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HOW THE FEDERAL RESERVE BROKE
THE AMERICAN ECONOMY

CHRISTOPHER LEONARD

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Simon & Schuster Paperbacks
An Imprint of Simon & Schuster, Inc.
1230 Avenue of the Americas
New York, NY 10020

First Simon & Schuster trade paperback edition January 2023

Interior design by Ruth Lee-Mui

Manufactured in the United States of America

1 3 5 7 9 10 8 6 4 2

Library of Congress Cataloging-in-Publication Data has been applied for.

ISBN 978-1-9821-6663-2
ISBN 978-1-9821-6664-9 (pbk)
ISBN 978-1-9821-6668-7 (ebook)

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PART 1

"RESPECTFULLY, NO"

CHAPTER 1

GOING BELOW ZERO

(2010)

Thomas Hoenig woke up early on November 3, 2010, knowing what he had to do that day, and also knowing that he was almost certainly going to fail. He was going to cast a vote, and he was going to vote no. He was going to dissent, and he knew that this dissent would probably define his legacy. Hoenig was trying to stop something: A public policy that he believed could very well turn into a catastrophe. He believed it was his duty to do so. But the wheels were already turning to make this policy a reality, and the wheels were far more powerful than he was. The wheels were powered by the big banks on Wall Street, the stock market, and the leadership of America's Federal Reserve Bank. Everyone knew that Hoenig was going to lose that day, but he was going to vote no anyway.

Hoenig* was sixty-four years old, and he was the president of the Federal Reserve Bank of Kansas City, a position that gave him extraordinary power over America's economic affairs. He was in Washington that morning because he sat on the Federal Reserve's powerful policy-making

*Pronounced HAW-nig.

committee, which met every six weeks to effectively determine the value and quantity of American money. Most people in America don't think very much about money—meaning the actual currency, or that thing we call a dollar. The word *dollar* is, in fact, just a slang term for American currency, which is actually called a Federal Reserve note. People spend Federal Reserve notes every day (if they're lucky enough to have them), but they rarely think about the complex, largely invisible system that makes money appear out of thin air. This system is the U.S. Federal Reserve System. The Fed, America's central bank, is the only institution on Earth that can create U.S. dollars at will.

Because he was a senior official at the Federal Reserve, Thomas Hoenig had to think about money all the time. He thought about it in the same way that a very stressed-out building superintendent might think about plumbing and heating. Hoenig had to think about money as a system to be managed, and to be managed just right. When you ran the system that created money, you had to do your job carefully, with prudence and integrity, or else terrible things might happen. The building might flood or catch on fire.

This is why Hoenig felt so much pressure when he woke up that November morning in Washington, D.C. He was staying at a very nice hotel, called the Fairmont, where he always stayed when he traveled from his home in Kansas City to the nation's capital. Hoenig was in town for the regular meeting of the Federal Open Market Committee, or FOMC for short. When the committee met in Washington, its members voted and set the course of the Fed's actions. There were twelve members on the committee, which was run by the powerful chairman of the Federal Reserve.

For a year now, Hoenig had been voting no. If you tallied his votes during 2010, the tally would read: no, no, no, no, no, and no. His dissents had become expected, but they were also startling if you considered Tom Hoenig's character. He wasn't, by nature, anything close to a dissident. He was a rule-follower. He was born and raised in a small town, where he started working at the family plumbing shop before he was ten years old. He served as an artilleryman in Vietnam, and when he came home he didn't protest against the war. Instead, he studied economics and banking at Iowa State, earning a PhD. His first job out of school was as an economist with the Federal Reserve regional bank in Kansas City, in the supervision department. At the Fed, he went from being a rule-follower to being a rule-enforcer. Hoenig rose through the ranks to became president of the Kansas City Fed in 1991. This was the job he still held in 2010. His responsibilities as one of twelve regional Fed bank presidents illuminate the structure of America's money system. The Federal Reserve system is unlike any other in the world; it is a crazy genetic mashup of different animals, part private bank and part government agency. People talk about the Fed as if it were a bank, but it is really a network of regional banks, all controlled by a central office in Washington, D.C. Hoenig had all the fiery disposition that one might expect from a regional Fed president, which is to say none at all. He was soft-spoken, civil, wore cuff links and pin-striped suits, and spent his days talking about things like capital requirements and interest rates. Hoenig was an institutionalist, and a conservative in the little "c" sense of the word.

And yet here he was, in late 2010, a dissident.

After he woke up in his hotel room, Hoenig had some time alone before the big day started. He gathered his thoughts. He shaved, put on a suit, knotted his tie, and gathered his papers. If he had any doubts about what he was going to do that day, he didn't advertise them. He had spent months, years, even decades preparing for this action. His vote would reflect everything he'd learned during his career at the Fed. He was trying to apply what he knew to help the Federal Reserve navigate through extraordinary times.

The American financial system had broken in late 2008, after the investment bank Lehman Brothers collapsed. That moment marked a threshold for people like Tom Hoenig. Economists and central bankers describe the ensuing panic as the Global Financial Crisis, eventually bestowing the moment with its own biblical label, the GFC. The world of central banking was neatly divided into two eras. There was the world pre-GFC and the world post-GFC. The GFC itself was apocalyptic. The entire financial system experienced a total collapse that risked creating another Great Depression. This would mean years of record-high unemployment, economic misery, political volatility, and the bankruptcy of countless companies. The crisis prompted the Federal Reserve to do things it had never done before. The Fed's one superpower is its ability to create new dollars and pump them into the banking system. It used this power in unprecedented ways after Lehman's collapse. So many of the financial charts that capture the Fed's actions during this period look like the same chart—a flat line that bounces along in a stable range for many years, which then spikes upward like a reverse lightning bolt. The upward spikes capture the unprecedented amount of money the Fed created to combat the crisis. Between 1913 and 2008, the Fed gradually increased the money supply from about $5 billion to $847 billion. This increase in the monetary base happened slowly, in a gently uprising slope. Then, between late 2008 and early 2010, the Fed printed $1.2 trillion. It printed a hundred years' worth of money, in other words, in little over a year, more than doubling what economists call the monetary base. There was one very important characteristic of all this new money. The Fed can create currency in just one way: It makes new dollars and deposits them in the vaults of big banks. Only about twenty-four special banks and financial institutions have the privilege of getting these pristine dollars, making those banks the seedbed of the money supply. The amount of excess money in the banking system swelled from $2 billion in 2008 to $1.2 trillion in 2010, a level 800 times higher than before.

