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Abolish Central Banks

By Richard W. Rahn

MONOPOLY ON MONEY MEANS A NEVER-ENDING CYCLE OF BOOM AND BUST

Should the Federal Reserve be abolished as Rep. Ron Paul and others have demanded? The Republican presidential candidates have agreed that they would like to replace Ben S. Bernanke as chairman of the Fed, and many have been equally critical of former Fed Chairman Alan Greenspan. The view that both Mr. Bernanke and Mr. Greenspan have done poor jobs is also shared by many economists and financial writers. But, if not Mr. Bernanke, who? And if not the Fed, what?

One of the criticisms of the Fed and other central banks is that they were engaged in inflation targeting - such as a 2 percent inflation rate measured by the consumer price index - and thus, they ignored the price bubbles in the real estate and stock markets that were being fueled by too much money growth, which turned out to be a major source of the continuing financial crisis.

It is also clear to many of us that the current Fed policy of ultralow interest rates of less than 1 percent for banks and money-market funds, combined with high inflation rates of 3.9 percent for the past year, is a formula for a new disaster. If a saver can only obtain 1 percent or so on cash savings but inflation is running at almost 4 percent, then the saver is losing 3 percent of his money each year in an inflation tax. Interest rates below the rate of inflation undermine financial institutions, distort business capital-allocation decisions and will reduce future economic growth rates and job creation.

In sum, the Fed and the other major central banks are making those least able to protect themselves from inflation and job loss poorer, and sending all of the wrong price signals to business people, which, in turn, is negatively affecting the world economy.

I have some sympathy for the central bankers because they have been given an impossible job - namely, they are supposed to be smarter than markets “and lean against the wind.” But they aren’t smarter and they don’t know which way the wind is blowing. They also have been saddled with correcting a problem brought on by politicians of governments that are accumulating debt far faster than their respective economies are able to finance them. The central banks can get rid of the debt problem by inflating the currency (i.e., reducing its value by printing too much money) to the point where the debts are almost meaningless but, as we learned in the 1970s, inflation only serves to make almost everyone poorer.

The basic problem is that governments have insisted upon having a monopoly in money, an idea that has been supported by most economists. The Austrian school economists, most notably the late Nobel Laureate F.A. Hayek, were skeptics of this view. In 1976, Hayek wrote one of his classic books, “Denationalization of Money,” in which he argued that money is no different from other commodities and that it would be better supplied by competition between private issuers than by a government monopoly.

Hayek wrote in the conclusion of his book, “The abolition of the government monopoly of money was conceived to prevent the bouts of acute inflation and deflation which have plagued the world for the past 60 years. It proves on examination to be also the much needed cure for a more deep-seated disease: the recurrent waves of depression and unemployment that have been represented as an inherent and deadly defect of capitalism.

“I still believe that, so long as the management of money is in the hands of government, the gold standard with all its imperfections is the only tolerably safe system. But we can certainly do better than that, though not through government.”

And finally: “If we want free enterprise and a market economy to survive … we have no choice but to replace the government currency monopoly and national currency systems by free competition between private banks of issue. … We have always had bad money because private enterprise was not permitted to give us a better one.”

Hayek’s critique of central banks and the government money monopoly is totally supported by the empirical evidence. The U.S. dollar, for instance, is now worth only 1/22 of what is was worth when the Fed was formed in 1913, and most other central banks have even a worse track record. There are many groups that have experimented - and still are experimenting - with private currencies, but as soon as they begin to get some traction to see if their currencies will really work, the jackboots from Treasury and the Internal Revenue Service shut them down. It is going to be difficult to abolish the government monopoly over money because it is so profitable for politicians. Seigniorage, interest-free monetary float and inflation provide huge revenues to government, which politicians love, without appearing to be explicit taxes.

But there is some reason to be hopeful because very bright and creative folks are experimenting with private monies on the Internet. Advances in computing power and encryption technologies are increasingly making it possible for people to get around the destructive government money monopoly. With some luck and some support from countries that are not part of the U.S. dollar, euro and Japanese yen blocs, free money might yet succeed. If not, we will continue to be doomed to a life of boom and bust, and inflation and deflation, as the central banks continue to nail all of us on the cross of government monopoly money.

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