



MEMORANDUM

TO: Federal Financial Analytics Clients
FROM: Karen Petrou
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On Wednesday, Democrats on the House Select Subcommittee on the Coronavirus [lambasted](#) the Fed's Secondary Market Corporate Credit Facility for buying bonds issued by companies that sinned by way of laying off workers, paying dividends, violating the law, and/or being known to associate with fossil fuels. Chairman Powell vainly defended the facility, countering at various times that it never lent anyone any money, that it only bought pre-existing bonds, that worrying about workers was beyond the Fed's mandate, and – garnering special skepticism – that no one benefited from Fed purchases. In this confrontation as in an increasing number of others, the Fed faces a fundamental challenge: by venturing into an array of unprecedented financial-market activities, it has unintentionally but irretrievably taken a stand on one of the most contentious financial-policy questions of our time: whether shareholder or stakeholder capitalism is the preferred U.S. policy that determines to whom Fed support and even rescues are directed.

Starting last March, each announcement for every Fed facility has boilerplate language dedicating the Fed's billions to "support the flow of credit for households and businesses." Which households and businesses are never said, a politically-astute omission and, as it's turned out, also an accurate one. It's been clear from the outset of its market interventions that the Fed is a fan of trickle-down [economics](#). Robust markets are seen as the way to get credit flowing even if it flows down from on-high.

Just this past week, the Federal Reserve Bank of Atlanta issued a "mission-accomplished" [report](#) on the Secondary Market Credit window, arguing that lower bond spreads proved its value. The Federal Reserve Bank of New York's blog is also replete with encomia on their benefits to smooth market functioning without regard to generic households and businesses, let alone those in most need of help.

To be sure, markets are good for some households – I just got a packet from my banker including a nice graphic linking the Fed's growing portfolio to an ever-upward market trajectory. This trajectory has of course taken a bit of a dip, but most investors are just fine – the last bit of data shows that the top one percent still holds 52 percent of U.S. corporate equities and mutual fund shares.

This is not, of course, what even the Fed means when it says households – it's trying to suggest widespread benefits of its many programs. Similarly, its approach to the benefited businesses is also characterized by trickle-down reasoning. None of the businesses in any of its facilities is small or even pretty small, but they are somehow also supposed to benefit from Fed largesse

except when a program is actually directly targeted to what the Fed likes to call Main Street businesses, not the very large corporations nestled in its other facilities.

Here, we see that the Fed's approach to shareholder capitalism is met with more than just Democratic skepticism. Although Democrats did all of the pounding at each of [this week's hearings](#) on the corporate facilities, the Main Street Lending Program came in for a bipartisan shellacking. Mr. Powell tried valiantly to explain that the facility's \$250,000 threshold sets a critical dividing line between loans suitable for a central bank's mission and those necessarily beneath its notice, virtually no one on any of the committees was convinced.

And no wonder – how could it be proper for a central bank only to support larger businesses once it had broken the taboo of doing any of this at all? It may well be burdensome to do a lot of little loans, but Congress is convinced that little loans are what the nation needs and suggestions that fiscal policy in the form of the PPP is the only option simply don't fly now that the Fed purports to be lending to "Main Street."

Congressmen on all sides of the aisle and in every political club understand something many in the markets have missed: that a U.S. central bank in the corporate finance business is either just a very, very big bank or a very, very fiscal agent. Either way, it's no longer the august arbiter of pristine monetary policy in which it takes such pride.

The barrier between finance and monetary policy is non-existent in some nations – Japan for example – where state capitalism is the order of the day. It's porous to the point of complete permeability in other regions – the EU as a case in point – where banks have long been viewed as national champions. However, once the barrier between central banking and commerce was inviolate in the U.S., made so in part by the profound hostility this nation has to centralized financial power. It is for this reason that it took two centuries to construct a U.S. central bank and why it parsimoniously circumscribed itself only to Treasury obligations for many decades of open-window operations and discount-window collateral eligibility. The Fed got a warning shot in 2010 when the Dodd-Frank Act included sharp restrictions on its 13(3) [powers](#) and another when Congress reaffirmed these restrictions even as it opened the [Main Street facility in the CARES Act](#). It's of course contradictory both to mandate strict Fed liquidity-support restrictions and demand more Fed support for hard-hit households and businesses, but that's Congress for you.

Because the Fed in March reopened the flood-gates, Congress in April sought to direct the deluge. The Fed is dancing on a tightrope to satisfy both financial markets and its Congressional masters. The stand it chose – for shareholder capitalism – may be what markets prefer, but it's far from what politicians – even many of the most conservative among them – demand when constituents come calling. Stakeholder capitalism is what Congress mostly wants even though some extoll the benefits of a "free market" because that's what voters demand when they understand themselves as stakeholders. COVID has taught Congress this lesson; that the Fed hasn't yet learned it puts its vaunted independence at grave risk.