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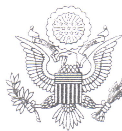

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AND RESEARCH

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LIVESTOCK, DAIRY, AND POULTRY

December 9, 2009

Dear Colleague:

The op-ed below from the *Wall Street Journal* explains how our ever-increasing national deficit and debt, and the federal government's efforts to finance them, are stifling job creation and innovation in America. I urge you to read it and to then consider joining 169 bipartisan cosponsors of H.J.Res. 1, to require a Balanced Budget Amendment to the U.S. Constitution. For more information, or to cosponsor this legislation, please contact Branden Ritchie on my staff at 5-5431 or branden.ritchie@mail.house.gov.

Sincerely,

Bob Goodlatte
Member of Congress

November 23, 2009
"Government Deficits and Private Growth" by George Melloan (The Wall Street Journal Op-Ed)

For anyone who wondered if last winter's federal seizure of the financial services industry would have adverse economic consequences, an answer is now available. The credit market has been tilted to favor a single borrower with a huge appetite for money, Washington. Private borrowers, particularly small businesses, have been sent to the end of the queue.

The Federal Reserve, which supervises some 7,000 banks, has been telling bankers that they must cut risk. The most spectacular step in that effort was the Fed announcement last month that it will evaluate the salaries of bank officers on how carefully they manage risk.

By official definition, Treasury securities are risk-free, so how better to manage risk than to pad your bank's portfolio with Treasury securities, which is what bankers are doing. Under the new management from Washington, bankers who take a flyer on a venture that might some day become an Apple, Microsoft or Google will risk not only their depositors' money but a possible pay cut. Banking has been captured by the nanny state, which means that its potential for contributing to economic growth and job creation has been sharply curtailed, even as its potential contribution to government growth has been expanded.

The federally dictated risk-aversion was underway even before the Fed began monitoring banker paychecks. According to the Fed's September flow of funds report, commercial banks were net buyers of Treasury securities to the tune of $25 billion on an annualized basis in the second quarter. They were net buyers of federal agency paper—think Fannie Mae and Freddie Mac—at an annualized rate of a whopping $185 billion, contributing mightily to federal efforts to keep these miscreants afloat. Meanwhile, private lending, which once was the mainstay of banking, was shrinking at a $392 billion annual rate.

Economist David Malpass detailed the squeeze on lending to small business in a recent post on his Encima Global blog. He noted that a member survey by the National Federation of Independent Businesses in May found that 16% of respondents were reporting loans hard to get, the worst reading since the 1980-82 recession. The Federation's October report showed only a small improvement. Mr. Malpass predicted further tightness through the third and fourth quarters.

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Washington hasn't been able to milk the taxpayers sufficiently to finance its massive deficit. The Chinese are getting skittish as well. So tapping bank deposits is yet another avenue to a big pot of cash. As for the bankers, they've been awarded an easy life. Thanks to the Fed's zero interest-rate policy, they can make a decent profit on "safe" Treasury and agency securities yielding 3% or more. The too-big-to-fail banks like Citi and Bank of America can draw on their big shareholder, the U.S. Treasury, if their capital needs further supplements. Bankers don't have to worry about making risk judgments because they've been ordered to not take risks. So maybe the Fed is justified in cutting their salaries, since whatever banking skills they had—meaning the ability to assess risk—are no longer needed or wanted. An office boy could buy government bonds.

There is a plentiful supply. The reported federal deficit for the fiscal year ended Sept. 30 was $1.4 trillion. That is a whale of a deficit in itself, but the primitive cash-flow accounting from which it is derived understates the real red ink. As former Treasury official Peter Wallison says, it's the way a mom and pop grocery does accounting: cash in versus cash out. It would not pass muster under the accounting rules corporations are required by the Securities and Exchange Commission to follow, in that it takes no account of such huge contingent liabilities like Medicare and the Enron-style off-budget agencies.

A number more relevant to what the government is actually demanding from the capital markets is the Treasury's financing requirement. At a recent Chartered Financial Analyst Institute conference, Treasury official Karthik Ramanathan proudly described the prodigious fund-raising task he and his colleagues pulled off in the fiscal year, what one might call a borrowing feat unparalleled in human history: "In the course of 291 auctions in 251 business days, Treasury issued nearly $7 trillion in gross Treasury marketable securities to raise approximately $1.7 trillion to finance the government."

But the Treasury Borrowing Advisory Committee on Long-term Finance was less than thrilled. In its August report to Secretary Timothy Geithner, the committee said: "This year's double-digit-as-a-percent-of-GDP budget shortfall [the federal deficit] is unsustainable. Moreover, there is little support for a marked shrinking in the deficit in the year ahead, as revenue trends likely will remain sluggish amid high unemployment and lingering capital losses and public spending will remain elevated as a share of the economy. Various policy efforts under discussion by the Administration and Congress also probably would add to the deficit and public debt on a net basis."

Needless to say, the Obama administration and Congress aren't heeding such warnings. More big spending programs on health care and green energy are getting teed up.

Fed Chairman Ben Bernanke said at a Richmond Fed market symposium last April that the Fed was attempting to "avoid both credit risk and credit allocation in our lending and securities purchase programs." The "attempt" has hardly been obvious and clearly is not succeeding, particularly with regard to credit allocation. Aside from the not-so-subtle efforts to enlist the banks in a government bond drive, there are the direct allocations of credit that have been practiced by the Fed and Treasury since the banking crisis a year ago. Infusions to Citigroup, Bank of America, JP Morgan Chase for the takeover of Bear Stearns, Fannie, Freddie, AIG, GM, Chrysler, the commercial paper industry, money market funds, etc., have clearly been credit allocation, big time.

James Hamilton of the University of California at San Diego wrote in his "econbrowser" blog on March 29 that, "the new Fed balance sheet represents a fundamental transformation of the role of the central bank." He noted that for many years the Fed had pumped money into the economy with no attempt to direct which borrowers would receive credit. The whole idea behind the Fed's open market operations is to make the process of creating new money completely separate from the decision of who receives any fiscal transfers.

"In a traditional open market operation," Mr. Hamilton writes, "the Fed buys or sells an existing Treasury obligation for the same price anyone else would pay for the security. As a result, the operation itself does not involve any net transfer of wealth between the Fed and the private sector. The philosophy is that the Fed should base its decisions on economy-wide conditions, and leave it entirely up to the market or fiscal authorities to determine where those funds get allocated.

"The philosophy behind the pullulating new Fed facilities is precisely the opposite of that traditional concept. The whole purpose of these facilities is to redirect capital to specific perceived priorities."

Yes, things have changed in a year. Feeding the government and starving free enterprise looks like a prescription for long-term economic stagnation. It's not unlike what we witnessed in the depression of the 1930s.