In doing all of this, the Fed had created a new foundation for the American financial system, built on extraordinary amounts of new money. Hoenig had a chance to watch firsthand as this system was created because he sat on the very committee that created it, the FOMC. In the beginning, during the crisis years of 2008 and 2009, he had voted to go along with the extraordinary efforts.

The dispute that Hoenig was preparing for, on that morning of November 3, 2010, was about what the Fed would do now that the days of crisis were over. A difficult and slow recovery was just beginning, and it was one of the most important moments in American economic history. It was the moment when one phase of economic conditions was ending and giving way to the next. The Fed had to decide what the new world was going to look like, and Hoenig was increasingly distressed by the path the Fed was choosing.

It is commonly reported that the FOMC meets every six weeks to "set interest rates." What this means is that the Fed determines the price of very short-term loans, a number that eventually bleeds out into the entire economic system and has an effect on every company, worker, and household. The basic system works like this: When the Fed raises interest rates, it slows the economy. When the Fed lowers interest rates, it speeds up the economy. The FOMC, then, is like a group of engineers in the control room of a nuclear power plant. They heat up the reactor, by cutting rates, when more power is needed. And they cool down the reactor, by raising rates, when conditions are getting too hot.

One of the most important things the Fed did during the Global Financial Crisis was to slash the interest rate to zero, essentially for the first time in history (rates had briefly flirted with zero in the early 1960s). Economists called the 0 percent interest rate the "zero bound," and it was once seen as some kind of inviolable boundary. You couldn't go below zero, it was believed. The rate of interest is really just the price of money. When interest rates are high, money is expensive because you have to pay more to borrow it. When rates are low, money is cheap. When rates are zero, money is effectively free for the banks who can get it straight from the Fed. The cost of money can't get lower than zero, economists believed, so the zero bound reflected the limits of the Fed's power to control interest rates. The Fed hit the zero bound shortly after Lehman Brothers collapsed, but the more important thing is what happened next. After hitting zero, the Fed didn't try to lift rates again. The Fed even started telling everyone very clearly that it wasn't *going* to try to lift rates. This gave the banks confidence to keep lending in a free-money environment—the banks knew that life at the zero bound was going to last for a while.

But by 2010, the FOMC faced a terrible dilemma. Keeping interest rates pegged at zero didn't seem to be enough. The economy had revived but remained in terrible health. The unemployment rate was still 9.6 percent, close to the levels that characterize a deep recession. The people who ran the FOMC knew that the effects of high and sustained unemployment were horrific. When people are out of a job for a long time, they lose their skills and they lose hope. They get left behind, compounding the economic damage of having been laid off in the first place. Even the kids of people who lose their jobs suffered a long-term drop in their earning potential. There was an urgency, inside the Fed, to stop this process. There was also the risk that the economic rebound might stall altogether.

That is why the committee began considering ways to break past the zero bound in 2010. The Fed's leadership was going to vote in November on a radical experiment, one that would effectively take interest rates negative for the first time, pushing yet more money into the banking system and shifting the Fed to the very center of American efforts to boost economic growth. No one knew what the world might look like after that. The experimental program had, like all things at the modern Fed, a name that was intentionally opaque and therefore difficult for people to understand, let alone care about. The plan was called "quantitative easing." If the program was enacted, it would reshape the American financial system. It would redefine the Federal Reserve's role in economic affairs. And it would make all of the things that Hoenig had been voting against look quaint. He was planning to vote against quantitative easing, and his dissent was going to be a lonely one. There was a tense debate inside the FOMC about quantitative easing, but the public barely knew about it. Political fights over America's money supply had become increasingly insular, even hidden, as they were decided by the Fed's leaders.

The politics of money used to be a charged political issue. It was once debated with the heat and passion that defined fights over taxes or gun control in 2010. Back during the presidential election of 1896, the Democratic nominee, William Jennings Bryan, made monetary policy one of his primary issues. He was a populist, and he used the topic to rile up crowds. This led to the most potent and most famous political statement ever made about American money, when Bryan proclaimed during a campaign speech, "You shall not crucify mankind upon a cross of gold!" Bryan was specifically talking about the gold standard in that speech, but he was also talking about short-term interest rates and the monetary base—exactly the issues regularly debated, in secret, by the twelve members of the FOMC. There was a reason the politics of money was so heated back in Bryan's day: The Federal Reserve hadn't yet been created. Managing the money supply was still in the public realm of democratic action. All of that ended when the Fed was founded in 1913. Power to control the money supply then belonged exclusively to the Fed, which then consolidated the power under the FOMC, which then debated behind closed doors. A big wall went up around the decision-making on money.

The things that bothered Hoenig about quantitative easing were just as important to the American people as the things that bothered Williams Jennings Bryan. The FOMC debates were technical and complicated, but at their core they were about choosing winners and losers in the economic system. Hoenig was fighting against quantitative easing because he knew that it would create historically huge amounts of money, and this money would be delivered first to the big banks on Wall Street. He believed that this money would widen the gap between the very rich and everybody else. It would benefit a very small group of people who owned assets, and it would punish the very large group of people who lived on paychecks and tried to save money. Just as important, this tidal wave of money would encourage every entity on Wall Street to adopt riskier and riskier behavior in a world of cheap debt and heavy lending, potentially creating exactly the kind of ruinous financial bubble that had caused the Global Financial Crisis in the first place. This is what Hoenig had been arguing inside the secret FOMC meetings for months, his arguments growing sharper and more direct, punctuated by his dissenting votes.

