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Fed Up PDF

The popular uprising against central banking

By Thomas E. Woods Jr.

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The way Ron Paul tells it, his more than 30 years of speaking and writing about money, inflation, and the Federal Reserve System attracted only limited interest outside libertarian and constitutionalist circles. The subject, and Paul as its spokesman, were scarcely to be found in the media, even—or perhaps especially—on the business networks.

But Paul's 2008 presidential bid changed that. Suddenly the Fed was on the table for discussion for the first time since Congress established it in 1913. With Paul making the evils of central banking and fiat money a theme of his campaign, the issue took on a vigor that few expected. Even calling for the Fed's outright abolition was longer unheard of on the television news networks.

When Paul first raised the issue in his campaign, he had no idea what he was tapping into. "I didn't realize people your age knew so much about money and inflation," he told a rally at the University of Pittsburgh last year. "But it gets the largest applause at college campuses. I figured the first time it happened [at the University of Southern California] it was an accident. … But then at the University of Michigan, they started to burn Federal Reserve Notes."

To Paul's surprise, some of his loudest applause lines involved salvos against the Fed. Chants of "End the Fed!" greeted his denunciations of the economic damage the central bank was unleashing. An underappreciated reason for Paul's fundraising prowess was his outspoken opposition to the Fed, a subject that had long been off limits in American politics. Eventually, a national organization called End the Fed, with local chapters around the country, gave institutional expression to the issue, sponsoring a series of demonstrations against the central bank in 39 cities last November.

This is a new phenomenon on the Right. The libertarian and conservative think tanks that liberally invoke the names of Austrian School economists like F.A. Hayek have tended to ignore these men's opposition to central banking, a position too politically incorrect even for those who pride themselves on their willingness to defend unpopular positions. The Ludwig von Mises Institute and the Foundation for Economic Education have been among the handful of exceptions to this rule, providing the scholarly infrastructure to convert what was sometimes an inchoate unease about the Fed among Paul supporters into well-honed arguments.

The *Washington Post* asked, "What magazine published the most scathing attacks on President Bush and his Iraq invasion?"

Unlike in the past, moreover, commentators with high media profiles now defend this view of money and central banking. Peter Schiff, president of Euro Pacific Capital, may be the best known of these. Schiff foretold the crisis before it happened, including the bankruptcy of Fannie Mae and Freddie Mac. His books *Crash Proof* and *The Little Book of Bull Moves in Bear Markets*, both of which have sold well, take an Austrian approach to current conditions. A grassroots movement is even trying to draft Schiff, a resident of Connecticut, to run for U.S. Senate against Chris Dodd in 2010.

Schiff isn't alone. Famed investor Jim Rogers calls for the abolition of the Fed when he's a guest on business networks. Indeed, he predicts the Fed's demise sometime in the next ten years. Another Austrian analyst all over television and the print media is James Grant, editor of *Grant's Interest Rate Observer*. Similarly high-profile is Mish Shedlock, whose Global Economic Trend Analysis blog takes a reliably anti-Fed position.

It's not surprising that arguments against the Fed are finally resonating. Since the crisis began in 2007, Fed Chair Ben Bernanke has engaged in all manner of emergency activity, much of it unprecedented and of such dubious legality that even some of those who may reject or be unfamiliar with arguments against the Fed have begun to wonder about the unaccountable power this institution wields over the economy.

For example, John Hussman of Hussman Funds accused the Fed of going beyond its legal boundaries when it offered a $30 billion "non-recourse loan" to J.P. Morgan, which was secured by the worst of Bear Stearns's mortgage debt. The Fed is supposed to provide liquidity to the banking system or shore up the solvency of a non-bank institution. This loan was neither. J.P. Morgan was in no financial trouble: it was "effectively offered a subsidy by the Fed at public expense."

Shedlock is even more blunt: "The Fed simply does not care whether its actions are illegal or not. The Fed is operating under the principle that it's easier to get forgiveness than permission. And forgiveness is just another means to the desired power grab it is seeking."

