*
138. *Id.* at 35–36.

from $15.5 trillion to $8 trillion, fluctuating around $12 trillion in 2012.[139] The index first reached $12 trillion in 1999, implying that there has been no net capital accumulation since that time: "The capital that has been accumulated since then has either been consumed or wasted in misdirected investments."[140]

> But it may happen that even the current level of wealth and income is based on false calculations, because the Fed has used every tool at its disposal and has even forged new ones in order to prop up housing and financial asset prices. The weak and tenuous recovery that the U.S. is now experiencing may well be a reflection of the depth of capital consumption and impoverishment that the U.S. economy has suffered as a result of the inflation-targeting policy of the past two decades.[141]

B. Bailouts and Monetary Stimulus

As discussed above, under the Austrian framework, in order to foster recovery once an economic recession hits, the best thing a central bank can do is "absolutely nothing."[142] Also as discussed above, even without a full audit, one can see this was not the Federal Reserve's response to the financial crash in 2008. In summary, Bloomberg found that the Fed committed $7.77 trillion as of March 2009 to rescuing the financial system, including $13 billion in undisclosed profits to banks.[143] The six biggest U.S. banks—JPMorgan, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley—borrowed as much as $460 billion from the Fed and accounted for sixty-three percent of the average daily debt to the Fed by all publicly traded "U.S. banks, money managers and investment-services firms."[144] Furthermore, a GAO audit under the Dodd-Frank Act detailed how the Fed provided $16 trillion in secret loans to bailout American and foreign banks during the financial crisis.[145] As discussed above, these types of bailouts by the Federal Reserve in the wake of the 2008 crisis created a classic moral hazard problem: these bailouts made it more likely that financial institutions "engage in more or less reckless financial planning, expecting that the monetary authorities will not allow a great mass of reckless planners to go bankrupt."[146] Furthermore, under the Austrian framework, these types of bailouts tend to "prop up" the malinvested business structure and impede real recovery.[147]

139. Salerno, *supra* note 116, at 36.
140. *Id.*
141. *Id.*
142. Rothbard, *supra* note 54, at 87.
143. Ivry, Keoun, & Kuntz, *supra* note 34.
144. *Id.*
145. GAO-11-696, *supra* note 45, at 131.
146. Hülsmann, *supra* note 86, at 44.
147. Rothbard, *supra* note 54, at 87.

Fed action in response to the crisis did not stop with immediate bailouts. On December 12, 2012, the Federal Reserve Board of Governors announced that the Fed, in addition to continuing to purchase "additional agency mortgage-backed securities at a pace of $40 billion per month," would be purchasing longer-term Treasury securities at a pace of $45 billion per month.[148] The Federal Reserve has engaged in this type of "quantitative easing" policy throughout the Great Recession "[t]o support a stronger economic recovery" by "maintain[ing] downward pressure on longer-term interest rates, support[ing] mortgage markets, and help[ing] to make broader financial conditions more accommodative."[149] Beyond impeding real recovery, there is evidence that Fed action is actually re-inflating into another boom: according to estimates by the U.S. Census Bureau and the Department of Housing and Urban Development, new home sales in November 2012 increased 15.3% from November 2011.[150] And, of course, with any Fed money creation comes concern about future price inflation.[151]

With the foregoing in mind, the next step of analysis investigates possible strategies to bring about Fed accountability and transparency. One such strategy could be achieved by employing political advocacy groups, such as Occupy Wall Street and the Tea Party, whose ideologies are conducive to addressing the issue of Fed transparency.

V. POLITICAL MOVEMENTS

A. *Occupy Wall Street*

The Occupy Wall Street movement, inspired by the Arab Spring and uprisings in Europe, began in September 2011.[152] The movement was sparked by a call from *Adbusters* magazine for activists to "bring a tent" to and show up at Wall Street.[153] On September 17, 2011, a few thousand activists gathered in New York City's financial district, with some setting up camp in Zuccotti Park.[154] The Occupy protesters took issue with "Wall Street banks, big

148. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Dec. 12, 2012), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20121212a.htm.

149. *Id.*

150. Joint Press Release, U.S. Census Bureau News & U.S. Dep't of Hous. and Urban Dev., New Residential Sales in November 2012 (Dec. 27, 2012, 10:00 AM), *available at* http://content.govdelivery.com/attachments/USESAEI/2012/12/27/file_attachments/182339/New%2BResidential%2BSales%2B%2528November%2B2012%2529.pdf.

151. ROTHBARD, *supra* note 60, at 991.

152. Sarah van Gelder, *Introduction: How Occupy Wall Street Changes Everything*, *in* THIS CHANGES EVERYTHING: OCCUPY WALL STREET AND THE 99% MOVEMENT 1, 1 (Sarah van Gelder ed., 2011).