As it turned out, Hoenig was almost entirely correct in his concerns and his predictions. Perhaps no single government policy did more to reshape American economic life than the policy the Fed began to execute on that November day, and no single policy did more to widen the divide between the rich and the poor. Understanding what the Fed did in November 2010 is the key to understanding the very strange economic decade that followed, when asset prices soared, the stock market boomed, and the American middle class fell further behind.

At first, when Hoenig started casting "no" votes, he was trying to convince his peers that they might take a different path. But this effort was undermined by the Fed's chairman, Ben Bernanke, who was quantitative easing's author. Bernanke was an academic who had joined the Fed in 2002 and became chairman in 2006. Bernanke led the response to the Global Financial Crisis, which made him famous. He was anointed *Time* magazine's Person of the Year in 2009 and appeared on *60 Minutes*. In bailing out the financial system, Bernanke made the bank more influential than it had ever been. In 2010, he was determined to push things further. Bernanke saw Hoenig's concerns as wrongheaded, and disarmed them masterfully by personally lobbying the other members of the FOMC.

It eventually became obvious that Hoenig's "no" votes were unlikely to sway any of his peers on the FOMC. His dissents now had a different effect. He was sending a message to the public. He wanted people to understand that the Fed was about to do something profound, and that someone had fought against it. He wanted to telegraph that the politics of money wasn't just a technical affair involving smart people who solved equations. It was a government action that imposed a public policy regime, affecting everyone.

After Hoenig was dressed and ready for the meeting, he made his way to the hotel lobby, where he would face his fellow FOMC members before they cast their votes.

When the Fed's regional bank presidents came to town in 2010, the bank put them up in the Hotel Fairmont and, in the mornings, they gathered in the lobby, where they waited to be picked up by one of the most powerful car pools in America. The Fed sent vehicles to ferry them as a group to its headquarters building, about fifteen minutes away in D.C.'s dense morning traffic. Sometimes the regional bank presidents rode together in a van, at other times they rode one or two to a town car.

There was a deep feeling of collegiality among the bank presidents, and Hoenig fit in with them. His appearance could be described as standard-issue banker. He had a square jaw, a dimpled chin, and blue eyes; he was good-looking in a conventional, almost generic way. He had the face of someone that you might expect to see across the desk from you, about to extend you a reasonable thirty-year home loan. He was tall, and dressed conservatively. The cadence of his speech and his vocabulary matched the subdued color and cut of his wardrobe. He unspooled sentences methodically, in a measured way, never letting his words race ahead of his intended message. When Hoenig got agitated, he repeated the phrase "lookit" a lot, but that was about as salty as it got.

For many years, Hoenig got along quite well with everyone on the FOMC. When he came down to the lobby, he could easily make small talk with the other regional bank presidents. They shared a bond that few outsiders could understand. They operated a large part of the

American economic machine, and they shouldered a heavy burden in doing so. They were also, to a person, pretty brilliant people. There was Janet Yellen, for example, president of the San Francisco Federal Reserve. She was arguably one of the most accomplished economists in the country, having served as a Fed economist in the late 1970s before teaching stints at Harvard, the London School of Economics, and U.C. Berkeley. She had been chairwoman of the White House Council of Economic Advisers in the late 1990s and was fluent in the complex language of macroeconomics. But she had never lost her Brooklyn accent. She could be blunt as well as charming when talking about what the Fed might do next.

Then there was Richard Fisher, the president of the Dallas Fed, who looked every part the investment banker that he'd once been. Fisher slicked back his white hair, wore sharp suits, and spoke in a baroque and grandiloquent way during FOMC meetings, mixing poetic metaphors and jokes throughout his long monologues. Just a couple of months prior, Fisher had opened his remarks by saying: "Mr. Chairman, I'll tell a story to frame my comments. Three Texas Aggies apply to be detectives . . ." This was a typical Fisherian opening. There was also Charles Plosser, president of the Philadelphia Fed, a reserved academic, and Charles Evans, the young president of the Chicago Fed and a self-described "inflation nutter."

These were Hoenig's people. They all spoke the same language. They shared the same burden. Hoenig had worked around people like this his entire career, since joining the Fed in 1973. But his position inside the FOMC had grown increasingly strained with each "no" vote that he cast. Hoenig was pushing himself further and further to the fringe of the Fed's power structure.

There were two reasons why Hoenig's dissents were causing so much tension. The first had to do with the way the Fed was run. Consensus, and unanimous votes, had become all-important inside the FOMC. The world needed to have faith that the Fed's leaders knew what they were doing, and that what they were doing was something much more like math than like politics. The mighty brains who ruled the FOMC were portrayed to the public as PhD-educated civil servants who were essentially solving complex equations rather than making policy choices. When an FOMC member dissented, it shattered this illusion. It pointed out that there might be competing points of view, even heated debate, about what path forward the Fed ought to take. Unanimous votes helped the FOMC keep its power by essentially denying that it had power—it was just a group of smart engineers operating the power plant according to the rule manual.

The second reason Hoenig's dissents caused so much tension was tightly linked to the first. Consensus was ever more important at the FOMC because the decisions it was making were more consequential. America's democratic institutions were increasingly paralyzed, which left more work to be done by its nondemocratic institutions, like the Supreme Court and the Federal Reserve. This reality was literally blaring from TV sets and splashed on the front pages on the morning that Hoenig went down to the lobby. The Hotel Fairmont offered guests free copies of *The New York Times*, and, on that morning of November 3, the *Times* carried one of those bold-type headlines across the top of the front page that telegraphs emergency. "G.O.P. TAKES HOUSE," the headline read. Below that, in smaller type, it proclaimed: "SETBACK FOR OBAMA AND DEMOCRAT AGENDA; CUOMO WINS; SHOW OF STRENGTH BY TEA PARTY."

