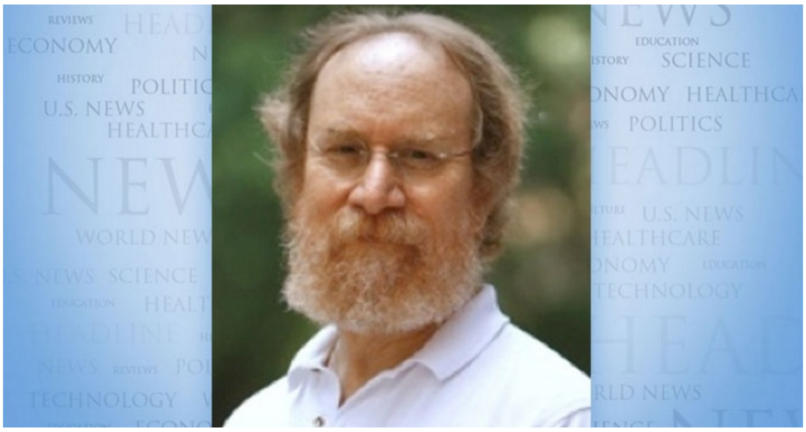
# Delete the Fed



Who should run the Federal Reserve System when chairman Ben Bernanke's term expires next year: Vice Chair Janet Yellen or former Obama adviser Lawrence Summers?

Neither.

Who then?

No one.

The fact is, we need the Federal Reserve like we need a hole in the head. Contrary to folklore, the Fed is not needed to stabilize the economy or to prevent unemployment. As the Fed heads into its second century, we ought to realize that its record is terrible. Even if we don't count the interwar period (which some economists call the new Fed's practice round), America's central bank is a flop. Monetary economists George A. Selgin, William D. Lastrapes, and Lawrence H. White wrote in "Has the Fed Been a Failure?":

> Drawing on a wide range of recent empirical research, we find the following: (1) The Fed's full history (1914 to present) has been characterized by more rather than fewer symptoms of monetary and macroeconomic instability than the decades leading to the Fed's establishment. (2) While the Fed's performance has undoubtedly improved since World War II, even its postwar performance has not clearly surpassed that of its undoubtedly flawed predecessor, the National Banking system, before World War I.

The authors support that generalization with details. On inflation: "Far from achieving long-run price stability, [the Fed] has allowed the purchasing power of the U.S. dollar, which was hardly different on the eve of the Fed's creation from what it had been at the time of the dollar's establishment as the official U.S. monetary unit, to fall dramatically" — by 95 percent.

Selgin, Lastrapes, and White also show that the central bank has given us longer recessions and slower recoveries.

But without the Fed, who would set interest rates to guide the economy? The first answer is that government policy and Fed manipulations can create the very recessions that the Fed then tries to reverse. If the politicians and their court economists would get over their hubristic belief that they are stewards of the economy, macroeconomic crises would disappear.

Besides, the Fed cannot set interest rates, not even its narrow federal-funds rate for overnight interbank loans. At most, it *targets* that rate by buying and selling government securities, but it doesn't always hit its target. The idea that the Fed can even heavily *influence* mortgage and other interest rates ignores important facts.

First, the Fed's operations are small compared to the complex U.S. and world economies. Writes monetary economist Richard Timberlake,

> Traditional economics properly teaches that many complex market forces — countless investment and savings decisions not dependent on monetary factors — are essential in determining interest rates. The Fed funds rate that Fed policy can influence through its monopoly over the quantity of money is *inconsequential* in shaping most short-term and long-term rates in capital markets, unless that moneymaking power subsequently promotes a pervasive price inflation. [Emphasis added.]

Second, the Fed can't lower rates through monetary inflation beyond the very short run. Why not? Because lenders will respond by raising their rates to avoid being screwed by price inflation – unless the Fed prevents the inflation, as it's been doing, by effectively borrowing back the new money from the banks at interest.

Moreover, as monetary economist Jeffrey Rogers Hummel points out,

> Globalization, with the corresponding relaxation of exchange controls in all major countries, allows [investors] easily to flee to foreign currencies, with the result that changes in central-bank policy are almost immediately priced by exchange rates and interest rates. Add to this the ability to purchase from many governments securities that are indexed to inflation, and it becomes highly unlikely investors will be caught off guard by anything less than sudden, catastrophic hyperinflation (defined as more than 50% per month) — and maybe even not then.

While inflation is not the threat it once was, the Fed is not harmless. "Bernanke has so expanded the Fed's discretionary actions beyond merely controlling the money stock that it has become a gigantic, financial central planner," Hummel writes.

No one should have such power.

Money was not invented by government. It was the spontaneous creation of people trying to ease exchange in the marketplace. Central banks like the Fed only messed money up, robbing the people while facilitating warfare and welfare spending through irresponsible large-scale government borrowing.

Thus the Fed should be deleted.

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