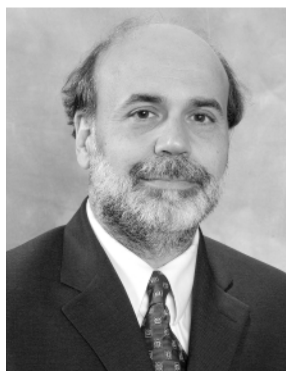
Why Not Monetary Freedom?

BY RICHARD M. EBELING

In all of the commentaries that have appeared since President George W. Bush nominated Dr. Ben S. Bernanke as Alan Greenspan's successor at the Federal Reserve, there has been one crucial question that has remained virtually unasked: Why do we need a central bank and therefore a new chairman for the Fed? In a world that claims to have rejected socialism, central banks remain one of the most powerful socialist institutions around the world—because make no mistake about it, central banking *is* monetary central planning.

The Federal Reserve is a government-created monopoly over the monetary and banking system of the United States, brought into existence by an act of Congress in 1913. Its assigned responsibilities include controlling the supply of money and credit to maintain a "stable" purchasing power of the monetary unit, securing high employment and economic growth consistent with monetary stability, and overseeing the banking system.



Ben S. Bernanke
Courtesy Princeton University

Its primary monetary tool is "open market operations," through which the Fed buys and sells government securities in order to modify the amount of bank reserves available for lending. It thus influences market rates of interest. For example, when the Fed buys government securities, it pays for them by creating money out of thin air; bank reserves are increased, tending to put a short-run downward pressure on interest rates.

Thus the quantity of money, its value, and the market price of borrowing and lending are directly or indirectly under the control or influence of the Federal Reserve. The Fed's seven-member Board of Governors—who are nominated by the President and approved by the Senate—are in essence the monetary central planners of the United States.

Bernanke, who served as a Fed governor before being appointed chairman of President Bush's Council of Economic Advisers, advocates "inflation targeting" as the "framework" that should guide monetary central planning. He rejects a "monetary rule," such as the one proposed by Milton Friedman years ago, under which the Federal Reserve would set monetary policy on "automatic pilot" and simply increase the money supply at some chosen annual rate, say, 3 percent a year. And he equally rejects the old Keynesian belief in complete "discretion," under which the Fed governors would shift monetary policy, possibly day to day, according to whatever seemed to be the economic and political trends.

Instead, Bernanke thinks that the monetary planners should have a longer-term "objective" in mind, such as a rate of price inflation of 2 percent a year around which the actual rate of price inflation may deviate on a month-by-month or quarter-by-quarter basis. The Fed should have the discretion to manipulate the money supply and influence market rates of interest in various ways that may seem necessary or desirable in the short run around that longer-run "target" rate of price inflation.

As Bernanke expressed it in *Inflation Targeting*, which he coauthored in 1999: "We find it fruitful to think of inflation targeting not as a policy rule, but as a framework within which 'constrained discretion' can be exercised. It is here that the nominal anchor function of inflation targets is central: Like a real-life anchor, inflation targets keep the economic ship in the desired area in the long term, while permitting it to respond in the short run to unpredictable swells and currents" of changing market conditions.

In Bernanke's view, inflation and deflation are general price trends that may emerge in the market. The pur-

Richard Ebeling (rebeling@fee.org) is the president of FEE.

pose of monetary policy is to restrain prices in general from moving in one direction or the other.

In fact, a sustained and continuing general rise in prices is impossible without an increase in the quantity of money. Rising prices are the effect of a preceding monetary expansion. But for Bernanke the role of monetary policy is to respond to price trends that seem to arise autonomously. Thus, in reality, the monetary authority is to be the inflation "policeman," "arresting" the rise in prices that its own policy will have created in the first place.

Why does Bernanke advocate an inflation target of, say, 2 percent rather than a target of zero price inflation? Because he believes that if price deflation were to occur, the Fed would need wiggle room to be able to push interest rates even to zero so money can be pumped into the market through the banking system in order to reverse the deflationary price trend. Hence the Fed must target a positive rate of price inflation so as to have the ability to fight price deflation.

A world of unending inflation, therefore, is the optimal "target" to be implemented by the monetary central planners, according to Bernanke. Even an annual rate of 2 percent price inflation, it should be remembered, would reduce the purchasing power of the dollar by half in one generation.

While Bernanke wants the policy discretion of the monetary planners to be constrained within the publicly announced boundary of the inflation target, he and the other Fed governors still implicitly presume to have the wisdom and ability to direct the monetary future of the United States.

The best monetary policy would be no monetary policy at all. The advocate of the free market, therefore, calls for the abolition of the Federal Reserve and the operation of a market-based system of private and competitive free banking.

A Socialist Vestige

Monetary central planning is one of the last vestiges of socialist central planning. The fact is, the Federal Reserve can no more correctly plan for the "optimal" quantity of money or a targeted rate of inflation than any other branch of government can properly plan for the optimal supply and pricing of shoes, cigars, soap, or scissors. And the history of monetary central planning in the United States and around the world has demonstrated the same inevitable failures as all other forms of socialist planning.

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The following would be the steps to bring this about:

1. The repeal of the Federal Reserve Act of 1913 and all complementary and related legislation giving the federal government authority and control over the monetary and banking system.

2. Repeal of legal-tender laws, which give government the power to specify the medium through which all debts and other financial obligations, public and private, may be settled.

3. Repeal of all restrictions and regulations on free entry into the banking business, including interstate banking.

4. Repeal of all restrictions on the right of private banks to issue their own bank notes and to open accounts denominated in foreign currencies or gold and silver.

5. Repeal of all federal and state rules, laws, and regulations concerning bank-reserve requirements, interest rates, and capital requirements.

6. Abolition of the Federal Deposit Insurance Corporation. Any deposit-insurance arrangements and agreements between banks and their customers, or among associations of banks, would be private, voluntary, and market-based.

In the absence of government regulation and monopoly control, a free monetary and banking system would exist; it would not have to be created, designed, or supported. A market-based system would naturally emerge, take form, and develop out of the prior system of monetary central planning. And monetary freedom would be established.