



MEMORANDUM

TO: Federal Financial Analytics Clients
FROM: Karen Petrou
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Late last week, Ranking Member Brown (D-OH) led senior Democrats in sending two astonishing letters to FRB Chairman Powell and Vice Chair Quarles. Going beyond criticism of recent Fed regulatory rewrites, the letters essentially [accused the vice chair](#) of reckless indifference to the lives of most Americans and the safety of the financial system on which they depend. The [Powell letter](#) waved an iron fist beneath a thin velvet glove – the senators were more courteous to Mr. Powell, but told him in no uncertain terms that their tolerance of Fed monetary policy is ebbing fast. Once, issues such as the big-bank Tier 1 leverage ratio – the specific battle cry of these letters – were not just obscure, but fought out between allies of big or small banks with little regard to political party. Now, technical questions have become political litmus tests. Once, Fed independence was immutable. Now, the Fed is picking fiscal winners and losers. Little wonder that Democrats want their say and, in 2021, they might get it.

I've read a lot of letters from Members of Congress to bank regulators over the years – God knows how many by now – but I can't recall one as flat-out angry as the Democrats' letter to Mr. Quarles. Once, ire of this magnitude was rare and almost always cloaked in collegiality. Even third-rail issues such as Social Security or Medicare reform were largely contested with civility. That temporary relief for banks under the Tier 1 leverage ratio sparks such a storm shows that the rewrite of financial regulation in 2021 – and there will be one – will make the battle over Dodd-Frank look like a genteel outing.

The role of the Fed was also once a matter of civil discourse, with the central bank going largely unquestioned since a House Banking chairman of the 1980s, Henry Gonzalez, revived reforms pioneered two decades before by his Banking Committee predecessor, Wright Patman. Mr. Gonzalez was an old-school progressive Democrat – a hard-scrabble, second-generation Texan who came to Congress after long fights for worker rights and other battles of the mid-20th century. Like him in many ways, His allies were hard-scrabble conservatives who fought hard on other fronts. They distrusted the Fed at least as much as Mr. Gonzalez and often for the same reason – populists and progressives regardless of party hated and feared both the central bank and all but the smallest banks.

The reason none of these Texas Democrats nor their Republican allies – and there were more than a few of them – ever got anywhere with Fed reform was that they faced an all-powerful, bipartisan phalanx of moderate Republicans and Democrats. Now, there's little center to American politics and thus a fragile firewall for the Federal Reserve. Had it stuck to its role and normalized its massive interventions after 2010, it would face criticism; because it didn't and now plays a virtually omnipotent macroeconomic role and a near-determinative fiscal one, it does.

A small case in point is to be found in today's hearing on the Fed's Main Street program. Critics allege that the Fed changed its rules solely to favor the oil-and-gas industry. Suspicions were aroused in part because this program, like so many other new Fed ones, is in partnership with the Treasury Department and the Trump Administration wanted new loans for fossil-fuel companies flowing fast. Critics may or may not be right about the Fed's concessions to Administration demands, but that the Fed is crafting programs large enough to make so great a market difference and that the terms of engagement favor some over others makes it inherently vulnerable to this attack and many, many more.

If these aren't the worst of political times – Members of Congress did once physically assault each other -- they're close. If these aren't also the worst of macroeconomic times, the data tell us that they are also close. After at least a decade in which Democrats became increasingly progressive and Republicans increasingly far less so, the center that Henry Gonzalez could not breach has collapsed. When there was a center, "Wall Street" and its friends at the Fed had a powerful political consensus on their side. Without a center and in the midst of the maelstrom, both large banks and the Fed may well face a reckoning next year.