The most significant argument against the Fed, though, is not political but economic. The Austrian view is that a central bank is not merely unnecessary but harmful. There is no need for a monopoly institution, by means of artificial money creation, to prevent the natural and healthy phenomenon of falling prices. There is likewise no need for a "lender of last resort" for the banking industry any more than for the personal computer industry or the shellfish industry. As long as the banking system is run on sound principles—an unlikely outcome, while there is a central bank with powers to prop up unsound banks—there is no reason for the bankruptcy of one or two major banks to provoke a systemic crisis, as can happen under the Fed system.

Then there are the problems that stem from artificial money creation. Not only do people on fixed incomes suffer from the rising prices that increases in the money supply bring about, but the process of money creation inevitably enriches politically well-connected groups at the expense of everyone else. The powerful are in a position to receive the newly created money first and spend it before prices have commensurately risen. Still other problems are discussed in the major Austrian treatments of money, including Mises's *Human Action* and Murray Rothbard's *The Case Against the Fed*.

Under a commodity standard, people could save for the future by accumulating gold and silver coins. The coins' value appreciated over time because of their natural increase in purchasing power, as the relatively slow increase in the production of precious metals was outpaced by the much faster increase in the production of other goods and services. Today, only a fool would try to save for the future by piling up dollar bills. Everyone is forced to enter the financial markets, which are risky even for knowledgeable investors,

in order to prevent the value of his retirement savings from vanishing before his eyes.

Austrian business cycle theory, which Paul has made a point of explaining, blames the central bank for the boom-bust cycle. (And yes, it can also account for financial panics that occurred before the Fed was established.) Under fiat money, currency without commodity backing, the central bank can artificially lower interest rates by increasing the supply of money—and thus the funds banks have available to lend—through the banking system. This is supposed to stimulate the economy. What it actually does is mislead investors into embarking on investments that the artificially low rates seem to validate but that cannot be sustained under existing economic conditions. Unprofitable investments are made to seem profitable, and over time the result is the squandering of untold resources in lines of investment that should never have been begun.

If lower interest rates are the result of increased saving by the public, those greater saved resources provide the means with which to see the additional investment through to completion. But the situation is very different when lower interest rates result from the Fed's creation of new money out of thin air. In that case, lower rates do not reflect an increase in the pool of savings from which investors can draw. Fed tinkering, in other words, does not increase the real stuff in the economy. The additional investment that the lower rates encourage therefore leads the economy down a path that is not sustainable.

That is how the Austrians knew the present bust was coming. The preceding boom had been based not on real factors but on bubble conditions created by the Fed's artificial credit expansion. It had to end in a bust, as Mises and Hayek said. That's also what they said in 1928 and 1929, as respectable opinion hastened to assure everyone that business cycles were a thing of the past.

To be sure, while the Fed is slowly but surely becoming an issue for discussion in politics and the media, as yet only a small segment of the population opposes—or indeed knows much about—the central bank. But because this issue is one about which most Americans are lethargic or uninformed, that small and growing segment can influence public life on a scale out of proportion to its numbers. And the presence of this once-excluded point of view makes it harder for the regime to pretend that economic crises have no cause, that no person or institution is to blame for them, and that the federal government and its central bank have the solutions.

Paul is said to be finishing a book on the Federal Reserve for 2009 release. If it should become a bestseller, the profile of the anti-Fed campaign will be raised still higher.

The End the Fed movement likewise is pressing forward. Organizer Steven Vincent says the group is coordinating a series of rallies in 40 cities on April 25, to be followed by an event at the National Press Club at which they will present the fruits of their nationwide petition campaign in support of Congressman Paul's Federal Reserve Board Abolition Act.

As the economic crisis continues to worsen, it will become harder and harder to portray old-school Keynesianism as "change," and the potential audience for the Austrian message will only grow. That, one hopes, is a silver lining to the disaster the Fed has unleashed. □

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