NOVA SOUTHEASTERN UNIVERSITY
Shepard Broad Law Center

May 15, 2018

Patrick D. Kelly
Secretary-Treasurer
Teamsters Local 952
140 South Marks Way
Orange, California 92868

Dear Mr. Kelly:

At a time of mounting federal budget deficits, there is little political support for massive federal spending programs on infrastructure, pension reform, and other pressing needs for working Americans. However, there's much the nation's central bank, the Federal Reserve, can do to help in all these areas, without adding a penny to federal deficits and while also contributing to a sustainable economic recovery, more balanced economic growth, and increasing levels of employment.

In the aftermath of the 2008 financial collapse, the Federal Reserve departed from conventional approaches to monetary policy by exercising long-dormant powers to assist the same Wall Street financial institutions that had largely caused the crisis. The central bank should extend similar financial assistance to Main Street interests.

The Federal Reserve's authority to provide assistance to Main Street

Since the 1930s, the Federal Reserve has had the authority under Section 13(3) of the Federal Reserve Act to make loans directly to non-bank enterprises "in unusual and exigent circumstances." Its Board of Governors has complete discretion in determining what constitutes unusual and exigent circumstances. The Federal Reserve repeatedly invoked such authority during the height of the 2008 crisis – such as in lending $29 billion to assist JP Morgan Chase in acquiring Bear Stearns, the Fed's $180 billion bailout of the American International Group (AIG), and its

multi-trillion-dollar liquidity support programs across financial markets -- including for mutual funds, commercial paper, primary dealers, and securities lending.

The Federal Reserve also engaged in successive asset purchase programs under its Section 14 Open Market authority. Under these so-called Quantitative Easing (QE) programs, the Fed purchased nearly $4 trillion in Treasury securities and mortgage-backed securities. This had the effect of propping up and pumping up financial markets and private financial institutions.

All of these interventions departed from the Federal Reserve's traditional role and powers in the conduct of monetary policy and from its supposed social neutrality. At no time since the financial crisis has the Federal Reserve provided financial support for Main Street interests in the form of loans or asset purchases.

It's long overdue for the Federal Reserve to use these same powers to provide relief to Main Street USA. Millions of Americans are underemployed and struggling in year ten of a great depression in jobs, incomes, and savings. We argue that the Federal Reserve already has the authority under Sections 13 and 14 to support a wide range of Main Street interests, including:

- federal agencies, such as any newly-created national infrastructure bank, for public works and infrastructure projects;
- state infrastructure banks for capital investments;
- Puerto Rico recovery program that helps refinance state-owned corporations and public sector budgets;
- Fannie Mae and Freddie Mac and other lenders, to modify residential mortgages;
- the student debt market, to modify loan repayments and provide a moratorium on repayments on student loans
- pension funds and union trust funds, to extend their solvency for decades;
- community banks and medium-sized banks that participate in infrastructure projects initiated by state and local governments; and
- small businesses of all kinds, as the Fed did in the 1930s.

None of such Federal Reserve support programs – from low interest loans to asset purchase programs – need cost the taxpayer a penny. Just as the trillions of dollars lent and spent by the Federal Reserve to help Wall Street did not add a penny to federal deficits or debt.

Pension Funds and Union Trust Funds

The 2008 financial collapse created an immediate crisis for pension funds, from corporate and "multiemployer" Taft-Hartley plans to public employee pension plans. The collapse in securities markets created major losses and long-term problems for all these pension plans.

The nation's 1400 multiemployer plans, covering more than 10 million participants -- including 4 million active employees and 6 million retirees -- are facing a hole of $553 billion in unfunded liabilities, with hundreds of plans and the Pension Benefit Guaranty Corporation itself all facing possible insolvency within the next decade. In addition, big public employee pension plans are also seriously underfunded, covering some 14.7 million active employees and 6.3 million retirees. Combined, these defined benefit pension plans cover some 25 million Americans – a large population suddenly facing financial insecurity and austerity, which could present a significant drag on the performance of the overall American economy.

Congress is presently considering fixes, from rescuing these pension funds with low-cost loans from the Treasury Department, to cutting benefit payments or letting the funds go bankrupt and wiping out pensions for retirees.

In 2014, Congress adopted the Multiemployer Pension Reform Act to help funds develop rescue plans, in part by reducing benefits to retirees. Now Congress is considering proposals to stabilize plans with 30-year loans from Treasury, potentially costing taxpayers as much as $100 billion if loans are not repaid.

The idea of Treasury loans to financial institutions is reminiscent of the Troubled Asset Relief Program (TARP), adopted in October 2008 to rescue the nation's banking system. TARP was originally intended to consist of Treasury purchases of the troubled assets of banks, particularly their toxic mortgage-backed securities. But this raised a political problem. If TARP paid fair market value for the troubled assets, the banks would suffer immediate losses and collapse. If TARP paid the historical cost of the investments, the taxpayers would be paying for a bailout of the banks. Instead, TARP was used to inject capital by purchasing non-voting warrants issued by the banks.

The real bailout of Wall Street banks and hedge funds was not through TARP, but through the Federal Reserve. At the same time as TARP, the Federal Reserve adopted the first of its so-called "quantitative easing" (QE) programs to purchase troubled assets from banks and hedge funds. The QE programs continued for

several years. At the same time, the Fed extended low interest loans (often at 0.25 percent) in massive amounts to big financial institutions, estimated at more than $26 trillion in 2009-2010 by the Government Accountability Office (GAO).

The combination of these Federal Reserve programs – massive Federal Reserve lending and asset purchase programs -- allowed the banks to regain solvency and repay their TARP obligations quickly, strengthened financial markets and facilitated a rebound in asset prices. For the past decade, the largest private commercial banks, hedge funds, and securities markets have benefitted from this Federal Reserve support.

Had the Federal Reserve extended its QE programs to cover pension funds, there would likely be no crisis in the nation's pension funds today. What's needed now is for the Federal Reserve to do just that.

Legal Constraints on Federal Reserve Support

Certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 restrict the Federal Reserve's authority under Section 13(3). The Fed can now lend directly to individuals, partnerships, and corporations in unusual and exigent circumstances: (1) only if those entities are "unable to secure adequate credit accommodations from other banking institutions"; (2) as part of a program or facility with "broad-based eligibility"; and (3) only if supported by the U.S. Treasury secretary and at least five members of the Board of Governors. These restrictions need not prevent the Federal Reserve from directly lending to Main Street interests under Section 13(3), and they in no way restrict the Federal Reserve's authority under Section 14 to engage in asset purchases that would help Main Street.

I have written about the Federal Reserve's authority to assist Main Street in my book chapter, "The Bottom-Up Recovery: A New Deal in Banking and Public Finance," published in an edited and peer-reviewed volume entitled, *When Government Helped: Learning from the Successes and Failures of the New Deal* (Oxford University Press, 2013). A number of economists have already endorsed these approaches, including several who served with me in 2011-2012 on Senator Bernie Sanders' advisory committee on reforming the Federal Reserve, including William Greider, Jane D'Arista, and Rob Johnson. D'Arista. Their proposals included Federal Reserve support for small businesses, infrastructure projects, private and public pension funds and retirement systems, and residential mortgages.

A review of the Federal Reserve's legal authority and its recent and not-so-recent history of crisis response suggests that there are a wide range of strategies that the Federal Reserve could now pursue to finance a bottom-up and sustainable recovery that helps working Americans, raises incomes and thereby helps to restore the tax base of governments at all levels.

It is time for the Federal Reserve to provide Main Street with just a small fraction of the financial support it has given to Wall Street in the past decade.

Sincerely yours,

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