The previous day had been Election Day across America, the first midterm election of Barack Obama's presidency, a crucial vote that would determine who controlled Congress. Just two years prior, voters had hit the "change" button and hit it hard, giving the Democratic Party control of the White House and both chambers of Congress. Now voters hit the change button again, taking away control of the House of Representatives and crippling the Democrats' control of the Senate by narrowing their majority. This was a rebuke to Obama's administration, but it was also just one in a long string of rebukes against the democratically elected government in Washington. Almost every election was a change election by 2010. Voters threw the bums out, then threw the new bums out. The American electorate seemed motivated primarily by anger and discontent, and this anger found a new form in the conservative Tea Party movement. If the Tea Party had a single animating principle, it was the principle of saying no. The Tea Partiers were dedicated to halting the work of government entirely. The *Times* quoted a Tea Party activist stating that her goal was to "hold the line at all hazards."

It was a shame that America's democratic institutions, like Congress, stopped working at the very moment they were needed most. The Global Financial Crisis of 2008 didn't come out of nowhere. The collapse came after many long years of decay inside an economic system that had stopped working for a majority of Americans. The problems were varied and complex, and they all helped create the conditions for crisis, with indebted workers, powerful banks extending risky loans, and wildly overvalued market prices. People were borrowing more money in part because the decline of labor unions had taken away the bargaining power of workers, depressing their wages and degrading their working conditions. Trade deals shifted jobs overseas as new technology meant that fewer workers were wanted. An aging population relied more and more heavily on underfunded government programs like Medicare, Medicaid, and Social Security, creating huge levels of government debt. The education system was falling behind that of peer nations. Years of deregulation meant that the banking system was dominated by a few titanic firms that specialized in making and selling opaque and risky debt instruments. These were huge challenges facing the nation, and the federal government had not substantially addressed any of them. There were conservative ways to deal with these problems, and there were liberal ways to deal with these problems. But, with the election of the Tea Party, Congress was not going to deal with the problems at all.

The federal legislative machine had been switched off, beginning an era of stasis and dysfunction.

This put a tremendous burden on each member of the FOMC. On November 3, the Federal Reserve became the central driver of American economic policy making. If American voters had just voted to halt government action, they did so at the very moment when the Fed was about to embark on a program of unprecedented activism. This is why the Fed was able to act so quickly. Back in 2008, the Fed had gotten about $1 trillion out the door before Congress was even able to tie its shoes and start debating stimulus bills and bank bailouts. The twelve FOMC members couldn't ignore that they were charting the course of American economic development.

And it was exactly at this historical moment that Thomas Hoenig decided to embark on his string of dissents, among the longest of any FOMC member in history. Hoenig dissented so frequently that it seemed like he enjoyed it. A columnist at *The Wall Street Journal* wrote a regular column called "The Lone Dissenter" in which he interviewed Hoenig after each "no" vote. Hoenig wasn't just undermining the image of a consensus-driven Fed, he was helping draw attention to the fact. This echoed loudly inside the cloistered world of the FOMC members, who spoke often and who traveled to the same conferences and award ceremonies. Hoenig had been well liked in that world, but now his peers talked to him with unease. They asked if he was *sure* he needed to do what he was doing. The relationship between Hoenig and Chairman Bernanke, though never close, was now adversarial. Years later, when Bernanke wrote his memoir, the book included relatively few mean-spirited comments, and many of them were reserved for Hoenig. Bernanke painted Hoenig as disloyal, obstinate, and maybe even a little unbalanced.

When the cars arrived, Hoenig and the other bank presidents walked outside through the glass doors of the hotel lobby, to the half-circle driveway sheltered beneath a broad portico where their ride awaited. Hoenig got in, and the vehicle nosed out of the driveway and into the busy morning traffic. The route from the hotel to Fed headquarters passed through the Foggy Bottom neighborhood of northwestern Washington, a quiet part of the city that feels far removed from the Capitol building and the busy streets surrounding the White House. One route to the headquarters passed through Washington Circle, a small park with a statue of America's first president in the middle, riding a horse, leaning back slightly with a sword in his hand as if preparing to enter the battlefield.

As the scenery passed by, Hoenig had a few final minutes to think, and to fortify himself for the day. Each member of the FOMC would present an argument during the daylong meeting, and Hoenig had been working hard on his statement. What was going to happen that day was basically a political debate, and Hoenig needed to carefully marshal his facts.

Even the basic politics of the Federal Reserve are confusing to outsiders. In the broader American world, the battle lines of political argument were relatively clear. You had your conservatives, who wanted to limit the government's reach, and you had your liberals, who wanted to expand the government's reach. The angry debates that played out on cable news each night tended to flow from these two broad theories of governance. But the politics of the Fed were scrambled, and didn't make a lot of sense within this broader framework. The basic tension within the Fed was described with language that had been borrowed from the world of foreign policy, using the terminology of "hawks" and "doves." In foreign policy, it was the hawks who advocated for aggressive military intervention and it was the doves who pushed against aggressive intervention by supporting diplomacy. Curiously, these terms were reversed when applied to the Fed. It was the doves inside the Fed who argued for more aggressive intervention and it was the hawks who tried to limit the Fed's reach.

The debate between hawks and doves at the Fed was usually talked about in terms of inflation, that dangerous state of affairs when prices rise quickly and the value of a currency falls. If the Fed is seen as a team of nuclear engineers who supervise economic growth, then inflation is seen as the meltdown to be avoided at all costs. The last time inflation hit America was in the 1970s, and it was remembered as a chaotic time when prices for everything from meat to gasoline to houses were rising uncontrollably. Central banks cause inflation when they keep interest rates too low for too long. Hawks hated inflation, and therefore wanted to keep interest rates higher and limit the Fed's reach. Doves were less afraid of inflation, and therefore more willing to print lots of money.

