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What Uber Can Teach the Fed

The bank's efforts to control the price and allocation of credit are increasingly distortive and making the Fed irrelevant to credit markets.

George Melloan

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Only a dance critic could fully appreciate the will-she-or-won't-she gavotte that reporters and traders perform, week after week, trying to guess Janet Yellen's intentions. For all sorts of reasons, including inadequate returns to pension funds, the chairwoman of the Federal Reserve is being urged to loosen her grip on interest rates. And yet, despite hints and half-promises, rates remain close to zero.

John Tamny's startling advice: Forget about it. In "Who Needs the Fed?" he argues that the Federal Reserve's distortive efforts to control the price and allocation of credit—under the false flag of "economic stimulation"—are making the institution increasingly irrelevant to credit markets.

The Fed has indeed become a big allocator, or misallocator, of credit. Its "quantitative easing" programs have funneled newly created dollars into a massive purchase of government debt and mortgage-backed securities, helping balloon the national debt to $19 trillion today from $9 trillion in 2007. But Mr. Tamny also argues that banks—dominated by the Fed and its principal instruments of monetary policy—are a "shrinking source" of credit, now accounting for only 15% of U.S. credit transactions. They have been supplanted by non-bank credit, including direct investment.

To set up his provocative thesis, Mr. Tamny revives an often neglected truth: Although the Fed can create money, money isn't credit. Money is only a medium that facilitates borrowing and lending, a "lubricant," not the substance of such transactions. Tangible goods are the substance.

Mr. Tamny reminds us that a lender, in essence, lends his surplus production

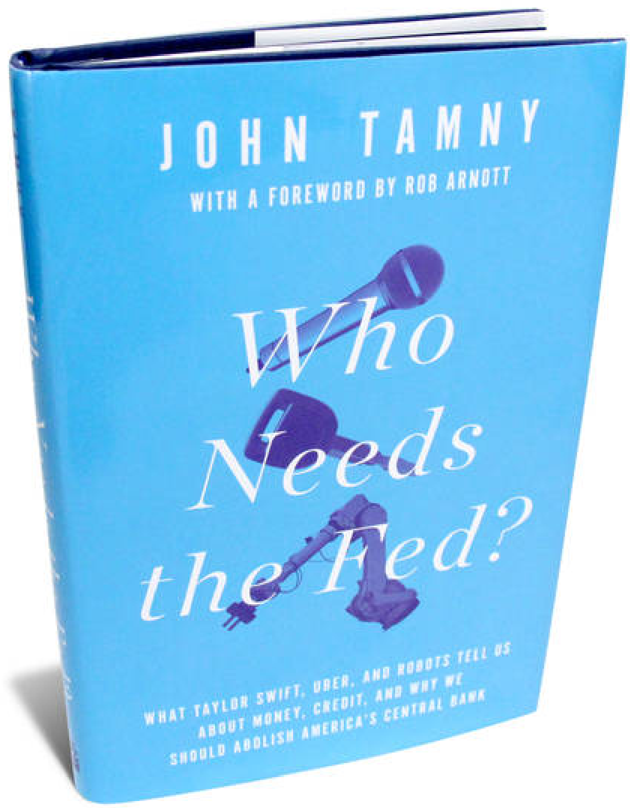

PHOTO: WSJ

WHO NEEDS THE FED?

By John Tamny

(denominated in money) to someone willing to pay rent on those resources. Borrowers use the money to buy other tangible resources—a house or car or, more important, the tools to make themselves more productive and thus able to generate surpluses of their own to offer up for rent. This is hardly rocket science, but it is often forgotten that dollars are only the medium. Without the production of real assets, there's no credit.

Because the Fed doesn't produce anything but the medium—albeit a medium that is government-backed—the Fed's credit-rigging efforts are tangential, not comprehensive. Through its symbiotic relationship with banks, it can and does influence bank credit. It has recently spread its price-control net more broadly by intervening in the "repo" market used by both banks and non-banks to adjust their balances.

But when you consider all forms of lending, you discover a broader landscape, one in which credit is dependent on the production and exchange of real goods and services. The millions of people who get up and go to work every morning, not the Fed, are the creators of that world.

Part of "Who Needs the Fed?" is devoted to how the author's definition of credit applies to the modern economy. Thus Mr. Tamny explains why singer-songwriter Taylor Swift was powerful enough to thwart Apple's plan to offer her music free of charge to promote its new music-streaming service. Ms. Swift objected to not getting paid and threatened to withhold from Apple streaming rights from her hit album "1989." She was able to force the technology giant to back down, Mr. Tamny says, because she controlled something valuable that Apple wanted—her music. In short, her ability to produce a sought-after product gave her market power or, to put it another way, credit.

Similarly, Mr. Tamny extols Uber, the San Francisco-based company that has burgeoned with an app that enables anyone with a smartphone and credit-card account to summon a car and driver on short notice. This is an example of the "sharing" economy, which through the magic of match-making software enables a seamless transaction between buyer and seller. Mr. Tamny also does a riff on robots and their promise for the future as they take over more and more tasks. As with technological advances throughout history, he says, the increased productivity, despite the job dislocations it causes, will be beneficial overall.

"Who Needs the Fed?" is studded with pointed aphorisms and remedial precepts. On the economy: "It's not capitalism if there's not a lot of failure." On attracting immigrants: "The most powerful market signal of all—and nothing else comes close—concerns where people choose to live." On Keynesian assumptions: "Government need never implement policies designed to encourage spending. As individuals, we're wired to demand things and our wants are unlimited." And: "Governments can only supply credit (access to real economic resources) that they've extracted from the real economy first. This is the opposite of stimulative."

Will the Federal Reserve indeed become irrelevant? Mr. Tamny seems to think so, but he may be too optimistic if he believes that the Fed will fade away and be replaced, for example, with private bank notes or an international gold standard. It is true, as he points out, that central banks are looking more aberrational as some try to push the cost of borrowing to less than nothing (negative interest rates). But it is hard to believe that mere irrelevance can ever lead to the end of institutions that have become so valuable to governments as they try to finance their spending excesses. Mr. Tamny concedes that it is foolhardy to predict the demise of any government agency, no matter how useless it might become. But could we get along without the Federal Reserve? Mr. Tamny makes a good case that we not only could but would be better off in its absence.

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