Why the Federal Reserve Needs Trump Nominee Judy Shelton

by Richard W. Rahn

THE DISTINGUISHED ECONOMIST, WHO SUPPORTS A MONETARY ANCHOR LIKE GOLD, WAS CALLED A 'RADICAL' BY ELIZABETH WARREN

President Trump has nominated distinguished economist, Judy Shelton, to be a member of the Federal Reserve's (Fed) seven-person board of governors. Mrs. Shelton is under attack for her alleged "unorthodox views." Elizabeth Warren — who advocates adding trillions of dollars in new federal spending, huge tax increases and massive new regulations — had the gall to call Mrs. Shelton radical. Mrs. Shelton has committed the sin of being right when many in the Washington establishment have been dead wrong.

In 1989, Mrs. Shelton wrote a book, "The Coming Soviet Crash: Gorbachev's Desperate Pursuit of Credit in Western Financial Markets," which shook many in the foreign-policy establishment. At the time, it was well understood that Soviets were in retreat, but no one before Mrs. Shelton had examined the Soviet budget numbers in a such detailed way. As a result of her hard work, expertise and rational intelligence, she was able to predict both the path and the timing of the Soviet collapse — and she turned out to be spot on.

Some of those foreign-policy types who were comfortable co-existing with the Soviet Union argued there would be a never-ending stalemate or eventually even a Western defeat, and were in denial about the Soviet decline and very critical of Mrs. Shelton's work. But she had less than a year to wait before being proved correct. Subsequently, I had the pleasure to work with her on the U.S. Committee to Aid Russian Reform. She was the only woman on the team and usually proved to be the most insightful.

Many of the great economists of the last century, like Milton Friedman and F.A. Hayek (both Nobel laureates), believed that government fiat currencies — that is currency without the backing of a hard asset like gold — would ultimately fail. The failure would occur because politicians like to spend more money than the tax system produces, leading to higher and higher levels of debt until the private sector refuses to buy any more of it. Spending other people's money is politically popular, and taxing is often unpopular. And even when the politicians increase taxes, it does not get them out of the box, because tax rate increases slow economic growth until the point where the economy is producing less tax revenue rather than more.

Look at the record. The United States and all the major nations were on the gold standard before the Fed was created in 1914. The Fed is mandated to provide "price stability." In the 120 years before the creation of the Fed, the United States experienced no persistent inflation. According to the Consumer Price Index, the dollar is worth less than 1/25 of what it was worth in 1914. Or, it now takes more than $25 to buy what $1 would buy in 1913. The price of gold was $18.93-18.99 per ounce from 1833 until 1913. The price of gold on Feb. 7, 2020, was $1,571 per ounce. So much for price stability under the Fed.

The Fed has an impossible mandate. As at least one former Fed chairman said, its job is to "lean against the winds" and take away "the punch bowl" when the economy is overheating. They attempt to do this by trying to control the size of the money supply and interest rates. Hayek, Friedman and their intellectual allies and disciples, including Judy Shelton and yours truly, believe this is a fool's errand. Many smart people have served on the Fed board, but they are no smarter than many others, and have no more ability to see the future (which is unknowable) than other learned people.

Politicians often hate gold or other hard monetary anchors because it limits their ability to spend without restraint. In 1936, John Maynard Keynes wrote his "General Theory of Employment, Interest, and Money," which gave what appeared to be a scientific rationale for larger levels of deficit spending — and so it immediately became a hit with the political class. Keynesian economics was all the rage for the first four decades after Keynes' book — but then the great inflation of the 1970s came upon us — showing that Hayek and Friedman had been right, not Keynes.

The irony is that many in the economic/political establishment still support bigger government with more taxing and spending, even though that model has been a clear failure worldwide. People like economist Paul Krugman (The New York Times) are in this camp. If nominated for a Fed position, Mr. Krugman would probably have no trouble being confirmed because he is a well-known establishment economist — despite a long record of failed predictions, including saying that the U.S. stock market would collapse with a Trump victory and that the world would go into recession.

In contrast, Mrs. Shelton is accused of being unorthodox and out of the mainstream because she is closer to Hayek and Friedman in her views about the desirability of a monetary anchor like gold. If the United States is going to have a Fed, it is important that the governors be diverse in their views as a way of minimizing mistakes. In terms of experience, education, a track record of predicting policy outcomes and understanding economic reality, I can think of no better person to serve on the Fed board than Judy Shelton.

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