It is unclear exactly who started the hawk-and-dove motif inside the Fed, but it stuck. Janet Yellen, for example, was often described as dovish because she supported low interest rates and more intervention. Tom Hoenig and Richard Fisher, in contrast, were described as hawkish because they sought to raise interest rates and limit the Fed's reach into markets. Needless to say, among the public, the doves got better press. Who could take issue with a dove? The theory seemed to be that doves were compassionate and wanted to help the economy and working people, while hawks were harsh and severe and wanted to *stop* the Fed from helping people.

Hoenig's actions during 2010 had turned him into the FOMC's ultra-hawk. It even turned him into something worse. In economic terms, he was seen as a type of prehistoric brute, something economists called a "Mellonist," a term that refers to Andrew Mellon, who was secretary of the Treasury when the Depression began. There aren't many actual villains in the world of economics, but Mellon is one of them. Mellon is famous for one thing: being heartless and delusional. This reputation came from a single piece of advice that he gave President Herbert Hoover as the markets collapsed. Mellon told Hoover to let the fire burn, let the people go broke. He believed the crash was a type of moral cleansing that was necessary to clear the way for a better economy in the future. "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate," Mellon is reported to have told Hoover. The reason this advice was delusional, as well as heartless, was that Mellon's economic theory was mistaken. It wasn't cleansing to liquidate the farmers and the stocks. The liquidation created a downward cycle of unemployment, weak spending, and slow growth that only grew harder to reverse the longer it lasted. By urging Hoover to liquidate so much value, Mellon liquidated years of future economic growth.

It seemed inconceivable that someone could push Mellon's view in 2010. And it appeared that this was exactly what Hoenig was doing. The Fed was trying to help. It was trying to boost economic growth. The Fed was trying to be dovish. By voting against these plans, Hoenig was apparently trying to keep the Fed on the sidelines as people suffered under a 9.6 percent unemployment rate. Hoenig, the extreme hawk, the Mellonist, was out of step with the times. This was, in fact, the reputation that solidified around Thomas Hoenig over time. Years after his string of dissents, a liberal financial reporter in New York, when asked about Hoenig, immediately responded: "Yeah, he's a crank." Around the same time, at a cocktail party in Washington, D.C., an economist with the American Enterprise Institute, the conservative think tank, immediately said about Hoenig: "He was wrong." Hoenig's concerns were universally remembered as being concerns over inflation, concerns that proved to be unwarranted because inflation never arrived. Over the years, the story about Hoenig became that of a misplaced Old Testament figure who had somehow wandered onto the modern economic landscape, clinging to outdated scripture and frantically warning about inflation, more inflation, and even hyperinflation.

The historical record shows that this narrative is entirely wrong. Hoenig didn't dissent because he was worried about inflation. He was also no Mellonist. During the Global Financial Crisis, Hoenig voted repeatedly to take emergency actions that were both far reaching and unprecedented. He believed in the Fed's role as a crisis responder that could flood the banking sector with money in times of panic. He believed in robust money-printing policies when banks were in trouble.

Hoenig only began dissenting in 2010, when it appeared that the Federal Reserve was committed to keeping the American money supply at the zero bound. A review of Hoenig's comments during the 2010 FOMC meetings (the transcripts of which become public five years after the fact), along with his speeches and interviews at the time, show that he rarely mentioned inflation at all. Hoenig warned about quite different things, and his warnings turned out to be prescient. But his warnings were also very hard to understand for people who didn't closely follow the politics of money. Hoenig, for instance, liked to talk a lot about something called the "allocative effect" of keeping interest rates at the zero bound.

The allocative effect wasn't something that people debated at the barbershop. But it was something that affected everyone. Hoenig was talking about the allocation of money, and the ways in which the Fed shifted money from one part of the economy to another. He was pointing out that the Fed's policies did a lot more than just affect overall economic growth. The Fed's policies shifted money between the rich and the poor, and they encouraged or discouraged things like Wall Street speculation that could lead to ruinous financial crashes. This whole way of talking about the Fed undermined the very construct of hawks versus doves. He was pointing to the fact that the Fed could cause meltdowns that had nothing to do with price inflation.

Hoenig didn't just say these things behind the closed doors of FOMC meetings. In May 2010, he laid out his views, and explained his dissents, in an interview with *The Wall Street Journal*. "Monetary policy has to be about more than just targeting inflation. It is a more powerful tool than that. It is also an allocative policy, as we've learned," Hoenig said.

When Hoenig talked about allocative effects, he was describing how 0 percent interest rates created winners and losers. When interest rates hit zero, and money becomes cheap, it pushes banks to make riskier loans. That's because the banks can't earn a profit by saving money, as they might be able to do in a world where interest rates are higher, like at, say, 4 percent. In a 4 percent world, a bank can earn a decent return by stashing its money in ultrasafe investments like government Treasury bonds, which would pay the bank 4 percent for the loan. In a 0 percent world, things are different. A bank earns much closer to nothing for stashing its money in an ultrasafe bond. This pushes the bank to search for earnings out there in the risky wilderness. A riskier loan might pay a higher interest rate, or a higher "yield," as the bankers call it. When banks start hunting for yield, they are moving their cash further out on the yield curve, as they say, into the riskier investments.

Life at the zero bound pushes banks way down the yield curve. What does a bank have to lose? A risky bet beats nothing. And this isn't just a side effect of keeping rates at zero. "That's the whole point," Hoenig explained, many years later. "The point was to get people willing to take greater risk, to get the economy started again. But it also allocates resources. It allocates where that money goes."