153. *Id.*

154. *Id.*

corporations, and others among the 1%" who were "claiming the world's wealth for themselves at the expense of the 99% and having their way with our governments."[155] The movement quickly spread beyond New York as protestors gathered in hundreds of cities around the United States and, within weeks, over 1500 cities worldwide.[156]

While the Occupy movement is not currently aimed at protesting Fed policies, many of the concerns of the Occupy protestors have roots in the Federal Reserve System. For example, economist and Occupy-champion Paul Krugman (although a notorious advocate for expansionary monetary policy by the Fed[157]) suggests that income inequality lies at the heart of America's economic woes.[158] Likewise, Professor Raghuram Rajan criticizes the policy response to income inequality:

> While many oppose an expansion in government welfare transfers, there are few to stand against an expansion of credit to the lower middle class—not the politicians, who want more growth and happy constituents; not the banks, which benefit from expanded lending; not the borrowers, who can now buy the house they had only dreamed of; and not the laissez-faire bank regulators, who are reluctant to oppose credit booms because they mistakenly think they can pick up the pieces easily if the boom collapses.[159]

Rajan writes that credit expansion is a way to expand middle-class consumption, causing the masses to "pay less attention to their stagnant monthly paychecks."[160] Thus, the policy response to rising inequality in the United States in the 1990s and 2000s was to encourage lending to low-income households.[161] The political benefits of higher consumption were immediate.[162] However, as discussed above, the unsustainable housing boom ended in unskilled workers not only losing their jobs, but also in debt from having borrowed to buy unaffordable houses.[163] Indeed, McLean argues that the

155. *Id.*

156. *Id.* at 2.

157. Indeed, in 2002, Krugman actually called on the Fed to create a housing bubble. *See* Paul Krugman, *Dubya's Double Dip?*, N.Y. TIMES, Aug. 2, 2002, http://www.nytimes.com/2002/08/02/opinion/dubya-s-double-dip.html ("To fight this recession the Fed needs more than a snapback; it needs soaring household spending to offset moribund business investment. And to do that . . . Alan Greenspan needs to create a housing bubble to replace the Nasdaq bubble.").

158. Paul Krugman & Robin Wells, *The Widening Gyre: Inequality, Polarization, and the Crisis*, *in* THE OCCUPY HANDBOOK 7, 9 (Janet Byrne ed., 2012).

159. Raghuram Rajan, *Inequality and Intemperate Policy*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 79, 81.

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 82.

financial crisis was not a referendum on home ownership, but rather a referendum on "the growing income inequality in America":[164]

> [T]he great machinery of the subprime lending market was not built to enable people to buy homes. Instead, its main purpose was to allow people to borrow against the equity in their homes—the driver of the majority of the risky loans that would have brought down the financial sector without a government bailout.[165]

Rajan suggests that "let them eat credit" is an appropriate way to summarize this policy leading up the financial crises.[166]

Another issue near and dear to the hearts of the Occupiers is transparency. Gillian Tett of the *Financial Times*[167] discusses two key problems with the financial system: the "silo problem"—banks reluctant to tell anybody details about their activities[168]—and the issue of "social silences"—finance being too "boring," "unfamiliar," and "technical" for mainstream public discourse.[169] Tett argues that neither of these problems has been eradicated post-crisis.[170] Thus far, "silo-busting" activity has been "far too modest and sporadic."[171]

Another major goal for the Occupy movement is a more democratic and egalitarian economy, or "to roll back the increasing threats to the inclusive nature of economic institutions in the United States."[172] Following in the footsteps of the Populists and Progressives of American history, Occupy protestors attempt to change political institutions "to remove the control that the wealthy have over the agendas and policies of the main political parties."[173] By definition, the Occupy movement carries general anti-Wall Street sentiments.[174]

164. Bethany McLean, *Your House as an ATM: The Myth of Homeownership*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 85, 99.

165. *Id.* at 85–86.

166. Raghuram Rajan, *Inequality and Intemperate Policy*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 79, 81.

167. Gillian Tett, *Hidden in Plain Sight: The Problem of Silos and Silences in Finance*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 44.

168. *Id.* at 46–47.

169. *Id.* at 48–49.

170. *Id.* at 50–51.

171. *Id.* at 52.

172. Daron Acemoglu & James A. Robinson, *Against Political Capture: Occupiers, Muckrakers, Progressives*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 110.