Hoenig was worried about what would happen when the Fed pushed all that money from safe investments out into risky investments. When cash is pushed out onto the yield curve, it leads to the second big problem that Hoenig warned about in 2010: something called an asset bubble. The housing market that collapsed in 2008 was an asset bubble. The dot-com stock market crash of 2000 was the bursting of an asset bubble. When an asset bubble crashed, the general public tended to blame the people at the scene of the disaster, who were inevitably greedy Wall Street types. It was the shortsighted stockbrokers who bid up the stock market, or the dishonest mortgage lenders who fueled the housing boom. But Hoenig had sat on the FOMC during both of these asset bubbles, and the following crashes, and he'd seen firsthand the Fed's vital role in creating them. Hoenig was worried, in November 2010, that the Fed was repeating this mistake. Just a few months earlier, at the

August FOMC meeting, Hoenig's frustration seemed to boil over. He said something that most Fed officials never acknowledged, at least in public. The central bank hadn't just rescued the economy from the crash of 2008. The Fed bore a great deal of responsibility for it.

"The financial and economic shocks we've experienced did not just come out of nowhere," he said. "They followed years of low interest rates, high and increasing leverage, and overly lax financial supervision, as prescribed by both Democratic and Republican administrations." He was explaining his dissent at that meeting, and warning that the Fed might be making the same mistakes that led to 2008. "The continued use of zero-interest rate will only add the risk to the longer-run outlook," he said.

Hoenig lost that fight, and all the other fights of 2010. The Fed didn't just keep rates pegged at the zero bound, but was now voting on the plan to go below the zero bound, with quantitative easing. Hoenig had fought against quantitative easing for months, and today he would lose that fight as well.

Hoenig's ride continued south toward the Fed headquarters, which were located in the Marriner Eccles Building. The Eccles Building was down on the quiet side of the Mall, near the opposite end from the Capitol dome. The building was modest by the standards of Washington. It wasn't very imposing. It was barely notable, in fact, next to the museums and trade buildings that populated the mall. The Eccles Building had a bright white marble façade and rectangular columns, as pristine as an engraving on a dollar bill: neat lines, sharp angles, and quiet authority.

The cars carrying the regional bank presidents were guided to a side entrance of the building, where they drove into a private basement lot. The passengers got out and walked down a hallway into the building itself, taking an elevator up to the second floor, where Hoenig and the other bank presidents made their way to the boardroom.

The décor inside the Eccles is what you'd get if a big bank and a museum had a child. The hushed, carpeted hallways were lined with fine art. The offices alongside them were large and well appointed. The boardroom was the most famous feature of the Eccles Building, and the most famous feature of the boardroom was the enormous ovoid table at its center, a gleaming slat of polished wood that seemed to go on forever. The FOMC members gathered around this table when they debated. An ornate gilded chandelier hung directly above the table for lighting. There was a yawning fireplace, framed by a large mantelpiece, on one side of the room. On the opposite side were rows of chairs where staffers assembled and sat during the meeting, offering presentations when called upon.

Tom Hoenig took his seat as the FOMC members made small talk and found their places. Hoenig first joined this table, as a voting member of the FOMC, when the legendary Alan Greenspan presided as chairman of the Fed. But Hoenig's experience at the central bank went back even further than that. He had worked at the Fed under the leadership of five chairmen, starting with Arthur Burns back in the 1970s, and including the legendary tenure of Paul Volcker, who raised interest rates into the double digits in the early 1980s to beat inflation (causing a brutal recession in the bargain).

There had never been anything like a peaceful, stable period at the Fed. Things were always changing and one crisis always led to another. But there had also never been a period quite like the one under Greenspan's successor, Ben Bernanke, who changed everything.

When Ben Bernanke published a memoir in 2015, he entitled it *The Courage to Act*. This captured the theory of Bernankeism. It held that monetary intervention is necessary, courageous, even noble.

It was Bernanke, after 2008, who pushed the Federal Reserve to do things it had never done before, to grow the monetary base larger than what it had ever been, to push the interest rate down to zero, to offer a "forward guidance" that promised interest rates would stay at zero, inducing banks and investors to take more risk. These aggressive actions were at odds with Bernanke's demeanor. He was soft-spoken, friendly, and approachable. His closely trimmed, graying beard gave him an avuncular look. He seemed happy enough, at first, to be something like a caretaker chairman, after Greenspan's long tenure: a low-key manager who would quietly pull the levers of monetary policy in a cautious way. But the crash of 2008 turned Bernanke into a global celebrity, along with the secretary of the Treasury, Hank Paulson, and the New York Federal Reserve Bank president, Timothy Geithner. They were the trio at the center of things, bailing out the giant insurance conglomerate AIG, letting Lehman Brothers fail, pushing for a $700 billion bank bailout. Bernanke became the face of the American economic rescue effort.

If Bernanke was bold during the crisis, it was partly because the Fed had moved too slowly before the crash, when it let the housing bubble inflate, infect the financial system, and explode. In 2007, when mortgage borrowers started defaulting in large numbers, Bernanke said during an industry conference that the problems in subprime mortgages weren't that dangerous. "We believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited," Bernanke said, "and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system."

When the system did fall apart, Bernanke had a chance to define his legacy. He was, in many ways, perfectly suited for the job. As an academic, Bernanke had focused on the Great Depression and written extensively about ways in which a new depression might be averted. One of his central ideas was that the Fed hadn't acted boldly enough back in the 1930s. The central bank had actually worsened the Depression by tightening the money supply. The solution, Bernanke believed, was to be as aggressive as possible after a crash. He had spent many years thinking up new ways that the Fed could boost economic growth even after pushing interest rates to zero. He didn't see the zero bound as an inviolable limit, but just as another data point. Bernanke published papers on this concept as far back as the early 2000s, when 0 percent rates were still just a wild idea. Some of Bernanke's ideas were outlandish. He suggested that the Fed could set a limit on the long-term interest rates of Treasury bonds* by purchasing unlimited amounts of them, for example. He discussed something called a "helicopter drop" of money, in which the U.S. government would give people a huge tax cut by simply selling all of its debt to the Fed, which would print the money to buy it. Bernanke had suggested that the central bank of Japan could end that nation's slump by depreciating the value of its currency to stimulate exports, even though inflation would jump to a very high 3 or 4 percent. Bernanke had backed off most of this by the time he became Fed chairman, but he had never lost his interest in experiments.

The stagnant economy of 2010 encouraged such experiments. Economists knew that it would take years to recover from the banking crisis, but the reality of high unemployment so long after the crash was still shocking. The unemployment rate was still above 9 percent and economic growth remained weak. There was a crisis gathering strength in Europe thanks to deeply indebted nations like Greece and Spain. These problems, if left unaddressed, could create a cascading effect across the world. The American stock market started to sink again during the spring of 2010, with the Dow Jones Industrial Average falling about 1,000 points, or 9 percent, between May and June.

Members of the FOMC were worried about this, but they generally agreed that another recession was unlikely. Still, there was always a risk, and the Fed didn't want to be caught underestimating a problem. At first, Bernanke was only pushing to keep interest rates at zero. It seemed like the safe thing to do. But Hoenig started dissenting. He explained his heightened worries during the FOMC meeting in August. "I think of it more as planting the seeds of a briar patch that we will have to deal with not in a year from now, but three or four years from now, as we have in the

* Financial traders use specific terms to discuss U.S. Treasury debt. They call short-term U.S. Treasuries Treasury "bills," while longer-term Treasuries are called Treasury "notes" and very-long-term Treasuries are called Treasury "bonds." This book uses common vernacular terms "Treasury Bills" or "Treasury Bonds," while specifying the duration of Treasurys when relevant.

past. So I very much oppose this policy," he said. The dissents didn't mean that much to Bernanke because Hoenig remained a lone voice. There was a lot of debate inside the FOMC meetings, but the actual votes kept coming out in the lopsided tally of 11 to 1, with Hoenig being the one.

In August, Bernanke began a public campaign to initiate his greatest innovation, and one of the greatest experiments in the Fed's history. This was the program called quantitative easing. The program had been used on a large scale once before, during the financial crash. But it had never been used in the way that Bernanke believed it should be used in late 2010, as an economic stimulus plan to be employed outside a crisis. Bernanke built public support to use quantitative easing this way, strangely enough, at an event that Hoenig himself helped host. Every summer, the Kansas City Fed held a symposium in Jackson Hole, Wyoming, a gathering of global central bankers and economists that was the closest thing that monetary policy had to the Academy Awards. It was a place for red carpet strolls and moments captured by news photographers. The Fed chairman's speech was always a major event, and in 2010 Bernanke did not disappoint. He announced the program that would help the Fed push interest rates below zero and stimulate the economy when no one else was willing to do so. The mainstream press, which covered Bernanke's speech, didn't yet have the vocabulary to describe what the chairman was talking about. It was only months later that the term *quantitative easing* entered the broader lexicon (to the degree that it ever did). Even the best financial reporters filed muddled-sounding stories from Jackson Hole about a Fed plan to buy bonds, long-term debt, and Treasurys. It sounded dry, technical, and harmless.

But the members of the FOMC knew otherwise, because they knew how the plan would work and what it was intended to do. The Fed had done quantitative easing once before, during the heat of the 2008 financial crisis. It was an emergency effort, an extraordinary thing for an extraordinary moment: The Fed directly bought mortgage debt to stabilize the mortgage market. Now Bernanke was suggesting that the

Fed turn quantitative easing, for the first time, into a normal operating tool to manage the economy.

The basic mechanics and goals of quantitative easing are actually pretty simple. It was a plan to inject trillions of newly created dollars into the banking system, at a moment when the banks had almost no incentive to save the money. The Fed would do this by using one of the most powerful tools it already had at its disposal: a very large group of financial traders in New York who were already buying and selling assets from the select group of twenty-four financial firms that were known as "primary dealers." The primary dealers have special bank vaults at the Fed, called reserve accounts.* To execute quantitative easing, a trader at the New York Fed would call up one of the primary dealers, like JPMorgan Chase, and offer to buy $8 billion worth of Treasury bonds from the bank. JPMorgan would sell the Treasury bonds to the Fed trader. Then the Fed trader would hit a few keys and tell the Morgan banker to look inside their reserve account. Voila, the Fed had instantly created $8 billion out of thin air, in the reserve account, to complete the purchase. Morgan could, in turn, use this money to buy assets in the wider marketplace. This is how the Fed creates money—it buys things from the primary dealers, and it does so by simply creating money inside their reserve accounts.

Bernanke planned to do such transactions over and over again until the Fed had purchased $600 billion worth of assets. In other words, the Fed would buy things using money it created until it had filled the Wall Street reserve accounts with 600 billion new dollars. Bernanke wanted to do this over a period of months. Before the crisis, it would have taken about sixty years to add that many dollars to the monetary base.

There was one more thing about quantitative easing that made it so powerful. Bernanke was planning to buy long-term government debt, like 10-year Treasury bonds. This was a bigger deal than it sounds. The

*Of course, in modern times this reserve account wasn't a physical vault at all, but more like a digital account on an electronic ledger.

Fed had always bought short-term debt because its job was to control short-term interest rates. But the central bank was now targeting long-term debt for a strategic reason: Long-term debt was Wall Street's equivalent of a savings account. It was the safe place where investors tied up their money to earn a dependable return. With quantitative easing, the Fed would take that savings account away. It would reduce the supply of 10-year Treasury bonds that were available. All the money that the Fed was creating would now be under a great deal of pressure because it could no longer find a safe home in a 10-year Treasury. All the new cash would be pushed out on the yield curve, out there into the risky investments. The theory was that banks would now be forced to lend money, whether they wanted to or not. Quantitative easing would flood the system with money at the very same moment that it limited the refuge where that money might be safely stored. If economic growth was weak and fragile during 2010, then quantitative easing would shower the landscape with more money and cheaper loans and easy credit, enticing banks to fund new businesses that they might not have funded before.