173. *Id.*

174. *See* John Cassidy, *What Good Is Wall Street?*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 54, 77 (arguing that Wall street bankers do not create enough economic value to justify the rewards they reap); Arjun Appadurai, *A Nation of Business Junkies*, *in* THE OCCUPY HANDBOOK, *supra* note 158, at 113, 116 ("The avalanche of business knowledge and information dropping on the American middle class . . . has made us business junkies, ready to be lead like sheep to our own slaughter by Wall Street, the big banks, and corrupt politicians.").

A movement with the foregoing concerns—namely, opposition to an economy that "redistributes wealth from the poor and middle class to those at the top" through, among other things, "bailouts for giant banks and corporations"[175]—should have great interest in the operations of the Federal Reserve. As discussed above, inflation has a redistributionary effect in favor of the inflators and early receivers of the new money.[176] In practice, Bloomberg has found that the Fed committed $7.77 trillion as of March 2009 to rescuing the financial system—with the six biggest U.S. banks borrowing as much as $460 billion.[177]—while the GAO uncovered $16 trillion in secret loans to bailout American and foreign banks during the financial crisis.[178] This type of money creation represents not only a regressive "inflation tax" on the "99%," but also the political power that the "1%" has in the political system. As discussed above, Fed credit expansion policy during the boom was ultimately to the detriment of the middle- and lower-class. Certainly, any movement that is anti-Wall Street should at least be curious about the Fed. What better way to foster transparency in the financial system and "stick it" to the 1% than to audit the Fed?

Thus, Occupy Wall Street should be part of a coalition that pushes for an audit of the Federal Reserve. Furthermore, after more light is shed on Fed operations, the movement should be part of a coalition that provides a political check on credit expansion, thus helping to regulate the boom-bust cycles in the U.S. economy.

B. The Tea Party

In 2009, the Tea Party movement emerged as a "mad as hell" opposition movement in response to a push by President Obama and the Democrats for economic and healthcare reform.[179] The movement emerged during a time when the Bush administration had spent hundreds of billions of dollars bailing out Wall Street with the Troubled Asset Relief Program (TARP) and the Obama administration had passed an $800 billion economic "stimulus" package.[180]

The Tea Party complains of "federal government spending, the government's soaring debt, and the increasing size of government":[181]

> It complains of high taxes and excessive government spending, and it has taken the name the Tea Party, where "Tea" stands for "Taxed Enough

175. Van Gelder, *supra* note 152, at 3.
176. ROTHBARD, *supra* note 60, at 992.
177. Ivry, Keoun, & Kuntz, *supra* note 34.
178. GAO-11-696, *supra* note 45, at 131.
179. RONALD P. FORMISANO, THE TEA PARTY: A BRIEF HISTORY 5 (2012).
180. *Id.* at 13–14.
181. *Id.* at 11.

> Already." It calls for—no, demands—limited government, debt reduction, no higher taxes, and no new spending. It reveres the Constitution, interpreting it as limiting the powers of the federal government, and argues that Congress has far exceeded its rightful boundaries.[182]

The Tea Party has had an impact on both the Democratic and Republican parties, particularly in the 2010 midterm elections, helping create a Republican majority in the House of Representatives and exerting influence on the 2011 Republican legislative agenda.[183]

The Tea Party movement is composed of various ideological factions, including conservatives, the "Religious Right," and constitutionalists,[184] as well as big business and libertarians.[185] It follows, then, that the movement is wrought with internal ideological clashes.[186] However, Professor Elizabeth Price Foley identifies three core principles shared by various Tea Party factions across the country:

> (1) limited government—protecting and defending the idea that the federal government possesses only those powers enumerated in the Constitution; (2) unapologetic U.S. sovereignty—protecting and defending America's borders and independent position in the world; and (3) constitutional originalism—interpreting the Constitution in a manner consistent with the meaning ascribed by those who wrote and ratified the text.[187]

These core principles manifest themselves in current issues that are important to the Tea Party, including healthcare reform, fiscal responsibility, immigration, internationalism, and the war on terror.[188]

At least one of the core concerns that helped spark the Tea Party movement is directly related to this "audit the Fed" analysis: "The federal government's shift into bailout mode . . . reflecting the resurgence of Keynesian economic philosophy in which a failing economy can best be salvaged by a constant infusion of government cash—a counterintuitive, let's spend-our-way-out-of-this-mess mentality."[189]As the Fed bails out Wall Street[190] and continues its quantitative easing programs,[191] the movement's anti-bailout, anti-Keynesian mentality fits squarely with legislation to audit the Fed, as well as providing a political check on the Fed's credit expansion