Hoenig had spent a whole year complaining about the dangerous "allocative effects" of 0 percent interest rates. Now, at Jackson Hole, those complaints looked quaint. The allocative effect of quantitative easing would be like nothing ever seen in American finance.

Inside the FOMC meetings, quantitative easing was debated for being what it was—a large-scale experiment that carried unclear benefits and risks. There was more opposition to the plan than was publicly known at the time. Hoenig wasn't the only FOMC member with strong objections to the plan. The regional bank presidents Charles Plosser and Richard Fisher expressed concerns about it, as did the president of the Richmond Federal Reserve Bank, Jeffrey Lacker. But if quantitative easing was radical, Bernanke insisted that it was called for by extraordinary times.

During the FOMC meeting in September, Hoenig offered his most condensed, straightforward critique of what the Fed was doing. He pointed out that the deep malaise in American economic life wasn't caused by a lack of lending from banks. The banks already had plenty of money to lend. The real problem lay outside the banking system, in the real economy where the deep problems were festering, problems that the Fed had no power to fix. Keeping interest rates at zero, and then pumping $600 billion of new money into the banking system—money that had nowhere to go but out into risky loans or financial speculation—wasn't going to help solve the fundamental dysfunctions of the American economy.

"I am not arguing for high interest rates at all—I never have been. I am arguing for getting off of zero, getting away from thinking that if we only added another trillion dollars of high-powered money, everything would be okay. It won't," Hoenig said.

He warned that another round of quantitative easing would push the Fed into a "new regime" that wouldn't easily be ended. "At this point, the crisis should have taught us that we need to increase our emphasis on longer-run macroeconomic and financial stability and not just on inflation goals. We have allocative effects, and I think we should be very, very mindful of that."

At this moment, there did seem to be a chance that Hoenig might sway some of his colleagues. When Bernanke responded to Hoenig, later in the meeting, Bernanke argued for quantitative easing with a defense that would become his primary defense in the coming years, one he repeated many times. He pointed out that the Fed faced risks if it *didn't* intervene.

"This is very, very difficult," he said. "We don't have good options. It feels safer not to do anything, but then, on the other side, we have an economy which is underperforming very severely—we have very high unemployment. So there's no safe option. Whatever we do, we're going to have to make our best judgment and hope for the best."

While Bernanke debated inside the FOMC, he had very skillfully shaped the terms of the debate. By announcing quantitative easing in Jackson Hole, he had raised expectations that the plan would happen. This prompted speculators to start trading as if the program were a certain thing, driving up prices for some assets. Within a few months, the market might have fallen if the Fed didn't follow through.

It was during this period, in autumn, when the relationship between Bernanke and Hoenig became as outright hostile as it could be within the genteel world of monetary policy. Months earlier, in May, Hoenig had given the interview to *The Wall Street Journal* in which he directly criticized the 0 percent interest-rate policy, explicitly warning that it might stoke asset bubbles. Now, during a public speech, Hoenig said that quantitative easing was akin to making a "deal with the devil." This was not the polite language usually employed by FOMC members. This was a public condemnation.

These comments irritated Ben Bernanke, perhaps even more than Hoenig's dissenting votes had irritated him.

When the Fed gathered to vote on the quantitative easing plan in November, the two-day meeting began on an unpleasant note. Bernanke opened the meeting with something of a scolding for the gathered FOMC members. He said that there had been too many leaks of information about their meetings and, just as worrisome, some Fed officials seemed to feel increasingly free to express their opinions on important policy matters during their public speeches. It was hard not to see this complaint as directed squarely at Tom Hoenig. Bernanke said that airing such "very strong, very inflexible positions" undermined the FOMC's credibility.

Janet Yellen agreed. "I personally see them as damaging our credibility and our reputation at a time when the institution is under enormous scrutiny, and we can ill afford it," she said.

Consensus was important. Presenting a unified front to the outside world was important. Vocal dissent was disloyalty. That was the message on November 2, the first day of the meeting. Now, on November 3, Tom Hoenig and the other members took their seats around the giant table and prepared to hold their final debate on quantitative easing.

"Good morning, everybody," Bernanke said as he began the meeting. "We made an awful lot of progress yesterday. FOMC productivity is up," he joked, drawing laughter from the crowd. But there wasn't much need for small talk. Bernanke quickly handed over the stage to one of his deputies, Bill English, who gave a long presentation about how quantitative easing might work and what effect it might have.

The Fed's own research on quantitative easing was surprisingly discouraging. If the Fed pumped $600 billion into the banking system, it was expected to cut the unemployment rate by just .03 percent. While that wasn't much, it was something. The plan could create 750,000 new jobs by the end of 2012, a small change to the unemployment rate but a big deal to those 750,000 people.

After English was finished, the FOMC members asked him questions, mostly technical in nature. But it didn't take long for the criticism to begin.

Jeffrey Lacker, president of the Richmond Fed, said the justifications for quantitative easing were thin and the risks were large and uncertain. "Please count me in the nervous camp," Lacker said. He warned that enacting the plan now, when there was no economic crisis at hand, would commit the Fed to near-permanent intervention as long as the unemployment rate was elevated. "As a result, people are likely to expect increasing monetary stimulus as long as the level of the unemployment rate is disappointing, and that's likely to be true for a long, long time."

Charles Plosser, the Philadelphia Fed president, was more blunt. "I do not support another round of asset purchases at this time," he said. "The economy has been through a soft patch this summer but it appears to be emerging from it." Plosser suggested that the Fed might be misleading the public about its plans, presenting a false sense of certainty about its path forward and the risks associated with it. "I think it would be a mistake to convey to the public that we know how to fine-tune an asset-purchase program to achieve our objectives when, in fact, we don't," he said. "Again, given these very small anticipated benefits, we should be even more focused on the downside risks of this program."