182. *Id.* at 1.
183. *Id.* at 6.
184. FORMISANO, *supra* note 179, at 52.
185. *Id.* at 63.
186. *Id.* at 52, 63.
187. ELIZABETH PRICE FOLEY, THE TEA PARTY: THREE PRINCIPLES 19 (2012).
188. *Id.*
189. *Id.* at 9.
190. Ivry, Keoun, & Kuntz, *supra* note 34; GAO-11-696, *supra* note 45, at 131.
191. Bd. of Governors of the Fed. Reserve Sys., *supra* note 148.

policy. Moreover, anti-inflationism has a place in conservative ideology,[192] while libertarian philosophy outright opposes the existence of the government-chartered central bank.[193] Finally, and most directly in line with Tea Party principles, the fact that the federal government can borrow from the central bank in order to fund its operations[194] has direct and obvious implications for the Tea Party's main goal of curtailing "federal government spending, the government's soaring debt, and the increasing size of government."[195]

Thus, the Tea Party should be part of a coalition that pushes for an audit of the Federal Reserve. Furthermore, after more light is shed on Fed operations, the movement should be part of a coalition that provides a political check on credit expansion, thus helping to regulate the boom-bust cycles in the U.S. economy. Indeed, we have seen that "pressure from anti-tax Tea Party activists and other small government advocates" caused 2012 presidential candidate Mitt Romney to at least give lip service to the idea[196] and the Republican Party to include the measure in its platform.[197]

CONCLUSION

The 2008 financial crisis and subsequent "Great Recession" provides a textbook example of Austrian Business Cycle Theory, with an inflationary boom leading to an inevitable bust.[198] Furthermore, financial institutions are more likely to engage in riskier behavior as a result of Fed bailouts that create moral hazard.[199] Despite the role the Fed plays in bringing about and prolonging economic downturns, under current law, monetary policy decisions, agreements with foreign central banks and governments, and Federal Open Market Committee transactions are immune from Federal Reserve audits.[200] However, the Occupy Wall Street and Tea Party movements provide an ideological coalition that can push for an audit of the Federal Reserve. Furthermore, after more light is shed on Fed operations, the movements should be part of a coalition that provides a political check on credit expansion, thus helping to regulate the boom-bust cycles in the U.S. economy. That is not to say that either group is likely to embrace—or even understand—Austrian Business Cycle Theory. However, the movements' concerns for other issues, from inequality to "big government," can have the unintended consequence of

192. ROTHBARD, *supra* note 60, at 992.

193. *See* PAUL, *supra* note 10, at 192.

194. MISES, *supra* note 60, at 568.

195. FORMISANO, *supra* note 179, at 11.

196. Lerer & Davis, *supra* note 12.

197. COMM. ON ARRANGEMENTS FOR THE 2012 REP. NAT'L CONVENTION, *supra* note 14, at 4.

198. Salerno, *supra* note 116, at 5.

199. Hülsmann, *supra* note 86, at 44.

200. 31 U.S.C. § 714 (2006).

bringing about financial reform through an "unholy coalition" of unwitting Misesians.

There is precedent for this type of "unholy coalition": the 2009 version of the "audit the Fed" bill was introduced by libertarian Ron Paul in the House[201] and self-described socialist Bernie Sanders in the Senate.[202] Still, one might object that a full audit and corresponding political check on Fed credit expansion are not likely. Indeed, Mises himself wrote: "In the opinion of the public, more inflation and more credit expansion are the only remedy against the evils which inflation and credit expansion have brought about."[203] However, the fact remains that, according to Rasmussen, roughly seventy-five percent of Americans favor auditing the Federal Reserve.[204] As the ideological tide of the electorate—as represented by the Tea Party and Occupy Wall Street movements—moves towards a Fed audit, so too does Congress: "audit the Fed" finally passed the House in 2012 after Ron Paul had been introducing the bill in Congress *for a decade*.[205] Dr. Paul provides anecdotal evidence of the excitement surrounding the push for Fed reform on college campuses:

> I was able to speak to more than 4,000 students. . . . [W]hen I mentioned monetary policy, the kids started cheering. Then a small group chanted, "End the Fed! End the Fed!" The whole crowd took up the call. Many held up burning dollar bills, as if to say to the central bank, you have done enough damage to the American people, our future, and to the world: your time is up.[206]

If an audit of the Federal Reserve can appeal to the ideological tendencies of both the left-wing Occupiers and the right-wing Tea Partiers, perhaps this modest reform is a more practical alternative than trying to address Judge Posner's prognosis of a failure of an entire economic system.

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201. Federal Reserve Transparency Act, H.R. 1207, 111th Cong. (2009).
202. Federal Reserve Sunshine Act, S. 604, 111th Cong. (2009).
203. MISES, *supra* note 60, at 574.
204. *75% Favor Auditing The Fed*, *supra* note 15.
205. Moody, *supra* note 11.
206. PAUL, *supra* note 10, at 4.

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